

Strategies for Mitigating Risk When Drafting Commercial Real Estate Purchase and Sale Agreements

Presented by Daniel Meyer

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Deposits, Due Diligence & Permitting

- » Primary topics of negotiation regarding deposits: amount, events or deadlines triggering the deposit “going hard” (i.e., non-refundable) or additional deposits needing to be paid. Regardless of when deposit goes hard, remains applicable against purchase price.
- » Buyer’s payment of one or more deposit(s) serves several functions relating to due diligence, permitting and damages under PSAs, in addition to its function as security for Seller’s agreement to negotiate and close on the sale of the property to the Buyer.
- » Multiple deposit structure can provide Buyer flexibility and enable Buyer to pursue a property’s diligence and permitting activities over a longer period, while also providing additional incentive for Seller to enter a longer-term diligence and entitlement process. Such structures are particularly useful for projects involving brownfields and other environmentally sensitive properties, difficult permitting processes, and for multiple-parcel assemblage.
- » In providing Seller’s own diligence materials to Buyer prior to or upon execution of the PSA, Seller will want to limit what it provides to “those materials in Seller’s possession” and/or “under Seller’s reasonable control” and will want to disclaim all liability for anything contained in such Seller-provided diligence. If a Buyer wishes to access the property prior to PSA execution, consider using a Site Access Agreement that includes, but is not limited to, typical indemnification, disclaimer of liability, confidentiality, restoration, insurance, and other matters typically addressed in the PSA itself.



Deposits, Due Diligence & Permitting

- » Controlling access to and dissemination of diligence reports generated during Buyer's diligence will be of importance to Seller, especially with respect to environmental matters.
- » Seller and Buyer can use their negotiation of the permitting provisions of the PSA to implement some degree of control and predictability to the permitting process. Seller will want to consider whether it wants to control and/or monitor the Buyer's permitting, the degree to which Seller wants to assist/cooperate and whether Seller has the right to step in and obtain permits if Buyer is unable.
- » By using a multiple deposit structure, Buyer may be able to limit the money it puts at risk, both in terms of deposit monies and transactional expenses, by having additional deposits become due only after certain milestones have been made or deadlines passed.



Representations, Warranties & Covenants

- » As-Is Clauses and Limitations
 - » Seller looks to include as much “As-Is” language as possible, and Buyer wants to limit the overarching nature of such clauses. Buyer will typically look to the specific Seller reps and warranties to be made by Seller under the PSA to help further erode As-Is clauses, but more on that later.
 - » Example of very Seller-favorable “As-Is” provision with release language:



AS-IS Clauses and Limitations

EXCEPT AS SPECIFICALLY SET FORTH IN THIS AGREEMENT, BUYER REPRESENTS THAT IT IS A KNOWLEDGEABLE AND EXPERIENCED BUYER OF REAL ESTATE AND THAT, IN PURCHASING THE PROPERTY, BUYER SHALL RELY SOLELY ON (I) ITS OWN EXPERTISE AND THAT OF ITS CONSULTANTS, (II) ITS OWN KNOWLEDGE OF THE PROPERTY BASED ON ITS INVESTIGATIONS AND INSPECTIONS OF THE PROPERTY AND (III) THE EXPRESS REPRESENTATION AND WARRANTIES MADE BY SELLER IN PARAGRAPH 10.

THE PROPERTY IS BEING SOLD, AND BUYER IS ACCEPTING POSSESSION OF THE PROPERTY ON THE CLOSING DATE, “AS IS, WHERE IS, WITH ALL FAULTS,” WITH NO RIGHT OF SETOFF OR REDUCTION IN THE PURCHASE PRICE EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT AND EXCEPT FOR SELLER’S REPRESENTATIONS AND WARRANTIES SET FORTH IN THIS AGREEMENT THAT EXPRESSLY SURVIVE THE CLOSING (“SELLER’S WARRANTIES”). EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, INCLUDING SELLER’S WARRANTIES IN PARAGRAPH 10, NEITHER SELLER, ITS COUNSEL, MANAGER OR ANY BROKER, NOR ANY PARTNER, OFFICER, DIRECTOR, MANGER, EMPLOYEE, AGENT OR ATTORNEY OF SELLER, ITS COUNSEL, MANAGER OR ANY BROKER, NOR ANY OTHER PARTY RELATED IN ANY WAY TO ANY OF THE FOREGOING (EACH A “SELLER PARTY” AND COLLECTIVELY, THE “SELLER PARTIES”) HAVE OR SHALL BE DEEMED TO HAVE MADE ANY VERBAL OR WRITTEN REPRESENTATIONS, WARRANTIES, INFORMATION, PROMISES OR GUARANTEES (WHETHER EXPRESS, IMPLIED, STATUTORY OR OTHERWISE) TO BUYER WITH RESPECT TO THE PROPERTY, ANY MATTER SET FORTH, CONTAINED OR ADDRESSED IN THE DILIGENCE DOCUMENTS (INCLUDING, BUT NOT LIMITED TO, THE ACCURACY AND COMPLETENESS THEREOF) OR THE RESULTS OF THE INVESTIGATIONS.



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Representations, Warranties & Covenants

- » Buyer's counsel will seek to limit the above language as much as possible but will also seek to further limit the use of specific Seller representations and warranties in the PSA, such as Seller's knowledge of certain unfavorable conditions, occurrences, notices, threatened government actions, including takings, and the like.
- » Buyer will seek to have a "Bring-Down Certificate" signed and delivered by Seller at Closing, certifying that Seller's reps and warranties made in the PSA remain accurate as of the Closing Date.
- » Use of Disclosure Schedules for Carveouts
 - » The practice of using so-called "Disclosure Schedules" to carve out specific matters from Seller's express reps and warranties made in the PSA is one that is more commonly seen in M&A transactions involving an operating company's assets being acquired.
 - » The schedules are attached to the PSA, refer back to the specific subsection of each Seller rep and warranty that the disclosed matters are being carved out from, and allow Seller to voluntarily disclose known issues, thereby mitigating liability post-closing.
 - » For example: *10. D. Except as set forth in Schedule 10. D hereto, Seller has not received written notice of any litigation or administrative agency or governmental or quasi-governmental proceeding pending with respect to the Property or Seller that would materially and adversely affect the value of the Property or Seller's ability to consummate the transactions contemplated by this Agreement. To Seller's knowledge, there are no threatened actions, suits or proceedings against the Property or any portion thereof.*



Representations, Warranties & Covenants

- » “Knowledge” Standards for Reps & Warranties
 - » The above example of a Seller rep and warranty relating to the receipt of government notices provides a good segue to another oft-disputed issue in the drafting of PSAs: the “knowledge” standard of Seller.
 - » Why is it important? In making whatever, preferably limited, reps and warranties in the PSA, Seller will want to limit the standard of duty imposed on it to discover and disclose matters that could impact the truth and accuracy of Seller’s reps and warranties.
 - » In addition to limiting the reps and warranties to one or more designated representatives of Seller (usually a principal or other employee of Seller with the most knowledge of such matters) and including language expressly limiting the liability of such designated representative, Seller’s counsel will seek to add language along the lines of:
 - » To the best of Seller Representative’s actual knowledge, without any duty to conduct inspections or further investigate any matters addressed in any report whether in the form of Seller’s Diligence or Buyer’s Diligence, there are no...
 - » Buyer’s counsel will seek to push back and obtain a compromise on the “knowledge” standard used, especially in an otherwise As-Is deal.



Representations, Warranties & Covenants

» Rep & Warranty Insurance Policies

- » Like the use of Disclosure Schedules, the growth in Sellers' use of rep and warranty insurance policies on CRE deals largely finds its roots in the M&A world, where such policies have become commonplace over the past two decades.
- » Insurer essentially underwrites the risk profile of the diligence materials and matters produced during the early stages of a deal and weighs it against the specific reps and warranties (including knowledge standards and duties, any use of disclosure schedules as carveouts, etc.) to come up with a policy rate.
- » While such policies can offer additional piece of mind for Sellers, they are not without material costs and, as such, are typically only seen on larger deals involving more complex assets or issues.



Environmental Liability, Insurance, and ELURs

- » The transfer of environmentally sensitive properties and the attendant allocation of liability for the post-transfer performance and expenses of RECs and their remediation and monitoring are a vigorously negotiated topic in PSAs. Seller will, of course, seek to disclaim and terminate liability, to the extent possible under applicable federal and state laws and regulations, as of the Closing.
- » Similar to our discussion of rep and warranty insurance, insurers perform risk assessments based upon, among other factors, the property's environmental history, present condition, the relative creditworthiness of the various parties, degree of involvement/oversight of any federal and/or state agencies in the remediation and monitoring activities, etc., weigh the risk profile against the provisions of the PSA dealing with environmental liability and obligations, and determine a policy rate.
- » A discussion of Environmental Land Use Restrictions (ELURs) and the Bona Fide Prospective Purchaser (BFPP) process would easily take more time than we've been allotted for this presentation, so if you're involved in a transaction where environmental matters are a known or potential concern, there are tools available to ensure a more predictable allocation of liabilities as between prior owners, Seller and the Buyer.



Remedies, Damages & Survival Periods

- » Deposit(s) often become “liquidated damages” under PSAs
- » *If Buyer is in breach or default under this Agreement prior to Closing, and such default is not cured within five (5) business days after written notice thereof from Seller to Buyer (except for the failure to pay the Deposit within three (3) days after it is due and the balance of the Purchase Price at Closing, which in each case shall be a default without notice or opportunity to cure), the Deposit shall be delivered by Escrow Agent to Seller as liquidated damages as Seller’s sole and exclusive remedy for Buyer’s breach or default, whereupon this Agreement shall terminate and the parties shall have no further obligations to each other except for such provisions that specifically survive the termination of this Agreement. Seller and Buyer acknowledge that it would be extremely impractical and difficult to ascertain actual damages that would be suffered by Seller if Buyer fails to consummate the purchase of the Property as and when contemplated by this Agreement. This liquidated damages provision shall not limit Seller’s right to (i) receive reimbursement for or recover damages in connection with any obligations of Buyer that survive the Closing or the termination of this Agreement (such as the indemnities set forth in Paragraphs 5.F and 19.F) or (ii) pursue any and all remedies available at law or in equity in the event that, following any termination of this Agreement, Buyer or any party related to or affiliated with Buyer asserts any claims or right to the Property that would otherwise delay or prevent Seller from having clear, indefeasible and marketable title to the Property. Seller waives any right to require Buyer to consummate the sale contemplated in this Agreement.*



Remedies, Damages & Survival Periods

- » Seller will look to cap its potential damages for its breach of the PSA to forfeiture of the Deposit back to Buyer, may agree to some reimbursement of Buyer's expenses in certain limited circumstances and subject to a cap, and will fight Buyer's attempts to include specific performance remedy.
- » Conversely, Buyer will typically want to limit damages for its breach to forfeiture of its Deposit to Seller as liquidated damages and may waive its right to seek specific performance against Seller in return.
- » Both parties should seek to mitigate potential future liability by using limited survival periods (both in duration and scope of what survives), damages caps, strengthening (or loosening) of knowledge, duty to inspect and other standards in the PSA, and limiting liability to, for example, Seller's interest in the subject Property and no other assets of Seller or its principals and shareholders.



Questions?

Thank You

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