

Use of Special Covenants, Representations, Warranties & Indemnification Provisions in Commercial Real Estate Agreements

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**USE OF SPECIAL COVENANTS, REPRESENTATIONS,
WARRANTIES AND INDEMNIFICATION PROVISIONS
IN COMMERCIAL REAL ESTATE AGREEMENTS**

I. INTRODUCTION

The purpose of this presentation is to briefly discuss the use of special covenants, representations, warranties and indemnifications in a typical commercial real estate purchase agreement. Sometimes these provisions are appropriate; sometimes they are not. Buyers and Sellers can easily confuse special covenants, representations, warranties and indemnification provisions; consequently, they are misused. The use of these provisions should be tailored to fit the transaction:

- A. Undeveloped land;
- B. Income producing property such as apartment buildings or shopping centers;
- C. Improved property that is used in connection with a business such as a manufacturing or distribution center;
- D. Property with existing improvements that will be rehabilitated for another purpose.

Each raises unique concerns and a "boilerplate" set of provisions will not always work.

II. SPECIAL COVENANTS

- A. General - The entire purchase agreement is a covenant made by and between the parties. A covenant has been defined as follows:

An agreement or promise of two or more parties that something is done, will be done, or will not be done. Shafer v. Board of Trustees of Sandy Hook Yacht Club Estates, Inc., 76 Wash. App. 267, 274, 883 P.2d 1387, 1392 (Wash. App. 1994).

- B. "Special" covenants are included in the purchase agreement to address concerns of a party related to a particular transaction - Examples:
 - 1. Seller's obligation to produce certain documentation prior to closing;
 - 2. Seller's obligation to obtain a "no action" letter from the MPCA; or
 - 3. Buyer's obligation to use its "best efforts" to obtain financing or re-zoning.

C. Remedies for Pre-Closing Breach of a Covenant

1. Seller breach:

- a. Termination and earnest money returned;
- b. Buyer's right to cure and deduct;
- c. If appropriate, damages;
- d. Specific performance; and
- e. Delay closing if necessary.

2. Buyer breach:

- a. If the breach is **failure to close**, (i) terminate and retain earnest money as liquidated damages - It is important that the Buyer be required to put up substantial earnest money to make this remedy effective, or (ii) **as an alternative**, in the right situation, specific performance; the right to seek specific performance against a nonperforming Buyer can be a hollow right unless the Buyer is a solvent.
- b. **In addition to Section 2a above**, retain right to claim damages for breach of special covenant. Example - Buyer causes damage during physical inspection, Buyer does not close, but Buyer has caused damage to property. Seller should have right to recover damages for breach of special covenant in addition to retaining the earnest money.

D. Remedies for Post-Closing Breach of Covenant - Avoid any post-closing covenants if possible.

1. Damages;
2. If Seller obligation - The best protection for Buyer is to have part of the purchase price escrowed until Seller performs;
3. If Buyer obligation - Quantify the obligation, if possible, and try to get funds escrowed.

III. REPRESENTATIONS

A. Background. Why give any? Is there a duty to disclose? Is it wise to make representations?

1. Doctrine of Caveat Emptor

"Doctrine of caveat emptor" states that where parties deal at arm's length, and each exercises or relies on his own judgment, Buyer, having opportunity to do so, ought to inspect thing bought and learn whatever a fair examination will disclose and, if he neglects to avail himself of his opportunity and right to inspect, or if he makes an inspection but fails to note discoverable defects, he buys at his own risk, unless he exacts a warranty or can show fraud on part of Seller. Permian Bldg., Inc. v. Greenblatt, 442 S.W.2d 831, 835 (Tex. Civ. App. 1969).

2. Minnesota Case Law Concerning Representations

a. What is actionable?

(1) Fraudulent and negligent misrepresentation. In Minnesota, "an actionable misrepresentation requires proof either that the misrepresenter acted dishonestly or in bad faith, i.e. with fraudulent intent, or, alternatively, that the misrepresenter was negligent." Florenzano v. Olson, 387 N.W.2d 168, 173 (Minn. 1986)

(a) According to Florenzano, to recover in an action for fraudulent misrepresentation (paralleling Restatement (Second) of Torts § 526 (1977)), the misrepresenter must either know or believe the matter not to be as represented or be conscious of ignorance of truth, or realize that the information relied upon by the misrepresentee is not dependable. Id.

(b) By contrast, the Florenzano court stated that to prevail in an action for negligent misrepresentation, the misrepresentee must prove that the misrepresenter failed to discover or communicate certain information that an ordinary person in his position would have discovered or communicated. Id.

Under neither theory, however, is one held to warrant the truth of all statements made. A good faith, non-negligent mistake is not the basis of liability for misrepresentation in this state.

