SUBJECT TO APPROVAL CLAUSES – DO THEY WORK?

Introduction

A recent judgment of the New Zealand Court of Appeal has provided salutary lessons on the care that needs to be taken when you are writing conditions for an agreement for sale and purchase as well as the care that a purchaser must give to fulfilling its obligations under those conditions. MDS Property Lawyer, Dan Crossen reviews this recent judgment and the need for good professional advice when conditions are being put into the agreement

Court of Appeal decision

In *Arcadia Homes Limited (in Liq) v More To This Life Limited [2013] NZCA 286*, the Court of Appeal upheld a High Court decision which determined that a clause which purported to make the purchase of a Wanaka property subject to the purchaser's director's approval does not give that director an unfettered option to withdraw from the agreement but instead requires that director to do all things reasonably necessary to enable that clause to be fulfilled. It was noted that this was the first case in which a "subject to director's approval" clause had come before the New Zealand Courts.

Briefly, the facts of the case are that the sole director of the purchaser company (Arcadia) entered into an agreement for sale and purchase of the property while on holiday in the region. A condition was inserted that stated that the agreement was subject to and conditional upon the directors' approval of the agreement on or before a certain date (part of the case revolved around whether the company had one director or not but this is not relevant for the purposes of this article).

The director soon after entered into another agreement for sale and purchase on behalf of the company for a different property in the region. The purchaser then instructed its solicitor to cancel the first agreement on the basis that the directors did not approve the purchase. The purchaser's solicitor referred to certain inspections and investigations that the purchaser had undertaken which informed the director's decision to approve the agreement.

The vendors did not accept that the purchaser was able to avoid the agreement and so served a settlement notice. The vendors then cancelled the agreement and the property was resold for significantly less that the purchase price under the agreement with Arcadia.

The first question, therefore, that the Court of Appeal considered was whether the condition in question was a condition precedent or a condition subsequent? If it was a condition precedent then it was in effect an "option" which would entitle the purchaser to avoid the agreement at its option.

If it was a condition subsequent then the purchaser would be bound by specific terms of the agreement for sale and purchase and in particular the requirement that the party for "whose benefit the condition has been included shall do all things which may reasonably be necessary to enable the condition to be fulfilled by the date for fulfilment" (clause 9.8 in the current 9th edition 2012 Agreement for Sale and Purchase).

The Court of Appeal held that the condition was clearly not framed as an option and, accordingly, it turned on whether the director of the purchaser had done all things reasonably necessary to satisfy himself that the agreement should be approved.

It turned out the director had done very little, particularly in contrast with the way the director conducted himself in undertaking prompt and considered due diligence for the second agreement. It is quite apparent from the facts that the director only entered into the agreement to hold the property while he looked for something better in the area. The High Court and Court of Appeal also came to this conclusion.

The Court of Appeal stated that in order to make "a fair and reasonable decision" the purchaser's director should have at least obtained a guaranteed search of the title, a LIM and a valuation from a registered valuer. None of these things were undertaken by Arcadia's director. The same considerations apply to contracts that are made "Subject to my solicitor's approval" of to the purchaser being satisfied as to various conditions. Genuine effort to confirm approval must be made.

Conclusion

Therefore, and for the sake of clarity for both vendors and purchasers, the best practice is that if a mere option to purchase is intended you should have your solicitor draft a specific option agreement. Options can be incorporated into a standard agreement for sale and purchase but it is much clearer to have a separate agreement. Also, this case is a good reminder that due diligence clauses generally should be drafted or at least reviewed by a solicitor. You should also discuss with your solicitor what is reasonably required of you in your due diligence investigations.

The information contained in this document is of a general nature and should be used as a guide only. All references to law and legislation apply to New Zealand law and legislation only. We recommend that before acting on it, you consult your legal professional