



# Update

Property & Projects

June 2010

## Termination clause in real estate contracts held to be a penalty

The standard REIQ contract for houses and residential land (**REIQ Contract**) has been used in the real estate market for many years.

It contains clauses about the rights of the parties where the buyer terminates a contract. In the case of *Thompson v Riggall*, the seller terminated the contract because the buyer breached the terms. The seller resold the property. The seller then sued the buyer for damages and, relying on the REIQ Contract terms, the seller sought to recover as damages the difference in the sale price as well as the expenses incurred for the resale and the expenses incurred for the original contract.

The Court of Appeal held that clause 9.4(1)(b) of the REIQ Contract is not enforceable because under general law damages principles, the seller could not recover expenses related to the original contract, which would have been incurred in any event, as well as the other expenses and that such expenses are not a genuine pre-estimate of damages.

There are important consequences from this decision.

The law relating to penalties is not new but it is interesting to see it applied to a clause in a contract which the real estate industry and lawyers have accepted for so long.

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## Finance clauses often misunderstood

Finance clauses are important. They give the buyer the right to terminate the contract if finance is refused. But often the buyer thinks that a finance clause may be used as an excuse to terminate a contract. Where an application for finance has been properly made and refused the buyer does have the right to terminate. If the buyer does not act according to the terms of the finance clause the right to terminate may be jeopardised. Sometimes the buyer does not make reasonable attempts to obtain finance, but then seeks to terminate the contract under the finance clause. There are risks associated with that approach.

There are some other issues that are relevant to finance clauses. In the case of *Scali Properties Pty Ltd v Crittenden*, the buyer did not tell the seller about the

outcome of the application for finance by the due date. The seller terminated the contract. The Court found, on the facts, that between the finance date and the date that the seller terminated, the seller had acted in a way that affirmed the contract rather than in a way that was consistent with the seller's right to terminate the contract.

Often it is assumed that if no notification about finance approval is given, the contract has become unconditional. This is not correct.

Finance clauses should be carefully drafted. The REIQ Contract contains lengthy provisions. The parties should always act according to the terms of the contract.



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