Fight for Your Right to (the Correct) Party

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The Beastie Boys gave us more than simply quality music; they dispensed (knowingly or unknowingly) real estate advice. In one of their early songs, they advised that all real estate practitioners, developers, owners, buyers, and brokers would be well served to fight for their right to (the correct) party. Without the power of the seller to sell, there is no chance for a buyer to buy.

Agreements of sale for the purchase of real property contain many tricky provisions: contingencies, risk of loss, pre-closing operating covenants, and the list goes on. What many attorneys, brokers, buyers, sellers, and other interested parties fail to focus on is the identity of the seller. Seems simple, right? After all shouldn't the owner of the property know who owns the property? The answer, far too often, is "No."

How can a seller not know who owns the property? Why is the identity of the seller so often difficult to pin down?

THE SELLER IDENTITY QUAGMIRE

Most peoples' frame of reference when it comes to the identity of an owner of the property is with respect to a family residence. Typically, when a buyer asks a seller who owns a house, the seller will identify himself or herself individually or the person and his or her spouse/partner, but many times this simplistic answer is incorrect. Many people purchase their homes in a family trust or as tenants in common or tenants by the entirety or joint tenants with rights of survivorship. Married couples may have purchased the home prior to marriage and the name on the title contains the wife's maiden name. Maybe the home is in fact owned by a person's business and the list goes on.

Commercial properties further confound the seller identity mystery. Individuals rarely own commercial properties, although this is not a hard and fast rule. Buyers may think they are purchasing a property from John Developer, but in fact Mr. Developer merely holds an ownership interest in some anonymous special purpose entity (an entity created solely for the purpose of, in this case, owning the property). This entity could be a limited liability company, a general partnership, a limited partnership, a corporation (a Subchapter C corporation or Subchapter S corporation), a limited liability partnership (*e.g.*, a professional corporation), a limited liability limited partnership (a peculiar Florida entity) or such other state specific entity.

Although mainstream limited liability companies, limited partnerships, and corporations are typically easy to identify through a preliminary title search, the identity of a trust or general partnership could create more interesting problems. Often, sellers simply refer to an individual when identifying the seller on an agreement of sale, when in fact they are a trustee of a trust or a general partner with some other individual. Bottom line, though a seller is rarely trying to dupe a buyer into contracting with the wrong party, the risk of mistake due to carelessness, short handed but imprecise references, and poor memory can cause much pre-closing consternation among buyers.

TITLE INSURANCE IS A BUYER'S FRIEND

How is a buyer to protect its interests? Certainly, obtaining title insurance is a step in the right direction. Searching title provides many services to a buyer. Not only does it provide indemnification insurance to the buyer in the

event buyer does not actually acquire fee simple title to the property, it also serves as an oversight review mechanism. That is to say that the title company is in some senses a failsafe in the event the attorneys, buyers, sellers, and brokers fail to do their job in ensuring that the property is transferred in an orderly and proper manner.

In addition, a title company will be able to search the records, find the original deed into the seller, and, more importantly, obtain a history as to whether the seller's interest was transferred at any time after the initial purchase of the property. In certain deals it may even make sense to obtain a title search as to the owner of the property prior to executing the agreement of sale. Simply looking at the most recent past deed may not tell the complete story as, interests may have been transferred, individuals may have passed away, and potential mergers, acquisitions, and consolidations of the original entity may have occurred. By obtaining a pre-execution title search and/or chain of title report, much of the seller identity mystery may be cut off at the pass.

It also is important to obtain a bring down of title prior to closing. Many times, especially with trusts and general partnership and sales by individual members, events occur in the time that has elapsed between the execution of the agreement of sale and the closing of the purchase. A bring down is a relatively easy way to double check whether the buyer has, in fact, disclosed all of the information regarding its composition.

In addition, in states where title gap indemnifications are required, a pre-closing bring down will help serve to shift a substantial amount of the risk regarding title related issues from the contracting parties to the title company. Many title companies may require one or both of the contracting parties to essentially insure the title gap between the date of the commitment until the date of recordation of the deed and ac companying closing documents. By dating down the time period of the title until the date of closing and further requiring the title company to record in a fixed number of days (*e.g.*, three to seven days), buyer's risk of exposure is greatly reduced.

REPRESENTATIONS AND WARRANTIES

Obtaining a representation and warranty from the seller in the agreement of sale may also help to identify the identity of the seller. This is not to excuse the buyer from its due diligence obligations with respect to the property or forgive the need for title insurance, but it may help focus both parties, particularly the seller, on exactly who the correct party is in transaction. It is also important that this representation and warranty survive closing and delivery of the deed. Often, sellers are more likely to read and consider the provisions set forth in a warranty section of an agreement of sale rather than simply in the introductory paragraph of that same agreement.

The representation and warranty is particularly important in the period between the end of the title review period and the closing. The seller must be obligated to notify the buyer promptly of any title changes between the conclusion of the title review period and prior to closing. By keeping the buyer and seller in constant communication during this gap period, the buyer is less likely to have to scramble in the event of a change in the composition of the seller. This post-title review obligation is particularly important where individuals, general partners, or trusts are concerned as the individual may die or become incompetent during the intervening days or months. By being pro-active, probate and guardian issues can be finalized well in advance of closing.

DETAILS: THE HOBGOBLINS OF LITTLE MINDS

States and commonwealths by and large perform a satisfactory job in policing the creation and maintenance of legal entities. Unfortunately, departments of states are not perfect. For example, Ribbon Street LLC; Ribbon Street L.L.C.; Ribbon Street L.L.C.; and Ribbon Street, LLC may be four different entities. Numbers cause additional problems. Title companies often plead with parties to avoid numbers, the word "the", and even punctuation. Numbers and punctuation marks cause substantial search problems.

Here again, there is no substitute for a buyer's doing appropriate homework. By obtaining a copy of the articles of formation of the seller's entity from the state, the correct entity will be correctly identified. Sometimes, the original deed into the seller may not even have the correct punctuation or name of the seller entity. For example, clients and scriveners will, in assembling parcels for an acquisition, inadvertently change the name of the acquiring entity from one deed in to another (*e.g.*, J & O Partners vs. J & O Partnership). While nine times out of ten the difference is due to simple carelessness, it is essential that issues such as this be identified and resolved prior to closing. At times it is wise to request that the seller prepare a corrective deed to both ensure that the chain of title is consistent, and that there are no gaps in the ownership line. The small cost of recording a corrective deed may prevent future seller identity crises.

THE CASE OF THE DISAPPEARING SELLER

A buyer must ensure that the seller entity actually exists and is in good standing. Do not take the seller's word for it. Even if a buyer knows for certain that the identity of the seller is correct, it is hazardous to assume that the seller in fact still exists and is authorized to sell.

For example, often a seller will create an entity to own a property. The entity files its annual statements, pays its taxes, and files its tax return on an annual basis for 20 years. Alas, the alter ego of the seller, whom we'll call Joe Owner, has opted to move to warmer pastures and sell off his real estate holdings. To keep legal fees down, Mr. Owner has handled the filing of the annual statements, payment of taxes, and filing of tax returns by himself for the entire duration of his ownership. In November, Mr. Owner's wholly owned entity signs an agreement of sale with Mr. Developer. Mr. Owner then decides that because he's selling the property there is no need to keep the entity going, so he just throws away the state notices with respect to the filing of an annual report and payment of taxes. He is going to terminate the entity the day after closing so he does not care.

This is a problem. All of a sudden buyer arrives at the closing and everything checks out: seller is correct and the person authorized to sign on behalf of seller is correct, but there is no validly existing seller entity. This is an example of a situation in which a title company can be a seller's friend, or in the absence of the title company, a little due diligence request on behalf of buyer can go a long way. Requesting from seller a certified copy of its articles of organization; a good standing certificate; a resolution of the authorizing officer, member, or partner of the entity; and a copy of the partnership, operating, shareholder, or comparable agreement (dated within 30 days of closing) may save a good deal of time and frustration.

Title companies, amazingly enough, often fail to perform this function. As a buyer, it is imperative that a final check be made, not more than 30 days prior to closing, that the seller entity exists, that the seller has the authority to sell, and that the entity remains in good standing. In addition, it is important to double check that the person signing the deed and other conveyance documents actually has the authority to convey the property. A resolution may authorize a person to dispose of the property, but if the underlying partnership, operating, shareholder, or similar agreement does not provide such power the resolution is essentially worthless. While sellers may balk at a buyers snooping through their entity documents, it is imperative that it be determined that the authorized seller signatory is, in fact, authorized. Apparent authority, as opposed to actual authority, of the seller may hold up well in court, but why enter the legal arena when the issue is rather easily resolved prior to closing.

TRUST ME

Trusts, estates, and family partnerships create unique issues with respect to the identity of the seller. In all cases, the receipt of copies of the family partnership agreement, probate documents, and trust agreement are a must for all buyers. It is important to review not only who has the power to sell the property (*e.g.*, the trustees, executor/executrix, or authorized family partnership member) but who has the power to object to the sale. An executor in a non-probated estate may not have the power to convey prior to probating the estate. A trustee may require the consent of the beneficiaries in certain instances. A family partnership may require unanimous consent to sell. In the end, there is no substitute for looking at the documentation and confirming with the title company that it has looked at, and signed off on the authority of the trust, estate, or family partnership to convey the property.

CONCLUSION

Imagine that an individual wants to buy a particular property. The sellers offer no representations and warranties, are on the verge of bankruptcy, and suggest that they plan to disappear after closing. The individual is concerned that even with representations and warranties, there may be nothing to go after should the sellers disappear. At the end of the day, the prospective buyer must rely on his or her own due diligence. The buyer should make a thorough review of the sellers involved with the transaction, determining whether the sellers have the proper authority to sell and appropriate resolutions to convey. While the title company will certainly function as a supportive crutch, a decision must be made whether the buyer would still buy the property if the sellers disappeared after closing. If the answer is "yes," then the buyer should be more inclined to buy. If the answer is "no," the buyer should take a good look at the pro and cons of the transaction.

Of course, there are many strategies available for determining the identity of the correct party in a real estate transaction: obtaining title insurance, requesting representations and warranties from the seller, reviewing state corporate records, examining past deeds and conveyance documents, and pouring over the seller's entity documentation. In any event, it is important to actively ferret out the validity, enforceability, and existence of the seller.