

PUBLICATION

Indeterminate Due Diligence Material in Agreements Should Cause Concern

September 25, 2007

Summary: *A seller should use caution when entering into a sale agreement containing a provision to provide due diligence material to the buyer if the description of the material requested is vague or indeterminate. Such a provision may enable the buyer to delay the expiration of the inspection period or the closing by claiming the option period never began to run because the seller failed to produce all the agreed due diligence material.*

A seller should use caution when entering into purchase and sale agreements containing a provision requiring the seller to furnish the buyer with copies of the seller's due diligence material. This provision, which is common to commercial sales contracts, requires the seller to furnish the buyer with copies of all documents relating to the seller's property ownership within days of the effective date of the contract. These documents typically consist of, but are not limited to, surveys, title policies, environmental reports, engineering reports, traffic studies and reports, site plans and development plans. Problems may arise if the description of the material is vague or indeterminate and requires "any and all" of a particular document as this can inadvertently extend either the inspection or the option period and delay closing. Moreover, this might also indefinitely prevent a sale to another potential purchaser.

The inherent danger in these provisions is the open-ended language requesting all of a particular type of document. This opens the door to a potential disagreement over what constitutes actual compliance. By not setting clear parameters to disclosure requirements, the seller leaves room for the buyer to claim that, while the seller may have provided some of the documentation, he failed to completely furnish all of the required documentation and therefore failed to meet the required condition. The buyer is then able to claim that as the condition was not met, the inspection or the option period never began to run. This could potentially lead to unplanned extensions of option periods and delays of closing and could cause adverse consequences to a seller.

A case is pending on appeal before the Supreme Court of Alabama dealing with just this issue. This case involves an option contract for unimproved land for commercial development. In this case, after the option period had expired, the buyer took the position that the option period had never begun to run because the seller had failed to furnish all of the required materials. In response to this, the seller filed suit in the Circuit Court of Etowah County, Alabama. The original buyer then counter-claimed, alleging that as the seller failed to furnish certain required documents including an environmental report, the option term never started. The court held that the seller was free to sell the property to another purchaser. The case is now on appeal.

This situation is a potential danger in any agreement containing open-ended language such as "all title policies, title commitments and abstracts." A seller should attempt to clarify the provision in the following ways:

1. The provision should be specific and narrow in scope in order to avoid any confusion and potential claim of non-compliance. For example, a provision requesting title information should be limited to the seller's latest title insurance policy.
2. It should also be clear that the seller is furnishing these materials to the buyer as an accommodation only and is making no representations or warranties as to the accuracy of the material being furnished. Should the buyer choose to rely on this material, it is at his own risk.

3. Include a clause stating that failure to produce any of these materials does not constitute an extension of the inspection period or the option period and that the buyer is responsible for his own due diligence.
4. Furthermore, the contract should also place an obligation on the buyer to notify the seller within a certain period of time should any of the documents not meet the buyer's requirements. Should the buyer not notify the seller within this period of time, then this will constitute a waiver of any potential claim the buyer may have had that the option period did not begin to run until the seller had satisfied the buyer's requirements.

A seller should be extremely cautious when entering into contracts containing these provisions due to the potential consequences if the language of the provision is too indefinite. As always, we would be happy to review any contract you have for potential problems such as this and to assist you in making any necessary adjustments to the contract to avoid this situation. Please feel free to contact us should you have any questions or concerns about a particular contract or should you simply wish to discuss this matter further.