Recent Developments in Business, Contract & Property Law

presented by

David Pierce
# RECENT DEVELOPMENTS IN KANSAS BUSINESS, CONTRACT, AND PROPERTY LAW

by

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I. BUSINESS LAW ISSUES

A. General Structuring Issues


   a. The controlling interest in Kansas Heart Hospital, L.L.C. (KHH) is held by two corporations, Cardiac Health of Wichita, Inc. (CHW) and Cardiac Associates of Wichita, Inc. (CAW).

   b. In 1999 the KHH management committee became concerned that its shareholders (physicians) may be contemplating investment in a competing health care facility. This was perceived to be a conflict of interest for any CHW shareholder that may invest in a competing facility.

   c. In response to this concern, in 2000 the bylaws of CHW were amended to provide:

     "No shareholder of the corporation shall be permitted to own either directly or indirectly through any means of ownership, all or any portion of a competing health care facility located within one hundred (100) miles of the city limits of Wichita, Kansas. A ‘competing health care facility’ is defined as any medical hospital or facility specializing in cardiac, cardiothoracic, or vascular care. . . .

     *In the event a shareholder violates the terms of this restriction, the corporation may compel redemption of the shareholder’s stock pursuant to Section 1.5(b) of these bylaws, however, the maximum redemption price shall not exceed Five Hundred Twenty-Five Dollars ($525.00) per share, increased or decreased by any percentage change in the Consumer Price Index. The intent is to prohibit ownership of a competing health care facility, not a limitation of anyone’s group"
practice or facilities integrated within the practice. The Board of Directors shall issue such interpretations as are necessary to carry out the intent of this restriction.”

d. In 2004 several doctors, who were CHW shareholders, invested in Kansas Medical Center (KMC) which was determined to be “a competing health care facility” with KHH within 100 miles of Wichita.

e. In January 2005 the CHW Board redeemed the doctor’s shares relying on its bylaw redemption authority.

f. In February 2005 the CAW Board redeemed the doctor’s shares in CAW because a CAW bylaw requires ownership of CHW stock in order to own CAW stock.

g. The stock redemptions do not affect the doctor’s staff privileges at KHH; they need not own an interest in KHH to practice at KHH.

h. Issue: Can a restriction on stock ownership, that provides for redemption by the company, be imposed through a bylaw instead of an amendment to the articles of incorporation?

(1) The court distinguishes between restrictions on a “class” of stock and restrictions targeted at the “holder” of the stock on an individual, as opposed to class, basis.

(2) K.S.A. §§ 17-6002(a)(4), 17-6401(a), and 17-6602 all contemplate that restrictions on a class of stock must be addressed in the articles of incorporation.

(3) K.S.A. § 17-6426(b) allows for “ownership restrictions” to be “imposed either by the articles of incorporation or by the bylaws or by an agreement among any number of security holders or among such holders and the corporation.”

(a) This section also states: “No restriction so imposed shall be binding with respect to securities issued prior to the adoption of the restriction unless the holders of the securities are parties to an agreement or voted in favor of the restriction.”

(b) All of the affected individuals in this case not only
voted in favor of the bylaw amendment, but also further expressed their approval on a “Voting Form.”

(4) The court concludes:

“[T]he challenged provision operated only against certain stockholders (in the event of a stockholder investing in a competing health care facility), not against an entire class of stock. Because of this, the district court correctly classified the provision as a restriction on the amount of stock that could be owned. In other words, under the express language of the bylaw provision, certain persons were not permitted to own shares of CHW stock; their ownership was restricted. Thus, the provision fell within K.S.A. 17-6426(b) as a restriction “on the amount of the corporation’s securities that may be owned by any securities holder.”

(5) Therefore, the restriction could be imposed using the bylaw instead of an amendment to the articles of incorporation.

(6) The context of the transaction, and viewing the situation as would be “understood by a hypothetical reasonable third party” the word “redeem” in CHW’s bylaws means “purchase” the holder’s interest as would be the case in a buy-sell agreement.

(a) It is not the sort of statutory redemption that must be authorized by the articles of incorporation.

(b) “The reasons that would trigger the reacquisition of the stock are not within the control of the board of directors and would not be targeted at a class of stock. Rather, it would be targeted at the holder of the stock who no longer meets eligibility requirements as defined in the contract among the shareholders.”

(7) “We conclude the use of the word ‘redemption’ in CHW’s bylaw section 1.5(e) is susceptible to more than one meaning and, when considered in the context of the bylaw and Kansas’ statutes, would be understood by a reasonably prudent person to mean CHW had the power to purchase the stock at the predetermined price. Therefore, section 1.5, as a restriction on transfer and ownership and allowing for CHW to reacquire
the stock, was valid and enforceable and did not violate K.S.A. 17-6401(b) or K.S.A. 17-6410.”

i. Issue: In determining whether the bylaw applied to the doctors’ investment in KMC (was KMC a “competing health care facility” before it was constructed?), will the actions of the board of directors for CHW be evaluated applying the business judgment rule?

(1) The business judgment rule is:

“The presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation’s best interest. The rule shields directors and officers from liability for unprofitable or harmful corporate transactions if the transactions were made in good faith, with due care, and within the directors’ or officers’ authority.”

(2) First issue: is this even a “business judgment” issue? The court notes the bylaw trigger was tied to the board’s decision whether to redeem the CHW shares of stock. If there had been a violation of the bylaw, then the board had to determine how to respond.

(3) Court relies upon a 2001 Court of Appeals decision, Gray v. Manhattan Medical Center, Inc., for the propositions:

(a) “The business judgment rule gives a corporation’s directors the authority to interpret and apply the bylaws and the lease in the corporation’s best interest.”

(b) “[T]here was a dispute regarding the interpretation of the lease and bylaws. . . . The fact that [the directors] chose a course of action Gray disagrees with does not affect the applicability or reduce the protection of the business judgment rule.”

(4) Interestingly, the bylaw itself states: “The Board of Directors shall issue such interpretations as are necessary to carry out the intent of this restriction.”
(5) The court concludes: "The decision made by CHW's board of directors was a business judgment decision."

j. Accepting that the business judgment rule applies, was the board's action made by disinterested directors, acting on an informed basis, in good faith believing the decision was in the best interest of the corporation?

(1) Disinterested Directors. The fact they may benefit proportionally with all remaining shareholders by the repurchase of the doctors' shares does not make them "interested" or subject to any sort of conflict. "A director is interested 'where the director has a financial or pecuniary interest in a transaction other than that which devolves to the corporation or to all of the shareholders generally.'"

(2) Informed Directors (duty of due care). The facts indicate the directors were provided the necessary information to properly evaluate the issues prior to making their decision.

(3) Good Faith Actions. Issue is not one of "fair value," as in a cash-out merger, but rather good faith application of the contractual provisions of the bylaws. There was a good faith belief that KMC was a competitor and that the bylaw provisions were triggered.


a. The asset valuations in this case are being scrutinized because Norman's surviving spouse, Maryam, elected to take her statutory spousal elective share, which requires the valuation of assets Norman gave to his son, Lawrence (Maryam's step-son), that are subject to the augmented estate procedures as "uncompensated nonprobate transfers to others . . . ."

b. The asset involved begins with Norman's 100% ownership of the stock in Midland Resources, Inc. (MRI).

c. In February 1997 Norman and Lawrence created the Hjersted Family Limited Partnership (HFLP) with Norman owning a 96% limited
partnership interest plus a 2% general partnership interest; Lawrence owned a 1% limited partnership interest and a 1% general partnership interest.

(1) Norman transferred 100% of his MRI stock to the HFLP pursuant to a purchase agreement whereby Norman and Lawrence purchased their respective shares in the HFLP.

(2) The MRI stock is the only asset of the HFLP.

d. In June 1998 Norman created the Norman B. Hjersted Revocable Trust and named himself trustee. In September 1999 Norman conveyed all his interests in the HFLP to the Trust.

e. In March 2000 Norman entered into a gift/sale transaction with Lawrence.

(1) Norman transferred his (the Trust's) 96% limited partnership interest in the HFLP to Lawrence characterizing $675,000 of the value as a gift to Lawrence and then Lawrence agreed to purchase the balance of the value at a price to be determined later by appraisal.

(2) May 2000 John Korschot, an appraiser, was hired to value the 96% limited partnership interest.

(3) Appraiser Korschot found the following values:

(a) First tier discount for the MRI stock. Assigned a 20% "lack of marketability" discount because it was stock in a close corporation. Value, after discount: $2.25 million.

(b) Second tier discounts associated with the stock being held by a limited partnership:

(i) 10% "lack of control" discount. Limited partner interest; not a general partner interest.

(ii) 22.5% "lack or marketability" discount. Difficult to sell a limited partnership interest.

(c) Final valuation: $2.25 (after 20% discount) x 96% =

$2,160,000 minus $702,000 (32.5% discount) = $1,458,000 - $675,000 (deemed gift) = $808,000 in purchase price value [numbers do not account for minor adjustments].

(4) Lawrence contends not more than the $675,000 should be considered a gift (and part of the augmented estate) with the balance being excluded as purchase price (spouse will receive the benefit of payments under the note).

(5) Maryam contends:

(a) Should only be a 10% discount on the MRI stock: Therefore, her value for the MRI stock is $410,000 more than the value used by Lawrence and Norman; plus

(b) There should be no additional discount to account for the MRI stock being owned by a limited partnership. Therefore, for this item her value is $702,000 higher.

(c) Total difference: $410,000 + $702,000 = $1,112,000.

f. The trial court accepted Maryam’s position, allowed a 10% discount on the MRI stock value but no additional discounts for the fact the stock was held in a limited partnership and only a limited partnership interest was being sold.

g. The Court of Appeals upheld the trial court’s refusal to allow any discount for the limited partnership element.

(1) The Court of Appeals attributed a negative motive to use of the limited partnership, commenting on “the artificiality or illusory nature of the partnership entity . . . .”

(2) The Supreme Court notes this finding is not in accord with the trial court’s finding that “HFLP was organized for valid family and business purposes . . . .” The trial court also found: “that the partnership was a valid and existing limited partnership at the time of the gift on March 1st 2000 and continues to be so.”

h. The Supreme Court concludes: “the Court of Appeals was incorrect
in weighing conflicting evidence and in relying upon the purported artificiality or illusory nature of the HFLP to conclude that Korschot's discounts were unnecessary."

i. Maryam's appraiser admitted that he valued only the MRI stock and gave no consideration to the fact the stock was held by the HFLP.

j. Court reverses and remands the case "to at least address the validity of Korschot's 32.5% discounts for lack of marketability and lack of control of HFLP interests, and may adjust, compromise, or even reject one or both."

k. Court offers "some general contours of guidance which the district court may decide to consider, or not to consider, at its discretion."

(1) Estate and Gift Contexts.

(a) The use of a limited partnership to layer ownership and reduce its value is an accepted estate planning technique.

(b) "In short, the district court may possibly find: that the HFLP interest transfers were manifestations of Norman's legitimate business and estate planning; that they would be entitled, at least for transfer tax purposes, to discounts for marketability and control; and that a similar rationale would allow such discounts for valuing those assets in the augmented estate for the spousal elective share purposes."

(c) Will the district court ultimately choose to allow Norman to do to his spouse what the courts allow him to do to the IRS?

(2) Dissenting Shareholder Context.

(a) Court notes it has adopted the rule "that minority and marketability discounts should not be applied when the fractional share resulted from a reverse stock split intended to eliminate a minority shareholder's interest in the corporation."

(b) On remand, the district court "may consider whether
Maryam is comparable to a minority shareholder entitled to the undiscounted value of HFLP interests. But it should concurrently consider the caveat contained in Comment e to A.L.I. [Principles of Corporate Governance] § 7.22 cited in Arnaud: [that valuation for this type of corporate transaction may not be appropriate in other contexts, e.g. tax. “The standard of valuation employed in any given context should reflect the purpose served by the law in that context . . .” (Emphasis by the court.).]

(3) Spousal Election Context.

(a) Note dual purpose of the statute: “preventing a surviving spouse’s disinheritance” and “prevent the surviving spouse from needlessly overriding the decedent’s legitimate intent to benefit others . . . .”

(b) “Disallowance of those discounts by the district court could arguably be considered inconsistent with Norman’s legitimate intent to benefit his son Lawrence (through substantially reduced taxes) via the HFLP interest transfers.”

(c) “[A]ny valuation decision by the district court on remand should be reached after considering both – often at odds – public purposes contained in the spousal elective share statutes.”

(4) Divorce Property Settlement Context.

(a) In a prior Kansas case a 20% marketability discount was applied to determine the value of stock in a closely held corporation for property division purposes.

(b) Other jurisdictions permit, and refuse to permit, such discounts where valuing property for division in divorce.

1. Concurring opinion of Justice Davis, joined in by Chief Justice McFarland and Justice Luckert: the comments contained in item “k.” seem to suggest the Court favors discounts. Should leave this to the
trial court.

B. The New Business


a. The court's opinion provides insight regarding the sale of a business, the associated due diligence process, and problems that can occur when the sales price is based upon revenue projections by the seller.

b. Scott Goldman, through various Eaton Hall entities, built up a successful trade show business which Ascend Media agreed to purchase for $3.3 million.

(1) The purchase price was based, in part, upon a multiple of projected income from the 2006 show.

(2) The numbers were derived from a 2006 show budget prepared by Mr. Goldman which projected $1.27 million in revenue; the actual revenue was about $1.02 million, or about a 19% shortfall.

c. Ascend Media contended this inflated the purchase price by $1.8 million.

d. Although the court finds the facts may support Eaton Hall's good faith estimate of 2006 show income, good faith is an issue of fact that cannot be resolved at summary judgment.

e. However, the other issues raised are resolved in Eaton Hall's favor as a matter of law.

(1) The facts regarding the disclosures, representations, and actions of Eaton Hall all support the conclusion it acted in accordance with the purchase and sale agreement.

(2) In the process of arriving at this conclusion, the court works its way through the contract terms, disclosures made as part of the due diligence process, and an evaluation of the accuracy of Eaton Hall's disclosures and representations.

a. It requires careful planning when an employee decides they no longer want to work for the “boss” but instead want to compete with the boss as an independent entrepreneur.

b. This case reviews the legal problems that can arise when employees commence a competing business, while still employed by their soon-to-be competitor.

c. As alleged in the complaint, former employees of Resource, while still employed by Resource, began setting up their competing business under the Ability name.

d. Plaintiff alleges its employees: gained access to files on Resource computers and other property to assist Ability in competing with Resource; made representations to Resource customers that suggested a relationship between Resource and Ability; and generally set into motion a plan to depart Resource as employees and take with them Resource business and good will.

e. The plaintiff’s claims include:

(1) Violation of the Lanaham (Trademark) Act for use of the Resource name in violation of federal law protecting a service mark;

(2) violation of the Computer Fraud and Abuse Act, a federal law designed to protect confidential and proprietary information maintained in an electronic format;

(3) breach of the duty of loyalty employees owe their employer in this situation;

(4) tortious interference with Resources’ business relationships with its clients;

(5) conversion of Resources’ equipment, including confidential and proprietary information; and

(6) a civil conspiracy that resulted when the employees took
action to execute their plan to ultimately compete with their employer.

f. All of the plaintiff's claims survive defendants' motion to dismiss.


a. Former employer brought action against doctor to enforce a covenant not to complete.

(1) The covenant was for 3 years, applied to practice within Sedgwick County, Kansas, and required the doctor to pay to the employer "liquidated damages" equal to "25% of all earnings collected from such practice [within Sedgwick County] during such period [3 years after leaving her current employment]."

(2) No limitation on practicing medicine outside of Sedgwick County.

b. Trial court held the covenant did not protect a legitimate business interest, its duration was too long, and in any event the employer lacked "clean hands" to obtain specific performance because it had previously breached provisions of the contract.

c. Court of Appeals reverses.

(1) "The paramount public policy is that freedom of contract should not be interfered with lightly."

(2) Covenant supported by consideration. It was part of the initial employment contract ["ancillary to the written contract of employment"].

(3) Other factors:

(a) "Does the covenant protect a legitimate business interest of the employer?"

(b) "Does the covenant create an undue burden on the employee?"
(c) "Is the covenant injurious to the public welfare?"

(d) "Are the time and territorial limitations contained in the covenant reasonable? The determination of reasonableness is made on the particular facts and circumstances of each case."

d. Applying the factors, the court holds:

(1) The covenant protected the employer’s legitimate business interest "in its referral system, patient base, and goodwill."

(2) The time (3 years) and territorial (Sedgwick County) limits were reasonable.

(a) Prior decisions did not create a 2-year limit. Under these facts, 3 years was a reasonable period of time.

(b) "The protection given by the covenant was only coextensive with the area from which the Clinic drew most of its patients."

(3) "The trial court determined that the restrictive covenant did not prevent Dr. Louis’ patients from receiving quality medical care because she could not practice in Sedgwick County."

(4) The amount involved was not a penalty, but rather reasonable liquidated damages. Employer’s overhead expenses routinely account for 50% of a doctor’s earnings; in this case only 25% will be replaced by the payment, to cover overhead, recruitment, training, and other expenses.

e. Although there were prior salary calculations by the employer that were a breach of the employment contract, the doctor did not object to them, and is estopped to assert them now (some were to the doctor’s benefit, some were not).

f. In any event, the prior breaches did not relieve the doctor from her restrictive covenant obligations, or preclude the employer from seeking specific performance.

(1) Was this a "specific performance" case?
II. CONTRACT LAW ISSUES

A. Formation


a. Hefton hired an auctioneer to sell five tracts of land at auction, subject to minimum sales prices the seller must obtain for each tract. Young was the high bidder on two tracts; his bid on tract 3 was below the minimum and his bid on tract 4 was above the minimum. Young asserted he was entitled to both tracts at the bid price because the auctioneer failed to give Young notice the land was being sold subject to the seller’s minimum price.

b. The evidence was conflicting as to whether the auctioneer announced that any bid or contract was subject to the seller’s final approval.

c. The sales bill stated: “All contracts will be signed at the end of the auction. Earnest money is only refundable if seller rejects contract.”

d. No specific statement that the auction was “with reserve.”

e. Court notes that many courts have relied upon the U.C.C. provision regarding auctions of “goods” for guidance in the real estate area.

(1) K.S.A. § 84-2-328(3) states: “Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale.”

(2) This is consistent with the general rule that a “seller of property at auction has the right to prescribe, within reasonable limits, the manner, conditions, and terms of sale.”

f. “Usually the auctioneer, at the time and place appointed for the auction, announces these terms and conditions that, when so announced, are generally deemed to supersede all others and to bind the purchaser even though he or she did not hear or understand the announcement or was not present at the time of the announcement.
and the terms were not brought to his or her actual attention.”

g. The court notes there are three types of auctions:

(1) With reserve (“the placing of the property for sale is an invitation for bids, not an offer to sell”);

(2) without reserve (“the placing of property for sale constitutes an offer to sell and each bid represents a conditional acceptance, subject to receipt of a higher bid”); and

(3) conditional (“the seller reserves the right to accept or reject bids after the close of the bidding.”).

h. Court concludes, from all the evidence (much of it conflicting), the trial court properly concluded this was a “conditional auction.” Conditioned upon the seller obtaining their minimum bid.

(1) No contract as to tract 3 because the amount bid was below the minimum amount. The bidder’s offer was rejected.

(2) A contract was formed as to tract 4 because the amount bid exceeded the minimum amount. The bidder’s offer was accepted, resulting in a contract.

i. Statute of frauds issue.

(1) K.S.A. § 33-106: “No action shall be brought whereby to charge a party . . . upon any contract for the sale of lands . . . unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or some other person thereunto by him or her lawfully authorized in writing.”

(2) The memorandum can be an informal writing, several writings construed together, which provide the following information:

(a) The parties to the contract;

(b) the subject matter of the contract; and
(c) "the terms and conditions of all the promises constituting the contract and by whom and to whom the promises are made."

(3) It is interesting that the court states: "See Restatement (Second) of Contracts § 131 (1979)" following this list of requirements.

(a) Although the reference to "the terms and conditions of all the promises constituting the contract" seems a bit demanding, presumably to the extent a term or condition is not represented, it is simply deemed not to exist.

(b) This is where the Restatement citation becomes important because § 131 merely requires "reasonable certainty" regarding "the essential terms" of the contract, not all the terms.

(4) The court affirms the trial court's holding that the statute was satisfied by considering the "Exclusive Right to Sell Listing Agreement" which identifies the property and is signed by the seller, and the "Bid Sheet Information" with the bid receipt and check signed by the buyer. The terms and conditions of the sale were stated in the Internet sales bill and the printed sales bill.

j. This sort of lawsuit can be easily avoided by clearly stating, in all communications regarding the auction, whether the sale is "without reserve" or otherwise subject to enumerated conditions – the most common of which will be the minimum sales price acceptable to the owner of the property being auctioned.


a. Navair, Inc., for almost 30 years, was the exclusive distributor in Canada for IFR Americas, Inc. Navair would procure buyers of IFR's products which IFR would sell at a discount to Navair.

b. In October of 2002 IFR gave Navair notice that IFR would not renew their distributorship contract which would expire on October 31, 2002. In this case the court considers the precise date on which the
contract would end as to a particular sale that Navair was concluding with the Canadian government when it received IFR's non-renewal notice.

c. The trial court granted IFR summary judgment concluding "IFR was willing to protect Navair's price quotations until January 31, 2003" but not beyond that date.

d. Navair contended the parties had agreed Navair would have a "reasonable time" to conclude the transaction with the Canadian government which was not concluded until after January 31, 2003.

e. The Court of Appeals reverses the trial court and holds that an issue of material fact exists regarding how long "IFR was willing to protect Navair's price quotations."

f. In the process of arriving at its decision, the court explores some of the foundations of contract law.

(1) First, IFR argued that without a specific termination date any agreement to extend as to the Canadian government sale lacked an "essential term" and was therefore unenforceable.

(2) The court rejects this argument noting that under such circumstances courts will readily imply a term: that the extension will be for a "reasonable time."

(3) Citing Kansas case law the court notes: "a 'basic principle of contract construction is that where a contract does not specify the time of performance or for the occurrence of a necessary event, a reasonable time will be implied.'"

(4) This means the trial court, on remand, must ascertain what would be a reasonable time under all the circumstances.

g. IFR's second argument is that since it understood the extension would end on January 31, and Navair did not, there was no "meeting of the minds" and therefore no mutual assent essential for the formation of a contract.

(1) This argument, which the court also rejects, allows it to discuss why the frequently stated requirement of "meeting of the minds" really does not require any such thing.
It does this by distinguishing between the *objective* and *subjective* theories of contract.

The court notes: "Contracts are not formed by comparing mental states [subjective theory]; they are formed by what the parties *communicate* [objective theory]." The court makes the point with the following quotation from the 4th edition of Williston on Contracts:

"In the formation of contracts . . . it was long ago settled that secret, subjective intent is immaterial, so that mutual assent is to be judged only by overt acts and words rather than by the hidden, subjective or secret intention of the parties. During the first half of the nineteenth century, however, there were many expressions which seemed to indicate a contrary rule. Chief among these was the familiar statement, still invoked by many courts today, that a contract requires a 'meeting of the minds' of the parties. However, the fundamental basis of contract in the common law is reliance on an outward act (that is, a promise), as may be seen by the early development of the law of consideration as compared with that of mutual assent."


The court also relies upon the analysis of the Kansas Court of Appeals in *Southwest & Associates, Inc. v. Steven Enterprises, LLC*, where the phrase "meeting of the minds" is used but then immediately limited to its modern objective context:

"In order to find that Southwest and Steven Enterprises entered into an enforceable contract, Southwest is required to show a meeting of the minds as to all essential terms. In determining intent to form a contract, the test is objective rather than subjective, meaning that the relevant inquiry is the manifestation of a party’s intention, rather than the actual or real intention. Put another way, the inquiry will focus not on the question of whether the subjective minds of the parties have met, but on whether their outward expression of assent is sufficient to form a contract."
i. The court uses these observations to conclude: “[E]ven if IFR understood that the extension would lapse on January 31, 2003, that understanding is irrelevant because there is no evidence that this understanding was communicated to Navair when the two parties agreed to an extension of the December Agreement.”

j. The Restatement (Second) of Contracts fully supports the objective analysis, except, in one situation: “misunderstanding.”

(1) Restatement (Second) of Contracts § 20 contains what I like to call the “Rule Against Perpetuities of Contract Law” and provides, in part:

“There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and (a) neither party knows or has reason to know the meaning attached by the other . . . .”

(2) This is a restatement of the holding in the Raffles v. Wichelhaus case regarding the two ships named Peerless which sailed from Bombay; one in October, the other in December.

(3) Although this would seem like a big hole in the objective theory of contracts, as a practical matter it is usually subsumed by interpretive rules, such as those found at Restatement (Second) of Contracts § 201, where at least one party is deemed to have known, or should have known, of the meaning attached by the other.


   a. $5.6 million contract in which Carrothers Construction agreed to build a wastewater treatment plant for the City of South Hutchinson.

   b. Contract contained a liquidated damages clause providing for $850 per day in liquidated damages for each day Carrothers failed to meet the “substantial completion” deadline and the “final completion” deadline.
c. Carrothers did not complete all its work on the plant until 171 days beyond the stated completion date. This resulted in the City holding back $145,350 in liquidated damages.

d. Issue #1: did substantial completion occur when the City began using the plant (in November) or when all the computer controls and safety devices were completed (in January)?

   (1) Court looks to the contract terms to define “substantial completion.”

   (2) The contract specified the “work” that must take place to achieve completion includes completing the computer control and safety systems, which was not done until 171 days after the completion date.

   (3) Although the City was actually using the plant by operating it manually (without computers and safety devices) beginning in November, it was not “substantially complete” until January.

e. Issue #2: does the liquidated damages clause provide for an illegal “penalty”?

   (1) The propriety of liquidated damages is a question of law.

   (2) The burden of proof is on the party challenging the clause.

f. Legal principles applied by the court to resolve issue #2:

   (1) Penalty is designed to “secure performance.” *I.e.*, make it cost so much they must perform.

   (2) Liquidated damages designed as “payment of a sum in lieu of performance.”

   NOTE: This analysis supports the “efficient breach” concept.

   (3) “The instrument must be considered as a whole, and the situation of the parties, the nature of the subject matter and the circumstances surrounding its execution taken into account.”
Two considerations given "special weight":

(a) The amount is conscionable. "[R]easonable in view of the value of the subject matter of the contract and of the probable or presumptive loss in case of breach . . . ."

NOTE: As noted below, the court accepts the proposition that this includes not only a prospective inquiry (what could the parties have anticipated at the time they entered into the contract) but also a retrospective inquiry (is it conscionable in light of the actual loss suffered by the non-breaching party).

(b) The amount is uncertain. "[T]he nature of the transaction is such that the amount of actual damages resulting from default would not be easily and readily determinable." Evaluated at the time the contract is entered.

g. Court tests the "reasonableness" of the liquidated damages applying (1) a predictive analysis: is the amount reasonable in light of what the parties knew, or could know, at the time they entered into the contract; plus (2) an actual comparative analysis: is the amount reasonable in light of the actual damages suffered by the claimant?

h. RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981) (emphasis added) states:

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.

(1) It appears the "or" has been read more like an "and" by requiring the damages to pass both measures: reasonable when compared to "anticipated" damages and "actual" damages.

(2) The comments to the black-letter statement support the "or-equals-and" interpretation: "The parties to a contract may effectively provide in advance the damages that are to be
payable in the event of breach as long as the provision does not disregard the principle of compensation.”

(a) If no damages are in fact incurred, then the concept of compensation would be disregarded if the breaching party were nevertheless required to pay liquidated damages.

(b) Comment a. to § 356 of the Restatement also provides: “The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on ground of public policy.”

(c) An endorsement of the “efficient breach” concept.

   i. Citing Hutton Contracting Co., Inc. v. City of Coffeyville, 487 F.3d 772 (10th Cir. 2007), the court observes: “The Hutton court indicated that Kansas courts have not definitively answered the question whether the enforceability of liquidated damages provisions should be determined prospectively only, or whether Kansas courts would also apply a supplemental retrospective analysis.”

      (1) The court examines a series of Kansas Court of Appeals cases and concludes it has applied a supplemental retrospective analysis in the past.

      (2) “Thus, to the extent this court has acknowledged that liquidated damages must bear some reasonable relationship to the actual injury or damages caused by the breach, this court has recognized that a retrospective analysis of a liquidated damages clause is also appropriate.”

j. Applying the tests to the facts:

   (1) Step #1: Is the amount conscionable: “reasonable in view of the value of the subject matter of the contract and of the probable or presumptive loss in case of breach.”

      (a) $5.6 million contract compared to $145,350 for a six month delay; less than 3% of the total contract
amount.

(b) Prospective Inquiry: Court recites the types of damages considered by the City’s consulting engineers, MKEC Engineering Consultants, Inc., and concludes: “In light of these potential actual expenses, the amount set forth in the contract of $850 per day is reasonable when viewed prospectively.”

(c) Retrospective Inquiry: Carrothers argues the City incurred no damages due to the delay because they were able to actually use the plant before it was completed.

(i) City in fact had an engineer on site daily until the project was completed. Also required additional City staff involvement until it was completed.

(ii) “Thus, the amount of liquidated damages set forth in the contract of $850 per day was reasonable when viewed retrospectively in relation to the actual damages sustained by the City caused by Carrothers’ delay.”

(2) Step #2: Were the damages resulting from the default “easily and readily determinable”?

(a) The City’s consulting engineers in this case, MKEC, did an excellent job, at the time the contract was drafted, analyzing the potential elements of loss that should be considered in arriving at the $850/day liquidated damages provision.

(b) “As demonstrated by the many factors MKEC considered in determining the appropriate amount of liquidated damages, the actual damages would have been difficult to calculate at the time the parties entered into the contract.”

k. Court affirms trial court’s grant of summary judgment to the City.

l. The court’s adoption of the additional “retrospective” inquiry may not
be consistent with the route the Kansas Supreme Court may ultimately follow.

(1) For example, on May 16, 2008 the Kansas Supreme Court issued its opinion in *Kansas Heart Hospital, L.L.C. v. Idbeis*, Case No. 97,131, 2008 WL 2065843 (Kan., May 16, 2008), where the court considered whether a bylaw requiring a stockholder to sell its stock back to the company at a predetermined price was an illegal penalty.

(2) The court, without discussion, rejects a retrospective analysis stating: "The determination of whether there is a penalty does not depend on speculating on the performance of investments." To support this proposition it cites the *TMG Life* case, a 1995 Court of Appeals case, and quotes the following passage from *TMG Life*: "The reasonableness of a liquidated damages clause should be determined as of the time the contract was executed, not with the benefit of hindsight."

(3) Because the court does not address the precise issue of a prospective and retrospective inquiry, the context of its statement in *Kansas Heart Hospital* may be to merely highlight that there is a prospective analysis – not that a court would never evaluate the situation using a retrospective analysis. This issue apparently remains open for the Kansas Supreme Court – although the Kansas Court of Appeals has clearly adopted a prospective and retrospective analysis in the *Carrothers* case.


   a. Another of a mounting line of unsuccessful cases attacking contract disclaimers in standard form real estate sales contracts.

   b. The process, and the design of the process, is pretty basic:

      (1) First, have the property owner fill out a detailed statement revealing everything they know about the property they are selling.

      (2) Second, deliver the disclosure statement to the prospective
buyer so they can read it to determine the status of the property; and often determine whether there is anything that warrants further inspection.

(3) Third, real estate agent instructs the buyer to obtain an inspection, if they want one.

(4) Fourth, buyer is instructed to sign documents that say they are not relying upon anything in the disclosure statement.

(5) Fifth, buyer purchases the property and discovers a major defect which the seller most likely knew about, but was not revealed in the disclosure statement.

(6) The legal result, in Kansas, is now pretty clear: buyer loses.

c. *Katzenmeier* is a suit alleging intentional and negligent misrepresentation. Summary judgment was granted to the seller because, under the express terms of the contract, the buyer could not have reasonably relied upon the allegedly false representations made by the seller.

d. It appears the only way to combat the effect of such disclaimers is to refuse to agree to them – which requires adequate counseling, which is not likely to come from the buyer’s real estate agent – they will tell them to get an inspection.

e. As with any contract regarding a major financial transaction, the only way parties can adequately protect themselves is through competent legal counsel.

(1) Counsel can begin by turning the seller’s disclosure into affirmative representations that will survive the closing and provide the buyer with the power to rescind, or damages, attorney fees, etc., in the event a representation proves to be inaccurate.

(2) In the long term, this will not be a happy state of affairs for the real estate industry as the sale of residential real estate departs from the simpler cookie-cutter form of transaction and begins to resemble the more heavily-lawyered commercial real estate deal.
I predict this will continue to be the trend until disclaimers in form contracts are revised to remedy the imbalance now created in favor of the seller, and everyone else involved in the transaction, except the buyer.


a. Rabb Sales, Inc. entered into a contract giving it the right to distribute the products of Domino Amjet, Inc.

b. Domino filed a motion to dismiss in response to Raab’s complaint asserting breach of contract, negligent misrepresentation, and unjust enrichment.

c. One of Domino’s defenses to the contract claim was that Domino terminated the contract in November 2006. However, the contract contained what is commonly referred to as an “evergreen clause” which would automatically extend the contract for an additional year (November 1 to October 31) “in the absence of three months’ prior written notice by either party.”

(1) Under this provision the notice of termination would apparently have been due before August 1.

(2) Therefore, the contract was extended through October 31, 2007 unless some other event terminated it, and assuming the proper termination notice is given to prevent the contract from extending beyond October 31, 2007.

(3) The court denies Domino’s motion to dismiss Raab’s contract claim.

d. The court grants Domino’s motion to dismiss Raab’s negligent misrepresentation claim after finding it barred by the “economic loss doctrine” recognized by Illinois law.

(1) The court found that Illinois law applied to the dispute because of an express choice of law provision.

(2) Under the economic loss doctrine “a plaintiff may not recover solely economic damages in a tort action.” Such “economic
losses due to defeated expectations of a commercial bargain” are matters of contract, not tort.

e. The Kansas Court of Appeals has applied the economic loss doctrine in several cases.

(1) *Pendville v. Contemporary Homes, Inc.*, 32 Kan. App.2d 435, 83 P.3d 1257 (2004), collects the relevant Kansas case law and describes the purpose of the rule as follows: “The doctrine is designed to prevent a party from asserting a tort remedy in circumstances governed by the law of contracts.”

(2) The doctrine recognizes that a contract can provide a sort of immunity from tort liability when the asserted wrong would otherwise be a potential breach of contract.

(3) However, the doctrine is still being defined in Kansas. See generally, *Kevin Breer & Justin D. Pulikkan, The Economic Loss Rule in Kansas and its Impact on Construction Cases*, 74 J. Kan. B. Ass’n 30 (2005).

C. Performance and Breach


a. Imaging Solutions entered into a contract with Inter-Americas to provide Inter-Americas with a new document imaging system consisting of hardware, software, and support and training services.

b. Completion of the contract depended upon the cooperation of the parties to identify ways to convert data from its existing system to the new system.

c. After the contract was entered into, Inter-Americas delayed installation due to other priorities. Once installation began, Imaging Solutions proceeded diligently addressing issues as they arose.

d. Inter-Americas, without advance notice, sent a letter claiming Imaging Solutions breached the contract for not timely performing and that Inter-Americas was entitled to rescind and recover
$255,405.88 in damages.

(1) Imaging Solutions responded indicating the delay was caused by Inter-Americas' actions but that Imaging Solutions remained ready to perform.

(2) Inter-Americas filed suit.

e. Trial court granted summary judgment to Imaging Solutions rejecting Inter-Americas claims and granting judgment on Imaging Solutions' counterclaim for damages.

f. Court of Appeals holds the contract was not ambiguous and all the facts, except those concerning damages on Imaging Solutions' counterclaim, are uncontroverted.

g. Issue: Is this transaction a “sale of goods” governed by Article 2 of the Uniform Commercial Code?

(1) Yes. In Kansas, computer software is considered to be “goods” subject to the UCC even though incidental services are provide with the sale of software. Wachter Management Co. v. Dexter & Chaney, Inc., 282 Kan. 356, 144 P.3d 747 (2006).

(2) “A contract involving both software and services will be governed by the UCC if ‘without the purchase of the software, the services would have been unnecessary.’”

(3) “$35,000 for various services in a $240,000 contract convinces us these services were incidental.” Predominant factor test?

h. Issue: Did Imaging Solution perform in a timely manner?

(1) Yes. “When a contract is silent about when a shipment, delivery, or any other action is to take place, the time span for doing such will be within a reasonable time under K.S.A. 84-2-309(1). Further, K.S.A. 84-1-204(2) states that what is a reasonable time for taking any action depends on the nature, purpose, and circumstances of such action.”

(2) “The only conclusion we can draw from these facts is that,
despite Inter-America's many delays in communicating and meeting with ISC, ISC's performance under the contract was continuing reasonably. Thus, ISC was not in breach of the contract when Inter-Americas sent its demand letter on October 5, 2005."

(3) Inter-Americas made no complaint about the pace of performance until it sent the October 5 demand letter.

i. Issue: Did Inter-Americas have a duty to inform Imaging Solutions and provide it with an opportunity to cure any act of nonperformance?

(1) Yes. "If Inter-Americas believed ISC was in breach of the contract, under the UCC it had a duty to tell ISC of its breach." Court refers the reader to K.S.A. 84-2-602(1) dealing with "rejection of goods," and states:

"Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller."

(2) "Such notice must be 'seasonable' as contemplated by K.S.A. 84-1-204(3) (within the time agreed or within a reasonable time)."

(3) "With such notice, the law allows ISC the right to cure any claimed breach if it could do so within the time for performance under the contract or within a reasonable time if it had reasonable grounds to believe that Inter-Americas was satisfied with its performance." Court refers to K.S.A. 84-2-508 which states:

"§ 84-2-508. Cure by Seller of Improper Tender or Delivery; Replacement."

(1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be
acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender."

(4) NOTE: The buyer’s duty to give notice of "rejection," and the seller’s ability to cure a defect in performance, are on-going obligations and rights for contracts that contemplate a series of performances. Also note how this on-going process is further expanded when you mix goods and services. The goods may be delivered in a one-shot deal, followed by a long-term set of performances related to the "service" component of the transaction.

(5) "In this case, Inter-Americas, without any warning that it was displeased with ISC’s performance, improperly ended the contract. Thus, it prevented ISC from completing the contract and receiving the benefits of its labor. Therefore, the district court did not err in granting summary judgment in favor of ISC on its counterclaim against Inter-Americas."

(6) Example of a case in which the party asserting a breach becomes the breaching party and liable for the other party’s damages.

Although Imaging Solutions is entitled to damages under its counterclaim, the amount of damage is an issue of fact that should not have been determined through summary judgment.


a. The Coleman Co., Inc. entered into a contract with Fleetwood Folding Trailers, Inc. ("FFT"), authorizing FFT to use the Coleman trademark on trailers manufactured by FFT. When FFT failed to comply with various provisions of the contract, Coleman followed the contractual termination procedure which required:

(1) FFT must fail to perform or fulfill any term or obligation of the agreement;

(2) Coleman must provide "written notice" to FFT of those defaults; and
(3) After receipt of notice, such default continues for 30 days.

b. Following written notice, and FFT's failure to cure within 30 days, Coleman declared the contract terminated.

c. The trial court found that Coleman would have to establish a "material breach" of the contract before it could terminate the agreement.

d. The Court of Appeals holds the trial court erred when it implied a "material" breach was required by the termination clause.

e. The termination right applied to FFT's failure to perform "any term or obligation" of the contract. "The parties' inclusion of 'any' suggests that the provision breached may be one or more of the provisions in the agreement, not that the provision breached must be material to the agreement."

f. Regarding the contractual opportunity to "cure," the court holds that under any definition of the term FFT failed to take the necessary action to remedy its noncompliance with the contract.

(1) FFT argued for an interpretation that it had 30 days to cease violating the agreement; Coleman argued FFT would have 30 days following notice "to remedy any existing breaches and return the parties to their predefault conditions within the 30-day period."

(2) The clause states Coleman can terminate when FFT "fails to perform or fulfill any term or obligation . . . in the time and manner provided, and if such default shall continue for thirty (30) days after written notice thereof."

(3) The court rejects FFT's interpretation stating: "The 30 days were not intended to give breaching parties an extended time period to commit new breaches."


a. CTP, LLC entered into a promissory note with Foundation Property Investments, LLC, to fund the purchase of a truck stop.
b. Monthly payments on the note were made on time during the first four months but were late during the following nine months, including the June 1, 2005 payment.

c. When the July 1, 2005 payment did not arrive on July 1, Foundation, by letter dated July 8, gave notice the note was in default and Foundation was “exercising its option to declare all of the unpaid principal and interest immediately due and payable.”

d. The trial court rejected CTP’s waiver defense and granted Foundation summary judgment for the full amount owed, including accrued interest, attorney fees, and costs.

e. The Kansas Court of Appeals reverses the trial court and holds that Foundation’s acceptance of late payments for a nine-month period constituted a waiver of its rights under the acceleration clause.

f. Observing that the note at issue did not contain an anti-waiver provision, Foundation’s course of performance in accepting late payments without objection limited its ability to declare an acceleration.

(1) Under these circumstances, Foundation would need to give CTP advance notice that it would no longer accept late payments.

(2) The acceleration clause can be used by Foundation prospectively, so long as CTP is put on notice that Foundation expects future payments to be made in a timely manner.

g. The court also states the basic rules for interpreting promissory notes and mortgages: They are contracts, and they will be governed by “ordinary rules of construction applicable to contracts . . . .”

(1) “Like other contract rights . . . an acceleration clause may be waived.”

(2) “Waiver” in this context is “the intentional relinquishment of a known right . . . .”

(3) The intention to waive a right can be inferred from conduct.

h. In Kansas, such implied waiver can be controlled by use of an “anti-
waiver” clause such as:

“Any waiver of any payment hereunder or under the instrument securing this note at any time, shall not, at any other time, be taken to be a waiver of the terms of this note or the instrument securing it.”

i. The note at issue in Foundation did not contain an anti-waiver clause.

j. Although not raised in this case, an alternative basis for the holding in CTP’s favor could be a breach of the covenant of good faith in the enforcement of the contract.

(1) For example, Restatement (Second) of Contracts § 205 provides:

“Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”

(2) Cases frequently focus on good faith to define a party’s discretion in the “performance” of imprecise contractual provisions.

(3) However, it is equally applicable when a party is seeking to “enforce” their contract.

(4) A case that illustrates this principle is Baker v. Ratzlaff, 1 Kan. App.2d 285, 564 P.2d 153 (1977), which deals with the structurally similar situation where the seller had a right to terminate a supply contract if payment was not made upon delivery.

(a) The seller had accepted payment after delivery but, without prior notice, exercised its contractual termination right for a subsequent failure to pay upon delivery.

(b) In that case the seller was held to be the breaching party when it relied upon the termination clause following a payment made after delivery. Such action breached its obligation to enforce the contract in good faith.

k. The court also addresses CTP’s argument that Iowa law should be
applied to the note because it was signed in Iowa.

(1) The court rejects this argument noting the contractual transaction in which the note was delivered was entered into in Kansas and the management services agreement, which was part of the transaction, contained a choice of law provision designating Kansas as the governing law.

(2) This issue was of limited significance because the court holds Kansas, like Iowa, would recognize a waiver of the acceleration clause.


a. The Court of Appeals upholds summary judgment for the real estate broker under a nonexclusive right to sell agreement.

b. The purchaser of the property saw the listing on the broker’s website, contacted the listing agent, Johnson, who then directed the purchaser to contact the owners to find his way to the property.

c. The purchaser met with the owners and entered into a contract to purchase the land for $1,500,000 with the understanding the sale would be structured as a “1031 exchange” so the sellers could defer capital gains taxes on the sale.

(1) The contract was signed, and a $75,000 down payment made, the same day, May 19, 2004.

(2) The exchange property was obtained, and the transaction closed, on April 12, 2005.

d. The sellers refused to pay the 5% commission claiming:

(1) the agent had not done anything to complete the sale and it was a nonexclusive listing;

(2) the contract closed after the 90-day period following the August 22, 2004 termination of the listing agreement; and

(3) no commission was due in the event the property was exchanged instead of being sold in a cash sale.
e. Rejecting each of these arguments, the court first holds:

(1) Although the owners did the work in preparing the contract, obtaining the purchaser's signature, and closing the transaction, this was all done with a "buyer procured by a real estate agent hired by the owner."

(2) The court notes: "the key undisputed fact remains that the Lowes [owners] knew that Lewis and Logan [the purchasers] had been sent to them through the efforts of Johnson, Antrim's salesperson. Moreover, without Antrim's website listing, Lewis would not have learned of the ranch."

(3) Therefore, the agent was the "procuring cause" of the sale and is entitled to receive their commission.

f. Regarding the termination date of the listing agreement, the Court holds the critical date is the date the sales contract is entered (May 19, 2004), not the date it is ultimately closed (April 12, 2005).

g. The court holds that the contract contemplated that if the property were sold in an exchange transaction, a commission would still be due, it just may not be possible to deduct it from cash sales proceeds because cash may not be involved.


a. Dr. Guss accepted a phased retirement program in 2003 which included reducing his salary and work obligations by one-half.

b. With respect to his half-time teaching schedule the contract provided:

"The exact schedule by which this reduction is achieved may be adjusted annually by mutual agreement between the Employee and the University."

c. The parties agreed that for the fall 2003-2004 academic year Guss would teach a full-time load (6 hours) in the spring semester and not teach in the fall semester.

d. For the 2004-2005 academic year the University informed Guss he was required to teach 6 hours in the fall and 6 hours in the spring.
Guss rejected this schedule and insisted he be able to continue with the prior, mutually-agreed fall 2003-2004 schedule, by teaching 6 hours in the spring.

e. Guss did not show up for work in the fall of 2004 and was terminated by the University.

f. Guss filed an informal grievance with the University regarding the matter. A departmental hearing was conducted and the committee held that although Guss was entitled to payment for accumulated sick leave, his contract claim was denied. The Dean of the department concurred with the committee's recommendation. The University Appeals Committee issued its recommendation to the University's president on February 18, 2005 and the president accepted the recommendation (denying Guss' contract claim) by letter dated February 24, 2005. Guss filed his petition for judicial review on March 23, 2005, within 30 days of the president's letter.

g. On April 12, 2005 the University's president issued a letter informing Guss that the process was completed, and therefore, at that time, all administrative remedies had been exhausted.

(1) The University uses this April 12 letter to argue that the appeal by Guss was premature.

(2) The issue is when was a "final order" issued which triggered the time frame for seeking judicial review.

(3) "An agency action is nonfinal if the agency intends, or is reasonably believed to intend, that its action is 'preliminary, preparatory, procedural or intermediate.'"

(4) "A 'final agency action' is simply any agency action other than a non-final agency action."

(5) "No special incantations or magic words are required to create a final agency order. Kansas courts have consistently recognized that a relatively informal letter may constitute a final order for purposes of the statute."

(6) Although the University still had a sick pay calculation to make, the decision to pay it had already been made. There was no substantive issue still under "active consideration" by
the agency.

h. Court of appeals affirms the trial court's holding that the parties' contract required "mutual agreement" to change the spring-only schedule that had been mutually agree to beginning with the 2003-2004 academic year. Therefore, the University's unilateral action was a breach of the contract.

III. PROPERTY LAW ISSUES

A. Conveyancing Formalities


a. Issue: Were deeds of land properly delivered prior to the grantor's death so the lands belonged to the grantees and were not part of the grantor's estate?


c. This dispute concerns four tracts of land conveyed to three donees, Gertrude Reader, Hazel Denison, and Isabel Idol (three of Margret's four sisters, she also had four brothers).

d. The conveyances were gifts from Margret to Gertrude, Hazel, and Isabel, made by deeds signed sometime in 1967.

(1) Each deed contained the following reservation of a life estate in Margret:

"Reserving unto party of the first part [Margret] and her assigns the full benefit, use, rents, issues and profits from the above described real estate, for and during her natural life."

(2) "Margret signed the deeds and had them notarized. However, the acknowledgment and the notary's signature do not include the day or month that the deeds were acknowledged."

(3) "According to both Hazel and Isabel, Margret delivered the deeds to them in 1967 or 1968. Isabel placed the deeds in a safety deposit box she owned with Hazel. Margret's name
was not on this safety deposit box."

e. Court affirms trial court’s grant of summary judgment finding that the deeds had been properly delivered to Hazel, Isabel, and Gertrude prior to Margret’s death and therefore they became the owners in fee of their respective tracts of land at Margret’s death.

f. Legal principles applied by the courts to resolve the issue:

1. “[T]o transfer title through a warranty deed, the grantor must cause the deed to be delivered to the grantee during the grantor’s lifetime.”

2. “Delivery may be constructive as well as actual or personal, and it may be made to a third party [e.g. the deed to Gertrude given to Hazel and Isabel] to hold for the grantee, where an intention is manifested to give the conveyance present effect.”

3. Delivery is a question of intent to be determined by examining all the facts and circumstances surrounding the transaction to ascertain whether “the grantor had a present intent to divest himself or herself of title to the property and vest it in the grantee.”

4. “Because delivery is a question of intent, it is normally a question of fact. However, when the facts are not controverted, then delivery is a question of law.”

5. “The rule of law is that in deed of gifts to children or relatives, the reservation by the grantor of the use of the property during his lifetime is evidence of an intention to deliver the instrument before his death, for there could be no purpose in placing such a reservation in the deed if it were not delivered in his lifetime.”

6. “When a deed that is duly executed and acknowledged is found in the grantee’s possession, in a third-party’s possession, or when the deed has been recorded, it is presumed that the grantor delivered the deed.”

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1The Court of Appeals reproduces major portions of Brown County District Court Judge James A. Patton’s opinion which is both a concise but comprehensive, effective statement and application of the law in this area.
"Conversely, when a deed is signed and acknowledged but found in the grantor’s possession, the law presumes that the grantor did not deliver the deed."

"The party challenging the preceding presumptions must supply clear and convincing evidence to rebut the presumption."

"Recording is not necessary to effectively deliver a deed . . . ."

g. Summary Judgment Proper? Although delivery based upon the oral testimony of Hazel and Isabel, the plaintiffs had the burden to come forward with evidence to controvert their statements.

"[A]n unsupported challenge to a witness’ credibility is not sufficient to create a genuine issue of a material fact."

"[T]he failure of appellants to provide affirmative evidence, contrary testimony, or a writing that challenges Hazel’s or Isabel’s statements concerning actual delivery of the deeds to them clearly justifies the district court’s ruling granting partial summary judgment that valid delivery of the deeds occurred."

2. Delivery Not Required for Transfer-On-Death Conveyance; But Recording is Mandatory.

a. Today, when tax planning is not an issue, it is possible to use a “transfer-on-death” deed to provide for a conveyance of land that does not take effect until the death of the grantor. Until the grantor dies, they can change the grant, dispose of the property to others, or encumber the property in any way.


c. Although the statutes allow the grantor to avoid all the traditional delivery requirements (the grantee need not even be aware of the conveyance), it imposes a new mandatory requirement: acknowledging and recording in the office of the register of deeds in the county where the real estate is located, prior to the death of the owner . . . ." K.S.A. § 59-3502 (2005).

d. If the transfer-on-death deed is properly created, it “shall not be
considered a testamentary disposition and shall not be invalidated due to nonconformity with the provisions of chapter 59 of the Kansas Statutes Annotated." K.S.A. § 59-3507 (2005).

(1) In this manner, the grantor can avoid creating a present interest in the grantee, but still have it qualify as a gift if it remains unrevoked at the donor/grantor's death.

(2) Nor will it violate the statute of wills for failing to comply with the formalities of a will.


f. These provisions regarding real estate and automobiles complete the range of property that can be transferred outside of probate – but without the undesirable aspects of joint tenancy.

(1) Provides the same sort of benefits that have been available under “pay-on-death” bank accounts.

(2) Avoids issues of current ownership, percentage of ownership, contribution by the parties, and creditor rights.

g. K.S.A. § 59-3513 (2005) provides a statutory list of other "nontestamentary transfers" to include various types of contracts: insurance, annuity, employment, employee benefit plans, deferred compensation or pension plans, individual retirement plans, and tuition programs.

h. See generally, In re Estate of Roloff, 36 Kan. App.2d 684, 143 P.3d 406 (2006) (addressing issues regarding transfer-on-death deed; apply joint tenancy concepts to hold the interest vested immediately in the named donee upon the donor’s death).

B. Subdivision Disputes


a. Certain homeowners in the Four Colonies subdivision wanted to restrict the ability of homeowners to rent their houses. Many of the
houses in the neighborhood were being rented and the homeowners desired to take action to phase-out rentals by amending the Bylaws of the Four Colonies Home Association.

b. 372 of the 681 lot owners attended the special meeting (55% of the total owners) to consider the Bylaw amendment. Of the 372 attending, 191 (51.34%) voted in favor of the Bylaw change. The Bylaws required a majority vote of those attending the meeting to amend a Bylaw.

c. The property use restrictions are contained in the “Four Colonies Declaration of Covenants, Conditions, and Restrictions” which provides it can be amended only by an agreement of not less than 75% of the lot owners. 511 of the 681 lot owners.

d. Issue: Whether the association can impose a post-purchase property use restriction on lot owners through a Bylaw amendment, as opposed to a Declaration amendment.

(1) “Basically, the declaration is considered the enabling document or the constitution of the association. Generally, any attempt to restrict a property owner’s use of the property as authorized by the declaration is considered void and unenforceable.”

(2) Although the Declaration does not directly address the issue of renting, it assumes renting will be allowed by specific references to “lessees and tenants of such owners.”

(3) Because the Declaration does not prohibit or limit leasing, the Bylaw conflicts with the Declaration by eliminating, or severely restricting, the ability to rent the properties within the subdivision.

(4) The Bylaw is unenforceable.

“Based upon the Declaration and Bylaws filed of record, the Kiekels knew their property rights could be further restricted by an amendment to the Declaration. The Kiekels did not, however, have notice that their property rights could be further restricted by a bylaw amendment. Four Colonies cannot circumvent the intent of the Declaration, the enabling document, by subsequently amending the Bylaws.”

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e. Other arguments that the Kiekels’ unruly tenants violated the Declaration:

1. Court rejects argument that the renting of property in the subdivision constitutes using the property “for business, professional, trade or commercial purposes . . . .”

2. Court rejects argument that individual tenant problems can be addressed using the “[n]o noxious or offensive activity” limitation in the Declarations.

f. This case, and the *North Country Villas* case that follows, demonstrate the absolute necessity, when representing a prospective purchaser, to ensure they fully understand the rights, obligations, limitations, and risks associated with becoming a property owner in a subdivision or other area subject to declarations, bylaws, and associations.


a. Issue: Did the developer retain the right to exempt its lots from the Declaration of Covenants, Restrictions, and Easements for the subdivision such that it could convey its remaining lots, and its exemption power, so its grantee could construct a non-conforming four-plex in an area were all other owners were limited to single-family and duplex structures?

b. 2001 Declaration of Covenants, Restrictions, and Dedication of Easements of North Country Villas filed with Shawnee County Register of Deeds.

c. 2001 Not-for-profit entity, North Country Villas Homeowners Association created. Two classes of membership: Class A, one vote per lot owner; Class B, issued only to the developer, four votes per lot owned.

d. 2001 to 2005: sold lots to the public. November 2005, developer sold lots to Kokenges and to Clampitt-Hersh and then assigned “all of its interest as Declarant and all its interest as a Class B membership owner in the Urban Hills Subdivisions” to the Kokenges and Clampitt-Hersh. The assignees then filed a document revoking the
Declaration as to the lands owned by them and the Kokenges proceeded with the construction of a four-plex on its lots.

e. Suit by the Homeowners Association against the original developer, the Kokenges, and Clampitt-Hersh, to declare the amendment or revocation invalid and halt construction of the four-plex that violates the Declaration.

f. Use contract interpretation rules to interpret the Declaration.

(1) The developer's rights as a Class B member were freely assignable because there was no limitation on assignment contained within the Declaration.

(2) The rights were not personal to the original developer. The assignees could perform the same duties as the original developer: e.g., “to protect the value, desirability and attractiveness of the property.”

g. The revocation or amendment was not permissible under the Declaration.

(1) The Declaration states: “Class B owners may amend at any time as to the lands owned by Declarant.”

(2) The court holds: “Such an amendment provision is too broad to be enforceable.”

(3) The court “adopts” RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 6.21 for the proposition that, in the words of the court, “courts should only enforce a declaration amendment if the declaration clearly informed purchasers of the specific changes that could be made to the subdivision’s character and general plan through such an amendment.”

(4) The court focuses on the concept of “notice” that the developer could exempt itself from the common plan that all the other parties are subject to under the Declaration.

h. RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 6.21 (1998) states:

“A developer may not exercise a power to amend or modify the
declaration in a way that would materially change the character of the development or the burdens on the existing community members unless the declaration fairly apprises purchasers that the power could be used for the kind of change proposed.”

(1) “The character of a common-interest community as indicated by the existing housing and promotional materials is frequently one of the most important considerations for prospective purchasers. People generally believe that a developer will continue to build housing of a similar quality and character, and anticipate that the value of the property they buy will not be undercut by future construction in the project.” Comment a. to § 6.21.

(2) “Developers may retain powers within a particular phase, or within an entire project, to waive or amend the servitudes. If this provision is couched in general terms, it is unlikely to alert purchasers to the true risks involved in their purchase. To protect their legitimate expectations, developers are prevented from exercising such powers to make material changes in the character of the development or the burdens on existing owners unless the declaration clearly gives notice that it can be exercised with that effect.” Comment a. to § 6.21 (emphasis by the court).

i. General Observation for Property Practitioners: the Restatement (Third) of Property: Servitudes has already had a major influence on easement, restrictive covenant, and equitable servitude law in Kansas. See City of Arkansas City v. Bruton and Jeremiah 29:11, Inc. v. Seifert at pages 47 and 52. As the North Country Villas case illustrates, the black-letter statements and comments can be highly persuasive and now some have been “adopted” by the Court of Appeals.

C. Successive, Concurrent, and Simultaneous Interest Issues


   a. Father owns life estate in land, his son owns the vested remainder.

   b. Third party buys the land, in fee, from the father and son.
c. What do we do with the proceeds when the parties are not in agreement?

(1) Here no attempt at division was made during the father’s lifetime – the son retained all the money subject to a request by the father to receive 5% of the income.

(2) The issue became relevant when the father’s surviving spouse elected to take her spousal share and triggered the augmented estate procedure requiring a determination of how much of the money in the son’s possession belonged to the father.

d. Two approaches:

(1) Value the life estate at the time of the sale and pay the father that value.

(2) Treat all the funds as principal and allow the life tenant to receive the income from the principal.

e. Kansas Supreme Court, at least for non-judicial sales, adopts the first approach, quoting the rule as stated in Am.Jur.2d:

“When a life tenant and a remainderman unite in a nonjudicial sale of the property, without agreeing as to the division or disposal of the proceeds, the life tenant is entitled to receive, absolutely, from such proceeds the estimated value of his or her estate computed as of the time of the sale.”


a. In 1964 Osborn, as lessor, entered into an oil and gas lease covering a 520-acre tract of land. By 2004 the lease was owned by Brake (92%) and Blankinship (8%); Osborn’s surface and mineral interests were owned as follows:

Tract #1 (South 240 acres).
Surface: Dexter (100%); Minerals: Dexter (50%) and Monroe (50%).

Tract #2 (North 280 acres).
Surface & Minerals: Nelson (100%); Nonparticipating Royalty (Monroe).
b. In 2004 Brake and Blakinship, as lessees, and Dexter, Nelson, and Monroe as lessors, amended the original lease by requiring the lessees to undertake specific actions on the lease, by stated time frames, with the provision that "[f]ailure to comply with each of the conditions above set forth will result in termination of the oil and gas lease."

c. Dexter and Nelson filed suit asserting a "failure to comply" and the trial court terminated the oil and gas lease, as to the mineral interests held by Dexter and Nelson.

d. On appeal, in addition to challenging the cancellation, the lessees contended that Monroe, as an undivided mineral interest owner in Tract #1, and as a nonparticipating royalty owner in Tract #2, was an indispensable party to the action.

e. The Court of Appeals adopts the reasoning stated in §§ 877.3 and 877.4 of the Williams & Meyers Oil & Gas Law treatise to conclude that a mineral interest cotenant (§ 877.3) and a nonparticipating royalty owner (§ 877.4) are not indispensable parties under Kansas Statutes Annotated § 60-219.

(1) With regard to the undivided mineral interest, any continuing burdens created by the action are a product of cotenancy, not the failure to join a party.

(2) With regard to the nonparticipating royalty interest, they must, as before the cancellation, look to the mineral interest owner to protect their interests. The Williams & Meyers treatise indicates the nonparticipating royalty owner’s interests will be protected by the alignment of interests between executive (Nelson) and non-executive (Monroe) or, when the interests diverge, through the executive’s “duty of fair-dealing” toward the non-executive.

f. The court also notes the lessees did not dispute the alleged failure to comply with the express covenants contained in the lease amendment.

(1) Instead the lessees argued “substantial performance” through “significant effort and expenditures.”

(2) The court holds this was inadequate to constitute compliance with express lease covenants that provided for termination in the event the specified acts were not accomplished within the
stated time frames.

(3) In terminating the lease the court merely gives effect to the express agreement of the parties.

g. The plaintiffs requested attorney fees pursuant to Kansas Statutes Annotated § 55-202 which authorizes fees and damages when, following a proper pre-suit demand, a lessee improperly fails to comply with the lessor's demand to release a terminated lease.

(1) Even though the plaintiffs were the prevailing party in this action, the trial court refused to award attorney fees.

(2) The court of appeals affirms this decision noting the award of fees under 55-202 is discretionary and the trial court's decision will be reversed only for an abuse of discretion.

(3) The court concludes: "We simply cannot conclude that no reasonable person would have denied the fee request under these circumstances."

D. Servitudes

1. **Scope of an Easement.** *City of Arkansas City v. Bruton, 284 Kan. 815, 166 P.3d 992 (2007).*

   a. This case is significant because the concepts the court discusses can be applied to any easement. It also demonstrates the court's acceptance of the Restatement (Third) of Property as a very persuasive guide in resolving servitude issues.

   b. In 1935 the City obtained an easement from the Bruton's predecessor in title to construct and maintain a dike across a 5.4 acre tract of land adjacent to the Arkansas River.

   c. In 2000 the City and the U.S. Army Corps of Engineers sought to build the dike higher and in a manner that came closer to the Bruton's residence.

   d. The Brutons argued the proposed work was beyond the rights granted in the 1935 easement. The City argued it was within the scope of the easement and constituted "maintenance" of the structure as contemplated by the easement.
e. The trial court found the easement was ambiguous and interpreted it focusing on the "purpose" of the easement and found the actions of the City were proper as a matter of law—and granted summary judgment to the City.

f. The Court of Appeals held the easement was not ambiguous but that an issue of fact existed regarding whether the City's proposed work falls within the scope of the express terms of the 1935 easement.

g. The Supreme Court reverses the Court of Appeals, in a 4/3 decision, holding the terms of the easement were not ambiguous and, based upon expert testimony provided only by the City, the City's actions were:

(1) within the geographic scope of the easement (the original footprint of the flood control structures);

(2) within the activities authorized ("maintenance"); and

(3) the activities are "in accordance with plans and specifications" referenced in the easement document.

h. The relevant terms of the easement include:

"[F]irst parties hereby grant, sell, warrant and convey to second party, its successors and assigns forever, a right of way and easement with the right, privilege and authority to said party of the second part, its successors and assigns to construct and maintain a dike for the purpose of protecting said city and its inhabitants from damage by flood waters coming from the Arkansas River, in, on, over, through and across the following described lands in Cowley County, Kansas . . . .

It is understood and agreed that said dike is to be constructed and maintained in accordance with plans and specifications prepared by the U.S. Army Engineers, which plans and specifications have been examined and approved by first parties."

i. The majority of the Court held the uncontradicted expert testimony of the City's expert witness established that the City's actions
complied with each of the three limitations on its easement.

j. The dissenting justices believe an issue of material fact remains as to whether the City's actions were "in accordance with plans and specifications" referenced in the easement document."

   (1) The dissenting justices did not believe the City's expert addressed this issue.

   (2) However, even if the Court concludes the City's expert addressed the issue, the matter was controverted by the landowner's non-expert testimony. The dissent takes issue with the conclusion the "in accordance with plans and specifications" is an issue requiring expert testimony.

   (3) The "plans and specifications" issue is made more complex because no "plans or specifications" were ever found. The only evidence on the matter was from the City's expert testifying as to which one of several drawings at the time the improvements were originally made most likely reflect the "plans or specifications."

k. Teachings from the Bruton case: Get familiar with the RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES. The Court cites, quotes, and relies extensively upon the RESTATEMENT (THIRD) in its opinion.

l. When addressing the maintenance issue, the court quotes RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 4.10 (1998), which provides:

   "[T]he manner, frequency, and intensity of the use [of an easement] may change over time to take advantage of developments in technology and to accommodate normal development of the dominant estate or enterprise benefitted by the servitude."

m. The Court also quotes § 4.13 which provides:

   "Unless the terms of a servitude determined under § 4.1 provide otherwise, duties to repair and maintain the servient estate and the improvements used in the enjoyment of a servitude are as follows:

   (1) The beneficiary of an easement or profit [e.g., oil and gas lease in
Kansas has a duty to the holder of the servient estate to repair and maintain the portions of the servient estate and the improvements used in the enjoyment of the servitude that are under the beneficiary’s control, to the extent necessary to

(a) prevent unreasonable interference with the enjoyment of the servient estate, or

(b) avoid liability of the servient-estate owner to third parties.”

(Emphasis added).

n. The Court quotes Comment b. to § 4.13 as follows:

“[u]nder the rule stated in § 4.10, the holder of an easement or profit is entitled to make any use of the servient estate that is reasonable for enjoyment of the servitude, including the right to construct, improve, repair, and maintain improvements that are reasonably necessary.”

(Emphasis by the Court).

o. The Court then proceeds to apply the Restatement provisions to the easement at issue: “We conclude that the term ‘maintenance’ as defined by the above authorities [which also included Webster’s dictionary] is broad enough to encompass the City’s recent improvements to the dike.”

p. The Court applies the Restatement provisions to conclude that the addition of “the riprap and toe drain” were “fully within the City’s rights to maintain that easement.”

q. The Court also applies Restatement (Third) of Property: Servitudes § 4.1 (1998), which provides:

“(1) A servitude should be interpreted to give effect to the intention of the parties ascertained from the language used in the instrument, or the circumstances surrounding creation of the servitude, and to carry out the purpose for which it was created.”

r. The Court quotes from the Official Comments to § 4.1:

“[t]he circumstances of the mode of creation of the servitude affect
the manner in which it is interpreted. *If the servitude is expressly created, the expressed intentions of the parties are of primary importance.*”

Comment a. (emphasis by the Court).


   a. Mr. Schuck negotiated an easement with Rural Telephone Service Co., which limited the easement to a 40' corridor to lay a telephone cable.

   b. When Rural Telephone laid the cable it, by accident, laid it outside of the easement corridor.

   c. Several years later the error was discovered and Schuck demanded $40,000 for an easement covering the cable. Rural Telephone responded by filing a condemnation action.

   d. Schuck responded by filing an action seeking to enjoin the condemnation action.

   e. The trial court found Rural Telephone had the power of condemnation and the taking was necessary for a lawful corporate purpose. The court specifically found that moving the line would require splicing which would degrade the service provided by the line to all users.

   f. Schuck argued filing the eminent domain proceeding demonstrated Rural Telephone’s bad faith. Rejecting this assertion the Supreme Court states:

   “Filing a petition for eminent domain does not demonstrate bad faith; rather, it demonstrates an attempt to resolve the problem through the courts after settlement negotiations failed. Having made what appears to have been a good-faith mistake, Rural Telephone then had to make a choice as to how it would cure the mistake. Rural Telephone’s evidence that the taking was necessary to fulfill its public purpose of providing quality telecommunication service to its customers sufficed to show that it did not abuse its discretion.”
g. “Our holding here is limited to the facts of this case; we do not condone Rural Telephone’s failure to conform with the easement which it freely negotiated. Under the facts presented here, however, the district court’s determination that Rural Telephone has the power of eminent domain and that the taking was necessary to its lawful corporate purposes is sound.”


   a. This is a wonderful case for defining the intersection of property law and contract law.

   b. In 1978 the Jordans conveyed land to the Dallingas by what the court describes as an “indenture” form of conveyance which had signature lines for the grantors and the grantees.

      (1) However, the deed was only signed by the grantors, the Jordans.

      (2) The deed was delivered and recorded by the Dallingas who entered into possession of the conveyed land.

      (3) The deed contained covenants restricting the land to residential use.

   c. Jeremiah obtained the Dallinga land in 1999. Seifert owns property adjacent to Jeremiah; Seifert’s source of title is also from the Jordans.

   d. When Jeremiah sued the Seiferts over a boundary dispute, the Seiferts counterclaimed to enforce the residential-only covenants in Jeremiah’s chain of title.

      (1) Jeremiah had been using its land for non-residential purposes which violated the restrictive covenants in its deed.

      (2) Jeremiah defended arguing since the original conveyance was in the form of an “indenture,” as opposed to a “deed poll,” the Dallingas never consented to the restrictive covenants in the deed.

         (a) A deed poll is a conveyance signed only by the grantor.
An indenture is a conveyance signed by the grantor and grantee, usually when there are reciprocal rights being transferred.

The trial court held that although the deed was effective to convey the land to the Dalingas, the restrictive covenants were not binding on the Dalingas because they did not sign the deed.

The Court of Appeals reversed the trial court holding the deed complied with the requirements for an effective conveyance and the covenants ran with the land binding Jeremiah as the Dallingas' successor in interest. The Court of Appeals reasoned as follows:

Whatever function the "indenture" and "deed poll" distinctions once served, they have been eclipsed by K.S.A. § 58-2203 which indicates only the grantor needs to sign the deed.

This requirement is more precisely stated in K.S.A. § 58-2209 which provides: "All deeds or other conveyances of lands, or of any estate or interest therein, shall be subscribed by the party granting the same . . . ." (Emphasis added).

As the Court of Appeals observes, the Dallingas' acceptance of the deed takes the place of their signatures.

A unanimous Supreme Court reverses, holding that the failure to have the Dallingas' sign the deed meant the register of deeds should not have accepted it for recording but, even though it was in fact placed of record, it did not provide constructive notice of the restrictive covenant.

"The controlling issue in this case is whether there was constructive notice of the restrictive covenant on commercial enterprises. We hold that the absence of the Dallingas' signatures on the 1978 deed made it insufficient to provide the necessary constructive notice to subsequent purchaser Jeremiah. Notice was not merely key; it was indispensible. Persons who take real property without actual or constructive notice of restrictive covenants will not be bound by them."

"Under our statutory scheme, any constructive notice must of
necessity be drawn from the recorded document itself or from other recorded documents it references."

(3) "The Dallingas’ signatures were intended to signify and would have signified their acceptance of the covenant’s burden or, viewed from the opposite but effectively indistinguishable perspective, their willingness to grant an equitable servitude on the property conveyed to them. Their failure to sign the deed left this acceptance or grant uncommunicated and the covenant ambiguous. Where ambiguity exists, and construction is thus necessary, Kansas strictly construes such covenants against limitations on the free use of real property."

(a) This final observation, about strict construction, runs counter to the modern approach taken by the Restatement (Third) of Property: Servitudes § 4.1, comment a.

(b) Comment a provides, in part:

"Historically, the strict-construction doctrine was part of the arsenal of restrictive doctrines courts developed to guard against the dangers imposed by servitudes. It complemented the horizontal-privity requirement, the ban on benefits in gross, and the touch-or-concern doctrine. Together these doctrines gave courts the ability to minimize or eliminate the burdens of servitudes without developing direct substantive limitations or modification and termination doctrines. In modern law, these doctrines have proved too restrictive and have been replaced in this Restatement with doctrines targeted more precisely at the harms servitudes can create. Substantive limits prohibiting servitudes that violate public policy are set forth in § 3.1. Provisions for modification and termination of servitudes that no longer serve a useful purpose are set forth in § 7.10, and remedies may be fashioned to avoid coercive enforcement of servitudes under § 8.3." (Emphasis added).

(c) What about people who purchased land emanating from the original grantor relying upon a covenant to
Something to think about:

g. A contract analysis: A owns Tract A, B owns Tract B. A and B desire to enter into an agreement regarding their mutual maintenance of the fence between Tract A and Tract B. They enter into an agreement whereby A and B each covenant to do, or not do, certain things regarding maintenance of the fence. They state that the agreement is binding on their “heirs and assigns” and is intended to be a covenant running with the land.

(1) As a matter of contract law, B’s failure to sign the agreement may indicate a lack of agreement (mutual assent) or it may create enforcement problems under the statute of frauds.

(2) As a matter of “real covenant law,” even if the document were signed by both parties, it would not “run with the land” because it lacks the requisite “horizontal privity.” There is no privity of estate.

(3) As a matter of “real covenant law,” to have the requisite property-based privity (as opposed to privity of contract), the covenant must be made in conjunction with a transfer of the affected property.

(4) However, applying an “equitable servitude” analysis, courts will generally enforce this form of purely contractual covenant relying upon “notice” as opposed to privity of estate.

h. A property analysis: Assume A owns Tract A/B and conveys a portion, Tract B, to B. If the fence covenant is made as part of the conveyancing transaction, the requisite horizontal privity would exist.

(1) The covenant would “run with the land, i.e., bind a subsequent owner,” so long as (quoting the Supreme Court in Jeremiah):

“[T]he grantor and grantee must intend that the covenant run with the land; the covenant must touch and concern the land; and there must be privity of estate [horizontal privity] between the original parties to the covenant, the original parties and the present litigants [vertical privity], or between
the party claiming the benefit of the covenant and the party burdened. In addition, the covenant must be in writing, and the successor to the burden must have had notice of it.”

(2) Note that the covenant in this case is not a stand-alone transaction as in the “contract analysis” noted above.

(3) In this situation, conveying the property to B, and B’s acceptance of the property, would be sufficient to bind B to the covenant.

(4) There is no need for B to sign the deed. The covenant will “run with the land” because it meets the requirements for a real covenant:

(a) There is the requisite “intent”:

“It is understood that this conveyance is made and accepted and the realty is hereby granted, on and subject to the above covenants, conditions, restrictions, and reservations, which covenants, conditions, restrictions and reservations shall apply to and run with the conveyed land.”

(b) There is the requisite “touch and concern”:

It burdens the grantee’s land by limiting its use to “residential purposes.” It benefits the grantor’s land by prohibiting adjacent “manufacturing or commercial enterprise” and protects the residential character of the area.

(c) There is “privity of estate” between the original parties to the covenant:

There is horizontal privity between the original grantor and grantee. There is vertical privity between the grantor and Seifert and between the grantee and Jeremiah.

(d) The covenant is in “writing”:

It is contained in the very deed in which the grantee
also relies upon as their source of title.

(e) The grantee’s successor must have “notice” of the covenant:

Constructive notice is sufficient.

In this case the very deed which is the source of the grantee’s only property interest in the land at issue is also the document which contains the limitation on the use of the property the document conveys.

(i) The Supreme Court holds the deed that conveyed the land to the grantee, which was accepted by the grantee, and gave notice to the world of the conveyance to the grantee, cannot be relied upon to give notice of the covenant language in the same deed—because the form had a signature line for the grantee and it was not signed.

(ii) Clearly, absent the signature line, the deed would create a valid covenant, in the same manner it created a valid conveyance of the land subject to the covenant.

(iii) The failure to sign the deed did not impact the grantee’s ability to locate and read the deed; *somebody read it to determine that current grantor held title to the land the current grantee was purchasing.*

i. Applying a property analysis the restrictive covenants in the deed became part of the baggage the Dallingas’ assented to when they accepted the deed.

(1) Although there may be some cautionary benefits to having the grantees sign the deed, it is not necessary (not until, however, the Courts decision in *Jeremiah 29:11, Inc. v. Seifert*) when the grantee accepts the conveyance.

(2) This is where a property analysis can be used to make contractual obligations binding on a party that has not signed
the document.

j. Jeremiah also argued it was unaware of the restrictive covenants.

(1) That is the normal state of affairs for most property owners regarding restrictive covenants.

(2) Typically the restrictions are created at the time the land is subdivided and are found in the document initially conveying the burdened land.

(3) Subsequent conveyances may refer to them in a vague manner ("subject to any restrictions of record") or not at all.

(4) Real estate agents don't focus on them unless the purchaser makes a specific inquiry.

(5) An important service attorneys can provide is to ensure their client obtains and reviews any restrictive covenants before they become obligated to purchase a property.

k. **About the statute of frauds:** The Court of Appeals rejects Jeremiah's statute of frauds argument under K.S.A. § 33-106 which imposes a writing requirement on any contract for the sale of lands. The Supreme Court did not find it necessary to address the statute of frauds issue.

(1) It appears the statute applicable to this situation is not K.S.A. § 33-106 but rather K.S.A. § 33-105 which states: "No leases, estates or interests of, in or out of lands . . . shall at any time hereafter be assigned or granted, unless it be by deed or note, in writing, *signed by the party so assigning or granting the same . . ." (Emphasis added).

(2) Section 33-105 employs a "property" analysis while § 33-106 employs a "contract" analysis.


a. This case demonstrates the importance of the sort of property/contract analysis discussed in the *Jeremiah* case.
b. In 1995 A and B enter into a joint operating agreement covering a designated contract area covered by several oil and gas leases. In 2000 B assigns its interest to C. In 2005 C assigns its interest to D. In 2006 D consents to drilling another well on the contract area. A, the operator, drills the well and bills D for D's share of the costs. D is unable to pay. Can A sue C, who no longer owns any working interest in the contract area, to pay the costs that D agreed to but cannot pay? What if the costs related to plugging a well that was being operated when C owned its interest?

c. The Texas Supreme Court, applying a relatively simple contract analysis, holds C is liable for the costs D failed to pay.

(1) Although not mentioned in the Court's opinion, the costs happened to be associated with plugging a well that was in existence when C owned its interest.

(2) The Court does not limit its holding to such a situation.

(3) "Because the operating agreement did not expressly provide that Eland's [C's] obligations under the operating agreement should terminate upon assignment and Seagull [A] did not expressly release Eland [C] following the assignment of its working interest [to D], we reverse . . . and render judgment for Seagull [A] . . . ."

(a) Although not addressed by the Court, A would also have a cause of action against B.

(b) Note that A has privity of contract with B.

(c) A has privity of estate with D.

(d) At the time of the suit A had neither privity of contract nor privity of estate with C.

(e) Agreements between B/C and C/D regarding liability to A would not alter A's rights against B, C, or D.

(f) Only a novation granted by A agreeing to substitute C for B, and D for C, would release B and C from their continuing liability.
d. "Generally speaking, a party cannot escape its obligations under a contract merely by assigning the contract to a third party... Thus, as a general rule, a party who assigns its contractual rights and duties to a third party remains liable unless expressly or impliedly released by the other party to the contract."

(1) This is the assignment of "rights" vs. delegation of "duties" distinction.

(2) "No delegation of performance relieves the party delegating of any duty to perform or any liability for breach."

e. The court also alludes to, but never develops, a property law analysis:

(1) "Even when the contract does not expressly provide for the consequences resulting from the assignment of one's interest, the contract's subject or other circumstances may indicate that obligations were not intended to survive assignment."

(2) Quoting from the Restatement of Property: Servitudes § 538:

(a) "Whether a promise respecting the use of land of the promisor will continue to bind the promisor after he has ceased to have an interest in the land with respect to which the promise was made depends upon the intention manifested in the making of the promise."

(b) "Such promises are often of such a character that they can be satisfactorily performed only by the possessor of the land affected."

(3) Curiously, the Court states: "Eland does not argue that this contract's subject or circumstances imply that it should be released of its obligations after assignment."

f. If the covenant "runs with the land" then did the parties intend that rights and duties similarly run with the land?

(1) **Defensive** use of the covenant running with the land analysis.

(2) See, e.g., *Gallagher v. Bell*, 516 A.2d 1028 (Md. Ct. App. 1986) (covenant to pay pro-rata cost of streets and utilities when and if they are installed was a covenant running with
the land which burdened the present owner of the land).

(a) "The Gallaghers [the original promisors] defended . . . that the covenant they made in 1961 was a covenant running with the land and that their liability on it terminated when they conveyed the property to Ms. Camalier in 1980."

(b) "Although the courts are not unanimous in this view, there is a body of law to the effect that, if the covenant runs with the land, the liability of the covenantor ends when he conveys the burdened land."

(c) "[T]he continuing liability of an original covenantor on a covenant of the type involved here will end upon his conveyance of the burdened property if the parties intended for that to be the case, and that the record here demonstrates such an intent."

(d) In Seagull the liability of Eland [C] was not based upon him being the original covenantor [who was B], or the current owner [D], but rather an intermediate owner.

g. Other theories to avoid liability:

(1) Landlord/tenant: no privity of contract; no privity of estate.

(2) Suretyship. Eland [C] is a surety for the performance of his assignee [D], but only as to accrued obligations at the time of the assignment.

IV. COPIES OF POWERPOINT SLIDES

[See Slides beginning at page 62 of this document.]
Recent Developments in Business, Contract, and Property Law

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Business Law Issues
General Structuring Issues

- **Kansas Heart Hospital, LLC v. Idbeis**, Case No. 97,131, 2008 WL 2065843 (Kan., May 16, 2008).
- Bylaw amendment that prohibits ownership of an interest in a "competing health care facility" within 100 miles of Wichita, Kansas.
- If violated the corporation can force the stockholder to sell their stock to the corporation.

Business Law Issues
General Structuring Issues

- **Issue**: Must the stock ownership restriction be contained in the articles of incorporation instead of a bylaw?
- If the restriction applies to a "class" of stock it must be contained in the articles of incorporation.
- Here the restriction applies to a particular "holder" of stock and as an "ownership restriction" can be done through bylaw.
Business Law Issues
General Structuring Issues
• **K.S.A. § 17-6426(b):** can impose "ownership restrictions" either by: "the articles of incorporation or by the bylaws or by an agreement among any number of security holders or among such holders and the corporation."

Business Law Issues
General Structuring Issues
• **K.S.A. § 17-6426** Also requires that:
  • "No restriction so imposed shall be binding with respect to securities issued prior to the adoption of the restriction unless the holders of the securities are parties to an agreement or voted in favor of the restriction."
  • All the parties involved in this case voted in favor of the restriction.

Business Law Issues
General Structuring Issues
• **Issue:** By authorizing the corporation to "redeem" the stock in the event the ownership restriction is violated, does it trigger a statutory redemption that must be provided for in the articles of incorporation?
Business Law Issues
General Structuring Issues

• The use of the phrase "redemption of the shareholder's stock" in the bylaw does not refer to a statutory redemption.
• Court considers the "context" of the term "redeem" and notes it can have different meanings in different contexts.

Business Law Issues
General Structuring Issues

• What would a "hypothetical reasonable third party" think the term meant?
• Court concludes a reasonable person reading the provision would conclude it gave the corporation the right to purchase a holder's stock - if the holder takes the specified action (acquires the interest).
• The corporation cannot unilaterally compel a party to sell their stock - as in the case of a typical redemption.

Business Law Issues
General Structuring Issues

• Issue: In determining whether the bylaw applied to the doctors' investment in KMC as a "competing healthcare facility," will the actions of the CHW board of directors be evaluated applying the business judgment rule?
Business Law Issues
General Structuring Issues

• The Business Judgment Rule:
  "The presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest."

Business Law Issues
General Structuring Issues

• "The rule shields directors and officers from liability for unprofitable or harmful corporate transactions if the transactions were made in good faith, with due care, and within the directors' or officers' authority."

Business Law Issues
General Structuring Issues

• The board had to interpret the bylaw to determine whether the triggering event had occurred — because that would in turn trigger the board decision whether to redeem the doctors' CHW shares.
  "The business judgment rule gives a corporation's directors the authority to interpret and apply the bylaws... in the corporation's best interest."
Business Law Issues
General Structuring Issues

- **Applying the Business Judgment Rule:**
- **Disinterested Directors:** benefit different from that they receive as a shareholder.
- **Informed:** duty of care in making their decisions.
- **Good Faith:** not a "fair value" issue but reasonable interpretation and enforcement of the bylaw.

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Business Law Issues
General Structuring Issues


To what extent will the court recognize, for purposes of augmented estate and spousal election procedures, lawfully-created, and lawfully-existing, legal entities that may affect the value of the deceased spouse's property?

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Business Law Issues
General Structuring Issues

- Maryam, wife of Norman.
- Lawrence, Norman's son by prior marriage.
- The asset at issue: Norman's 100% ownership of the stock in Midland Resources, Inc. (MRI).
- **Issue:** What is a 96% limited partner's interest in the MRI stock worth when held in a limited partnership?
Business Law Issues
General Structuring Issues
• Since 1981 Norman had owned all the stock in a closely held company, Midland Resources, Inc. (MRI).
• February 1997 Norman and Lawrence created the Hjersted Family Limited Partnership (HFLP).
• The only asset of HFLP was the MRI stock.

Business Law Issues
General Structuring Issues
• HFLP ownership: Norman 96% as a limited partner; 2% general partner. Lawrence 1% limited partner; 1% general partner.
• June 8, 1988: Norman created the Norman B. Hjersted Revocable Trust, naming himself as trustee.
• Executed “Last Will and Testament” which “poured over” probate assets into the trust.

Business Law Issues
General Structuring Issues
• September 10, 1999: Norman transferred his 96% & 2% interests in HFLP to the trust.
• March 1, 2000: Norman entered into a gift/sale transaction with Lawrence covering the 96% limited partnership interest in HFLP.
• $675,000 designated as a gift.
• Balance of the value covered by a purchase.
Business Law Issues
General Structuring Issues

• To determine the purchase value, the 96% limited partnership interest was appraised.
• MRI stock: $4500/share x 500 shares = $2,250,000.
• The $4500/share reflected a "lack of marketability" discount of 20%.
• Because the stock was an asset of HFLP, the appraiser applied a discount of 10% for "lack of control" and an additional 22.5% discount for "lack of marketability."

Business Law Issues
General Structuring Issues

• Trial Court: accepts Maryam's appraisal figures that use a 10% discount to the MRI stock value but no discounts for the fact the MRI stock is a limited partnership interest in HFLP.
• $1.1 Million difference in valuations.
• Court of Appeals: Assumed the limited partnership would not be recognized (illusory); assumed the transaction was designed for illegitimate purposes. Affirm.

Business Law Issues
General Structuring Issues

• Court of Appeals also improperly considered that Lawrence owned not only the 96% limited partnership interest, but also Norman's 2% general partnership interest (which included control).
• This was not, in fact, the case as of the valuation date.
• "[A] minority discount allows an appraiser to adjust for 'lack of control' over the entity on the theory that the minority interests are not worth the same as the majority interests due to the lack of voting power. A marketability discount allows an appraiser to adjust for 'lack of liquidity' in the interest itself on the theory that there is a limited supply of purchasers of that interest."

• Value of stock in a closely held corporation is a jury question.

• The determination of asset value concerning the augmented estate is a question of fact for the district court.

• Cannot simply ignore the entity the parties have created. There must be a factual and legal basis for disregarding the entity.

• Here the trial court found the entities were properly created and valid.

• Reversed and remanded for trial court to consider the validity of Lawrence's valuation.
Business Law Issues
General Structuring Issues

• "Guidance" provided by the court.

• **Estate and Gift Tax Context.** Common estate planning and value reduction technique for tax purposes: put the interest into a limited partnership to obtain a control and marketability discount.

• **COMMENT:** Will the district court ultimately choose to allow Norman to do to his spouse what the courts allow him to do to the IRS?

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Business Law Issues
General Structuring Issues

• **Kansas Dissenting Shareholder Case Law:**

• **Arnaud v. Stockgrowers State Bank:** "that minority and marketability discounts should not be applied when the fractional share resulted from a reverse stock split intended to eliminate a minority shareholder's interest in the corporation."

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Business Law Issues
General Structuring Issues

• Consider the caveat contained in Comment e to A.L.I. [Principles of Corporate Governance] § 7.22 cited in Arnaud: [that valuation for this type of corporate transaction may not be appropriate in other contexts, e.g. tax. "The standard of valuation employed in any given context should reflect the purpose served by the law in that context..."] (Emphasis by the court.).
Business Law Issues
General Structuring Issues

- **Kansas Spousal Elective Share Context:**
  - Protect surviving spouse; prevent the needless disruption of an estate plan.
- **Kansas Divorce Context:**
  - Control and marketability discounts applied when valuing assets when divided pursuant to a divorce.

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Business Law Issues
General Structuring Issues

- Concurring justices object to providing the trial court with suggestive outcomes when it considers the case on remand.

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Business Law Issues
The New Business

  - The court's opinion provides insight regarding the sale of a business, the associated due diligence process, and problems that can occur when the sales price is based upon revenue projections by the seller.
Business Law Issues
The New Business

- **Issue:** Good faith of seller in projecting revenue from future 2006 trade show, which would then be used to calculate buyer's purchase price for seller's trade show business.
- Actual revenue was 19% less than projected.
- $1.8 million difference for a $3.3 million sale.

Business Law Issues
The New Business

- **Factual issue:** good faith on part of seller in its 2006 trade show revenue projections.
- **Matter of law conclusions:** The facts regarding the disclosures, representations, and actions of Eaton Hall (seller) all support the conclusion it acted in accordance with the purchase and sale agreement.

Business Law Issues
The New Business

- Resource employees, while still employed by Resource, began setting up competing business under the Ability name.
- **Issue:** How do you leave your employer to open up a competing business?
- Good example of all the things not to do.
Business Law Issues
The New Business

- Plaintiff alleges its employees: gained access to files on Resource computers and other property to assist Ability in competing with Resource; made representations to Resource customers that suggested a relationship between Resource and Ability; and generally set into motion a plan to depart Resource as employees and take with them Resource business and good will.

Business Law Issues
The New Business

- The following claims survive the defendants' motion to dismiss:
  - Violation of the Lanham (Trademark) Act.
  - Violation of the Computer Fraud and Abuse Act.
  - Breach of duty of loyalty.
  - Tortious interference.
  - Conversion.
  - Civil Conspiracy.

Business Law Issues
The New Business

  - Former employer brought action against doctor to enforce a covenant not to complete.
  - Covenant required the doctor to pay to the employer "liquidated damages" equal to "25% of all earnings collected from such practice [within Sedgwick County] during such period [3 years after leaving her current employment]."
Business Law Issues
The New Business

- Trial court held the covenant did not protect a legitimate business interest, its duration was too long, and in any event the employer lacked "clean hands" to obtain specific performance because it had previously breached provisions of the contract.

Court of Appeals reverses.

- "The paramount public policy is that freedom of contract should not be interfered with lightly."
- Covenant supported by consideration.
- Protects a legitimate business purpose.
- No undue burden on employee.
- Not injurious to the public welfare.
- Time and territorial limitations are reasonable.

Contract Law Issues
Formation

- Contract formation through the real estate auction.
- Issue: Was the seller obligated to sell the auctioned real estate to the high bidder?
- Court finds the sale was conditional; conditioned upon obtaining a minimum price.
Contract Law Issues
Formation

- **Sales** bill stated: "All contracts will be signed at the end of the auction. Earnest money is only refundable if seller rejects contract."
- No contract as to tract 3 because the amount bid was below the minimum amount. The bidder’s offer was rejected.
- Contract formed as to tract 4 because the amount bid exceeded the minimum amount. The bidder’s offer was accepted.

Contract Law Issues
Formation

- **Three types of auctions:**
  - **With Reserve** ("the placing of the property for sale is an invitation for bids, not an offer to sell");
  - **Without Reserve** ("the placing of property for sale constitutes an offer to sell and each bid represents a conditional acceptance, subject to receipt of a higher bid"); and
  - **Conditional** ("seller reserves the right to accept or reject bids after the close of the bidding.").

Contract Law Issues
Formation

- Court notes that many courts rely upon the U.C.C. provision regarding auctions of "goods" for guidance in the real estate area.
- **K.S.A. § 84-2-328(3)** states: "Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale."
Contract Law Issues
Formation

• Statute of frauds issue.
• K.S.A. § 33-106: "No action shall be brought whereby to charge a party . . . upon any contract for the sale of lands . . . unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing and signed by the party to be charged therewith, or some other person thereunto by him or her lawfully authorized in writing."

Contract Law Issues
Formation

• Court affirms the trial court’s holding that the statute was satisfied by considering the “Exclusive Right to Sell Listing Agreement” which identifies the property and is signed by the seller, and the “Bid Sheet Information” with the bid receipt and check signed by the buyer.
• The terms and conditions of the sale were stated in the Internet sales bill and the printed sales bill.

Contract Law Issues
Formation

• Navair, Inc. v. IFR Americas, Inc., 519 F.3d 1131 (10th Cir.2008).
• Navair, for nearly 30 years was the exclusive distributor of IFR products in Canada.
• IFR provided its products to Navair at a discount which it then sold to its Canadian customers.
Contract Law Issues
Formation

• Following termination of the distributorship the parties agreed to extend the termination date as to one pending sale being negotiated with the Canadian government.
• IFR argues they agreed upon a set date of January 31, 2003.
• Navair argues they agreed upon a reasonable time to conclude the sale.

Contract Law Issues
Formation

• The trial court granted summary judgment for IFR finding the agreed termination date was January 31, 2003.
• The court of appeals reverses holding it is an issue of fact regarding how long "IFR was willing to protect Navair’s price quotations."

Contract Law Issues
Formation

• Issue: If IFR intended a termination date of January 31, and Navair did not, since there was no "meeting of the minds" was a contract formed regarding the matter?
• IFR attempts to inject a subjective theory of contracts.
• Under an objective theory there need be no "meeting of the minds" in a literal sense of the phrase.
"Contracts are not formed by comparing mental states [subjective theory]; they are formed by what the parties communicate [objective theory]."

"In determining intent to form a contract, the test is objective rather than subjective, meaning that the relevant inquiry is the manifestation of a party's intention, rather than the actual or real intention."

The Restatement (Second) of Contracts fully supports the objective analysis, except in one situation: § 20 dealing with "Misunderstanding":

"There is no manifestation of mutual assent to an exchange if the parties attach materially different meanings to their manifestations and (a) neither party knows or has reason to know the meaning attached by the other . . . ."

This is a restatement of the holding in the Raffles v. Wichelhaus case regarding the two ships named Peerless which sailed from Bombay; one in October, the other in December.
Contract Law Issues
Formation

- Although this would seem like a big hole in the objective theory of contracts, as a practical matter it is usually subsumed by interpretive rules, such as those found at Restatement (Second) of Contracts § 201, where at least one party is deemed to have known, or should have known, of the meaning attached by the other.

Contract Law Issues

- Analysis used to determine whether a liquidated damages clause is really an unlawful penalty provision.
- Does it Compensate Non-Performance as opposed to Compel Performance?

Contract Law Issues

- $5.6 million contract in which Carrothers Construction agreed to build a wastewater treatment plant for the City of South Hutchinson.
- Contract contained a liquidated damages clause providing for $850 per day in damages for each day Carrothers failed to meet the "substantial completion" deadline and the "final completion" deadline.
Contract Law Issues

• **Issue:** Did substantial completion occur when the City began using the plant (in November) or when all the computer control and safety devices were completed (in January)?
  
  • Court relies upon definition of "substantial completion" in the contract, which will not occur until installation of the computer controls and safety devices.

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Contract Law Issues

• **Issue:** Does the liquidated damages clause provide for an illegal "penalty"?
  
  • Legal principles applied by the court:
    • Penalty designed to "secure performance."
    • Liquidated damages designed as "payment of a sum in lieu of performance."
  
  • NOTE: This analysis supports the "efficient breach" concept.

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Contract Law Issues

• Two considerations given "special weight": *conscionable* and *uncertain*.
  
  • #1: The amount is *conscionable*. "[R]easonable in view of the value of the subject matter of the contract and of the probable or presumptive loss in case of breach . . . ."
  
  • $145,250 damages / $5.6 million contract = 3% of the total contract price.
Contract Law Issues
• Court tests the "reasonableness" of the liquidated damages applying:
  • (1) **predictive analysis**: is the amount reasonable in light of what the parties knew, or could know, at the time they entered into the contract; plus
  • (2) **retrospective (actual comparative) analysis**: is the amount reasonable in light of the actual damages suffered by the claimant?

Contract Law Issues
• The court examines a series of Kansas Court of Appeals cases and concludes it has applied a supplemental retrospective analysis in the past.
  • "Thus, to the extent this court has acknowledged that liquidated damages must bear some reasonable relationship to the actual injury or damages caused by the breach, *this court has recognized that a retrospective analysis of a liquidated damages clause is also appropriate.*"

Contract Law Issues
• **Prospective Inquiry**: the City's consulting engineers, MKEC Engineering, conducted a reasoned analysis of projected damages when it selected the $850/day amount. Many variables.
  • **Retrospective Inquiry**: although the City was able to operate the plant, it still had additional fees and expenses it incurred until it was complete.
Contract Law Issues

• #2: The amount is uncertain. "[T]he nature of the transaction is such that the amount of actual damages resulting from default would not be easily and readily determinable."
• Evaluated at the time the contract is entered.

Contract Law Issues

• The Kansas Supreme Court may not follow the additional "retrospective" inquiry.
• For example, on May 16, 2008 the Kansas Supreme Court issued its opinion in Kansas Heart Hospital, L.L.C. v. Idbeis, Case No. 97,131, 2008 WL 2065843 (Kan., May 16, 2008), where the court considered whether a bylaw requiring a stockholder to sell its stock back to the company at a pre-determined price was an illegal penalty.

Contract Law Issues

• The court, without discussion, rejects a retrospective analysis stating: "The determination of whether there is a penalty does not depend on speculating on the performance of investments."
• The argument was absent the bylaw the stockholder could sell its stock at its current fair market value, not the original purchase value adjusted for inflation.
Contract Law Issues

• Looking at current values would be similar to a retrospective comparative analysis: comparison of actual loss, at the time the bylaw is triggered, compared to the current value of the stock.
• The Supreme Court rejects this approach.

Contract Law Issues

• To support this proposition it cites the TMG Life case, a 1995 Court of Appeals case, and quotes the following passage from TMG Life: "The reasonableness of a liquidated damages clause should be determined as of the time the contract was executed, not with the benefit of hindsight."

Contract Law Issues

• Restatement (Second) of Contracts § 356(1) (1981) (emphasis added) states:
  • "(1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty."
Contract Law Issues

- The Kansas Court of Appeals, in Carrothers, reads the "or" in the Restatement as an "and," suggesting a prospective and retrospective analyses must be satisfied.
- If freedom of contract is a major public policy, why not enforce the clause if it meets either analysis?
- This would be consistent with use of the word "or" instead of "and" in the Restatement.

Contract Law Issues

- The "no-reliance clause" in residential real estate contracts.
- Another of a mounting line of unsuccessful cases attacking contract disclaimers in standard form real estate sales contracts.

Contract Law Issues

- The process is pretty basic:
  - First, have the property owner fill out a detailed statement revealing everything they know about the property they are selling.
  - Second, deliver the disclosure statement to the prospective buyer so they can read it to determine the status of the property; and often determine whether anything warrants further inspection.
Contract Law Issues

• **Third**, real estate agent instructs the buyer to obtain an inspection, if they want one.
• **Fourth**, buyer is instructed to sign documents that say they are not relying upon anything in the disclosure statement.
• **Fifth**, buyer purchases the property, discovers a major defect which the seller most likely knew about, but was not revealed in the disclosure statement.

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Contract Law Issues

• Katzenmeier is a suit alleging intentional and negligent misrepresentation.
• Summary judgment was granted to the seller because, under the express terms of the contract, the buyer could not have reasonably relied upon the allegedly false representations made by the seller.
• Court of Appeals affirms.

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Contract Law Issues

• It appears the only way to combat the effect of such disclaimers is to refuse to agree to them – which requires adequate counseling, which is not likely to come from the buyer's real estate agent – they will tell them to get an inspection.
• As with any contract regarding a major financial transaction, the only way parties can adequately protect themselves is through competent legal counsel.
Contract Law Issues
• Counsel can begin by turning the seller’s disclosure into affirmative representations that will survive the closing and provide the buyer with the power to rescind, or damages, attorney fees, etc., in the event a representation proves to be inaccurate.

• In the long term, this will not be a happy state of affairs for the real estate industry as the sale of residential real estate departs from the simpler cookie-cutter form of transaction and begins to resemble the more heavily-lawyered commercial real estate deal.

• The “evergreen” clause.
• Automatic contract extension unless advance notice given in a timely manner.
• Rabb Sales, Inc. entered into a contract giving it the right to distribute the products of Domino Amjet, Inc.
Contract Law Issues

- One of Domino's defenses to the contract claim was that Domino terminated the contract in November 2006.
- The contract contained an "evergreen clause" which would automatically extend the contract for an additional year (November 1 to October 31) "in the absence of three months' prior written notice by either party."

Contract Law Issues

- Court denies Domino's motion to dismiss Raab's contract claim.
- Court grants Domino's motion to dismiss Raab's negligent misrepresentation claim after finding it barred by the "economic loss doctrine" recognized by Illinois law.

Contract Law Issues

- Under the economic loss doctrine "a plaintiff may not recover solely economic damages in a tort action."
- Such "economic losses due to defeated expectations of a commercial bargain" are matters of contract, not tort.
Contract Law Issues

- The Kansas Court of Appeals has applied the economic loss doctrine.
- *Pendville v. Contemporary Homes, Inc.*, 32 Kan. App.2d 435, 83 P.3d 1257 (2004), collects the relevant Kansas case law and describes the purpose of the rule as follows: "The doctrine is designed to prevent a party from asserting a tort remedy in circumstances governed by the law of contracts."

Contract Law Issues

- The doctrine recognizes that a contract can provide a sort of immunity from tort liability when the asserted wrong would otherwise be a potential breach of contract.

Contract Law Issues
Performance and Breach

- Imaging Solutions entered into a contract with Inter-Americas to provide Inter-Americas with a new document imaging system consisting of hardware, software, and support and training services.
Contract Law Issues
Performance and Breach

- Completion of the contract required cooperation between the parties.
- Delay by Inter-Americas.
- Diligence by Imaging Solutions.
- Inter-Americas, without notice, declares the contract breached and demands rescission. Files suit.
- Trial court grants summary judgment to Imaging Solutions.

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Contract Law Issues
Performance and Breach

- Step One: What body of Kansas law should be applied?
  - General contract law or UCC Article 2?
  - Sale of computer software, with incidental services, is a UCC sale of goods.
  - Predominant factor test: $240,000 contract consisting of $205,000 in goods (software) and $35,000 in services.

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Contract Law Issues
Performance and Breach

- Issue: Did Imaging Solutions perform in a timely manner?
  - Yes. No defined times for performance so court must apply "reasonable time."
  - K.S.A. 84-2-309(1) (reasonable time).
  - K.S.A. 84-1-204(2) (depends upon the "nature, purpose, and circumstances of such action").
Contract Law Issues
Performance and Breach

- **Issue:** How should Inter-Americas proceed if it believed there was a breach?
- **K.S.A. 84-2-602(1)** (rejection within reasonable time, must "seasonably" notify the seller).
- **K.S.A. 84-2-508** (seller's right to cure a non-conforming tender of performance).

Contract Law Issues
Performance and Breach

- Note the fluid nature of rejection and cure when the contract (for goods and services) contemplates performance over an extended period of time.
- Example of how the party claiming a breach can become the breaching party.
- Damages suffered by Imaging Solutions requires a trial.

Contract Law Issues
Performance and Breach

- **Step One:** What body of Kansas law should be applied?
- Contract to use trademark and sell trailers under Coleman name.
- General contract law; not UCC Article 2.
Contract Law Issues
Performance and Breach
• Contract provided for a notice of default and cure procedure.
• Contract gave Coleman right to terminate for any uncured default.
• Failure to cure the default during the 30-day period gave Coleman the right to terminate – even though the default would not otherwise be considered a "material breach."

Contract Law Issues
Performance and Breach
• Whether a breach is "material" is always a difficult analysis.
• Avoid the risk of declaring something "material," and then having a court later find it was not, by simply defining, in the contract, events that will allow a party to discontinue their performance under the contract and terminate the deal.

Contract Law Issues
Performance and Breach
• Promissory note payments made late, and accepted by creditor, for many months.
• Creditor then declares that a subsequent late payment triggered a default allowing creditor to demand payment in full.
Contract Law Issues
Performance and Breach

- Trial court granted summary judgment to creditor - the contract allowed them to accelerate payment.
- Court of Appeals reverses finding the creditor had waived timely payment in the past and therefore must provide debtor with notice they will insist upon timely payment in the future.

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Contract Law Issues
Performance and Breach

- Court suggests this would not have been the case if the parties had an "anti-waiver" clause in their note.
- **Alternative analysis:** creditor's obligation of good faith when enforcing its contract.
- **Restatement (2d) of Contracts § 205:**
  - "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."

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Contract Law Issues
Performance and Breach

- A case that illustrates this principle is *Baker v. Ratzlaff*, 1 Kan. App.2d 285, 564 P.2d 153 (1977), which deals with the structurally similar situation where the seller had a right to terminate a supply contract if payment was not made upon delivery.
- Seller had obligation to inform debtor that future payments must be timely.

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Contract Law Issues
Performance and Breach

- The Court of Appeals upholds summary judgment for the real estate broker under a nonexclusive right to sell agreement.
- Buyer found out about the property through broker's website – even though buyer did all the work in showing the property and in negotiating and closing the sale.

Contract Law Issues
Performance and Breach

- Although the owners did the work in preparing the contract, obtaining the purchaser's signature, and closing the transaction, this was all done with a "buyer procured by a real estate agent hired by the owner."
- Broker was the procuring cause and therefore entitled to its commission.

Contract Law Issues
Performance and Breach

- University could not *unilaterally* change professor's teaching schedule when the contract stated the schedule "may be adjusted by mutual agreement . . . "
Contract Law Issues
Performance and Breach

- Did the professor appeal the University's ruling too soon? No.
- "No special incantations or magic words are required to create a final agency order. Kansas courts have consistently recognized that a relatively informal letter may constitute a final order for purposes of the statute."

Property Law Issues
Conveyancing Formalities

- Classic case of did the decedent "deliver" gift deeds prior to her death.
- If so, the real estate is not part of her estate and her heirs (she died intestate) have no claim to the lands.
- If not, the gifts are invalid and the property will pass by intestate succession.

Property Law Issues
Conveyancing Formalities

- This dispute concerns four tracts of land conveyed to three donees, Gertrude Reader, Hazel Denison, and Isabel Idol (three of Margret's four sisters, she also had four brothers).
- The conveyances were gifts from Margret to Gertrude, Hazel, and Isabel, made by deeds signed sometime in 1967.
Property Law Issues  
Conveyancing Formalities  
• Each deed contained the following reservation of a life estate in Margret:  
  • "Reserving unto party of the first part [Margret] and her assigns the full benefit, use, rents, issues and profits from the above described real estate, for and during her natural life."  

Property Law Issues  
Conveyancing Formalities  
• According to both Hazel and Isabel, Margret delivered the deeds to them in 1967 or 1968. Isabel placed the deeds in a safety deposit box she owned with Hazel. Margret’s name was not on this safety deposit box."  
  • This was the uncontested evidence of delivery.  
  • Court of Appeals affirms trial court’s holding the deeds were properly delivered.  

Property Law Issues  
Conveyancing Formalities  
• Basic legal principles stated in the Outline at pages 38-39, § f. Note the major role of "presumptions" in this area.  
  • "Delivery may be constructive as well as actual or personal, and it may be made to a third party [e.g. the deed to Gertrude given to Hazel and Isabel] to hold for the grantee, where an intention is manifested to give the conveyance present effect."
Property Law Issues
Conveyancing Formalities

- **Transfer-On-Death Deeds.**
  - When tax planning is not an issue, use of a "transfer-on-death" deed may be the preferred approach for gifting land.
  - Until the grantor dies, they can change the grant, dispose of the property to others, or encumber the property in any way.

- Although the statutes allow the grantor to avoid all the traditional delivery requirements (the grantee need not even be aware of the conveyance), it imposes a new mandatory requirement:
  - "acknowledging and recording in the office of the register of deeds in the county where the real estate is located, prior to the death of the owner . . . ." K.S.A. § 59-3502 (2005).

- The transfer-on-death approach to disposing of property avoids the present ownership issues associated with joint tenancy.
  - Recognizes that in most cases the owner of the land (motor vehicle, bank account, etc.) merely wants to provide for transfer at their death without creating any present rights in the at-death donee.
Property Law Issues
Subdivision Disputes


• Homeowners in the Four Colonies subdivision wanted to restrict the ability of homeowners to rent their houses.

• The restriction was accomplished by amending the Bylaws of the Four Colonies Home Association.

Property Law Issues
Subdivision Disputes

• The property use restrictions are contained in the "Four Colonies Declaration of Covenants, Conditions, and Restrictions" which provides it can be amended only by an agreement of not less than 75% of the lot owners. 511 of the 681 lot owners.

Property Law Issues
Subdivision Disputes

• Bylaw was amended by majority vote of those lot owners attending the meeting.

• 372 of the 681 lot owners attended the special meeting (55% of the total owners) to consider the Bylaw amendment.

• Of the 372 attending, 191 (51.34%) voted in favor of the Bylaw change.

• **191 (Bylaw) vs. 511 (Declaration).**
Property Law Issues
Subdivision Disputes

• Changes to property use must be accomplished by an amendment to the Declaration.
• Amendment of the By-Laws is ineffective.
• "Basically, the declaration is considered the enabling document or the constitution of the association. Generally, any attempt to restrict a property owner's use of the property as authorized by the declaration is considered void and unenforceable."

Property Law Issues
Subdivision Disputes

• Based upon the Declaration and Bylaws filed of record, the Kiekels knew their property rights could be further restricted by an amendment to the Declaration. The Kiekels did not, however, have notice that their property rights could be further restricted by a bylaw amendment. Four Colonies cannot circumvent the intent of the Declaration, the enabling document, by subsequently amending the Bylaws.

Property Law Issues
Subdivision Disputes

• Broad, general authority to amend Declaration of Covenants did not give developer authority to exempt its lots from development restrictions imposed on the lots it had sold to others.
Property Law Issues
Subdivision Disputes

• The Declaration creates two classes of owners, class "A" and class "B."

• All class B ownership is held by the developer which entitles the developer to 4 votes per lot compared to the class A owners' 1 vote per lot.

• Class B voting rights can be transferred, along with the lots owned by the developer.

Property Law Issues
Subdivision Disputes

• The Declaration states: "Class B owners may amend at any time as to the lands owned by Declarant."

• The court negates this authority by applying principles it adopts from the Restatement (Third) of Property: Servitudes.

Property Law Issues
Subdivision Disputes

• The court "adopts" Restatement (Third) of Property: Servitudes § 6.21 for the proposition that, in the words of the court, "courts should only enforce a declaration amendment if the declaration clearly informed purchasers of the specific changes that could be made to the subdivision's character and general plan through such an amendment."
Property Law Issues
Subdivision Disputes

- Restatement (Third) of Property: Servitudes § 6.21 (1998) states:
  - "A developer may not exercise a power to amend or modify the declaration in a way that would materially change the character of the development or the burdens on the existing community members unless the declaration fairly apprises purchasers that the power could be used for the kind of change proposed."

Property Law Issues
Subdivision Disputes

- The court holds: "Such an amendment provision is too broad to be enforceable."
- The court focuses on the concept of "notice" that the developer could exempt itself from the common plan that all the other parties are subject to under the Declaration.
  - Note the influence of the Restatement.

Property Law Issues
Successive & Concurrent Interests

- Father owns life estate in land, his son owns the vested remainder.
- Third party buys the land, in fee, from the father and son.
- What do we do with the proceeds when the parties are not in agreement?
Property Law Issues
Successive & Concurrent Interests

- Two approaches:
  - (1) Value the life estate at the time of the sale and pay the father that value.
  - (2) Treat all the funds as principal and allow the life tenant to receive the income from the principal.

Property Law Issues
Successive & Concurrent Interests

- Kansas Supreme Court, at least for non-judicial sales, adopts the first approach, quoting the rule as stated in Am.Jur.2d:
  "When a life tenant and a remainderman unite in a nonjudicial sale of the property, without agreeing as to the division or disposal of the proceeds, the life tenant is entitled to receive, absolutely, from such proceeds the estimated value of his or her estate computed as of the time of the sale."

Property Law Issues
Successive & Concurrent Interests

  - In 1964 Osborn, as lessor, entered into an oil and gas lease covering a **520-acre tract** of land.
  - By 2004 the lease was owned by Brake (92%) and Blankinship (8%).
Property Law Issues
Successive & Concurrent Interests

- Osborn's surface and mineral interests now owned as follows:
  - **Tract #1 (South 240 acres).**
    - **Surface:** Dexter (100%);
    - **Minerals:** Dexter (50%) Monroe (50%).
  - **Tract #2 (North 280 acres).**
    - **Surface & Minerals:** Nelson (100%);
      Monroe (Nonparticipating Royalty).

Dexter and Nelson sued asserting the lease had terminated.

- Is Monroe an indispensable party under K.S.A. 60-219?
- **Tract #1:** Monroe is a cotenant of the mineral interest.
- **Tract #2:** Monroe is a nonparticipating royalty owner.

The Court of Appeals adopts the reasoning stated in §§ 877.3 and 877.4 of the Williams & Meyers Oil & Gas Law treatise to conclude that a mineral interest cotenant (§ 877.3) and a nonparticipating royalty owner (§ 877.4) are not indispensable parties under Kansas Statutes Annotated § 60-219.
Property Law Issues
Successive & Concurrent Interests

• With regard to the undivided mineral interest, any continuing burdens created by the action are a product of cotenancy, not the failure to join a party.
• With regard to the nonparticipating royalty interest, they must, as before the cancellation, look to the mineral interest owner to protect their interests.

Property Law Issues
Successive & Concurrent Interests

• "Substantial performance" does not satisfy a special limitation.
• Trial court did not abuse its discretion in denying fees to prevailing lessors.
• Award of fees under K.S.A. 55-202 is discretionary, not mandatory.

Property Law Issues
Servitudes

• Scope of easement to build and maintain dike for flood control.
• Issue whether actions to improve the dike were within the scope of authority to "maintain" the dike "in accordance with plans and specifications" that cannot be found.
Supreme Court reverses Court of Appeals, in a 4/3 decision, holding the terms of the easement were not ambiguous and, based upon expert testimony provided only by the City, the City's actions were within the scope of the easement terms.

Dissent: issue of material fact regarding the "plans and specifications" issue.

Teachings from the Bruton case: 

Get familiar with the Restatement (Third) of Property: Servitudes. The Court cites, quotes, and relies extensively upon the Restatement (Third) in its opinion.


"The manner, frequency, and intensity of the use [of an easement] may change over time to take advantage of developments in technology and to accommodate normal development of the dominant estate or enterprise benefitted by the servitude."
Property Law Issues
Servitudes

- Court quotes Comment b. to § 4.13 as follows:
- "Under the rule stated in § 4.10, the holder of an easement or profit is entitled to make any use of the servient estate that is reasonable for enjoyment of the servitude, including the right to construct, improve, repair, and maintain improvements that are reasonably necessary." (Emphasis by the Court).

Property Law Issues
Servitudes

- The Court then proceeds to apply the Restatement provisions to the easement at issue:
- "We conclude that the term 'maintenance' as defined by the above authorities [which also included Webster's dictionary] is broad enough to encompass the City's recent improvements to the dike."

Property Law Issues
Servitudes

- Court also applies Restatement (Third) of Property: Servitudes § 4.1 (1998):
- "(1) A servitude should be interpreted to give effect to the intention of the parties ascertained from the language used in the instrument, or the circumstances surrounding creation of the servitude, and to carry out the purpose for which it was created."
Property Law Issues
Servitudes

• Court quotes from the Official Comments to § 4.1:
  "The circumstances of the mode of creation of the servitude affect the manner in which it is interpreted. If the servitude is expressly created, the expressed intentions of the parties are of primary importance."

Property Law Issues
Servitudes

• Schuck v. Rural Telephone Service Co., Inc., Case No. 98,098 180 P.3d 571 (Kan., April 4, 2008).
  Mr. Schuck negotiated an easement with Rural Telephone Service Co., which limited the easement to a 40' corridor to lay a telephone cable.
  When Rural Telephone laid the cable it, by accident, laid it outside of the easement corridor.

Property Law Issues
Servitudes

• Several years later the error was discovered and Schuck demanded $40,000 for an easement covering the cable.
  Rural Telephone responded by filing a condemnation action.
  Schuck responded by filing an action seeking to enjoin the condemnation action.
Property Law Issues
Servitudes

- Court holds, under the circumstances, Rural Telephone properly used its powers of eminent domain to respond to the error.

Property Law Issues
Servitudes

- 1978 the Jordans conveyed land to the Dallingas by an "indenture" form of conveyance which had signature lines for the grantors and the grantees.
- Deed signed by the grantors, not the Jordans.
- Deed delivered and recorded by the Dallingas who entered into possession of the land.

Property Law Issues
Servitudes

- The deed contained covenants restricting the land to residential use.
- Jeremiah obtained the Dallinga land in 1999. Seifert owns property adjacent to Jeremiah; Seifert's source of title is also from the Jordans.
- When Jeremiah sued the Seiferts over a boundary dispute, the Seiferts counterclaimed to enforce the residential-only covenants in Jeremiah's chain of title.
Property Law Issues
Servitudes

• Jeremiah defended arguing since the original conveyance was in the form of an "indenture," as opposed to a "deed poll," the Dallingas never consented to the restrictive covenants.

• Supreme Court holds that failure to have the Dallingas' sign the deed meant the register of deeds should not have recorded it but, even though placed of record, it did not provide constructive notice of the restrictive covenant.

Property Law Issues
Servitudes

• The Court of Appeals reasoned:
  • Whatever function the "indenture" and "deed poll" distinctions once served, they have been eclipsed by K.S.A. § 58-2203 which indicates only the grantor needs to sign the deed.
  • How about K.S.A. § 58-2209: "All deeds or other conveyances of lands, or of any estate or interest therein, shall be subscribed by the party granting the same . . . ."
  • The Dallingas' acceptance of the deed takes the place of their signatures.

Property Law Issues
Servitudes

• A "contract" analysis:
  • A owns Tract A, B owns Tract B.
  • A and B desire to enter into an agreement regarding their mutual maintenance of the fence between Tract A and Tract B.
  • They enter into an agreement whereby A and B each covenant to do, or not do, certain things regarding maintenance of the fence.
Property Law Issues
Servitudes
• As a matter of contract law, B’s failure to sign the agreement may indicate a lack of agreement (mutual assent) or it may create enforcement problems under the statute of frauds.
• As a matter of “real covenant law,” even if the document were signed by both parties, it would not “run with the land” because it lacks the requisite “horizontal privity.” There is no privity of estate.

Property Law Issues
Servitudes
• As a matter of “real covenant law,” to have the requisite property-based privity (as opposed to privity of contract), the covenant must be made in conjunction with a transfer of the affected property.
• However, applying an “equitable servitude” analysis, courts will generally enforce this form of purely contractual covenant relying upon “notice” as opposed to privity of estate.

Property Law Issues
Servitudes
• A property analysis:
• Assume A owns Tract A/B and conveys a portion, Tract B, to B. If the fence covenant is made as part of the conveyancing transaction, the requisite horizontal privity would exist.
• The covenant would “run with the land, i.e., bind a subsequent owner,”
Property Law Issues
Servitudes

- Note that the covenant in this case is not a stand-alone transaction as in the "contract analysis" noted above.
- In this situation, conveying the property to B, and B's acceptance of the property, would be sufficient to bind B to the covenant.
- There is no need for B to sign the deed. The covenant will "run with the land" because it meets the requirements for a real covenant.

Property Law Issues
Servitudes

- In this case the very deed which is the source of the grantee's only property interest in the land at issue is also the document which contains the limitation on the use of the property the document conveys.

Property Law Issues
Servitudes

- However: The Supreme Court holds the deed that conveyed the land to the grantee, which was accepted by the grantee, and gave notice to the world of the conveyance to the grantee, cannot be relied upon to give notice of the covenant language in the same deed—because the form had a signature line for the grantee and it was not signed.
Property Law Issues

Servitudes

• Does it matter that the subsequent owner of the land was in fact unaware of the covenant in the original deed?
• This is the situation with most purchasers.
• At least in this case the covenant was in the same document as the current owner's source of title.
• Often it is merely a reference to a subdivision plat containing the covenants.

Importance of the Contract vs. Property Analysis

• Can you be held liable for your assignee who elects to participate in a well (ten years after you assigned all your interest in the contract area) and then fails to pay their share of the development costs?

Property/Contract Analysis

• The "advance novation" clause of the Oil and Gas Lease:
• "In the event of an assignment hereof in whole or in part, liability for breach of any obligation issued hereunder shall rest exclusively upon the owner of this Lease, or portion thereof, who commits such breach."
Property/Contract Analysis

- The advance novation clause in the Oil and Gas Lease uses a **privity of estate** basis for liability.
- Each party liable only for acts occurring during their ownership of the leasehold and to the extent of their leasehold interest.

Property/Contract Analysis

- Court's holding in *Seagull*:
  - Working interest owner's obligations under operating agreement continue even after assigning its working interest to a new owner.
  - No novation, or "advance novation."

Property/Contract Analysis

- Assignee of working interest failed to reimburse operator for its share of operating costs.
- Assignee and **assignor** each held liable for the $268,418.90 in unreimbursed costs.
- "[A] party cannot escape its obligations under a contract merely by assigning the contract to a third party."
Property/Contract Analysis

• This assumes the contract does not provide for a release from continuing liability (the advance novation clause).
• "[A] party who assigns its contractual rights and duties to a third party remains liable unless expressly or impliedly released by the other party to the contract."

Property/Contract Analysis

• The court reviews the operating agreement and concludes it: "simply does not explain the consequences of an assignment of a working interest to a third party."
• Court also considers whether there is an implied release from continuing liability.
• Court discusses the Restatement of Property and the Restatement of Contracts.

Property/Contract Analysis

• Although not addressed by the court, a "property" analysis that could exempt the assignor from continuing liability following conveyance of its working interest is a "covenant running with the land" analysis.
• Argue the parties intended the burden to run with ownership of the working interest.
Property/Contract Analysis

• If the covenant "runs with the land" then did the parties intend that rights and duties similarly run with the land?
• Defensive use of the covenant running with the land analysis.
• See, e.g., Gallagher v. Bell, 516 A.2d 1028 (Md. Ct. App. 1986) (covenant to pay pro-rata cost of streets and utilities when and if they are installed was a covenant running with the land which burdened only the present owner of the land).

Property/Contract Analysis

• The Seagull case will prompt a careful review of existing operating agreements to determine whether they have express language addressing the issue or imply that the obligations should "run with the land" as opposed to having a lingering contractual presence.

Property/Contract Analysis

• For example, the A.A.P.L. Form 610-1989 Model Form Operating Agreement states: "This agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective heirs, devisees, legal representative, successors and assigns, and the terms hereof shall be deemed to run with the Leases or Interests included within the Contract Area."
Property/Contract Analysis

- Employing a property analysis it could be argued this standard language expresses the intent that liability should "run with the Leases or Interests included within the Contract Area."
- The problem is easily addressed in future agreements with appropriate language (either imposing continuing liability or providing for an advance novation).