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Defining When 'Time is of the Essence'

Court Offers Guidance on Required Language

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The Court of Appeals has recently reemphasized, for sellers' attorneys, the importance of drafting clear and unequivocal "time of the essence" clauses in those real estate contracts where circumstances justify conditioning the sale upon the buyer's timely performance of one or more stated conditions. In ADC Orange, Inc. v. Coyote Acres, Inc.,1 the Court reiterated its adherence to the long-standing rule that, unless the contract expressly includes a "time of the essence" clause, a seller will not be permitted to use a buyer's "default" as an excuse to unreasonably avoid the property sale and retain the down payment.2 The Court also reaffirmed and clarified the protocol that should be followed before a seller may default a buyer and secure its down payment.

The 'Coyote Acres' Holding

The Court of Appeals restated the rule that, unless the contract specifies "time is of the essence," failure to meet a contract date does not automatically result in a default, but that a seller may convert a non-time-of-the-essence contract into one making "time of the essence" (a) by giving the buyer clear unequivocal notice that time has become "of the essence," and (b) by giving the buyer reasonable time in which to perform. The Court found that the seller in Coyote Acres had not met these requirements and was therefore obliged to return the buyer's down payment.

While it could be argued that the decision merely restates existing law concerning "time of the essence" and does not break any new ground, a close analysis of the Court's opinion suggests that Coyote Acres does provide some needed clarification on "time of the essence" issues about which practitioners are often uncertain. The Court has (a) given clear guidance on the language that will make a real estate contract a "time of the essence" contract; (b) confirmed that contract terms, other than those relating solely to the closing date, may also be subject to "time of the essence" conditions; and (c) clearly stated how non-time-of-the-essence contracts may be converted into "time of the essence" contracts.

In addition, Coyote Acres illustrates both (a) the strict requirements that must be met before "time of the essence" will be enforced in real estate transactions, and (b) how the court's view of the reasonableness of the seller's or the buyer's actions will influence the final resolution of the parties' "time of the essence" controversy.

Facts in 'Coyote Acres'3

The case involved a real estate contract whereby the buyer, ADC Orange, Inc. ("ADC") agreed to pay Coyote Acres, Inc. ("Coyote"), the "seller," $600,000 for a parcel of property. The sale was conditioned upon ADC's obtaining subdivision and site plan approval from the town planning board for the construction of at least 25 "residence dwellings upon the Premises and such approvals being received no later than June 30, 2002."

The contract required ADC to make a down payment of $100,000 to be held in escrow by Coyote's attorney, but a contract rider provided that ADC was entitled to the return of the down payment if, despite good faith and due diligence, it failed to obtain the necessary governmental approvals.

In addition, the rider required ADC to make an interim payment of $250,000 "[u]pon the later of the preliminary approval having been received from the applicable authorities for the subdivision or December 31, 2001 but in no event later than December 31, 2001." The balance due under the contract was to be paid upon filing the final approval and subdivision map. As noted by the Court, "[t]he contract contained no time-of-the-essence clause and did not provide that ADC's failure to make the interim payment by December 31, 2001 would put it in default."

At the time the parties entered into their contract, in December 2000, Coyote did not yet own the property, but, as ADC claimed, Coyote had given oral assurance that it would acquire title very soon after the execution of the contract. Coyote did eventually acquire title, but not until July 12, 2002. In the interim, ADC's application for subdivision approval was dependent upon receiving authorization from the then-current property owner. A dispute arose over whether ADC had received the required written authorization. On June 22, 2001, ADC claimed that it had not yet received the authorization, and five days later ADC advised Coyote that "all of the time frames within the contract are suspended until [it] has received the written authorization from the current landowner." In response, Coyote faxed the current owner's authorization to ADC on June 27, 2001.

As the deadline for the "interim payment" approached, Coyote's attorney sent a fax to ADC's counsel, on Dec. 26, 2001, reminding ADC that "the contract of sale in the above matter requires an additional deposit of $250,000 to be made no later than December 31, 2001," and further stating that "I look forward to my timely receipt of such deposit." On Dec. 31, 2001, ADC's counsel sent a fax response in which he acknowledged the "reminder" and said that ADC's principal was out of the country but that the funds would be transferred "upon his return on Jan. 14, 2002."

On Jan. 10, 2002, Coyote's attorney informed ADC's attorney that Coyote considered ADC to be in default. ADC responded on Jan. 11, 2002 by sending a $250,000 check to Coyote's attorney and noting that the contract did not contain a "time of the essence" clause and, therefore, that the delay due to ADC's principal's absence from the country did not constitute a default.

The parties then entered into negotiations in which Coyote offered to withdraw its objections to the timeliness of ADC's payment if ADC would agree to changes in the contract. However, negotiations broke down, and Coyote declared ADC in default and returned the $250,000 check. ADC then commenced its action against Coyote seeking specific performance of the contract. Coyote answered seeking dismissal of the action contending (a) that ADC's breach of contract entitled it to keep the $100,000 down payment, and (b) that the contract was terminated when ADC failed to obtain subdivision approval by June 30, 2002, and,

if Coyote were to return the down payment, it would have no further obligation to ADC.

The parties then entered into a second set of negotiations for Coyote to drop its objections to the late payment in return for ADC agreeing to certain contractual changes, but the parties were again unable to agree on a compromise, and they continued to litigate. Meanwhile, the application for subdivision approval continued to be processed during the course of the litigation, and ADC did obtain preliminary subdivision approval from the town authorities on June 5, 2002, but final approval was not granted until June 2003.

'Mere Designation'

The Court noted that "in contracts of this kind, time is not ordinarily of the essence unless the agreement so provides."4 And, although the language of the ADC/Coyote contract obligated ADC to pay $250,000 "in no event later than December 31, 2001," the Court held that including this phrase (without also specifying that failure to make the interim payment timely would constitute a default) did not make time of the essence because "the mere designation of a particular date upon which a thing is to be done does not result in making that date the essence of the contract."5

While the phrase "time is of the essence" are the traditional words used in real estate contracts to trigger a default that entitles either the seller to retain the down payment or the buyer to specific performance, Coyote Acres suggests that it may be prudent also to include in the contract itself, and not solely in a "time of the essence" letter following a "default," clear and unequivocal notice that a stated default will result either in the forfeiture of the down payment, or in specific performance of the contract, as the case may be. In the event that the phrase "time is of the essence" is omitted from the contract, including clear and unequivocal notice of the consequences of a default will nevertheless be sufficient to make the contract "time of the essence."6 The ADC/Coyote contract did not contain such a notice, and, accordingly, the Court found that time was not "of the essence."

Rules Apply to All Terms

As the authors have noted in a prior article,7 in contracts where time is not made "of the essence," then either the buyer or the seller has the right to a reasonable adjournment of the closing date.8 Accordingly, although the issue in Coyote Acres involved the timing of an "interim payment" rather than a closing date, in the absence of language making time "of the essence" of the contract, ADC was entitled to a reasonable delay in making the required payment, and its two-week delay in doing so did not constitute a default that entitled Coyote to retain ADC's down payment. As the Court in Coyote Acres noted, the phrase "in no event later than" had previously been held by the Appellate Division to be "not sufficient to make time of the essence in connection with a closing date,"9 and the Court saw "no reason why the same rule should not apply under these facts, with respect to the [$250,000] installment payment."10

Clear Notice Required

Finally, the Court held, while acknowledging "that it is possible for the seller to convert a non-time-of-the-essence contract into one making time of the essence by giving the buyer 'clear, unequivocal notice' and a reasonable time to perform," Coyote's declaration of default was "ineffective" because the contract did not contain a "time-of-the-essence" provision and Coyote's Dec. 26, 2001, fax did not "put ADC on notice that its failure to pay on December 31 (as opposed to two weeks later) would amount to a default and the forfeiture of a $100,000 down payment."11 On this basis, the Court held that Coyote was obliged to return the $100,000 down payment to ADC.

However, the Court also held that "on this record" ADC was not entitled to specific performance. The Court said that, "[t]o obtain specific performance, it was necessary for ADC to show that it was ready, willing, and able to fulfill its contractual obligations,"12 but that ADC had failed to carry this burden because, as Coyote correctly argued, ADC had not obtained final subdivision approval by June 30, 2002, as the contract required.

It Pays to Be Reasonable

Nevertheless, ADC's specific performance claim could not be dismissed because ADC contended that Coyote had frustrated ADC's ability to obtain final subdivision approval, and it thus raised questions of fact that required a trial. This result highlights the principle that real estate attorneys need to be sensitive to how courts are likely to be influenced by the particular facts of a case in deciding what are otherwise pure questions of law. For example, while the Court's opinion in Coyote Acres, which followed the traditional rules discussed above, is certainly correct, the Court's rulings actually show a marked displeasure with the seller's actions in the case - particularly Coyote's use of the "default" as leverage to attempt to renegotiate the contract.

Coyote's attempted use of the default to renegotiate the parties' deal clearly demonstrated, contrary to its position in the litigation, (a) that time was indeed "not of the essence" and (b) that Coyote apparently suffered no damages from ADC's two week delay in making the $250,000 payment. The Court was undoubtedly influenced by these facts. After all, the Court not only ordered the return of the $100,000 down payment to ADC, but, by remanding the case for trial of ADC's specific performance claim, the Court held open the possibility that Coyote may yet be required to complete the sale of the property, at some unknown time in the future, after a final judgment in the case.

While ADC would then have to pay the entire purchase price to complete the sale, under the Court's ruling, Coyote must await the end of the litigation to collect any of that agreed price. Presumably, Coyote has also forfeited the "interim" payment that was otherwise required. Moreover, while the litigation continues, the property is subject to a lis pendens and unmarketable. Even if Coyote ultimately prevails, it will have lost the value of the property for the length of the litigation without any monetary compensation from ADC in the interim.

The Court's ruling was clearly intended to send a message to Coyote to find a way to settle the litigation as soon as possible, or else be subject to a possible specific performance judgment, whereby Coyote will incur continuing litigation costs that will, in effect, result in a net reduction of the purchase price to be paid for the property. This indeed is a harsh "lesson" for Coyote's declaration of default for ADC's two-week delay in payment, but it is also a clear warning to all prospective buyers and sellers that "time of the essence" is a powerful weapon that should not be used unreasonably and only when it is clearly justified.

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Endnotes:

1. NY3d, NYS2d, (2006), 2006 NY LEXIS 3200 (Oct. 19, 2006).

2. See, e.g., Grace v. Nappa, 46 NY2d 560, 565, 415 NYS2d 793 (1979); Zev v. Merman, 134 AD2d 555, 521 NYS2d 455 (2d Dept. 1987), affirmed 73 NY2d 781 (1988); see also Bailey and Desiderio, "Enforcing the Contract, Obtaining Down Payment or Specific Performance," NYLJ, 3/8/06.

3. The facts in Coyote Acres, as recounted in this article, are based on the description of the case set forth in the opinion of the Court of Appeals.

4. Coyote Acres, supra, citing Brum Realty v. Takeda, 205 AD2d 365, 613 NYS2d 372 (1st Dept. 1994).

5. Coyote Acres, supra, quoting Ballen v. Potter, 251 NY 224, 228 (1929); see also Karmatzanis v. Cohen, 181 AD2d 618, 581 NYS2d 339 (1st Dept. 1992) (holding that a letter which stated the seller "will not consent to adjourn the closing beyond 10/3/85 for any reason" was insufficient to make the closing "time of the essence.").

6. See Sohayegh v. Oberlander, 155 AD2d 436, 547 NYS2d 98, 100 (2d Dept. 1989); see also Hand v. Field, 15 AD3d 542, 790 NYS2d 681 (2d Dept. 2005).

7. See Bailey and Desiderio, supra, note 2.

8. See, e.g., Zev v. Merman, supra, note 2.

9. Coyote Acres, supra, citing Whitney v. Perry, 208 AD2d 1025, 617 NYS2d 395 (3d Dept. 1994).

10. Coyote Acres, supra.

11. Coyote Acres, supra.

12. Coyote Acres, supra.