

## **Negotiating Survival Clauses and Holdback Provisions in Commercial Real Estate Sales Transactions**

Avoiding Pitfalls of Merger Doctrine at Closing and Beyond

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TUESDAY, AUGUST 7, 2018

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Today's faculty features:

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# **Negotiating Survival Clauses and Holdback Provisions in Commercial Real Estate Sales Transactions**

**by**

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**Tuesday, August 7, 2018**

**1:00pm-2:30pm EDT, 10:00am-11:30am PDT**

# I. Introduction to Survival Concept

- A. Common law doctrine of merger: all obligations of Seller merged into the deed at Closing with no survival.
- B. Parties may want certain obligations and liabilities to survive the Closing.
- C. Express statement in Purchase and Sale Agreement that certain obligations and liabilities survive the Closing.
  - 1. Duration of Survival
  - 2. Security for post-Closing obligations.
  - 3. Limitations on surviving obligations (“floors” and “ceilings”).

## II. Merger Doctrine

- A. The deed is presumed to supersede all prior negotiations and agreements and, accordingly, all rights and remedies of the parties in relation to the transaction are determined by the deed.
- B. Purpose of doctrine is to provide security or safety in deeds or in titles held under them by preventing a party from raising a claim under a preceding contract.
- C. Generally recognized exceptions in fraud, mistake or accident.
- D. Statutorily established exceptions (e.g., consumer protection laws; environmental liability issues).

## II. Merger Doctrine

### E. Exceptions established by court decisions.

1. Court decisions that look to intent of the parties (e.g., covenants that cannot be performed until after the Closing).
2. Court decisions distinguishing covenants in Purchase and Sale Agreement relating to title satisfied by delivery of deed from other covenants that are “collateral to the deed”—the closing document does not cover the subject matter of the entire original contract.

### F. Contractually established exceptions.

1. Express statement of survival of certain contractual obligations, liabilities, warranties, etc.
2. Express statement of merger and non-survival.

# III. Purchase and Sale Agreement Issues that May Require Survival

## A. Representations and Warranties.

1. Physical issues; defects; compliance with laws.
2. Delivery of true and complete copies of Leases and Service Agreements to be assigned; pre-Closing defaults under assigned Leases and Service Agreements.
3. Accuracy of rent roll.
4. Other known issues.

# III. Purchase and Sale Agreement Issues that May Require Survival

## B. Reconciliation of estimated prorations.

### 1. Rent/Additional Rent.

- a. Reconciliation obligations with tenants as to expenses paid on the basis of estimates/tenant audit rights.

### 2. Taxes.

- a. Reassessments.
- b. Roll back taxes.

### 3. Leasing Costs.

- a. Allowances.
- b. Rent abatement.
- c. Commissions.

### 4. Buyouts with tenants.

- a. Limits on tenant obligation for tax increases due to reassessment on sale (in California, "Prop 13 protection").
- b. Future rent abatement.

# III. Purchase and Sale Agreement Issues that May Require Survival

- C. Ongoing work where costs are not yet ascertained.
  - 1. Tenant improvements.
  - 2. Initial construction.
  - 3. Ongoing repairs/replacements.
- D. Income guaranties tied to tenant rent commencement.
- E. Known post-Closing liabilities expressly assumed by Seller (e.g., payment of broker commissions, reimbursement of tenant improvements costs; obtaining of entitlements).
- F. Issues raised in tenant estoppels/seller estoppels.
- G. Costs of cure of defects in warrantied work/punch list items.

# IV. Survival Issues

- A. Duration of survival.
  - 1. Statute of limitation for claims.
- B. Maximum post-closing liability cap (the “ceiling”).
- C. Minimum post-closing liability amount (the “floor”).

# V. Strategies to Ensure Post-Closing Payment

- A. Seller as single purpose entity.
- B. Escrowed funds.
  - 1. Escrow holdback agreement.
    - a. Seller approval of Buyer requests for disbursement.
    - b. Dispute resolution.
- C. Parent/Affiliate Guaranty.
- D. Letter of Credit.
- E. Security interest in bank account to be held for survival period.

# V. Strategies to Ensure Post-Closing Payment

Drafting a survival provision

- Be clear.
- Identify what, exactly, is surviving the closing.
- Does the purchaser or seller need to issue notice of a claim or file suit within the survival period? Or does the cause of action only need to accrue during the survival period?

Be aware of State specific holdings regarding survival clauses and statute of limitations (e.g., GRT, Inc. v. Marathon GTF Tech., Ltd., 2011 Del. Ch. LEXIS 99)

## VI. Example Language

- Floor for damages; Only requires written notice of the claim during the survival period; Carveout for items which Buyer knows about

**Survival; Limitation on Seller's Liability.** Seller's Warranties shall survive the Closing and not be merged therein until December 31, 2019, and Seller shall only be liable to Buyer hereunder for a breach of a Seller's Warranty **with respect to which Seller receives a written notice of a claim** from Buyer on or before December 31, 2019. Notwithstanding the foregoing, however, if the Closing occurs, Buyer hereby expressly waives, relinquishes and releases any rights or remedies available to it at law, in equity, under this Agreement or otherwise, including any claim against Seller for damages that Buyer may incur, as the result of any of Seller's Warranties being untrue, inaccurate or incorrect if (a) Buyer is deemed to know that any Seller's Warranties were untrue, inaccurate or incorrect at the time of the Closing, or (b) the untruth, inaccuracy or incorrectness of such Seller's Warranties is not material. The untruth, inaccuracy or incorrectness of Seller's Warranties shall be deemed material for all purposes of this Agreement only if Buyer's aggregate damages resulting from the untruth, inaccuracy or incorrectness of Seller's Warranties are reasonably estimated to exceed \$25,000.00.

## VI. Example Language

- Cap on damages; Requires that action be commenced during the survival period  
The representations of Seller and Purchaser contained in this Agreement shall survive Closing; provided, however, (i) any cause of action of Purchaser against Seller by reason of a breach or default of any of the representations in Section XX set forth herein (collectively, "Seller's Representations") shall automatically expire as of the date which is six (6) months after the Closing (the "Representation Expiration Date"), except that the same shall not expire as to any such breach or default **as to which Purchaser has instituted litigation of a claim for any such breach or default** prior to the Representation Expiration Date, (ii) Seller's total liability for any breach or breaches of Seller's Representations shall in no event exceed \$250,000.00 in the aggregate, which liability limit shall survive Closing, and (iii) Seller shall not have any liability whatsoever to Purchaser with respect to any breach or breaches by Seller of Seller's Representations, if, prior to Closing, Purchaser obtains knowledge by virtue of a written document or report received on or prior to the Closing Date of a fact or circumstance, the existence of which would constitute a breach of Seller's Representations. Among other things, for purposes hereof, Purchaser shall be deemed to have knowledge of any fact or circumstance set forth in any environmental assessments, engineering reports, Estoppel Certificates or other written materials reviewed or received by Purchaser on or prior to the Closing Date. Seller's representations in Section 5 set forth herein shall be deemed automatically modified to the extent that any information contained in any environmental assessments or engineering reports or other written materials reviewed or received by Purchaser prior to the Closing Date is inconsistent with the matters which are the subject of such representations in Section 5

# VI. Example Language

- **Ceiling and floor on damages**

Seller's liability for breach of the covenants, indemnities, warranties and representations contained in this Contract and in any document executed by Seller pursuant to this Contract shall be limited to claims in excess of an aggregate \$50,000 and Seller shall be liable only to the extent that such aggregate exceeds such figure. Any liability of Seller under this Contract, or for a breach by Seller of any of its obligations under this Contract, shall be limited solely to the assets of Seller under this Contract, and in no event shall any liability be asserted by Purchaser against Seller's employees, members, partners, representatives, officers, directors, trustees, principals, agents, consultants, affiliates, parents, brokers, property managers, asset managers, or any of their respective successors or assigns in connection with this Contract. Seller's aggregate liability for claims arising out of such covenants, indemnities, representations and warranties with respect to the Property shall not exceed an amount equal to \$750,000.00.

# VI. Example Language

- Detailed notice requirements

Notwithstanding anything to the contrary contained in this Contract, neither Seller nor Purchaser shall be liable for consequential, punitive and/or exemplary damages of any nature whatsoever. After the Closing, any party (the “Non-Breaching Party”) shall provide written notice to the other party (the “Breaching Party”) of any alleged breach of such covenants, indemnities, warranties or representations and shall allow the other party thirty (30) days within which to cure such breach, or, if such breach cannot reasonably be cured within thirty (30) days, an additional reasonable time period, so long as such cure has been commenced within such thirty (30) days and is being diligently pursued, but in no event longer than ninety (90) days. If the Breaching Party fails to cure such breach after written notice and within such cure period, the Non-Breaching Party’s sole remedy shall be an action at law for actual damages as a consequence thereof; provided, however, notwithstanding anything in this Contract to the contrary, that: (i) any claim, suit, proceeding, litigation or action at law brought after Closing for any breach under this Contract, including, without limitation, any such claim, suit, proceeding, litigation or action at law based upon a misrepresentation or a breach of a covenant, indemnity, warranty or representation under this Contract or included in any document executed by Seller or Purchaser pursuant to this Contract shall be actionable or enforceable if and only if written notice of such claim is delivered to the Breaching Party within twelve (12) months after the Closing Date (the “Notice Period”); and (ii) provided such written notice is timely delivered to the Breaching Party by the Non- Breaching Party pursuant to (i) above, any such claim, suit, proceeding, litigation or action at law must be filed within one (1) year and one (1) day after the Notice Period, Seller, Asset Manager and Purchaser hereby waiving the right to file any such claim, suit, proceeding, litigation or action at law at any later date. The Notice Period referred to herein shall apply to known as well as unknown breaches of such covenants, indemnities, warranties or representations. Each of Seller and Purchaser specifically acknowledges that such termination of liability represents a material element of the consideration to Seller and Purchaser. The limitation as to Seller’s liability in this Paragraph 8.6.1 does not apply to Seller’s liability with respect to prorations and adjustments under Article 6. The provision of this Paragraph 8.6.1 shall survive indefinitely the Closing or earlier termination of this Contract and shall not be merged into the Deed or other closing documents.

# VI. Example Language

- **Post Closing Net Worth Requirement**

Until the Representation Expiration Date (and for so long thereafter as any written claim made by Purchaser remains pending), Seller covenants and agrees to maintain its legal existence and a tangible net worth equal to \$275,000.00. Such amount shall be in addition to any amount necessary to resolve other liabilities of Seller aside from the claim(s) of Purchaser.

# VI. Example Language

- Post Closing Escrow Agreement

RECITALS:

- A. Buyer and Seller have entered into that certain Purchase and Sale Agreement and Escrow Instruction dated as of \_\_\_\_\_, 20\_\_ (the “Purchase Agreement”), respecting the purchase and sale of that certain “Property” (as more particularly described in the Purchase Agreement) commonly known as the “\_\_\_\_\_” and located at \_\_\_\_\_ . All initial capitalized terms used herein but not herein defined shall have the meaning ascribed to such terms in the Purchase Agreement.
- B. Paragraph 22(j) of the Purchase Agreement contemplates the withholding from the Purchase Price payable to Seller at Closing of the Holdback Amount, which is to remain in the Holdback Escrow to pay for the cost of the Code Compliance Work.
- C. Buyer and Seller now desire to enter into this Agreement to provide for the establishment of the Holdback Escrow and the disbursement of the Holdback Amount to pay for the cost of the Code Compliance Work, and the for this Agreement to constitute instructions to Escrow Holder in connection with the Holdback Escrow, all as more particularly set forth herein.
- NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Buyer and Seller agree as follows:

# VI. Example Language

- Post Closing Escrow Agreement – Code Compliance Work

1. Concurrently with the Closing of the purchase and sale of the Property pursuant to the Purchase Agreement, Escrow Holder shall retain and holdback in Escrow (as the Holdback Escrow) from the Purchase Price otherwise payable to Seller, the sum of \_\_\_\_\_ Dollars (\$\_\_\_\_\_), as the Holdback Amount. Promptly following the Closing, Buyer shall cause the performance of the Code Compliance Work. Buyer agrees that it shall use reasonable efforts to insure that the Code Compliance Work is done at competitive prices, ascertained through a commercially reasonable bidding process. Seller agrees to execute and deliver to Buyer the forms required by any governmental authorities at the completion of such Code Compliance Work. Costs of performance of the Code Compliance Work shall be disbursed by Escrow Holder from the Holdback Escrow to Buyer as required during the course of performance of the Code Compliance Work, upon Buyer's submission to Escrow Holder of a request for payment accompanied by invoice(s) reasonably evidencing the requested amount. Any funds remaining in the Holdback Escrow after the completion of and full payment for the Code Compliance Work shall be returned to Seller, and Seller shall be responsible for the cost of any Code Compliance Work in excess of the Holdback Amount (after disbursement of the entire Holdback Amount) by payment of such excess cost to Buyer within thirty (30) days following Buyer's submission to Seller of reasonable evidence of such costs. Any funds remaining in the Holdback Escrow after the date which is \_\_\_\_\_ months following the date hereof shall be returned to Seller (except that if the performance of the Code Compliance Work is delayed by any force majeure occurrences beyond the reasonable control of Buyer, such \_\_\_\_\_ month period shall be extended by the period of any such delay(s), and Buyer shall notify Seller and Escrow Holder of any such delay(s) promptly following Buyer's first learning thereof).

# VI. Example Language

- Post Closing Escrow Agreement – Tenant Improvements

## WITNESSETH :

- WHEREAS, Seller and Purchaser have entered into and executed that certain Agreement of Sale dated March 22, 2018, (the “Contract”), regarding the property known as 1505 Pavilion Place, Norcross, Georgia (the “Property”), as more particularly described in the Contract.
- WHEREAS, The parties have agreed to escrow the total sum of Twenty Five Thousand and 00/100 Dollars (\$25,000.00) (the “Escrowed Funds”) from Seller’s proceeds at Closing pursuant to the terms of this Agreement.
- WHEREAS, Seller and Purchaser have asked Escrow Agent to serve as the escrow agent with regard to the holding and disbursement of the Escrowed Funds in accordance with the terms and provisions of this Agreement.
- WHEREAS, unless otherwise defined herein, defined terms shall have the meaning set forth in the Contract.
- NOW, THEREFORE, in consideration of the sum of TEN AND NO/100 DOLLARS (\$10.00) in hand paid to each of the parties hereto, and other good and valuable considerations, the receipt and sufficiency whereof are hereby acknowledged, the parties hereto covenant and agree as follows:

# VI. Example Language

- **Post Closing Escrow Agreement – Tenant Improvements**

The parties hereto hereby agree that Escrow Agent shall hold the Escrowed Funds as contemplated by this Agreement. Escrow Agent hereby acknowledges receipt of the Escrowed Funds. The Escrowed Funds shall be held and distributed until the earlier of May 15, 2018 or the date upon which the following punch list items (“Punch-List Items”) are completed as follows: \_\_\_\_\_

Within five (5) business days following Seller’s notification to Purchaser and Escrow Agent that the Punch-List Items are completed, which notification shall be provided on or before August 31, 2018 and shall include written confirmation from Tenant that the Punch-List Items have been completed, Escrow Agent shall release all of the Escrowed Funds to Seller, provided that if Purchaser provides notice to Seller and Escrow Agent within such five (5) business day period that it objects to the release of the Escrowed Funds on the basis that the Punch-List Items have not been satisfactorily completed, Escrow Agent shall continue to hold the Escrowed Funds until confirmation of release by Seller and Purchaser. Upon receipt of Seller’s notification in the preceding sentence, Purchaser shall have the right to inspect the Punch-List Items during the five (5) business day period. To the extent any of the Escrowed Funds have not been requested by Seller and remain with Escrow Agent after October 31, 2018, Purchaser may request that said funds be distributed to Purchaser; provided, however, that prior to disbursement to Purchaser, Escrow Agent shall give Seller notice and five (5) business days to object to said disbursement and provide evidence that the Punch-List Items have been completed as required by this Section.

# VI. Example Language

- Recertification of Representations and Warranties – signed at closing

## **SELLER’S CERTIFICATE OF REPRESENTATIONS AND WARRANTIES**

The undersigned hereby certifies on behalf of \_\_\_\_\_, a \_\_\_\_\_ (“Seller”), to \_\_\_\_\_, a \_\_\_\_\_ (“Purchaser”), that all of the representations and warranties of Seller as set forth in that certain Purchase and Sale Agreement (“Agreement”) with an effective date of January 1, 2018, including but not limited to those Seller representations contained in Paragraph 5 of the Agreement, are true and correct on and as of the date set forth below (the “Closing Date”) with the same effect as though made on and as of such date, subject to the limitations set forth in the Agreement and shall survive the Closing Date and shall inure to the benefit of and be enforceable by Purchaser, its successors and assigns for a period of ninety (90) days after the Closing Date. Seller hereby further acknowledges any continuing covenants and obligations which survive closing in accordance with the provisions of the Agreement.