



COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

APRIL 4, 2012 – APRIL 17, 2012

Representations, warranties in CRE

The scope of the seller representation and warranty provisions in a purchase and sale agreement often is a sticking point during negotiations in a commercial real estate transaction. The seller's representations and warranties are important to the buyer because they serve to confirm the existence or nonexistence of facts and circumstances concerning the seller, the property and operations at the property, all of which are relevant to the buyer's due diligence and analysis of the transaction.

As a general rule, sellers want to minimize their representations and warranties and prefer to sell the property "as is" without any representation or warranty. The law imposes an obligation on a party making a representation to know whether the representation was true. From the buyer's perspective, the more comprehensive the seller's representations, the more information the buyer has in order to evaluate the risks of the transaction and to make an informed decision about whether to purchase the property.

Although the terms "representation" and "warranty" often are lumped together in the purchase and sale agreement, they have distinct meanings. A representation has been defined as a statement of fact made to induce another to enter into an agreement. There are multiple types of warranties potentially applicable to a commercial real estate transaction, including warranties of title, merchantability and fitness for a particular purpose. In the context of representations, the term warranty generally can be understood



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as a promise that the representation was true. Courts have made the following additional distinctions between representations and warranties: 1. A warranty may be presumed to be material, while the burden is on a party claiming breach to show that a representation actually was material; 2. A warranty must be strictly complied with, while substantial truth is the primary requirement for a representation; 3. A warranty is an essential part of an agreement, while a representation is often only a collateral inducement; and 4. An express warranty is usually written on the face of the agreement, while a representation may be written or oral.

A seller's representations in a purchase and sale agreement generally fall into one of three categories:

■ Representations about the seller are designed to give the buyer adequate assurances that the seller has the ability and authority to sell the property before the buyer incurs significant expense conducting due diligence. The following are representations that a seller is commonly asked to make about itself in the purchase and sale agreement: 1. The seller is in good standing in its state of incorporation or organization; 2. The person signing the agreement on behalf of the seller is authorized

to sign, and all consents needed to authorize the contract have been obtained; 3. The signing of the agreement is not prohibited by any other contract and would not result in a default under any other agreement to which the seller is a party; 4. The agreement constitutes the valid and binding obligation of the seller (i.e., the contract is enforceable); 5. The seller is not insolvent or in bankruptcy; and 6. The seller is not a foreign person (goes to tax withholding obligations). Each of these representations regards information that the seller knows or at least should know about itself.

■ Representations about the property require the seller to disclose information about the physical condition and title of the property. The following is a non-exhaustive list of typical representations regarding the status of the property: 1. The seller has good and marketable title to the property; 2. The seller has not granted any third party an option or right of first refusal to purchase the property; 3. There are no pending or threatened condemnation proceedings affecting the property; 4. There are no pending or threatened litigation proceedings affecting the property; 5. There are no violations of applicable laws at the property; and 6. There are no boundary disputes or parties in possession of the property except as disclosed. Additionally, sellers may be asked to make representations regarding environmental conditions and compliance with environmental laws.

■ Representations concerning the operations of the property are particularly important when the

transaction involves an income producing property. Operational representations commonly regard: 1. Whether there are any leases in effect, including lease terms, status of amendments, and whether there are any known breaches by either the landlord or tenant under the lease agreements; 2. Whether the seller's books and records are accurate; 3. Whether service or other contracts affecting the property will be terminated or assigned to the buyer at closing; and 4. The status of planned or needed maintenance or repairs to the property.

Sellers often will take the position that these are due diligence items that should be the responsibility of the buyer. To the extent the seller is willing to make some or all of the representations and warranties identified in this article, the seller may try to limit its representations and warranties to its actual knowledge, or to the actual knowledge of an individual representative of the seller, or may try to minimize how long the buyer has to bring an action for misrepresentation. Ultimately, the scope of the seller's representations and warranties in a commercial real estate transaction is a matter of negotiation between the buyer and seller. Regardless of what representations the seller agrees to make, it is best practices for the buyer to conduct its own comprehensive due diligence, including as to operational issues, when evaluating whether to close on the transaction.▲