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**Peer to Peer 8**

# Purchase & Sale Agreements: Navigating Representations, Warranties, Baskets, Caps, and Permitted Title Exceptions.

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by:


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## REPRESENTATIONS AND WARRANTIES

Most sales of real property in commercial real property agreements are made on an as -is basis. In spite of the as-is nature of these transactions, it is customary for the Seller to make representations and warranties that are contrary to the as-is nature of the transaction. Sometimes, these reps and warranties survive the closing for a negotiated period of time or indefinitely. As a result, these reps and warranties can be the most heavily negotiated sections in purchase and sale agreements. Because the reps and warranties survive the closing and contravene the typically as-is nature of purchase and sale agreements, sellers attempt to limit the reps and warranties as much as possible while buyers want to use the reps and warranties to initially gather as much information as possible from the seller related to the reps and warranties.

Reps and warranties cover a wide variety of topics, and range from customary reps and warranties that are general in nature to representations and warranties that address specific issues. These issues may include matters that are not of record and specific items that the purchaser wants answered.

Here is an example of standard reps and warranties.

- Authority to Sell. Seller has the right, power and authority to enter into this Agreement and to sell the Property to Purchaser in accordance with the terms and conditions hereof and will deliver satisfactory evidence of such right, power and authority to Purchaser at Closing.

- Ownership of Property and Personalty. Seller is the sole owner of good, fee simple, marketable and insurable title to all of the Property, and good, unencumbered marketable title to the Personalty, subject only to the Permitted Exceptions.

- Permits. All necessary governmental permits for the development and/or operation of the Property as currently conducted are readily available. No governmental authority having jurisdiction over the Property has issued or threatened to issue any notice or order that adversely affects the use, development, construction and/or operation of the Property as presently conducted.

- Hazardous Waste. For purposes of this paragraph, “hazardous substance” means any matter giving rise to liability under the Resources Conservation Recovery Act (“RCRA”), 42 U.S.C. Section 6901 et seq., the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), 42 U.S.C. Sections 9601 et seq., or generally any contaminant, oil, radioactive or other material, the removal of which is required or the maintenance of which is prohibited or penalized by any local, state or federal agency authority or governmental unit.

- To Seller’s best knowledge, having made diligent inquiry, the Property does not contain any hazardous substance nor does any adjacent property;

- Seller has not conducted, authorized or permitted the generation, transportation, storage, treatment, handling, or disposal of any hazardous substance at the Property;

- Seller is not aware of any pending or threatened litigation or proceedings before any administrative agency in which any person or entity alleges the presence, release, threat of release, placement on or in the Property or any adjacent property, or the generation, transportation, storage, treatment, or disposal at the Property or any adjacent property, of any hazardous substance;

- Seller has not received any notice of and has no actual or constructive knowledge that any governmental authority or any employee or agent thereof has determined, or threatens to determine, that there is a presence, release, threat of release, placement on or in the Property or any adjacent property, or the generation, transportation, storage, treatment, or disposal at the Property or any adjacent property, of any hazardous substance;

- There have been no communications or agreements with any governmental authority or agency (federal, state or local) or any private entity, including, but not limited to, any prior owners of the Property, relating in any way to the presence, release, threat of release, placement on or in the Property or any adjacent property, or the generation, transportation, storage, treatment, or disposal at the Property or any adjacent property, of any hazardous substance;

- Seller shall indemnify and hold Purchaser harmless against any loss, cost, or liability incurred by Purchaser arising out of the existence of "hazardous substance" existing on the Property on or before the date of Closing.

- No Condemnation Proceedings. There are no condemnation or eminent domain proceedings pending, threatened or contemplated against the Property or any part of the Property, and Seller has received no notice, oral or written, of the desire of any public authority or other entity to take or use the Property or any part of the Property.

- The Property is not subject to any leases, operating or maintenance agreements that cannot be terminated by Purchaser (as Seller's assignee), without charge or penalty, upon thirty (30) days' or less notice.

- There is no litigation or any administrative proceeding pending with respect to the Property or for which Seller has received service of process or written notice of the threat thereof.

- Flood Hazard Area. No portion of the Property is located within any Special Flood Hazard Area designated by the United States Department of Housing and Urban Development, or in any areas similarly designated by any agency or any other governmental authority.

- Non-Foreign Person. Seller is not a "foreign person" for purposes of the withholding rules of the Federal Deficit Reduction Act of 1984.

- Mechanic's Liens. At or prior to Closing, Seller shall pay for all labor that has been performed on, or materials furnished to, the Property for which a mechanic's or materialmen's lien or liens could be claimed by any person, party or entity.

- Access to Public Road. "_____", which is a public roadway, abuts the Property, and the right of ingress and egress from said roadway to and from the Property is not restricted or limited in any manner.

- Leases. There are no Leases pertaining to the Property, and no tenants, lessees or other occupants of all any part of the Property, except as disclosed by Seller to Purchaser in accordance with Section 4.3 above.

- Personalty. There is no Personalty used or required in connection with the maintenance, management or operation of the Property except as disclosed by Seller to Purchaser in accordance with Section 4.3 above.

- Outparcel Provisions. The following subsections shall apply only if the Property is or will be divided as an outparcel of a portion of a shopping center:

    - Signage Rights. Seller has an insurable right (i.e., insurable by a title company at standard rates as an appurtenance to the legal description being insured at Closing) to use any and all pylon or monument signage now or hereinafter erected in the Shopping Center.

    - No Violation of Lease. The subdivision of the Property (i) does not cause any lease affecting the Property to be violated; and (ii) encumbers the adjacent property (by declaration, memorandum of lease, or otherwise) so that no third party owning the adjacent property has the right to violate any provisions contained in any lease affecting the Property.

    - Parking and Access Rights. Any subdivision of the Property provides or shall provide for access and parking of the Property so that the occupant thereof shall at all times have rights to adequate parking and access both under any lease affecting the Property and in compliance with all laws.

Sellers can limit representations and warranties by several means. One is to designate the party who has the knowledge and thereby limit the representation to the actual knowledge of t such party. Second, Sellers may limit representations and warranties to not survive closing or if surviving, the timing of the survival of the representations and warranties. A third way is by modifying the language of the rep and warranty to apply only to the seller's knowledge. Finally, some sellers will provide that if the purchasers come into knowledge that the rep or warranty

has been breached, the seller will have the right to cure the breach of representation or warranty. If the purchaser closes with the knowledge of the breach, the applicable rep and warranty will be deemed waived. An example of this language is as follows:

- Disclosure. Notwithstanding any contrary provision of this Agreement, if Seller becomes aware during the pendency of this Agreement prior to Closing of any matters which make any of their representations or warranties untrue, Seller shall promptly disclose such matters to Purchaser in writing. In the event that Seller so discloses any matters which make any of Seller's representations and warranties untrue in any material respect or in the event that Purchaser otherwise becomes aware during the pendency of this Agreement prior to Closing of any matters which make any of Seller's representations or warranties untrue in any material respect, Seller shall bear no liability for such matters (provided that such untruth is not the result of Seller's breach of any express covenant set forth in this Agreement), but Purchaser shall have the right to elect in writing on or before the Closing Date, (i) to waive such matters and complete the purchase of the Property without reduction of the Purchase Price in accordance with the terms of this Agreement, or (ii) as to any matters disclosed following the expiration of the Due Diligence Period, to terminate this Agreement.

- Purchaser's Knowledge. Notwithstanding anything to the contrary provided herein, if, prior to Closing, Purchaser obtains actual knowledge that any representation or warranty of Seller is inaccurate or incorrect and Purchaser nonetheless proceeds with Closing, Seller shall have no liability for any such inaccurate or incorrect representation or warranty.

Generally, representations in a purchase agreement do not survive closing and are merged into the deed. *See e.g. Courtesy Props., LLC v. S&ME, Inc.*, 2020 U.S. Dist. LEXIS 242927, *8 (internal quotations omitted). However, in most situations Buyers will request the representations to survive closing—often for a period between six months and two years, but this time period can be negotiated for any period agreeable by the parties.

Some sellers will refuse to make any representations or warranties based on the way they are organized. In this event, the buyer will need to make sure that they are comfortable with the balance of the transaction, and that any items that require representations and warranties are vetted another way.

Hypothetical #1

1. You represent the seller or purchaser of an outparcel in a shopping center. As a seller, what reps and warranties in the above bullet points are acceptable? What would you insist on as a purchaser? How would you modify them and why? Are there alternatives to the reps and warranties for either party?

2. New Retail Use LLC has a purchase agreement to buy a subdivided portion of a shopping center with existing leases and supplemental agreements between current operators and Center Owner LLC. These leases and agreements are not of record. Buyer is concerned that these documents could include use and parking restrictions or granted other rights that could impact its ability to operate.

3. New Retail Use LLC requests that the purchase agreement require Center Owner LLC to provide a copy of all of these documents for New Retail Use LLC to review to confirm. Should Seller provide these documents? If not, what could Seller do to get Buyer comfortable while limiting is exposure?

4. A city announcement has stated that a new trolley system will be built that will serve the city property. The property is being negotiated for a purchase agreement, and the purchaser is prospectively building a new retail center in place of the unconfigured buildings. Purchaser has read about the trolley project through the press releases, but does not know how it affects the property. The seller has received notice from the In addition to the boilerplate reps and warranties, purchaser's counsel asks for the following rep and warranty in the initial draft. Seller and the municipality have had several meetings regarding the proposed taking, but nothing has been formalized yet, except that the rail will be going through the boundary line of the property. The seller knows that this may be problematic for the purchaser:

   > "There are no condemnation or eminent domain proceedings pending, threatened or contemplated against the Property or any part of the Property, and Seller has received no

notice, oral or written, of the desire of any public authority or other entity to take or use the Property or any part of the Property."

How should the seller respond? What are the competing issues that the seller's attorney needs to be aware of to properly represent their client?

## LIMITATIONS ON SELLER LIABILITY

Baskets

Another way for sellers to limit liability is by inserting limitations on Seller's financial risk in the purchase agreement through baskets. A "basket" is a mechanism that limits seller's liability to breaches of the purchase agreement or surviving reps and warranties to an agreed upon amount. . A basket will consist of the amount between a floor and a cap. The floor is the minimum amount for which the seller will be responsible, and the cap is the maximum amount of liability for which the seller is responsible. Often, the basket is tied to a percentage of the purchase price (typically between 0.5% and 1%)), or a different amount agreed between the parties.

Baskets can be either "tipping" or "non-tipping." In a tipping basket, once the floor is met, seller is liable for all losses, regardless of whether such losses are less than the floor or not. In a non-tipping basket, seller is never liable for the losses below the basket floor. Below is an example of a non-tipping basket:

- Seller's liability for breach of any covenant, indemnity, representation or warranty with respect to the Property shall be limited to claims in excess of an aggregate $50,000 and Seller shall be liable only to the extent that such aggregate exceeds such figure. Seller's aggregate liability for claims arising out of such covenants, indemnities, representations and warranties with respect to the Property shall not exceed $250,000.

Caps

As discussed above, a "cap" is an upper threshold amount for seller's liability. Like baskets, this amount is often a percentage of the purchase price, typically between 5% and 25% of the purchase price, but unlike baskets, they do not contain a floor. Caps are preferred by seller because it gives clarity and certainty with respect to potential future liability.

One way a buyer can limit a cap is by tying caps to only certain terms of the PSA. For example, some caps will apply only to representations and warranties, but not to the covenants of Seller under the agreement. Another way for buyer to limit a cap is by limiting it to certain representations and warranties, but leaving certain core representations where seller would owe all losses if these were breached. Many of these items are resolved based on the bargaining power between the buyer and seller.

Hypothetical #2

Your client is the seller of property who is adamant that it wants to limit future liability as much as possible. What PSA terms are you prioritizing and what is your approach to negotiating with buyer? Is the seller's position feasible as it relates to the limitation of liability? As the buyer, what will you try and negotiate in order to limit any surprises after the closing? How can you deal with the seller's insistence on the limitation of subsequent liability?

## PERMITTED EXCEPTIONS

Sellers and purchasers also typically negotiate what type of permitted exceptions to the buyer's title to the property will be acceptable. Among the negotiated pieces include: (1) removal of liens and judgments; (2) historic purchase option rights in mall agreements; and (3) tax districts. Standard language in many contracts can be as follows:

*"Permitted Exceptions" shall include and refer to: any and all exceptions to title set forth in Seller's existing title insurance policies that are made available for Purchaser's inspection pursuant to the provisions hereof; zoning ordinances and regulations and other laws or regulations governing use or enjoyment of the Property; matters affecting title created by or with the consent of Purchaser; liens to secure taxes and assessments not yet due and payable; and customary utility easements and other matters which do not materially and adversely affect the use, occupancy, development or value of the Property. Notwithstanding the foregoing, Seller shall remove at Seller's sole cost and expense on or prior to the Closing Date and*

*there shall not be treated as Permitted Exceptions any liens for monetary obligations voluntarily incurred by Seller (excluding any general or special assessments that are paid in installments to the extent not required to be paid as of the Closing Date) that are not assumed by Purchaser (for such purposes, all assessments collected with ad valorem real estate taxes shall be assumed by Purchaser and represent Permitted Exceptions).”*

Hypotheticals:

1. You are negotiating an agreement for the purchase or sale of an outparcel that is going to be redeveloped from a single building to a small shop center. The outparcel is located at the boundary of the center, and you know that there will be REAS. As a purchaser, how would you modify the above definition of permitted exceptions to meet your needs?

The negotiations for the removal of liens, can take various forms.

Most properties are likely to have some form of secured lien in the form of a mortgage or deed of trust depending on the jurisdiction. Without the removal of this lien at closing, the property remains subject to the secured lien and if new buyer does not pay the secured lien pursuant to the loan agreements, lender can still foreclose on the property. For this reason, this is not usually a contested request and is traditionally removed at closing using purchase price proceeds to remove the mortgage.

The secured lien may have other documents of recorded associated with it, including assignments of leases and rents and subordination agreements. Buyer’s counsel should be sure that these are included in the documents that must be removed prior to closing so that they do not accidentally end up as permitted liens.

Many times, a secured lien will be attached to non-real estate property located at the property, which can include fixtures under the UCC Article 9, Section 102.

For fixture filings, in order for a fixture filing to be perfected in addition to the filing of the financing statement in the method discussed above, a fixture filing is also required to be recorded in the local recorder’s office. Some states allow the fixture filing to be done through the mortgage, so this will be all one document. Other times, if there is no mortgage or the state does not allow these to be combined, the UCC-1 itself will be recorded in the recorder’s office. Since these documents are recorded in the recorder’s office, these typically will appear on a title commitment, but the purchase agreement should make clear that these are liens that are required to be removed at Closing.

One issue for any UCC liens is that these are typically “forgotten” documents during loan negotiations that can have sloppy descriptions of collateral, many of which end up with “all assets of Borrower.” This can create an issue where a financing was used for another property or non-real estate assets, but can be interpreted as attaching to personal property located at the to be disposed of property. Buyers have incentives to interpret these collateral descriptions broadly, which could leave Seller trying to release a lien that was not anticipated as being part of the deal at hand.

Conclusion.

Even though there are many ways that buyers and sellers can allocate liability, this will often be based on the bargaining power between the parties, the motivation of the seller to sell or the buyer to buy, and the willingness to make a deal on both sides. Reps and warranties and downstream liabilities are at the heart of the allocation of risk of properties, and one of the main reasons our clients need our services. Many of the aspects of these negotiated terms can be handled in a creative way that provides a solution for both sides in order to get what they need from the risk perspective.