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Time is of the essence, except when it shouldn't be

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(This is the 20th in a series of articles about issues that sellers and buyers face when negotiating a purchase-offer contract.)

"Time is of the essence" is common boilerplate in the standard, pre-printed real-estate contract brokers use between buyer and seller. What does it mean, and what are its implications for the parties?

Time is of the essence (TIOTE) is a requirement with penalties that binds both parties. It means that both buyer and seller must comply exactly with each and every reference in their contract to specific dates and times of day. TIOTE would, for example, apply to time deadlines for a financing contingency, inspection, timber evaluation and closing.

What happens when the parties have agreed that the buyer must have completed a percolation test by August 1st at 5 p.m., and he hasn't? The seller can insist that the perc test is no longer a part of their contract, because of the buyer's failure.

If the percolation test is worded as a results-must-be-acceptable-to-the-buyer contingency -- and not just a provision that allows the buyer to do the test -- the buyer who's missed the specific deadline will have forfeited his right to void his offer without penalty in the event the percolation results are unfavorable. Miss the deadline, in other words, and the buyer's contingency vanishes.

That means, in turn, the buyer must either perform on the contract (that is, buy the property at the agreed price) or default and lose, in most cases, his deposit as liquidated damages. If the contract lacks a liquidated-damages clause, the seller could sue for performance and win without much trouble.

TIOTE cuts both ways. A seller who is expected to finish a repair, secure a rezoning, settle a lien or clear up a defect -- and fails to complete the task on time -- can lose his sale if the buyer wants to enforce TIOTE. The buyer who terminates the contract for a seller breach may also be able to win some measure of compensation if he can show monetary harm and/or poor-faith on the seller's part.

It's often advisable for the parties to agree to moderate TIOTE language with the phrase, "unless an extension is agreed to by mutual consent," or words of that type.
Weather, credit volatility and unforeseen events can monkey wrench a deadline through no fault of anyone. It makes no sense for TIOTE handcuffs to blow up a sale for such reasons. The easiest solution is sometimes the best: If a perc test couldn't be performed in

wet ground conditions, the seller should voluntarily extend the deadline to protect his own interest in the sale he's agreed to.

Conventional wisdom has it that sellers benefit from TIOTE, because it forces the buyer to do what's he's permitted and expected to do within the established time frame. This prevents a seller from being stretched out for months. If the buyer fails to meet a deadline, the seller gets the deposit, at the very least. Every standard broker contract I've ever seen includes a straight TIOTE sentence. Conventional wisdom is right, a painful admission.

My experience is that TIOTE can benefit or penalize both buyer and seller, depending on what their contract provides. Like many things, it depends on the particulars of their agreement. If a buyer is submitting an offer with contingencies and no seller deadlines, TIOTE will clearly benefit the seller at the buyer's peril. TIOTE generally functions to make a contract asymmetrical in terms of risk; the risk falls disproportionately on the buyer. Many argue that's where the majority of risk belongs.

My sense is that courts tend to interpret TIOTE strictly. When the words establish a date within an agreement and no exceptions are included that can adjust the deadline, the buyer and seller are bound by their own words.

If closing is set for September 1st at 9 a.m. at the lawyer's office and the buyer fails to appear, the seller can declare the buyer to have breached the contract and then seek whatever remedy is available—liquidated damages in the form of a deposit forfeiture, or reasonable out-of-pocket expenses arising from the breach plus costs from delay of sale, or suit against the buyer to force performance.

Courts, however, have carved out exceptions to enforcing TIOTE. A court might ask whether the seller was harmed by the buyer's breach. Or extenuating circumstances might raise their ever-present heads. A court might use a "reasonableness" standard to determine whether the remedy sought by the seller is reasonably proportional to the harm experienced by the seller from the buyer's failure. With judges, you never know.

The best path I think is for the parties to give themselves a chance to amend the contract or invoke an extension clause when both are motivated to do the deal. The parties should make an effort to keep themselves out of court.

Sellers have been known to hammer buyers with TIOTE when the opportunity presents itself, especially when they have another buyer waiting in the wings. A small breach can bring down a very large hammer. Buyers, in particular, should understand what TIOTE means, or, alternatively, have very hard heads and very thick wallets.