

Some provisions to protect the buyer in a purchase agreement

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In a transaction for the purchase of commercial real estate, the written purchase agreement is the governing document. This article will suggest some provisions that will specifically protect and promote the interests of the buyer in that contract, including assessing the condition of the property, due diligence, closing, and default.

Assessing the condition of the property

First, the buyer needs to gather as much information about the property as possible, early in the purchase process. The purchase agreement should contain a provision whereby the seller is required, within a relatively short period of time after contract execution (such as five business days), to provide the buyer with full and complete copies of various documents pertaining to the condition of the property.

These documents should be specifically enumerated, and should include:

- most recent survey;
- most recent title insurance policy;
- environmental, soil, property condition, third-party injury, and zoning reports;
- filings with any liability insurance company concerning them, for the last three years;
- documents concerning casualty claims made within the last three years to any property/casualty insurer;
- complete and accurate copies of all leases, including any amendments or letter agreements or other lease-related documents;
- notices received from any governmental official.

Due diligence

The process of “due diligence,” by which the buyer reviews and examines the property to determine its suitability for the buyer’s purposes, is critical. With respect to the due diligence process, there are several provisions the buyer should attempt to include in the purchase agreement.

The first provision to include is the broadest possible description of the types of examinations that the buyer is permitted to conduct. Include language such as “any and all investigations, examinations, and tests that the buyer deems necessary.” Make sure to include

the ability to conduct soil studies and Phase I and Phase II environmental assessments.

The next provision is a specific statement of the expiration date of the due diligence period, so that there is no doubt about when the due diligence period expires.

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Also include a statement that the title and/or survey have the same deadline as the remainder of the other due diligence items. Sometimes contracts provide for a shorter time deadline for the title and survey review. The buyer should try to resist a shorter deadline, to make all objections due on the same date, namely the end of the due diligence period. Differing time periods can be confusing, and it can be disadvantageous to the buyer to have to comment on the title before the buyer has thoroughly reviewed the remaining aspects of the status of the property.

Include the right for the buyer to extend the due diligence period, exercisable by the buyer without the requirement of payment of additional funds, whether as an extension fee or an addition to the existing deposit. If the seller insists on a monetary payment in exchange for the extension, provide in advance that the monetary payment will be considered part of the deposit, so that the buyer will get that money back if the buyer ultimately terminates the contract on the basis of its due diligence.

It is advisable to include the broadest possible description of the grounds that will support a decision by the buyer to terminate the contract as a result of the buyer’s due diligence examinations. An example of this is if the buyer finds the property to be “unsuitable” for its intended purposes. Try to resist any requirement that the buyer provide specific reasons. Also, try to resist any requirement that the buyer must be “reasonable” in its determination of the unsuitability of the property, because you do not want to end up in litigation over whether the buyer was “reasonable” or not.

Finally, make sure to include a provision authorizing the buyer to inspect the property again, shortly before the closing. Usually at least 30 days elapses between the close of the due diligence period

and the scheduled closing date. Conditions can change during that time. Provide that the buyer has the right to re-inspect the property (including updating the title examination) shortly before (e.g., commencing five days before) the closing. Specifically state the buyer's remedies if it discovers a new unsuitable item at that time.

Closing

The purchase agreement also sets out the rights and obligations of the buyer and seller for the closing of the transaction.

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Consider adding a provision that allows the buyer to extend the closing date if circumstances beyond the buyer's control make the closing impracticable or unattainable. This is similar to a "force majeure" clause. Consider the impact of a hurricane or a flood or a snowstorm that might prevent the closing occurring, or a pandemic or government-ordered shut down due to a public emergency.

Attempt to specifically delineate the steps that a buyer must take in order to place the seller in default if the seller refuses to close. Make these steps as simple as possible. If a seller is refusing to close the deal, the buyer may not have a lot of time to react.

For example, the buyer may not be able to arrange for a court reporter to formally record the buyer's statement that it is "ready, willing and able" to close. Provide instead that communication under these circumstances may be by email, and it will be sufficient if the buyer indicates by email to the seller on the closing date that the buyer is "ready, willing and able" to close.

Default

The purchase agreement also establishes the rights and remedies of each party in the event of a default by the other. Oftentimes the standard purchase agreement provides inadequate remedies to the buyer in a case of a default by the seller.

About the author



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Provide that in the event of a default, the buyer receives not only the return of the buyer's deposit, but also an equal sum as liquidated damages. Otherwise, the buyer merely receives the return of the buyer's own money, and the seller is not deterred from breaching the contract in order to accept a more lucrative offer. Include the language that is required by your particular jurisdiction to make the liquidated damages provision valid. This is usually something to the effect that the parties agree that the actual damages would be difficult to assess and that the liquidated damages constitute a reasonable estimate thereof.

Make sure that in addition to liquidated damages, the buyer has the right to recover its actual out of pocket costs in the event of a seller default. An example of this is fees paid to third parties in connection with the confection of the contract and the due diligence process.

There is an additional issue raised by the prospect of a default by the seller. A buyer must be concerned that a seller will attempt to breach the contract if the seller has the opportunity to sell the property to someone else at a higher price. In the purchase agreement, a buyer can attempt to deter this scenario by adding a provision that allows the buyer to record a memorandum of the purchase contract in the public records. This will put a prospective substitute purchaser on notice of the buyer's rights.

Some states have provisions for this kind of procedure, and some don't. Try to include in the purchase agreement a provision that allows recordation of such a notice, that obligates the seller to execute it if the buyer so requests, and that allows the buyer to record that document unilaterally if the seller fails to sign it — without the seller's signature or, alternatively, with the buyer signing the document on behalf of the seller as its limited agent in this circumstance. If the seller has agreed to such a provision in the purchase agreement, the seller will be hard-pressed to object to the buyer recording such a notice.

In conclusion

A buyer may not succeed in including all of these provisions in its contract, but to the extent that the buyer can include a good number of them, the buyer will be better protected from the various things that can go awry.

Robert M. Steeg is a regular contributing columnist on real estate for Reuters Legal News and Westlaw Today.