

Q&A on the Cure Period Provision in the AAR Residential Resale Real Estate Contract

By K. Michelle Lind

The 2005 AAR Residential Resale Real Estate Contract (“Contract”) gives a party the opportunity to cure a failure to perform an obligation under the Contract. Pursuant to Section 7a of the Contract, if the non-complying party does not perform the contractual obligation within three days after receiving notice (“Cure Period”), the failure to perform becomes a breach of Contract. The Contract also explicitly states a basic tenet of contract law: an unfulfilled contingency is not a breach of contract.

Tip: A Cure Period Notice form is available on AARonline, but is not required.

Although a Cure Period may be a new concept to AAR’s membership, the ability to cure a breach is a common contractual provision. However, I have received some questions about the Cure Period, which are addressed below. Just remember, the Cure Period only applies when a party does or doesn’t do something that would have otherwise been an immediate breach of contract. It is simply a “second chance” to “fix” a problem before it becomes a breach – it does not address what happens when there is a breach.

Why was the Cure Period included in the Contract?

The Cure Period was included in the Contract for a variety of reasons, including:

When a party fails to comply with the contract, it is often because their agent failed to tell them to perform or failed to follow up to make sure they performed - resulting in agent liability if the other party declares a breach and immediately cancels the Contract.

The 5/00 contract defined certain failures to act as material breaches, some as breaches, and did not specifically address numerous other issues. The Cure Period provides guidance on dealing with all failures to act in a uniform manner and leverage to prompt compliance.

The Cure Period should help eliminate the question of whether a breach has been waived - because an action or inaction is not a breach until the Cure Period Notice is given.

The Cure Period can bolster the enforcement of the time is of the essence clause and the ability to cancel the Contract for a breach.

There is some inherent fairness in giving a party the opportunity to rectify a non-compliance with the Contract before the other party declares a breach and cancels the Contract or takes legal action.

The Cure Period applies to a non-compliance that would otherwise be a breach of contract. What is a breach of contract?

A breach of contract is a non-performance of a contractual duty, or in other words, a broken promise. (i) It is a violation of any of the terms or conditions of a contract without legal excuse. (ii) The remedies for a breach of contract may include forfeiture of the earnest money, actual damages (money), forfeiture of the contract (cancellation), or specific performance (forcing the breaching party to perform).

(i) *Restatement of the Law of Contracts § 312 (1932); Enterprise v. Nampa City*, 536 P.2d 729 (1975).

(ii) *Reilly, John W., The Language of Real Estate, Fifth Edition; Black’s Law Dictionary, Fifth Edition*, (“Failure without legal excuse, to perform any promise which forms the whole or part of a contract.”)

The Cure Period doesn’t apply to a contingency. What is a contingency?

A contingency is an event that must occur before a party is obligated to perform a contract. (i) A contingency is a condition, not a promise. If a contingency does not occur, the parties’ obligation to perform the contract never arises, (ii) so the failure to perform a contingency is not a breach. In the event that a contingency does not occur, the contract automatically terminates without action by either party, unless otherwise provided. (iii)

(i) *Connor v. Cal-AZ Properties, Inc.*, 137 Ariz. 53, 668 P.2d 896 (Ct. App. 1983); *Yeazell v. Copins*, 98 Ariz. 109, 402 P.2d 541 (1965); *Reilly, John W., The Language of Real Estate, Fifth Edition* (“Contingency: A provision in a contract that requires the completion of a certain act or the happening of a particular event before that contract is binding.”); *Black’s Law Dictionary, Fifth Edition*, (“Contingent: conditioned upon the occurrence of some future event which is itself uncertain or questionable.”).

(ii) *Connor*, 137 Ariz. 53, 668 P.2d 896.

(iii) *Id.*; *Medical Services Group, Inc. v. Boise Lodge No. 310*, 878 P.2d 789 (Idaho Ct. App. 1994); *716 Windsor St. Assocs. v.*

Catholic Charities/Cath., 2003 Conn. Super. LEXIS 622 (“A condition is distinguished from a promise in that it creates no right or duty in and of itself but is merely a limiting or modifying factor If the condition is not fulfilled, the right to enforce the contract does not come into existence.”); *K.A. Thompson Electric Co., Ins. v. Wesco, Inc.*, 27 Conn.App. 120, 124, 604 A.2d 828 (1992).

Does the Cure Period apply to the loan contingency in the 2005 Contract?

No. The 2005 Contract is contingent upon the buyer obtaining loan approval without conditions, in other words qualifying for a loan, by the COE date. (Section 2a) If the buyer in good faith fails to obtain loan approval - or qualify for a loan - by the COE date, the parties’ obligation to perform the Contract never arises. In such a case, the Contract automatically terminates the next day, and the buyer is automatically entitled to the return of the earnest money without further action by either party. (*Note: The Contract requires the buyer to deliver a notice of the failure to qualify, but that notice or lack thereof does not affect the automatic termination*). Therefore, if the buyer does not obtain loan approval without conditions by the COE Date, there no longer exists any contract to breach.

Although the Contract automatically terminates if the buyer fails to obtain loan approval by the COE date, the parties may ignore the automatic termination by mutual agreement, complete the transaction and close escrow thereafter if they choose to do so.

Tip: Any agreement to extend the COE Date should be reduced to writing and signed by both parties. (See Code of Ethics Article 9 and Standard of Practice 9-1)

If the buyer’s failure to have the downpayment or other funds necessary to obtain loan approval without conditions and close escrow is not an unfulfilled loan contingency, what is it? (Section 2b)

The buyer’s failure to have the down payment or other funds necessary to obtain loan approval without conditions is a non-compliance with the Contract (a potential breach) and the Cure Period applies. The buyer would have three days after delivery of the Cure Period Notice to deliver the down payment to the Escrow Company. If the buyer failed to deliver the down payment within three days, the buyer is in breach of Contract and the seller has a choice of remedies.

Can there be a breach without a Cure period notice?

No. There are no automatic breaches. The Cure Period Notice is always a prerequisite to declaring a breach of Contract.

On the day of COE, the buyer notices the pool motor has not been fixed by the seller as agreed. Is this material enough to hold up the COE in order for the buyer to notice the seller of the Cure Period? If the seller still doesn’t fix the motor, is this a material enough to warrant cancellation of the Contract?

The failure to comply with ANY provision in the Contract authorizes the Cure Period – materiality is not an issue. The buyer should immediately deliver a Cure Notice to the seller. The buyer may then delay closing for up to three days to allow the seller the opportunity to repair the pool motor. In the alternative, the buyer may close escrow and if the seller fails to make the repair within three days, pursue the seller for the breach and recover the cost of the repair (in small claims court or mediation).

If the buyer delays COE for the three day Cure Period and the seller still has not completed the repair, the seller is in breach of contract. Section 7b of the Contract sets forth the remedies in the event of a breach: “the non-breaching party may cancel this Contract and/or proceed against the breaching party in any claim or remedy that the non-breaching party may have in law or equity, subject to the Alternative Dispute Resolution obligations” set forth. However, if the buyer wants to cancel due to the pool motor pump, the buyer’s agent should refer the buyer to independent legal counsel (just as the buyer’s agent should do under the 5/00 contract).

The seller owns the security system and doesn’t want it conveyed to the buyer. It was mistakenly omitted in the Contract that the security system is to be excluded. A week before closing, the buyer becomes aware that the seller has taken the security system. Can the buyer notice the seller of the Cure Period now or must they wait for COE?

The buyer should immediately deliver the Cure Period Notice. If the seller unequivocally indicates a refusal to return the security system, the seller is in breach of Contract after expiration of the Cure Period. In any event, if the seller has not returned the security system by COE, the seller is in breach of Contract. Section 7b of the Contract sets forth the remedies in the event of a breach: “the non-breaching party may cancel this Contract and/or proceed against the breaching party in any claim or remedy that the non-breaching party may have in law or equity, subject to the Alternative Dispute Resolution obligations” set forth. Again, the buyer’s agent should refer the buyer to independent legal counsel (just as the buyer’s agent should do under the 5/00 contract).

The buyer becomes aware of a major roof leak and water damage on a Thursday (heavy rainstorm) and COE is the next day, Friday. The Buyer gives three-day notice of Cure to seller on Friday at 8:00 a.m. to repair it. Does the seller have until Tuesday at 8:00 a.m. to complete the repairs (notwithstanding a seller credit to buyer)?

No. If the buyer gives the Cure Period Notice on Friday, the seller has Saturday, Sunday and until 11:59 p.m. on Monday to complete the repair. (See Section 8i)

If the buyer cancels the transaction because they were unable to obtain loan approval without conditions, can the buyer notice the seller by just writing, “was not able to obtain loan approval”? Shouldn’t there be something in writing from the

lender to make it official? How does the seller know the buyer is telling the truth?

There is no obligation for the buyer to give any notice of the failure to obtain loan approval in the 5/00 Contract. In the 2005 Contract all that is required is for the buyer to “take a stand” and inform the seller and escrow company that the buyer won’t be closing escrow because of the inability to obtain loan approval. Any writing stating that the buyer was unable to obtain loan approval will suffice.

Tip: An Unfulfilled Loan Contingency Notice is available on AARonline, but is not required.

The Forms Committee would have preferred to require the notice of the inability to obtain loan approval to come from the lender. However, after much investigation and discussion it was determined that lenders generally focus on the loans that are still in process, which would, at a minimum significantly delay a loan denial notice. (According to the Lender’s Group, a lender is obligated to deliver a written loan denial notice within 30 days.) The Committee did not want to cause the buyer to breach for failure of the lender to provide the notice from the lender.

On the day of COE, the buyer decides to back out. All contingencies have been met. The seller forgets to notice the buyer of the Cure Period and the next day accepts a back-up offer with no contingency on the cancellation of the first Contract. What is the status of the earnest money on the first Contract?

Under either the 5/00 contract or the 2005 Contract, the seller should be advised to obtain legal counsel immediately. A seller is exposed to enormous liability by accepting an offer on a second contract that is not contingent upon cancellation of the first. A seller should always be advised to execute mutual cancellation instructions before accepting a non-contingent subsequent offer.

Under the 5/00 contract, if the seller signed mutual cancellation instructions without addressing the buyer’s breach, the seller may have waived the opportunity to pursue damages, including the option to accept the earnest money as the sole right to damages. Under the 2005 Contract, the result is likely the same, but for an additional reason. The seller’s entitlement to the earnest money as the sole right to damages may be dependent upon the giving of notice of a potential breach and passage of the Cure Period.

What’s to stop agents from writing into the contract, “Paragraph 7a. will not apply,” which takes out the Cure Period?

Nothing can stop an agent from omitting the Cure Period provision from the Contract - that would be a decision for the broker. However, if the Cure Period is omitted, I would consider omitting the requirements that loan documents be signed and repairs be completed three-days prior to COE as well. If not, and one of the parties does not perform, the party will be in immediate breach, which could result in cancellation three days prior to the COE.

Additionally, the Cure Period benefits both buyer and seller. If the provision is omitted and the client commits an inadvertent non-compliance with the Contract, resulting in an immediate breach and resulting liability, the client may be damaged. Therefore, omitting the clause to simply avoid the responsibility of giving the notice may not be in the client’s best interests.

Conclusion

As a general rule, I would advise that a Cure Period Notice be delivered every time a buyer or seller does not do something that they are supposed to do, since all it takes is a simple fax or email message. However, a Cure Period Notice is not necessary if the buyer is unable to “qualify” for the loan.

Michelle is General Counsel to the Arizona Association of REALTORS® (“AAR”) and a State Bar of Arizona board certified real estate specialist. This article is of a general nature and may not be updated or revised for accuracy as statutory or case law changes following the date of first publication. Further, this article reflects only the opinion of the author, is not intended as definitive legal advice and you should not act upon it without seeking independent legal counsel.