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Concurrent Session III: B. What's Going On: Updates, Trends and Hot Topics in the Legal Industry

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Whether it is pandemics, natural disasters or changes in leadership, the last few years have presented a number of unique challenges to the real estate industry that we have been forced to navigate (some successfully and others maybe not so much). Join this interactive discussion with seasoned attorneys and gain insights about the challenges and trends for the legal industry as well as strategies to keep up with these changing times.

I. DOCUSIGN AND REMOTE ONLINE NOTARIZATION

A. DocuSign.

i. Since March of 2020, the use of DocuSign and other e-signature platforms has increased significantly.

ii. For real estate transactions, purchase and sale agreements, amendments, and any closing documents that do not need to be recorded are typically being executed via DocuSign for convenience purposes.

iii. In many states, DocuSign can also be utilized for leases.

a. 85%-90% of leases and amendments are being executed via DocuSign.

b. DocuSign is not being utilized for leases in states where a notary is required, such as Ohio.

B. Remote Online Notarization.

i. A remote online notary can notarize documents through a secure online platform.

ii. The notary verifies the signer's identity via video call and then electronically signs and seals the document without meeting in person.

iii. County recorders in Ohio should accept a document notarized by an online notary.

II. DEAL TERMS & CONDITIONS IN PURCHASES AND SALES

A. Representations and Warranties.

Oftentimes, Sellers want Buyers to acquire real property on as "as is, where is" basis, with all faults, which means that the Buyer agrees to buy the property from the Seller with the Seller making few, if any, representations or warranties about the condition of the property. This is especially true in the case where the Seller has not owned the property for a long period of time and therefore, Sellers desire to limit, to the greatest extent possible, their liability under a purchase agreement. Most sophisticated Buyers do not agree to the 'as is' concept completely, resulting in the Seller providing limited

representations and warranties and a due diligence period for the Buyer to perform its own evaluation of the condition of the property.

A representation is a statement of fact regarding the property. A warranty is a promise that a statement of fact is true. In purchase agreements for retail properties, it is customary for Buyers to rely on representations and warranties of a Seller in determining whether or not to purchase the property, especially as it relates to matters that cannot be evaluated by third party inspections. Once the purchase and sale is consummated, in most jurisdictions, the representations and warranties of the Seller contained in the purchase agreement are deemed to have merged with the deed and will no longer be in force or effect unless the purchase agreement expressly states that such representations and warranties survive the closing. Accordingly, it is important for both parties to evaluate which representations and warranties of Seller will survive the closing and for what period of time.

i. Seller's Perspective.

1. Most Sellers are generally agreeable to giving representations and warranties in a purchase agreement relating to the following:

(a) Corporate formation and good standing

(b) Power and authority to sell the property

(c) Off record information that (I) is easily verified by the Seller and/or (II) the Buyer would not be able to obtain despite its inspections.

2. As a general rule, if Buyer can diligence it, Seller won't represent it!

3. As a result, Sellers may propose including the following limitations as it relates to the Seller representations and warranties:

(a) Limit the representation to the "actual knowledge of Seller's knowledge party

(b) Limit the Buyer's remedies by including a floor, cap and survival period (as further described below).

ii. Buyer's Perspective.

1. Buyers prefer for the Seller to make a significant number of representations and warranties and for such representations and warranties to be as broad as possible, including those relating to the condition of the property.

2. Buyers may take the following positions as it relates to Seller's representations and warranties:

   (a) Buyers want assurances that the individual on behalf of Seller who is providing the representations and warranties has specific knowledge about the property, such as a property manager and not necessarily an executive-level employee of Seller.

   (b) Buyers want the representations and warranties to survive the Closing for a certain period of time (and not to merge into the deed provided by Seller at Closing).

   (c) Buyers typically want to carveout out certain indemnity obligations from the limitation of Seller's liability as it relates to a floor and cap.

B. Floors, Caps and Survival Periods.

i. A floor means that Buyer must have damages in a certain aggregate amount before being able to make a claim against Seller.

   1. The amount varies per transaction but typically enough for Sellers to avoid being bothered by insignificant or nuisance claims.

ii. A cap means that the claims must exceed a certain dollar threshold before the Buyer is able to collect damages.

   1. The amount is typically based upon the purchase price (1-7%)

   2. The purchase agreement should specify whether Buyer can collect the full dollar amount of the cap or only the amount in excess of the floor.

iii. A survival period means that Seller's representations and warranties survive the closing for a period of time.

   1. The period of time is typically between 6 months and 24 months.

   2. Sometimes Buyers require that the Seller maintain its corporate existence and a liquid net worth equal to the amount of the cap during the survival period, although this requirement is not as strong as a post-closing escrow maintained by the title company or another entity to serve as a seller guarantor. If Buyer insists upon these requirements, they should be negotiated up front in the letter of intent.

   3. If Seller agrees to the survival of certain representations, Seller should require an "anti-sandbag" provision in the purchase agreement that

protects Seller from liability for a breached representation or warranty that Buyer discovers pre-closing whereby Buyer elects to proceed to Closing anyways.

C. <u>Indemnities and Guaranties</u>.

i. An <u>indemnity</u> (i) is a promise to be responsible for (or make good on) another's loss, and (ii) creates a primary obligation (i.e., an obligation that is independent of the primary obligor's obligation). Accordingly, if the primary obligor's obligation ceases to exist, the indemnifier's liability remains intact.

ii. A <u>guaranty</u> (i) is a promise by the guarantor to the beneficiary that a third party (i.e., the primary obligor) will perform an obligation or if such third party does not perform, then the guarantor will perform it or procure its performance, (ii) creates a secondary obligation (i.e., an obligation that is dependent on the primary obligor's obligation, and (iii) can never exceed the obligation of the primary obligor in the absence of wording to the contrary.

iii. <u>Advantages of Indemnities v. Guarantees</u>.

1. An indemnity is a primary obligation which is independent of the primary obligor's obligation.

2. If the agreement under which the primary obligor's obligation arises is modified, an indemnity will not be discharged whereas a guarantee could be in the absence of express wording to the contrary.

3. An indemnity does not need to comply with Section 4 of the Statute of Frauds (1677) whereas a guaranty needs to comply.

4. However, it's best practice to have a written instrument for both indemnities and guarantees.

iv. <u>Seller Guarantor</u>.

1. In commercial real estate contracts, sometimes guarantees are given by a parent company of the Seller to guarantee the performance of Seller's post-closing obligations and backstop Seller's post-closing liability for a breached representation or warranty.

2. A Seller guarantee is valuable if the parent company or other entity providing the guarantee is in a better financial position than the Seller; however, many times, Sellers do not want to expose another entity to liability and are unwilling to provide a guarantee.

v. Language is important regardless of labels and a court will look to various indicia and the context of the document itself to determine whether the parties agreed to a guarantee or an indemnity.

III. CORPORATE TRANSPARENCY ACT (the "CTA")

A. Brief Overview.

1. The CTA became effective January 1, 2024.

2. The CTA requires nonexempt companies to provide beneficial ownership information to the federal government.

   i. There are 23 exemptions and many nuances to analyze when determining filing obligations.

   ii. Nonexempt companies must provide: 1) name; 2) address; 3) jurisdiction of formation; 4) EIN; and 5) a list of beneficial owners.

3. Beneficial owners are individuals who either own more than 25% of the equity of a reporting company or exercise substantial control over the company in some regard.

4. Beneficial owners must provide: 1) name; 2) DOB; 3) residential address; and 4) a copy of a driver's license or passport.

B. Filing Requirements to Date.

1. Due to a nationwide injunction implemented by the Eastern District of Texas, the December 31, 2024 deadline to make the required filings was paused.

2. There has been a lot of litigation challenging the constitutionality of the CTA.

C. Changes to Purchase Contracts. As a result of the CTA, many practitioners have revisited their purchase agreement forms to evaluate whether updates are necessary, especially as it relates to 'drop and swap' transactions whereby a new entity is formed to acquire title to the property.

1. Is Seller or Buyer responsible for comply with FinCEN reporting requirements?

2. What is the remedy for non-compliance by a party? Self-help?

IV. FINANCING TRENDS

A. Loan Assumptions.

With higher interest rates and uncertainty about rate fluctuation, assumptions of existing loans may be an attractive option to buyers, but it adds complexity and time to acquisition transactions.

i. Timing.

1. Loan assumptions can typically be completed in 90 to 120 days. However, if the buyer requires any substantive changes to the loan documents, additional time will be needed.

2. The buyer is typically tasked with driving the process, with the seller having an obligation to cooperate in those efforts. Often there is a requirement for the buyer to apply for the assumption promptly after the purchase agreement is signed.

3. The lender's approval of the assumption should be a condition to closing the transaction, which may require flexibility with respect to the closing date.

ii. Costs. Loan assumptions involve several costs and fees payable to the lender and their consultants and attorneys. In addition to out-of-pocket costs, there is typically an assumption fee (often .25-1% of the loan amount). Lenders may also charge a non-refundable application fee. The purchase agreement should allocate these costs. Generally, the buyer is responsible for all costs other than the seller's legal fees.

iii. Changes to Loan Documents. Sellers may want to delay providing copies of the loan documents until after the purchase agreement is signed. However, obtaining the loan documents early is crucial, as any required changes should be submitted to the lender as early in the process as possible. Sellers may also specify that you can request no changes, but that is often unworkable due to a buyer's corporate structure or operational issues. While the loan documents a seller signed may not be comparable to what a buyer would negotiate for a new loan, it is not practical to request many changes, so the buyer should focus on what is really needed to make the deal work.

1. Buyers often will need modifications to transfer provisions to reflect the upstream structure for its entities. These types of changes are typically acceptable to lenders, but for CMBS loans, the buyer may need to provide a REMIC opinion.

2. Buyers may need adjustments to the financial reporting requirements to reflect their financial reporting processes and timelines.

3. Buyers are likely changing the property manager, which may necessitate changes based on whether or not the property manager is a buyer affiliate. In any event, a new subordination of property management agreement will likely be required.

4. Changes to provisions like lease approval thresholds or insurance provisions are usually typically in the "would like to have" category, and the trade-off of time and expense to negotiate these changes may drive the buyer to drop the ask.

5. Seller may not be willing to allow buyer to ask for much beyond the "must have" list, due to concerns about slowing down the approval process and keeping the asset off the market.

B. Interest Rates.

With the demise of LIBOR, most lenders are using SOFR as the index for variable rate loans.

i. What is SOFR?

1. SOFR stands for Secured Overnight Financing Rate.

2. The Alternative Reference Rates Committee (AARC) announced on June 22, 2017 its identification of Secured Overnight Financing Rate (SOFR) as a consensus best practice rate.

3. The daily SOFR is based on observable transactions in the Treasury repurchase market. Proponents find it preferable to LIBOR because there is extensive trading each day (much more than that of interbank loans).

4. Critics of SOFR point to the volatility of SOFR, time investment, considerable expenses and risks to participants in the derivative and cash markets (i.e., constructing the necessary protocols, implementing uniform procedures to properly calculate and cover the difference between the LIBOR rate and the secured risk-free SOFR rate, educating and convincing market participants that SOFR is a reasonable equivalent to LIBOR and developing uniform fallback rate triggers).

ii. Other Floating Rates.

1. AMERIBOR launched in December 2015 and is published by the American Financial Exchange. AMERIBOR reflects the borrowing costs for transactions between small and midsize U.S. financial institution members. It remains steady at month-end and year-end periods, unlike SOFR. Unlike LIBOR or SOFR, it is geared more toward smaller U.S. bank financing conditions, so it's global breadth and effect on multinational financial institutions is unknown.

2. Bank Yield Index (BYI) was introduced by ICE Benchmark Administration in January of 2019. BYI measures the average yields that investors are willing to invest over 1, 3, & 6-month periods. It is based on real commercial trades (i.e. certificate of deposit transactions) and considers more than overnight rates. Although presented as an alternative to LIBOR, it has not gained much popularity in U.S. commercial financing transactions.

3. The US Treasury rate is the interest rate the US government pays on its debt obligations. It's also the annual return investors expect from holding US government securities. Commercial mortgage rates have historically been influenced by the US Treasury yields, where lower treasury yields lead to lower mortgage rates, and some current mortgage lenders have adopted it as their index rate.

V. TRENDS IN WORK ENVIRONMENT

A. In Office; Hybrid: Remote.

Although hybrid work environments began to gain popularity long before COVID, most law firms required lawyers to be in the office most, if not all, working days. The success of remote working during COVID has prompted many employers to permit remote or hybrid working on an ongoing basis.

B. Positives and Pitfalls of Remote/Hybrid Working.

i. Positives.

1. Many workers find that remote or hybrid working increases their work-life balance, allowing them to capture time lost in commuting and office distractions.

2. Many also find they are more productive working from home.

3. Remote work widens the pool of available talent. Firms are not limited by the geography of their offices.

ii. Pitfalls.

1. Lawyers learn primarily through the apprenticeship model, which can be more difficult in a remote environment. It can also be more difficult to know when a new lawyer is falling behind.

2. Firm culture and loyalty may suffer if lawyers do not feel connected to their colleagues and partners.

3. There are ethical issues (such as unauthorized practice of law) and tax issues that may arise if a lawyer is working in a state where they are not licensed or where their firm does not have other operations.

VI. LEGAL FEE ARRANGEMENTS.

A. Volume Discounts. Firms may offer volume discounts to clients. This can be based on the number of matters or the total amount of fees billed. When a certain threshold is met, a discount is applied.

B. Dead Deal Rates. Clients may negotiate in some cases, such as drafting leases and amendments, that if a lease does not get signed up, the client will not pay the fees. This creates an incentive for the firm to close the deal.

C. Fixed Fees.

i. Firms can offer fixed fees or caps on transactions. For example, leases may be drafted for a fixed fee based on the square footage of the space being leased.

ii. In some cases, firms may offer a cap on legal fees. For example, if a client is engaged in a simple asset disposition, a firm may offer to cap its fees where the firm can estimate the amount of time that will be spent on the transaction.

VII. USE OF AI AND DOCUMENT MANAGEMENT SYSTEMS

A. Positives and Pitfalls.

i. Positives.

1. Legal research and due diligence can be streamlined by searching for concepts, not just keywords.

2. Diligence review aided by AI-powered technology can quickly identify key pieces of information in a large volume of material.

3. Drafting tools can improve the speed and accuracy of drafting emails and contracts.

ii. Pitfalls.

1. Legal AI tools generally have more knowledge about general contracting and litigation matters than real estate specific concepts.

2. AI generated materials must still be reviewed for accuracy and quality control.

3. The large language models that back generative AI are prone to "hallucinations", meaning they can create new facts and information (such as creating case law).

B. Security and Ethical Issues.

i. Publicly available applications are widely popular. However, most public applications are not practical for legal use as they gather and reuse information which may be privileged or otherwise confidential.

ii. Case law and regulations on lawyers' use of AI are constantly evolving. Many states have issued sanctions against lawyers for improper use of AI. In addition to confidentiality issues, lawyers' improper use of AI has led to scrutiny with respect to competency, proper supervision and unauthorized practice of law.

VIII. NOTICE REQUIREMENTS UNDER PURCHASE CONTRACTS AND LEASES

A. Brief Overview.

In purchase contracts and leases, the notice provision in such agreements refers to the specific requirements that the parties must comply with for communicating material information to each other, including the acceptable methods of delivery, the address(es) to where notices must be sent, and when the notice is deemed received by the recipient.

B. Methods for Delivery.

a. In the past, purchase contracts and leases permitted delivery of notices via overnight courier system, such as FedEx, USPS (with confirmation of receipt) and hand delivery. Some agreements even permitted notices via facsimile!

b. In recent years, many agreements have expanded the permitted means of delivery of notices to include electronic mail but only if followed by another permitted means of delivery, such as FedEx or USPS.

c. Due to governmental shutdowns resulting from COVID, it was challenging for parties to deliver notices via any method other than electronic mail and oftentimes, a party requested the opposing party to waive delivery of notice via other methods.

d. In connection with the current work environment whereby employees are permitted to work remotely, many parties continue to rely solely on electronic mail as a valid form for delivery of notices under purchase contracts and leases and do not require such delivery to be followed up by a FedEx or otherwise.

e. This presents some risks, however, if an email server rejects an email due to a large attachment, for example, and/or if an email address is incorrect.