

## **THE DANCE OF NEGOTIATIONS: What Gets Left In and What Gets Left Out**

### **1. Representations & Warranties: (EW)**

- (a) How inclusive should the list be?
- (b) Limiting to Seller's knowledge:
  - (i) When is "knowledge" the appropriate standard and when should a Purchaser rightly insist on an absolute standard? (e.g. environmental reps. v. contracts and leases)
  - (ii) How is "knowledge" defined? (e.g. some Sellers want to limit knowledge to the "knowledge" of a list of critical people who are deeply involved in the property rather than all persons comprising the Seller, some of whom may be passive investors with little interaction with the property in question)
- (c) Who backs up the reps and warranties? If Seller is an SPE then what entity will still be around with sufficient net worth after the closing is completed? This can be handled with an escrow of a portion of closing proceeds (which Sellers are reluctant to do) or an indemnity from a parent entity which will survive closing.
- (d) "Baskets" and "Caps". A Seller's preference is to set a threshold for claims (e.g. don't come to me post-closing unless your total claims equal at least \$\_\_\_\_\_ ) and also a cap to maximize their total exposure on the deal. Also, should any Seller breaches be exempt from these limitations?
- (e) How long do reps & warranties survive closing?
- (f) Consistency between closing documents and the reps & warranties section of the Purchase Agreement. As a Purchaser, make sure the limitations in the document (including any "As-Is" provision) don't undermine reps & warranties in the closing documents (e.g. your warranty deed) and as a Seller make sure the reps & warranties in the closing documents don't create more potential liability than you negotiated for in the body of the document.
- (g) OFAC Reps. Originally these started showing up in loan documents but they are common in purchase agreements now too. The prohibition against dealing with persons on the government's restricted lists is an absolute, strict liability standard BUT you can minimize your potential liability by demonstrating that you used good faith efforts to avoid dealing with these people. The (untested) theory is that by requiring these representations & warranties you are creating evidence of your good faith efforts to avoid trouble.

## 2. **Leasing: (DA)**

Fundamental Issue: Who controls the business inherent in the property between the time a purchase agreement is entered into and the closing? Control is generally divided in accordance with true economic interest in the property. The Purchaser does not want the Seller making bad business decisions which the Purchaser will suffer disproportionately for years after the sale. The Seller does not want to risk passing up opportunities for a transaction that may not close.

(a) What approval rights does the Purchaser have with respect to Leases being negotiated during due diligence period?

During this period, the Purchaser has nothing other than its investigation costs at risk, so the Seller retains substantial control. But because leasing affects the value of the property, it generally must notify the Purchaser of actions with respect to leases.

(b) What approval rights does Purchaser have with respect to Leases being negotiated during period following due diligence but prior to closing?

During this period the Purchaser generally has committed to purchasing the property and has earnest money at risk and therefore often has the right to approve leases, but not to compel the Seller to enter into leases. At this point, the Purchaser may have a greater economic interest in the property than the Seller.

## 3. **Tenant Estoppels: (JG)**

(a) What percentage of total is required? Any “key” tenants?

(b) Whose form do you use?

(c) Does Purchaser review estoppels before they are sent out to tenants?

(d) What is standard of review for completed estoppels (must a Purchaser be “reasonable” in accepting any discrepancies? Limit Purchaser objections to a materiality standard?)

(e) Is failure to obtain estoppels a default by Seller or merely a failure of a closing condition?

(f) If not enough tenant estoppels are obtained, will Purchaser accept a Seller estoppel?

(i) How long does Seller estoppel survive?

(ii) Who stands behind Seller estoppel?

(iii) Is liability under Seller estoppel carved out from basket and cap?

4. **Confidential Information: (EW)**

- (a) Is a separate confidentiality agreement necessary? It is a very good idea if you are going to be providing information about the property to the Purchaser prior to definitive purchase agreement being signed. These agreements can cover a range of items from documents delivered by the Seller to the results of any investigations undertaken by the Purchaser prior to purchase agreement execution.
- (b) To whom does confidentiality extend?
  - (i) What standard of care does a Purchaser have to take to maintain confidentiality? Some Sellers want a Purchaser to require all parties with whom the information is shared (e.g. lawyers, lenders, accountants etc.) to sign a confidentiality agreement. Most Purchasers consider this overkill and agree only to inform such third parties of the confidential nature of the materials.
- (c) Return of documents by Purchaser if transaction is terminated.
  - (i) Can Purchaser keep copies of anything?
  - (ii) Is Seller entitled to copies of reports ordered by Purchaser?
  - (iii) Should Seller be required to pay for such reports?

5. **Prorations: (DA)**

Fundamental issue: How do we adjust the closing payment on account of certain assets and liabilities that are associated with the land and may vary over time? Prorations allow for a fixed purchase price to be agreed on, subject to prorations. A few examples:

- (a) Taxes paid in arrears. Really a convention that assigns tax payments to the prior calendar year.
- (b) Prorations under leases may differ from prorations with respect to the purchase, e.g. if the tenant pays taxes on a cash basis but prorations are done on an accrual basis.
- (c) Leasing commissions and TI. These may have been paid up front, so generally the Seller is entitled to a credit for the unamortized portion.
- (d) Operating expense pass-throughs. Purchaser may want to true these up after closing if there is a significant risk that the Seller has been overcollecting.

6. **Earnest Money: (JG)**

Purpose of earnest money is first to show evidence that the Purchaser has the wherewithal to complete the purchase, and second, to give the Purchaser an incentive to close and compensate the Seller adequately if the Purchaser fails.

(a) Cash v. Letter of Credit.

Most Sellers are indifferent between the two, but (i) dealing with LCs is slightly more complicated, for example, the Seller should be sure the letter of credit is truly unconditional, and (ii) the letter of credit may put the Seller in a better position in the event of a Purchaser bankruptcy. If the letter of credit is to be placed in escrow (which is preferable to the Purchaser but not to the Seller) the Seller must take care to assure that the escrowee (usually the title company) can and will draw on the letter before it expires and place the funds in the escrow pending the resolution of any dispute.

(b) Terms of Escrow Agreement. Do both parties have to agree to release if Purchaser terminates before the end of due diligence or can Purchaser's order to return be unilateral up to that date?)

Generally Purchaser has the unilateral right to get its earnest money back in such circumstances, but the Seller could make an argument that it may have been damaged by Purchaser's actions during its inspection and therefore should have a say in the disposition of the earnest money.

(c) When are funds released to Seller?

Generally Seller becomes entitled to the earnest money if Purchaser is obligated to close and fails to close. Because there can be arguments over whether the Purchaser was really obligated to close, the earnest money is often kept in a joint order escrow so that the earnest money is preserved while any such dispute is resolved.

(d) To what extent does earnest money become non-refundable?

The longer the due diligence period, the stronger Seller's argument that some of the earnest money should become non-refundable, to be sure that Purchaser is fully diligent during that period, and to the extent earnest money does become non-refundable, Seller will argue that it should be remitted to Seller

7. **As-Is Where-Is Language: (EW)**

(a) How much is enough? 1 sentence v. 2 pages. Some sample language (long form and short) is attached as Exhibits 1 and 2.

8. **Title Objections: (DA)**

Title objection process sometimes allows title and survey review to lag (or in some cases to be finished sooner than) other due diligence; until the state of title has been agreed on there is really usually not yet a deal.

(a) Seller's obligations to cure. Often limited to monetary liens of a definite and ascertainable amount on the assumption that under no circumstances should these exist with respect to a well run property.

(b) Permitted Exceptions that are attached or described generally represent an attempt to limit the Purchaser's ability to get out of a deal on the pretense of title objections. But the many things that could affect title make Purchasers reluctant to agree to any type of encumbrance prior to due diligence.

(c) When does the state of title need to be agreed on? Purchasers prefer to preserve rights to walk for as long as possible, while Sellers have the opposite incentive.

9. **Remedies for default: (JG)**

Seller's remedy for Purchaser's default is typically the full amount of Purchaser's earnest money. Often, the contract will state that the earnest money will serve as liquidated damages. Now the questions arise, as indicated in the earnest money section above, whether Seller can easily obtain the earnest money and whether it will adequately compensate Seller for loss of time and other opportunities.

Purchaser's remedies are more complicated:

(a) The remedy of rescission will often be included; Purchaser can obtain the simple return of its earnest money.

(b) The remedy of specific performance is also typically included so long as Purchaser is willing to waive or compromise Seller's unintentionally unperformed obligations.

(c) The remedy of a reliance measure of damages is almost always contested. Purchaser will want to cover the possibility that Seller may intentionally diminish the value of the asset and thwart the closing. For that purposes, Purchaser may insist that Purchaser should have the option to receive not only the return of the earnest money and Purchaser's incurred expenses, but also a liquidated sum, perhaps related to the amount of the earnest money Purchaser has supplied. Seller may resist altogether, but will certainly want to eliminate a consequential or punitive damage calculation, and to limit Purchaser's recovery to circumstances in which Seller's default is willful.

10. **Miscellaneous additional issues: (JG)**

(a) What about proration of rent abatements, brokerage commissions, tenant improvement costs? Proration of percentage rents only after final collection?

(b) How would the parties address transfers structured as purchases of the interests in the owning entity, where Purchaser would need to address status of that entity, the liabilities of that entity, and indemnities respecting post closing issues with that entity?

(c) Would Seller agree to allow Purchaser to select the title company, including coinsurance and reinsurance arrangements. What about title endorsements? Who pays?

(d) Should the contract require Seller to cooperate with Purchaser in connection with Purchaser's obligation to provide an audit?

- (e) What about arrangements respecting liquor licenses and any other important governmental permission which is not transferable?
- (f) How should the parties address existing loans burdening the property. If they are to be prepaid, who pays the prepayment premium? If they are to be assumed, who pays the assumption fee, if any? Who takes the risk that the lender may exercise its right not to approve the assumption?
- (g) What should be included in Purchaser's laundry list of due diligence items to be reviewed? Many effective Purchasers provide an extensive laundry list, tailored to project type, assuming that Seller will resist to the extent it genuinely lacks documentation. The theory of those Purchasers is that they will be confident relying on their own underwriting if they have a complete factual basis for it, and they can also be more flexible in negotiating Seller's representations and warranties.
- (h) What about estoppels for covenants, conditions and restrictions of record?
- (i) Who pays for transfer taxes? What is the law? What is the custom? Who has greater leverage in the contract negotiations?
- (j) What about brokers' commissions payable upon conditional future events such as a tenant's exercise of a lease extension right?
- (k) Should Purchaser be entitled to operating statements for the property going back three years? Material correspondence in connection with the property with tenants and otherwise? Updated rent rolls at closing? Confirmation by Seller that there are no defaults under assumable service contracts? That there are no Seller employees?
- (l) What about tombstone advertising? Must the parties agree?
- (m) What about e-mail notice? Is that adequate? Must it be confirmed by a more conventional method?
- (n) What will the Seller and the Purchaser require in the form of an ERISA representation by the other party?

**EXHIBIT 1**

**LONG FORM**

(a) EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES EXPRESSLY PROVIDED IN PARAGRAPH 9.1 ABOVE, BUYER AGREES (I) THAT IT IS PURCHASING THE PROPERTY ON AS “AS IS, WHERE-IS” BASIS AND BASED ON ITS OWN INVESTIGATION OF THE PROPERTY, (II) THAT NEITHER SELLER NOR SELLER’S EMPLOYEES, AGENTS, BROKERS, REPRESENTATIVES, MANAGERS, PROPERTY MANAGERS, ASSET MANAGERS, OFFICERS, PRINCIPALS, ATTORNEYS OR CONTRACTORS (COLLECTIVELY, “SELLER’S REPRESENTATIVES”) HAVE MADE ANY WARRANTY, REPRESENTATION OR GUARANTEE, EXPRESS, IMPLIED OR STATUTORY, WRITTEN OR ORAL, INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR ANY USE OR PURPOSE OR OF REASONABLE WORKMANSHIP, CONCERNING THE PROPERTY OR ANY OF THE PRODUCTS OR IMPROVEMENTS LOCATED THEREON OR THEREIN (INCLUDING, WITHOUT LIMITATION, THE BUILDING), AND (III) THAT NEITHER SELLER NOR SELLER’S REPRESENTATIVES HAVE MADE ANY WARRANTY, REPRESENTATION OR GUARANTEE AS TO ANY GOVERNMENT LIMITATION OR RESTRICTION, OR ABSENCE THEREOF, PERTAINING TO THE PROPERTY, OR AS TO THE PRESENCE OR ABSENCE OF ANY LATENT DEFECT, SUBSURFACE SOIL CONDITION, ENVIRONMENTAL CONDITION, HAZARDOUS SUBSTANCE, TOXIC WASTE OR ANY OTHER MATTER PERTAINING TO THE PHYSICAL CONDITION (TITLE, MAPPING, GRADING, CONSTRUCTION, OR OTHERWISE) OF THE PROPERTY. DURING THE DUE DILIGENCE PERIOD, BUYER INTENDS TO BECOME FAMILIAR WITH THE PROPERTY AND ITS SUITABILITY FOR BUYER’S INTENDED USE. BUYER ACKNOWLEDGES THAT BUYER WILL BE PROVIDED ACCESS TO THE PROPERTY, AND WILL HAVE AN ADEQUATE OPPORTUNITY TO REVIEW ANY AND ALL ASPECTS OF THE PROPERTY BUYER DEEMS RELEVANT TO ITS DECISION TO PURCHASE THE PROPERTY, INCLUDING THE “DOCUMENTS” (AS DEFINED BELOW).

(b) EXCEPT FOR THE REPRESENTATIONS AND WARRANTIES EXPRESSLY PROVIDED IN PARAGRAPH 9.1 ABOVE, ALL OF SELLER’S AND SELLER’S REPRESENTATIVES’ STATEMENTS WHENEVER MADE, ARE MADE ONLY AS AN ACCOMMODATION TO BUYER AND ARE NOT INTENDED TO BE RELIED OR ACTED UPON IN ANY MANNER BY BUYER. ALL DOCUMENTS, RECORDS, AGREEMENTS, WRITINGS, STATISTICAL AND FINANCIAL INFORMATION AND ALL OTHER INFORMATION

**(COLLECTIVELY, “DOCUMENTS”) WHICH HAVE BEEN GIVEN TO BUYER BY SELLER, OR SELLER’S REPRESENTATIVES, HAVE BEEN DELIVERED AS AN ACCOMMODATION TO BUYER AND WITHOUT ANY REPRESENTATION OR WARRANTY (EXCEPT AS SPECIFICALLY PROVIDED ABOVE) AS TO THE SUFFICIENCY, ACCURACY, COMPLETENESS, VALIDITY, TRUTHFULNESS, ENFORCEABILITY, OR ASSIGNABILITY OF ANY OF THE DOCUMENTS, ALL OF WHICH BUYER RELIES ON AT ITS OWN RISK. BUYER ACKNOWLEDGES THAT NEITHER SELLER NOR SELLER’S REPRESENTATIVES HAVE MADE ANY REPRESENTATION REGARDING THE AVAILABILITY OF, OR AMOUNT OF, ANY FEE, ASSESSMENT, OR COST RELATING TO THE DEVELOPMENT, CONSTRUCTION, MAPPING, ACCESS, OCCUPANCY OR OWNERSHIP OF THE PROPERTY.**

**(c) BUYER HEREBY EXPRESSLY RELEASES SELLER GROUP FROM ANY AND ALL CLAIMS, LOSSES, PROCEEDINGS, DAMAGES, CAUSES OF ACTION, LIABILITY, COSTS OR EXPENSES (INCLUDING ATTORNEYS’ FEES) ARISING FROM, IN CONNECTION WITH OR CAUSED BY (a) BUYER’S RELIANCE UPON ANY OF THE DOCUMENTS OR STATEMENTS, REPRESENTATIONS OR ASSERTIONS CONTAINED THEREIN, (b) INACCURACY, INCOMPLETENESS OR UNRELIABILITY OF ANY OF THE DOCUMENTS. EXCEPT WITH RESPECT TO A BREACH BY SELLER OF ANY REPRESENTATION OR WARRANTY EXPRESSLY CONTAINED HEREIN, BUYER AND AFFILIATES OF OR PARTIES RELATED TO BUYER (BUT NOT UNRELATED SUCCESSORS OF BUYER) HEREBY WAIVES, RELEASES AND FOREVER DISCHARGES SELLER, ANY SHAREHOLDER, OFFICER, DIRECTOR, EMPLOYEE, AGENT OR PERSON ACTING ON BEHALF OF SELLER AND ANY AFFILIATE OF SELLER (THE “SELLER GROUP”) OF AND FROM ANY AND ALL CLAIMS, ACTIONS, CAUSES OF ACTION, DEMANDS, RIGHTS, DAMAGES, LIABILITIES AND COSTS WHATSOEVER, DIRECT OR INDIRECT, KNOWN OR UNKNOWN, WHICH BUYER NOW HAS OR WHICH MAY ARISE IN THE FUTURE, AGAINST THE SELLER GROUP RELATED IN ANY WAY TO THE PROPERTY. BUYER HEREBY AGREES NOT TO ASSERT ANY CLAIM FOR CONTRIBUTION, COST, RECOVERY OR OTHERWISE AGAINST SELLER OR ANY SUCH AFFILIATE RELATING DIRECTLY OR INDIRECTLY TO THE PHYSICAL CONDITION OF THE PROPERTY INCLUDING, WITHOUT LIMITATION, THE EXISTENCE OF OIL, LEAD PAINT, ASBESTOS, MOLD OR HAZARDOUS MATERIALS OR SUBSTANCES ON, OR THE ENVIRONMENTAL CONDITION OF, THE PROPERTY, WHETHER KNOWN OR UNKNOWN. THE PARTIES AGREE THAT ALL UNDERSTANDINGS AND AGREEMENTS HERETOFORE MADE BETWEEN THEM OR THEIR RESPECTIVE AGENTS OR REPRESENTATIVES ARE MERGED IN THIS**

**AGREEMENT AND THE EXHIBITS HERETO ANNEXED, WHICH ALONE FULLY AND COMPLETELY EXPRESS THEIR AGREEMENT, AND THAT THIS AGREEMENT HAS BEEN ENTERED INTO AFTER FULL INVESTIGATION, OR WITH THE PARTIES SATISFIED WITH THE OPPORTUNITY AFFORDED FOR INVESTIGATION, NEITHER PARTY RELYING UPON ANY STATEMENT OR REPRESENTATION BY THE OTHER UNLESS SUCH STATEMENT OR REPRESENTATION IS SPECIFICALLY EMBODIED IN THIS AGREEMENT OR THE EXHIBITS ANNEXED HERETO.**

## **EXHIBIT 2**

### **SHORT FORM**

The Property shall be accepted by the Purchaser on an “AS IS, WHERE IS” condition and “WITH ALL FAULTS” as of the date of this Agreement and of Closing. Except as expressly set forth in this Agreement or in the conveyance documents delivered to Purchaser at Closing, no representations or warranties have been made or are made and no responsibility has been or is assumed by Seller or by any partner, officer, person, firm, agent, attorney or representative acting or purporting to act on behalf of Seller as to (i) the condition or state of repair of the Property; (ii) the compliance or non-compliance of the Property with any applicable laws, regulations or ordinances (including, without limitation, any applicable zoning, building or development codes or any environmental laws); (iii) the value, expense of operation, or income potential of the Property; or (iv) any other fact or condition which has or might affect the Property or the condition, state of repair, compliance, value, expense of operation or income potential of the Property or any portion thereof.