

# The Legal Intelligencer

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## Attempted Oral Modification of Written Agreement of Sale Disallowed

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09-22-2009

Whether the purchase involves residential or commercial real estate, the mindset should be the same: Buyer beware. Because most real estate transactions are entered into at arm's length, it is important for potential purchasers to condition the sale on what they believe the property "is" so they can be allowed out of the transaction if the property turns out differently during the due diligence stage of the transaction. This is especially true when purchasing commercial real estate. The property is more than the physical structure. The value of the property also depends upon the revenue stream generated presently and potentially in the future from the property.

A recent decision handed down by the U.S. District Court for the Eastern District of Pennsylvania in *The Herrick Group & Associates LLC v. K.J.T. L.P.* only reinforces why it is so critical for potential purchasers to include language in their agreements of sale permitting them to remove themselves from the transaction prior to closing without penalty if the property does not turn out the way it was represented to them.

In *K.J.T. L.P.*, KJT owned a property located in Reading, Pa., known as Washington Towers, which consists of commercial space and residential apartment units, as noted in the opinion. The commercial space was being leased by a grocery store and technology company, which had separate leases running concurrently.

KJT eventually entered into an agreement of sale for the building with The Herrick Group, a company that often bought and sold commercial real estate for "flip transactions," the opinion said.

In the agreement of sale, KJT represented and certified as true both at the time of the execution of the agreement of sale itself and through closing that each tenant in the building had the right to occupy space in the building pursuant to a written lease, that all leases were full force and effect, and that it had no knowledge of any breach of any lease, as noted in the opinion.

Moreover, KJT was responsible for delivering so-called "estoppel letters" just prior to closing to Herrick, which confirmed, among other things, that the leases were unmodified (or state the modification) and in full force and effect, the dates to which rent and other charges have been paid, and state that KJT is not in default of any of the leases, as noted in the purchase and sale agreement references in the opinion.

If Herrick was unsatisfied with the content of any of the "estoppel letters," it had to make an objection within a prescribed period of time or it would waive any such issue with the "estoppel letters."

Under the agreement of sale, if KJT failed to so deliver the "estoppel letters," Herrick had the option to proceed forward with the closing or terminate the agreement altogether with KJT allowing the security deposit to be returned to Herrick along with accrued interest.

The parties also stipulated in the agreement of sale itself that it could only be amended by a written memorandum subsequently executed by the parties.

After the agreement was executed, Herrick performed due diligence of the property. Closing of the property was extended twice by mutual agreement of the parties and in writing, once in return for the payment of an additional deposit and the other times without charge.

Apart from the extensions of the closing date, the parties also entered into a letter agreement making additional changes to the agreement. Among other things, Herrick was allowed to assign its rights under the agreement to an unrelated third party, which it eventually did, as noted in the opinion.

Soon after the agreement was signed, an estoppel letter was obtained for the grocery store that stated that rent was paid in full even though that was incorrect, the opinion said. After the estoppel letter was executed but prior to the closing date, the grocery store abandoned its leased premises and ended its tenancy prematurely.

The estoppel letter issued with regard to the technology company fared no better. That letter did not reveal that the technology company had already abandoned its leasehold and that it owed gas, water and parking fees under the lease agreement, the opinion said.

KJT eventually discovered that the grocery store abandoned the leased premises prior to the closing date (but did not discover the issues involving the technology company until after KJT commenced litigation against Herrick), the opinion said.

After discovering the abandonment of the leased premises by the grocery store, the parties engaged in negotiations to salvage the sale. The bank financing the deal was also involved in these negotiations. During the negotiations, there were discussions about one of KJT's principals offering to guarantee the rental payments due under the grocery store lease. These discussions took place verbally and in writing and focused on whether the guarantee would be for the term of the lease or a part thereof and if the amount otherwise due would be placed in escrow at the time of closing as demanded by the bank.

Although no formal agreement was ever entered into between the parties as to the "rent guarantee" and signed by them, KJT claimed such an agreement had been orally reached by the parties. Herrick disputed that a deal had been struck with respect to the "rent guarantee" and, because of the impasse, declared its intention to terminate the agreement. Herrick then demanded that KJT allow the deposit made on account of the agreement be returned by Herrick. When KJT refused, Herrick filed suit in federal district court seeking the return of the deposit.

The federal district court in *K.J.T. L.P.* ruled that the deposit should be returned to Herrick because of the material breaches of the agreement committed by KJT and the failure of the parties to resolve these breaches through a modification of the agreement.

The federal district court's ruling hinged on whether the parties had entered into a modification of the agreement, which cured the breaches of the agreement through the "rent guarantee" allegedly promised by one of KJT's principals.

In Pennsylvania, "[a]n agreement that prohibits non-written modification may be modified by subsequent oral agreement if the parties' conduct clearly shows the intent to waive the requirement that the amendments be made in writing. An oral contract modifying a prior written contract, however, must be proved by clear, precise and convincing evidence."

The federal district court believed "although it [wa]s a close question whether KJT secured from Herrick a binding oral modification to guarantee the lease payments, KJT's evidence of the modification [fel] short of the 'clear, precise, and convincing evidence' required to prove such amendments."

In doing so, the federal district court noted that, while "KJT may have subjectively believed it had addressed Herrick's concerns on the eve of closing, ... relevant correspondence among the parties establishes the topic of lease guarantees remained a disputed issue until negotiations ended" and that "KJT failed to avail itself of ample opportunities to obtain a written amendment," unlike the other modifications to the agreement that had been memorialized in writing.

## LESSONS LEARNED

The underlying facts and circumstances in *K.J.T. L.P.* clearly show why it is vital for potential purchasers not to permit themselves to be trapped into an undesirable situation. Through good draftsmanship, KJT was forced to make certain representations about the tenants in the building. When these representations proved to be false, Herrick was allowed to terminate the deal.

Additionally, what saved Herrick from a financial disaster was the prohibition regarding oral modifications. While the federal district court found it to be a "close question," that provision in the agreement prevented KJT from claiming verbal discussions and innuendos formed the basis of an agreement binding the parties in contract. Without that provision in place, the federal district court may well have found that Herrick forfeited its deposit. •

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