

*“As is” clauses do not equal iron-clad protection**by Julie Nagorski*

Given the current state of commercial real estate, it is understandable that an owner of an underperforming building may be anxious to do whatever it takes to unload the asset, but sellers must take care to ensure that even in an “as is” sale, no exposure is created as a result of negligent or intentional misrepresentations or a failure to disclose a material condition of the building. Although most purchase agreements provide that the buyer take the property “as is,” this standard clause does not provide absolute protection from all claims regarding the condition of the property. A common “as is” clause seems iron-clad:

The land, building, fixtures, machinery, and equipment sold under this agreement are being sold in an “as is” condition, excluding all warranties, including but not limited to warranties of merchantability and fitness for any particular purpose.

Given the clear understandability and the breadth of an “as is” clause, many property owners believe that these provisions bar claims for the seller’s representations concerning the condition of the property. However, these contractual clauses do not necessarily shield a seller from all liability for all misrepresentations. In addition to a potential breach of contract claim, a seller may face liability for a fraudulent misrepresentation or an intentional failure to disclose a property condition. These types of statements and activities may render the “as is” clause unenforceable. A seller should have a basic understanding of different types of misrepresentations and omissions that may create liability expo-

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sure if proper care is not exercised in the transaction.

**Negligent misrepresentations**

A property owner generally cannot be held liable to a buyer for a negligent misrepresentation regarding the condition of the property, even if the contract does not include an “as is” clause. However, to better understand the claims under which a seller may be liable, an explanation of a negligent misrepresentation claim is helpful.

A misrepresentation is negligent when it is an accidental incorrect statement of the facts. A buyer must prove not only that the seller made a representation that was false, but also that the buyer reasonably relied on the misrepresentation and the buyer’s reliance on the representation caused it to experience damage. The reason why negligent misrepresentation rarely arises in an arm’s length real estate transaction is that there can only be liability where there is a trust relationship between the parties such that one party owes a duty of care to the other party. In an arm’s length real estate transaction, such a trust relationship is not generally deemed to exist. Under Minnesota law, the general rule is that adversarial parties negotiating at arm’s length do not have a duty of reasonable care. Therefore, a seller in a commer-

cial transaction is not typically liable for a negligent, or accidental, misrepresentation.

**Fraudulent misrepresentations**

However, in contrast to negligent misrepresentations, property owners generally are liable for fraudulent misrepresentations to purchasers. A fraudulent misrepresentation is an intentional incorrect statement of important facts. A fraudulent misrepresentation is more difficult to prove than a negligent misrepresentation. A buyer must prove that the seller made a false representation and that the seller either knew it was false or asserted that it was true without knowing whether it was true.

Further, the misrepresentation must have been important to the transaction. For example, if an owner of a fifteen story office building represents that all of the basement storage spaces are in good condition, but one of the storage spaces has minor damage that is easily repaired, it is less likely to be held liable for a fraudulent misrepresentation. Also, the buyer must prove that the seller intended the buyer to rely on the misrepresentation and that the buyer did in fact rely on the misrepresentation. Thus, for example, if the owner misrepresented the storage space, but the buyer learned the true condition of the storage space

before the closing and nonetheless chose to close, then the seller would usually not be liable for a fraudulent misrepresentation. Finally, the buyer must prove that its reliance on the representation caused it to suffer damages.

Under Minnesota law, a claim for a fraudulent misrepresentation is possible even when the purchase agreement included an “as is” clause where a property owner knows of the condition of the property and either misrepresents or conceals it, and the buyer relies on the misrepresentation or concealment in deciding to purchase the property. For example, if a seller makes temporary and makeshift repairs to a roof, and then tells the buyer that the roof had a couple of minor leaks in the past, but that it was still in good condition, it may be held liable for a fraudulent misrepresentation even though the contract states that the property is being sold “as is.” In one case involving a purchase agreement with an “as is” clause, the court held that a purchaser could recover from a seller for a fraudulent misrepresentation even though the purchaser was a sophisticated party, it had visited the site prior to the closing, and it did not inspect the seller’s records despite having that opportunity.

The rule that a party cannot commit a fraud and then hide behind a contract is based on public policy considerations. The courts are sending the message that a seller cannot lie and expect to get away with it. If a seller deliberately makes false representations to a buyer, then the “as is” clause is basically negated if the buyer relies on the fraudulent representations in agreeing to purchase the property.

### **Failure to disclose**

A seller can be held liable for a fraudulent misrepresentation when it fails to disclose a fact in certain circumstances. If a property owner chooses to disclose conditions of the property to a purchaser, it cannot hold back or hide facts it is aware of that make its disclosures misleading. For example, if a seller states that the roof never leaks when it is raining, and fails to also state that the roof does leak in the winter and spring because of ice dams, then the seller may be held liable for a fraudulent misrepresentation. Thus, a seller must be careful to avoid half-truths.

Another situation in which a seller can be found liable for a fraudulent misrepresentation is when it fails to “correct the record.” If a seller makes a representation believing it to be true, and then later learns before the closing that its statement was false, it must disclose the truth to the buyer to avoid being held liable for a fraudulent misrepresentation.

Lastly, a seller may even commit a fraudulent misrepresentation by remaining silent. In one Minnesota case, the court found a property owner liable when its tenant made misrepresentations to a potential purchaser about the lease in the presence of the landlord and the landlord remained silent instead of correcting the misrepresentation.

Even if the purchase agreement includes an “as is” clause, a court will generally hold a property owner liable for an intentional omission, particularly a deliberate omission concerning a condition that is not obvious. Thus, for example, if a seller knows that the stairs in the building need a major structural repair that the purchaser cannot readily

detect, and the seller fails to inform the purchaser, then a court may hold the seller liable for fraud, even with the “as is” clause. Again, this rule is premised on the public policy that a party cannot contract around a fraud.

### **Avoiding liability**

Before making any representations regarding the condition of your property to a potential buyer, it is wise to consult an attorney. Avoid half-truths and correct the record when necessary—whether you make a representation you later learn is false, or whether you hear someone falsely represent the condition of the property to the purchaser. Your attorney may also direct you not to make any oral disclosures regarding the property so that proving the actual contents of the disclosures, if necessary, will be simpler. No matter what the purchase agreement states, you will want to be careful not to deliberately misrepresent the property’s condition or attempt to hide any problems.

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