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Breach of a Contract to Sell Land in California - The Buyer without a Remedy Notes

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NOTES AND COMMENTS

BREACH OF A CONTRACT TO SELL LAND IN CALIFORNIA—THE BUYER WITHOUT A REMEDY

Traditionally the purchaser in a land sale contract has been well protected. If the vendor breached his agreement to convey, the purchaser could either bring an action for specific performance of the contract in equity, or an action at law for damages. If he elected the equitable remedy, he would receive the specific land he had contracted to purchase. If he chose instead an action at law for damages he could normally recover the loss of his bargain if the value of the land was greater than the contract purchase price.[1] In California however, it appears that in certain factual situations an injured purchaser may have neither of the above remedies available to him.[2]

The California rule regarding damages recoverable when a vendor breaches an agreement to convey real property is set out in Civil Code Section 3306.[3] This section denies the purchaser in a land sale contract the benefit of his bargain unless the vendor acts in "bad faith" in breaching his agreement. Not only does this section limit the recovery of the purchaser, it also places the burden of proof on the purchaser to show that the vendor has acted in "bad faith," if the purchaser desires to avoid its limiting effect.[4]

The California rule regarding specific performance is limited by Section 3391 of the Civil Code which provides that specific performance cannot be enforced against a party to a contract if he has not received an adequate consideration for the contract. Not only are the purchaser's rights so limited, but there is also an affirmative burden placed upon him. He must both allege and prove that the consideration for the contract is the "fair and reasonable value of the property at the time the agreement was entered into."[5]

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[1] McCormick, Damages § 177 *et seq.* (1935); 2 Sutherland, Damages § 579 (4th ed. 1916).

[2] See *e.g.*, Gilbert v. Mercer, 179 Cal. App. 2d 29, 3 Cal. Rptr. 456 (1960); and Rose v. Lawton, 215 Cal. App. 2d 18, 29 Cal. Rptr. 844 (1963), discussed *infra*.

[3] Cal. Civ. Code § 3306 which reads: ". . . The detriment caused by the breach of an agreement to convey an estate in real property, is deemed to be the price paid, and the expenses properly incurred in examining the title and preparing the necessary papers, with interest thereon; but adding thereto, in the case of bad faith, the difference between the price agreed to be paid and the value of the estate agreed to be conveyed, at the time of the breach, and the expenses properly incurred in preparing to enter upon the land."

[4] Wilson v. Rosenkranz, 112 Cal. App. 511, 297 Pac. 44 (1931).

[5] Baran v. Goldberg, 86 Cal. App. 2d 506, 194 P.2d 765 (1948); Lucientes v. Bliss, 157 Cal. App. 2d 565, 321 P.2d 526 (1958).

THE PROBLEM

A contracts to purchase B's home for $10,000. The market value of the property at the time is $12,000 but for some reason B is forced to sell his home. Before time for performance of the contract, B finds that he no longer *has* to sell and desires to repudiate the contract and retain his home. In this situation Civil Code Sections 3306 and 3391 raise the following question: Is it "bad faith" for B to refuse to convey if he asserts the equitable defense of inadequacy of consideration? If this is not a "bad faith" refusal, any vendor, upon discovering that he has made a bad bargain, can disavow his contract with impunity, answerable only for that part of the price he has received and the expenses properly incurred by the purchaser in examining the title and preparing the necessary papers. In effect, any vendor making a "bad deal" is not bound by it.

The case of *Mercer v. Lemmens*[6] seems to offer the solution to this problem. In this case plaintiff purchased a parcel of land from defendant in 1955. The deposit receipt provided that defendant would give plaintiff first opportunity to purchase, for $10,000, an adjoining fifty foot lot owned by defendant. Six years later defendant contracted to sell the adjoining lot to a third party for $22,000. The plaintiff then attempted to assert his right of first refusal. Defendant denied the claimed right and plaintiff brought suit for specific performance and damages for breach of contract. The trial court awarded plaintiff $12,000 damages—the loss of his bargain. The District Court of Appeals upheld this decision saying:

> The trial court found that defendant deliberately refused to perform his agreement with plaintiffs because he could sell to better advantage to others and without just cause, and that such refusal to perform was in bad faith. Accordingly, the allowance of the $12,000 difference between the preemptive price and the market value of the property was properly awarded as damages.[7]

The District Court of Appeals relied on the case of *Kahn v. Lischner*[8] wherein the defendant-vendor sold his land in order to obtain a higher price. This was found to be in "bad faith" on his part. It was held that:

> The trial court was justified in finding that appellant terminated his contract with respondent because he had made a bad bargain and saw an opportunity to make a better deal. . . . Bad faith of appellant having been found by the trial court, it was proper to assess damages pursuant to Civil Code, section 3306. . . .[9]

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[6] 230 A.C.A. 175, 40 Cal. Rptr. 803 (1964).
[7] *Id.* at 181, 40 Cal. Rptr. at 807.
[8] 128 Cal. App. 2d 480, 275 P.2d 539 (1954).
[9] *Id.* at 490, 275 P.2d at 545.

These two cases establish the rule that one who has made a bad bargain cannot plead that bad bargain as a defense in a suit for damages.

CONFLICTING CASES

Two recent decisions deal directly with this problem and reach a result contrary to the *Mercer* and *Kahn* cases. In *Gilbert v. Mercer*[10] appellant contracted with respondents to purchase sixty-five acres of land for $325. Respondents later repudiated the contract whereupon appellant brought an action for specific performance and damages. The trial court found that the consideration was not the "fair and reasonable value of the property at the time the agreement was entered into," and refused to grant either specific performance or damages. This finding was affirmed on appeal, the District Court of Appeals stating:

> . . . Since the finding of inadequacy of consideration alone will support the judgment for the defendants, this court deems it unnecessary to consider other findings or matters as to evidence which have no relation to and cannot affect that finding. . . . Plaintiff was not entitled to damages. Such relief is incidental to a decree of specific performance and cannot be given where no cause of action for specific performance is established.[11]

In *Rose v. Lawton*[12] there was an action for specific performance of a land sale contract and for damages for failure to perform the agreement. The purchaser had obtained a default judgment for specific performance. On appeal the judgment ordering specific performance was reversed because the purchaser had failed to allege that appellant had received an adequate consideration for the contract. The judgment awarding damages was also reversed in reliance on the *Gilbert* case and California Jurisprudence 2d.[13]

In both the *Rose* and *Gilbert* decisions the plaintiffs were not entitled to specific performance of a contract for the sale of land because they failed to allege or prove that the consideration named in the agreement was the fair and reasonable value of the property as required by Civil Code Section 3391. Their failure to establish a claim for specific performance was the basis for denying damages under Civil Code Section 3306. It appears that these cases establish a rule that unless one can establish his right to specific performance he has no right to damages. It would appear that a vendor can escape the loss of bargain measure of damages in California by

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[10] 179 Cal. App. 2d 29, 3 Cal. Rptr. 456 (1960).

[11] *Id.* at 31, 3 Cal. Rptr. at 457, 458.

[12] 215 Cal. App. 2d 18, 29 Cal. Rptr. 844 (1963).

[13] 45 CAL. JUR. 2d *Specific Performance* § 85 (1958). This point will be discussed more fully *infra*.

asserting the defense of inadequacy of consideration in a suit by the purchaser for specific performance.[14]

THE IMPORTANCE OF PLEADING

There is a difference, however, in the *Gilbert* and *Rose* cases which may distinguish them from the decisions in *Kahn* and *Mercer*. This difference is in the type of action brought. In the *Kahn* and *Mercer* cases the plaintiffs were suing for damages for breach of contract, whereas in *Gilbert* and *Rose* the actions were for specific performance, *and* for damages. Nevertheless, this difference in the form of action should not necessitate such contrary results, especially in a code pleading state such as California. In states with separate systems of law and equity, the right to an award of damages by a court of equity depends upon establishing a right to equitable relief.[15] In code states, on the other hand, it has been said:

> Nothing can be plainer or more certain than that a primary purpose of the Code was to combine legal and equitable remedies between the parties to any controversy so that complete relief, legal and equitable should be given in a single action. . . . Thus, in an action for specific performance, if it is established on the trial that specific relief cannot be given, the plaintiff may recover damages.[16]

Furthermore, in *Zellner v. Wassman*[17] the court said:

> There being but one form of civil action in this state, a plaintiff may recover if his complaint "states *any* cause of action entitling the plaintiff to *any* relief at law or in equity." . . . It is not essential that a complaint state a cause of action for the relief which plaintiff seeks, provided the facts stated show some right of recovery, *and a party cannot be thrown out of court merely because he may have misconceived the form of relief to which he is entitled.*[18]

Also, in *Long Beach Drug Co. v. United Drug Co.*[19] it is said that even if an equitable remedy cannot be had, if the contract is valid in other respects, the court should allow the complaint to be amended to seek damages even though it was not originally framed in the

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[14] This, of course, is contrary to the generally accepted reason for loss of bargain damages. MCCORMICK, DAMAGES § 179 (1935) deals with this problem directly and reaches a contrary result. It is said there: "If the vendor, as frequently happens, on scenting a new and more profitable bargain, conveys the land to another purchaser or otherwise disables himself from performing, or if when the time comes to complete the contract he willfully refuses, these are clear cases of bad faith, and render the vendor liable for loss of the bargain."

[15] WALSH, EQUITY § 22 (1930).

[16] *Ibid.*

[17] 184 Cal. 80, 193 Pac. 84 (1920).

[18] *Id.* at 87, 88, 193 Pac. at 87. (Emphasis added.)

[19] 13 Cal. 2d 158, 88 P.2d 698 (1939).

alternative. In view of the above cases any attempt to distinguish *Gilbert* and *Rose* on the form of their pleadings is not valid.

It is submitted therefore, that *Gilbert* and *Rose* represent a misapplication of a law which has been expressly overruled by the California Supreme Court. The misapplication arises in holding that the damages allowable under Civil Code Section 3306 are incidental to a decree of specific performance. Section 3306 specifies that damages recoverable for breach of contract are *in lieu of* specific performance.[20] The primary case relied upon in the *Gilbert* and *Rose* decisions dealt directly with this point.[21] In that case appellants alleged that respondent's failure to comply with the terms of a land sale contract was in bad faith. They sought damages under Civil Code Section 3306. The District Court of Appeals said:

> The trial judge disallowed damages for the reason, as stated in his oral decision, that since plaintiffs were not entitled to specific performance they were not entitled to damages. He relied upon the case of Hupp v. Lawler 106 C.A. 121. . . . The decision therein, regarding that point, was based upon the case of Morgan v. Dibble 43 C.A. 116. . . . The Supreme Court held to the contrary in the case of Pascoe v. Morrison 219 Cal. 54, . . . the court said . . . "while the equitable relief will be denied in such a case, now the action will be retained and the issue as to breach of contract and damages will be sent to a jury for trial. . . . *In addition thereto the facts as pleaded, without reference to any question of specific performance, entitled plaintiff to damages;* and, as shown by the cases heretofore cited, *the court was not only authorized, but it was its duty to grant such relief as the evidence warranted.*" It appears therefore that the decision in the case of Hupp v. Lawler, supra, upon which the trial judge relied, is not in accord with several other cases. The mere fact that plaintiffs were not entitled to specific performance did not preclude them from recovering damages for breach of contract.[22]

The court went on to point out that damages which were merely incidental to a decree of specific performance could not be awarded. It was, however, careful to distinguish these damages from damages for breach of contract which could be awarded. As indicated earlier,[23] the court in *Gilbert* also cited California Jurisprudence 2d, apparently relying on this statement:

> An action to recover damages in lieu of specific performance lies not at law, but in equity, for the right thereto depends on the right to specific performance, and is not available until the latter is established.[24]

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[20] Baran v. Goldberg, *supra* note 5. In 22 CAL. LAW REV. 208 this exact point is dealt with at great length and the same conclusion is reached.

[21] 86 Cal. App. 2d 506, 194 P.2d 765 (1948).

[22] *Id.* at 510, 511, 194 P.2d at 768. (Emphasis added.)

[23] 45 CAL. JUR. 2d *Specific Performance* § 85 (1958).

[24] *Id.* at 377. As authority for this point the case of Hupp v. Lawler, 106 Cal. App. 121, 288 Pac. 801 is cited. It should be noted that in the Baran case the District

However, a further reading in this same section reveals this proposition:

> Also, in a case where specific performance is not available because the party refusing to perform has not received adequate consideration, and the contract is not just and reasonable, the plaintiff is not prevented from recovering damages for breach of contract, at least if some cause of action is made out showing that damages on that theory may be allowable.[25]

And it is also pointed out that Civil Code Section 3306 provides for damages which are recoverable in lieu of specific performance, hence not incidental thereto.[26]

Proof of Bad Faith

The key to recovering the loss of bargain measure of damages under Section 3306 is to prove that the vendor acted in bad faith in breaching his contract. Therefore a study of the origin and nature of the rule embodied in Section 3306 is important in determining what a purchaser must do in order to prove bad faith.[27]

The so called good faith rule embodied in Section 3306 comes from the English decision of *Flureau v. Thornhill*.[28] This case held that where a seller of land failed to complete the contract because of defective title, damages for loss of his bargain were not recoverable by the purchaser unless the seller was guilty of fraud. The House of Lords strengthened this rule in *Bain v. Fothergill*.[29] The rationale for this rule is that there is always a degree of uncertainty as to whether good title could effectively be conveyed by the vendor, and a purchaser contracting with this knowledge should not be allowed to recover some fanciful loss of bargain if the vendor was incapable of completing his contract because of his defective title.[30]

However, this restriction is not followed in California. Here, it has been established that a deliberate refusal, without just cause or excuse, to perform a valid contract for the sale of real property

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Court of Appeals was very explicit in pointing out that *Hupp* had been expressly overruled by the State Supreme Court in *Pascoe v. Morrison*. See note 19 *supra*.

25 45 Cal. Jur. 2d *Specific Performance* § 85, p. 378.

26 *Id.* at 379.

27 There is an interesting and enlightening discussion of this point in 20 Ky. L.J. 304 (1932).

28 2 Wm Bl. 1078, 96 Eng. Rep. 635 (1776). Here the vendor was unable to complete his contract to convey an interest in land because of a defect in his title of which he had no knowledge at the time of contracting.

29 (1874) L.R. 7 H.L. (Ir.). In this case the seller knew at the time of contracting that he did not have a marketable title. However, it was his good faith belief that the defect would be cured by the time he was bound to convey. His belief turned out to be mistaken.

30 *Id.* at 210, 211.

constitutes bad faith within the meaning of the Section 3306.[31] This suggests two questions; what is a just cause or excuse, and what is a valid contract.

Just cause or excuse in refusing to perform is normally a fact question to be resolved by a jury.[32] However, where reasonable men could not differ there is no jury question. The law is clear that mere inadequacy of consideration, however gross, is never a sufficient ground for avoiding contractual obligations,[33] and that a transaction will not be deemed fraudulent merely because the party complaining made a bad bargain.[34] Furthermore, the mere fact that a contract is not specifically enforceable does not render it either void or voidable.[35] Therefore it would seem proper for a court to rule as a matter of law that a refusal to convey, alleging only inadequacy of consideration, is not a just cause or excuse. If this is not a just cause or excuse, it should follow that a refusal based on these grounds constitutes bad faith, entitling the purchaser to claim loss of bargain as his measure of the damages.[36]

CONCLUSION

From an examination of the authorities in this general area it is clear that in a suit for specific performance, the equitable defense of inadequacy of consideration allowed by Civil Code Section 3391 should not have any effect on the measure of damages that may be recovered by the purchaser in a land sale contract under Civil Code Section 3306. Furthermore, if the purchaser alleges and proves facts that entitle him to damages, the court *must* grant the relief warranted by the evidence *even though* such relief is not requested in specific language.

If a vendor wishes to bring himself outside the bad faith qualification, he must show some additional cause or excuse for his default. Because the California Supreme Court has not ruled directly upon this issue, it is this writer's opinion that the *Mercer* case re-estab-

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[31] Johnson v. Goldberg, 130 Cal. App. 2d 571, 279 P.2d 131 (1955); Eastwood Homes Inc. v. Hudson, 161 Cal. App. 2d 532, 379 P.2d 29 (1958); Kahn v. Lischner, 128 Cal. App. 2d 480, 275 P.2d 539 (1954); Rasmussen v. Moe, 138 Cal. App. 2d 499, 292 P.2d 226 (1956).

[32] Hamaker v. Bryan, 178 Cal. 128, 172 Pac. 391 (1918); Johnson v. Goldberg, 130 Cal. App. 2d 531, 279 P.2d 131 (1955).

[33] Sargent v. Shomaker, 193 Cal. 122, 223 Pac. 464 (1924); Costello v. Central Eureka Mining Co., 85 Cal. App. 2d 772, 193 P.2d 968 (1948).

[34] Jones v. Re-Mine Oil Co., 47 Cal. App. 2d 832, 119 P.2d 219 (1941); Kahn v. Lischner, 128 Cal. App. 2d 480, 275 P.2d 539 (1954).

[35] Morris v. Lilly, 147 Cal. 754, 82 Pac. 475 (1905); Desert Seed Co. v. Barbus, 66 Cal. App. 2d 838, 153 P.2d 184 (1944).

[36] See *e.g.*, Strait v. Wilkins, 16 Cal. App. 188, 116 Pac. 685 (1911); Konda v. Fay, 22 Cal. App. 722, 136 Pac. 514 (1913).

lishes the sound law in this area. The *Gilbert* and *Rose* decisions are erroneous deviations from the established law, and their adoption would seem to encourage speculation, deceit, fraud, perjury and other pernicious practices, all of which the holding in *Mercer* avoids.

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