No topic seems more vigorously debated in the real property purchase agreement than the representations and warranties of the Seller. Each side pursues its self-serving objectives:

Buyers want the broadest, most comprehensive warranties available. An expansive, absolute warranty protects against defects known or unknown and provides maximum protection to the Buyer after closing. Buyer’s use warranties to: 1.) Force disclosure of material or latent property information, whatever their source 2.) Force disclosure of what the Seller knows or should know 3.) Protect the Buyer from unknown and unwanted liability 4.) Provide a Buyer remedy for affirmative fraud, misrepresentation or the breach of warranty.

In contrast, Sellers seek to narrow and limit the scope of warranties. The less that is represented the better. The Seller seeks to 1.) Shift responsibility for obvious and recognizable problems to the Buyer. 2.) Avoid liability for unknown property defects 3.) Transfer title without lingering liability 4.) Limit the scope, cost and time of the Seller’s post-closing obligations.

The breadth and depth of the Seller’s representations and warranties depends on the market conditions, the perceived quality of the property and the Seller’s general reputation. I outline basic types of warranties seen in common purchase agreements, moving from Buyer’s warranties to Seller’s warranties. Generally, parties will find a common ground someplace between the two.

Buyer’s Warranties

1.) The Absolute Warranty

“There are no notices, violations, defects, or lawsuits affecting the property,” is an absolute warranty. The Seller warrants the condition of the property with no limitation or offset. To warrant “no defects” is akin to a standard of strict Seller liability. The Seller is on the hook regardless of the fault or negligence of the Buyer. An absolute warranty is rare, but often happens when the Seller has a tainted property with no other way of selling.

2.) The Best of Seller’s Knowledge
A Seller’s warranty is made "to the best of seller's knowledge." This includes what the seller actually knows at the time of the agreement plus what he or she “should have known” after a reasonable investigation. This creates a burden for the Seller to investigate. What is reasonable? What should the Buyer know? Under this warranty, the Seller has a duty to perform a search to uncover reasonable defects or problems.

3.) Exhaustive Warranty List

An alternative to warranting everything is to list almost everything. A list of Seller warranties might include the following:

a) Seller has good and marketable title to the Property, and Seller has the unrestricted power and authority to convey the Property to Buyer;
b) All documents provided by Seller, including but not limited to rent rolls and financial statements are true and correct;
c) Seller has no notice or knowledge that any tenant of the property is the subject of a bankruptcy or insolvency proceeding.
d) Seller possesses all licenses, permits, and government approvals necessary for operation of the Property;
e) The Property is not in violation of any zoning, land-use, environmental, public health, or safety laws;
f) There are no unsatisfied mechanics’ or materialmens’ lien rights concerning the property.
g) No litigation affecting the Property is pending or currently threatened;
h) The HVAC, plumbing, electrical, mechanical, and other systems of the building will be in good order and operating condition as of the close of escrow;
i) Seller is not aware of any pending or threatened condemnation proceeding affecting the Property;
j) Seller or its agents, lessees or assignees have not discharged or permitted the storage on the Property of any hazardous materials, and Seller is not aware of any discharge or storage of hazardous materials on the Property by any other persons.

Seller’s Warranties.

1.) Positive Nonrepresentations

"Seller does not represent or warrant that the parking lot is in good condition." This is an example of a positive nonrepresentation. These representations do little to protect anyone and absorb a lot of space, especially when repeated for numerous items. Some attorneys make a career of "positive nonrepresentations." It reminds me of the character “Mr. No” who says no to everything. Nonrepresentations are repeated over and over.

2.) The Negative Representation Warranty

The Seller absolutely warrants the knowledge they do not have. These types of warranties also absorb a lot of space, but do little to protect anyone. The Seller avoids reference to
what they know by documenting only that they do not know, even if they should know it. “Seller has received no notices of violations, suits or proceedings” is an example. This does not mean that violations, suits or proceedings do not exist. It only means that the Seller has received no notice. For most Buyers, such a warranty is also inadequate.

3.) The Seller’s Actual Knowledge

The Seller’s “actual” knowledge is often poised as a compromise warranty. This warranty includes only matters that the seller actually knows. Often, the important clause “actual knowledge” is joined to “with no duty of inquiry.” The Seller rids itself of the duty to perform further investigation, even if it would be reasonable under the circumstances. I have seen this operate in powerful ways, where the Seller has no duty to inquire whether the property is contaminated or the mechanical systems are in order, but if the Seller happens to know, they are required to disclose it. Some courts will construe actual knowledge to include a duty to inquire where “.. with no duty of inquiry” is missing.

Institutional Sellers often limit "actual knowledge" warranties to only specific people (who know something about the property) in the organization. This prohibits liability from attaching for the incidental knowledge which may be floating around the organization somewhere. However, it may also create a loophole for undesirable property information that is intentionally funneled to uninformed people to avoid disclosure. “Actual knowledge” should include information from any source, oral or written, including environmental remediation, seismic work or condemnation proceedings.

A further narrowing of the representation comes from the term “actual, current knowledge.” Actual, current knowledge is defined to exclude knowledge from prior to the Seller’s acquisition or active involvement in the property. Acts/omissions of predecessors of the Seller or information which is in the possession of the Seller generally or incidentally, but over which Seller’s representatives are not aware, is excluded.

4.) The Limited Absence of Warranties

Often, Sellers draft the contract to represent the Buyer is purchasing the property without the reliance on any representations or warranties, except as specifically stated. Basic warranties may include a representation that the property is not the subject of litigation or that the Seller entity has authority to enter an agreement.

5.) The “As Is, Where Is” Sale

The bottom of the scale and most desirable to the Seller is the “AS IS” “WHERE IS” sale. But even a blanket “as is” clause will not protect a Seller, especially in the face of an unsophisticated, nondiligent buyer. Under California law, the Seller maintains an independent duty to disclose any facts materially affecting the value or desirability of the property that would not be apparent to the buyer on inspection of the property. A Seller
who intentionally withholds material documents or latent property defects is unlikely to prevail before a California jury, regardless of an “As Is” clause. It is neither a “get out of jail free card” for wishful Sellers nor an all purpose Seller fraud shield. In short, the disavowal of contractual warranties does not eliminate a Seller’s disclosure obligations.

However, there are decisions which hold the existence of an “as is” clause imposes a greater duty upon the Buyer to investigate the property during the due diligence period.

Compromise

Buyers and Sellers often compromise around their reasonable expectations of what the other party should do. Seller’s limit their warranties to areas which are not discoverable by the Buyer’s due diligence. If the Buyer could find out on their own, why should be Seller risk making a representation? On the other hand, a Seller representation, if it is accurate and expensive to procure, can save the buyer time and money. There is a culture of Seller’s disclosing all reports in their possession, even if the reports are dated.

Narrowing Warranties

Sellers can effectively narrow the scope of a warranty by limiting its duration. For instance, a common warranty is for the Seller to warrant building conditions for one year after close of escrow. Problems with leases are usually discovered within a year; however, environmental problems may take longer to discover. The problem that arises one year and one day after closing becomes the obligation of the Buyer.

Another Seller narrowing strategy is to create a floor or ceiling before any damages are paid. Thus, a buyer’s action for breach of a representation or warranty is prohibited until buyer's out-of-pocket damages exceed $10,000 or other agreed upon amount. The damages may not exceed $200,000 or other agreed upon amount.

Parties might eliminate damages as a remedy entirely. For instance, I recently negotiated a contract with a large REIT where the Buyer’s damages where limited to specific performance of the contract and no economic damages.

Certificate of Closing

All warranties are made as of a specific signing date of the contract. Matters affecting the property may change during the escrow period. Hence, representations and warranties should be reaffirmed by certificate on closing. This covers both parties in the event of changes during the escrow or new knowledge that comes to light.

Survival of Warranties

Buyers take note: Warranties do not automatically survive the closing. Absent fraud, mistake, agreement, or other special circumstances, the closing will merge prior negotiations and agreements into the deed and discharge the seller's contractual
obligations. Hence, the purchase contract must have a warranty survival clause. Otherwise, the representations and warranties are worthless, and the Buyer may look only to warranties in the deed.

Title Insurance

What about warranties affecting the quality of the title (encroachments, easements, tax liens)? While California Civil Code requires grantors to impliedly warrant good title, free of certain encumbrances, unless the conveyance deed instructs otherwise (California Civil Code § 1113), most Buyers purchase a policy of title insurance on closing and look to the insurer, not the Seller, for post closing title remedy. Beware of the Seller who wants you to purchase property without title insurance and refuses title warranties.

Alternative to Warranties

When a Seller refuses to make a warranty, Buyer protection is afforded through insurance, indemnification, or a Buyer’s conditions precedent clause in the contract. For instance, the Buyer will condition the obligation to purchase on the satisfactory outcome of Buyer's investigation (e.g., seismic study, roof inspection, environmental audit, mold report);

A conditions precedent is appropriate where representations and warranties are unavailable, but material facts are discoverable through a Buyer's due diligence. However, some things known to the Seller may be outside of the public record or not accessible through investigation.

Whether the subject of warranty, insurance or inspection, certain topics should never be overlooked: hazardous materials, seismic issues, and latent mechanical problems are important to explore. Water damage is the most expensive and common damage claim for office buildings. Leaks, broken sprinkler heads and mold hidden behind the drywall should be investigated fully.

Warranty Trends

Warranty trends fluctuate with the bargaining strength of the parties and the particulars of the deal. Here are some examples

1. Increased Environmental Warranties

The pervasive, high cost of environmental remediation creates Buyer pressure for broader representations. Many Buyers are afraid of getting stuck with a contaminated property. The insurance industry has not yet responded with a product to assuage their fears. The cost of underground soil and groundwater contamination can easily exceed the value of the property.
2. Fewer Institutional Warranties

The securitization of real estate has created large, well funded and risk averse Seller entities. These entities answer not only to the Buyer, but also their own board of directors and shareholders. They press to minimize or eliminate all warranties. In institutional sales, I find pension funds and REITS argue that giving a post closing warranty violates their fiduciary duty to their shareholders. These entities preclude any recourse to an aggrieved Buyer and feel any concerns should be negotiated economic points in the deal. In the past, the rising market allowed institutional Sellers to get away with this. I think it is unlikely in the future given the ongoing market correction.

3.) Much ado about Nothing.

When the Seller is a multi-party entity, which intends to dissolve on closing, Seller representations and warranties have little value or meaning. Once the money is disbursed to the individuals on closing, the money disappears like chocolate cake at a teenage birthday party.. No one party is a worthwhile defendant since the purchase price is dispersed broadly to numerous Sellers.

In summary, representations and warranties provide a powerful tool to balance Buyer uncertainties and the pressures of the market. Warranties can be staged or limited in size, scope and duration to achieve what the parties want and need in a real estate sales transaction.