



Successfully managing real estate transactions - Stumbling blocks in the due diligence phase

Introduction & Agenda

Speakers



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Agenda

- I. Overview of the BGH decision of 15 September 2023 (case reference: V ZR 77/22)
- II. Consequences for the duty to inform and investigate
- III. Consequences regarding the relevant information
- IV. Consequences for the provision and use of the data room
- V. Consequences for the drafting of contracts
- VI. Questions & Answers



I. Overview of the BGH decision of 15 September 2023 (case reference: V ZR 77/22)

The BGH case

(V. Civil Senate, judgement of 15 September 2023 - V ZR 77/22 - OLG Celle)

Facts

- Notarised purchase agreement ("PA") dated 25 March 2019 for commercial units located in a building complex; purchase price approx. EUR 1.5 million
- Seller assured in the PA, among other things, that
 - ✓ **no resolutions had been passed on special levy due in the future (with one exception) and**
 - ✓ **no extraordinary costs, not covered by maintenance reserves, have been incurred in the current financial year or are expected in the future.**
- According to the PA, the seller has provided the buyer with the protocol of the owners' meetings of the last three years and the buyer is aware of these according to the PA.
- **Virtual data room: Upload of the resolution collection (since 2007)**
- **Protocol of the owners' meeting (2016):** Implementation of a so-called "**conversion and revitalisation**" resolution passed in 2006 **regarding extensive structural changes (EUR 50 million); Refusal to impose a special levy of the same amount on owners of commercial units.**
- Third-party owner sued to enforce payment of the renovation costs through a special levy → **Settlement:** Imposition of special charges on owners of commercial units from EUR 750,000 up to EUR 50 million (if required)
- Claim against the buyer → Cancellation of the purchase contract due to fraudulent misrepresentation; precautionary declaration of cancellation
- Lawsuit is seeking, among other things, the release from financing loan, alternatively payment of EUR 1.5 million, payment of EUR 184,551.82 concurrently against transfer of ownership and assignment of claim for restitution of land charges



Reasons for the decision

OLG Celle:

- **§ 123 (1) BGB (-) no right to cancel the PA due to fraudulent misrepresentation**
 - Information in the PA is correct, as no special levy was agreed when the contract was concluded
 - Objectively false assurance with regard to special contribution due in future does not have to be decided
 - Fraudulent misrepresentation not deliberately fulfilled, as it is unclear whether seller was aware of complaint

- **§§ 280 (1), 311 (2) no. 1, 241 (2) BGB (-) no claim for damages**
 - Seller has not suppressed true facts in disregard of the duty of disclosure
 - Allegation that minutes were "secretly" placed in data room and "foisted" does not hold up, as reference to owners' meeting and the upcoming renovation was made in the exposé
 - It is the buyer's responsibility to inform himself
 - No deadline has been agreed upon for the provision of information or documents

Reasons for the decision

BGH:

- **Right of cancellation/compensation for damages according to §§ 437 no. 2, 440, 323, 326 (5) BGB and §§ 437 no. 3, 440, 280, 281, 283, 311a BGB (-)**
 - ✓ **No material or defects of title in the object of purchase, as it is not a question of the condition of the building (need for renovation), but rather the**
 - ✓ **Lack of information** about the specific threat of a special levy (of up to EUR 50 million)
 - ➔ WEG resolution ≠ Property of the building and not a third-party right, as partial ownership is not encumbered by resolution
- **A claim for damages in accordance with §§ 280 (1), 311 (2) no. 1, 241 (2) BGB can be considered if**
 - ✓ Incorrect declaration by the seller in the purchase agreement
 - ✓ Incorrect/incomplete answer by the seller to the buyer's questions
 - ✓ Failure by the seller to inform the buyer of a circumstance requiring disclosure

1. Incorrect declaration in the purchase agreement

- **Information provided** that may be relevant to the purchase decision must be **correct** - even if there was **no duty of disclosure**
- Seller is liable for ensuring that the declaration of knowledge is correct and complete
- Seller's declaration: *extraordinary costs, which are not covered by the maintenance reserve have not occurred and are not imminent* → here: Declaration incomplete!

Protocol (2016):
Possible future construction costs (up to EUR 50 mio.) not covered by reserves, which may have to be enforced against the majority owner.

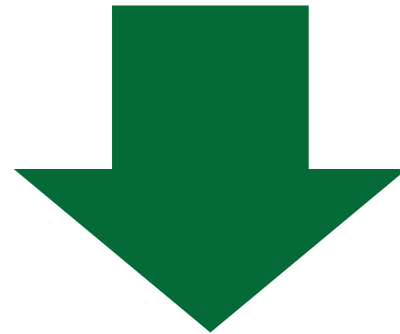
Risk that in the event of unsuccessful claims against the majority owner (in the internal relationship), costs will be distributed among all owners

The declaration did not specify that it only applies to concrete imminent costs.

- **The seller is presumed to be responsible** (§ 280 (1) s. 2 BGB)

2. Incorrect / incomplete answer to questions

- Answers to the buyer's questions must be **correct and complete** - irrespective of the existence of a duty of disclosure
- Pre-contractual fault on the part of the seller cannot be denied on the grounds that the **buyer was aware prior to the conclusion of the contract that**
 - ✓ **the building was in need of refurbishment and the seller's response would have given an impression of the scale of the cost burden.**
 - ➡ Seller's response incomplete with regard to cost burden and scope of costs
- Completing the response by **submitting documents** to the data room?



3. Failure to provide information about a circumstance requiring disclosure

Existence and omission of an obligation to provide information

Disclosable circumstance

- Costs of up to EUR 50 million for reorganisation measures **must be disclosed**
- Settled case-law:
 - No general legal obligation to clarify all circumstances that could influence a decision of intent during contract negotiations
 - Necessary information must be obtained at the buyer's own expense and risk
- BUT:
 - Obligation to inform the other party of circumstances that may inhibit the purpose of the contract and are therefore of **high importance** for the other party's decision, **as long as the other party can expect this information** in good faith

No omission of the duty of disclosure

- Uploading the documents in the data room was not sufficient to waive the duty of disclosure, although the buyer theoretically had the opportunity to take note of them
- The seller cannot simply expect the buyer to check all documents relating to the object of purchase for any defects in the object of purchase
- The situation is different if e.g. an expert opinion has been submitted
- **But: Reducing the duty of disclosure in the context of due diligence?**

3. Failure to provide information about a circumstance requiring disclosure

Reduction of the duty of disclosure due to the performance of due diligence by the buyer?

- **Starting point:** A buyer who carries out a due diligence is more likely to be expected to fully review the documents provided and check their respective significance for the purchase decision, especially if expert advisors are involved ← → **No obligation to carry out a due diligence before purchasing a property**
- Despite due diligence: **Case-by-case examination!**
- **The actual circumstances of the establishment and use of the data room must be taken into account**, in particular:
 - ✓ **Scope and systematic organisation of the information provided**
 - ✓ **Availability of table of contents and search function**
 - ✓ **Separate reference by the seller to subsequently posted documents**
 - ✓ **Time frame for checking the documents**
- If the circumstance is recognizably of high importance to the buyer and is not readily apparent from the information provided, the buyer may expect a separate notice.
- **BGH case:** Seller could not legitimately expect the buyer to take note before the contract was concluded → Separate notification required!

3. Failure to provide information about a circumstance requiring disclosure

Reduced disclosure requirements due to buyer's due diligence?

- **Effect of the buyer's acknowledgement of the last three years of protocol confirmed in the purchase agreement:**
Declaration by the seller that the buyer has received the minutes of the last three years.
- **Buyer's obligation to make enquiries due to references to the protocol of 2016 in the later reports?**
- **Does the obligation to provide information no longer apply due to indications of pending renovation measures?**
- **Result:** Partial annulment and referral back to the court of first instance
 - ➡ It needs to be clarified whether the 2016 protocol was received by the buyer before it was uploaded in the data room.

II. Summary of the consequences for the duties of disclosure and investigation

Consequences for the duty to inform and investigate

➡ **Background: § 442 BGB**

Para. 1: The buyer's rights due to a defect are excluded, if he is aware of the defect when the contract is signed. If a defect has remained unknown to the buyer due to gross negligence, the buyer can only assert rights due to this defect if the seller has fraudulently concealed the defect or has assumed a guarantee for the quality of the property.

Decision criteria:

- Is there a discrepancy of information supply between seller and buyer?
- Does the buyer carry out a due diligence? Has the buyer consulted advisors with appropriate expertise?
- How well versed in business is the buyer?
- Has the buyer requested information separately or expressed that he is particularly interested in a certain circumstance?
- Is the information easily identifiable in the data provided?

➡ **In case of doubt: Separate notice/separate document transmission required!**

III. Consequences regarding the relevant information

Consequences regarding the relevant information

➡ The fact in need of clarification is the decisive factor:

Decision criteria:

- Is the circumstance of very considerable importance for the buyer - and recognisable for the seller?
 - ✓ E.g. the case if a circumstance can frustrate the purpose of the contract or cause the buyer considerable economic damage

IV. Consequences for the provision and use of the data room

Consequences for the provision and use of the data room

- Preparation of the data room brought more into focus by decision
- Rule of thumb: The more extensive the information, the greater the need for clarity in the data room.

What makes a well-structured data room?

- ✓ Folder structure
- ✓ Table of contents
- ✓ Correct naming of the folders and documents
- ✓ Systematic organisation of documents in the respective folders and subfolders
- ✓ Filter function
- ✓ Search function
- ✓ Notification function for newly uploaded documents

V. Consequences for the drafting of contracts

Consequences for the drafting of contracts

- **Use of the data room should be precisely regulated by contract**
 - ✓ Utilisation period
 - ✓ Authorised users
 - ✓ Table of contents as an attached annex
 - ✓ Definition of "disclosed information"
- **Check disclaimers regarding the seller's duty of disclosure carefully**
 - ➡ They are limited in the case of (conditional) intentional and fraudulent behaviour of the seller, for which liability cannot be excluded in advance (§ 276 (3) BGB).
 - ➡ Observe objective and subjective guarantees.

VI. Questions and answers



Thank you
for your attention

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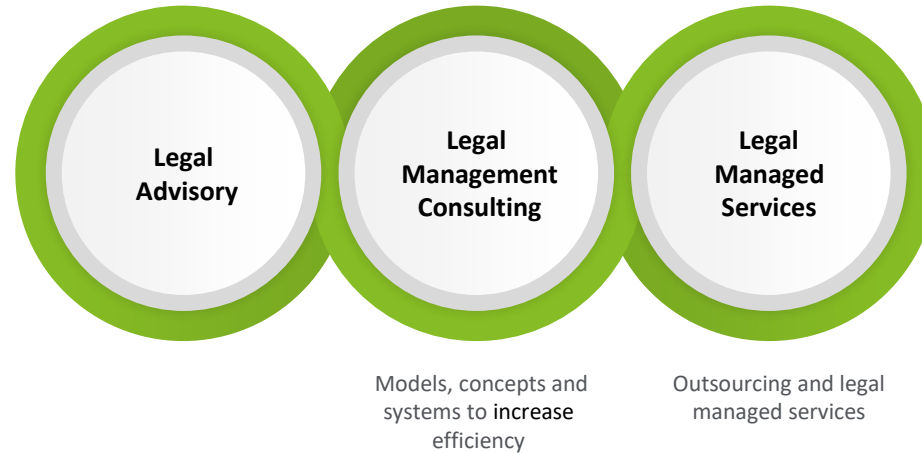
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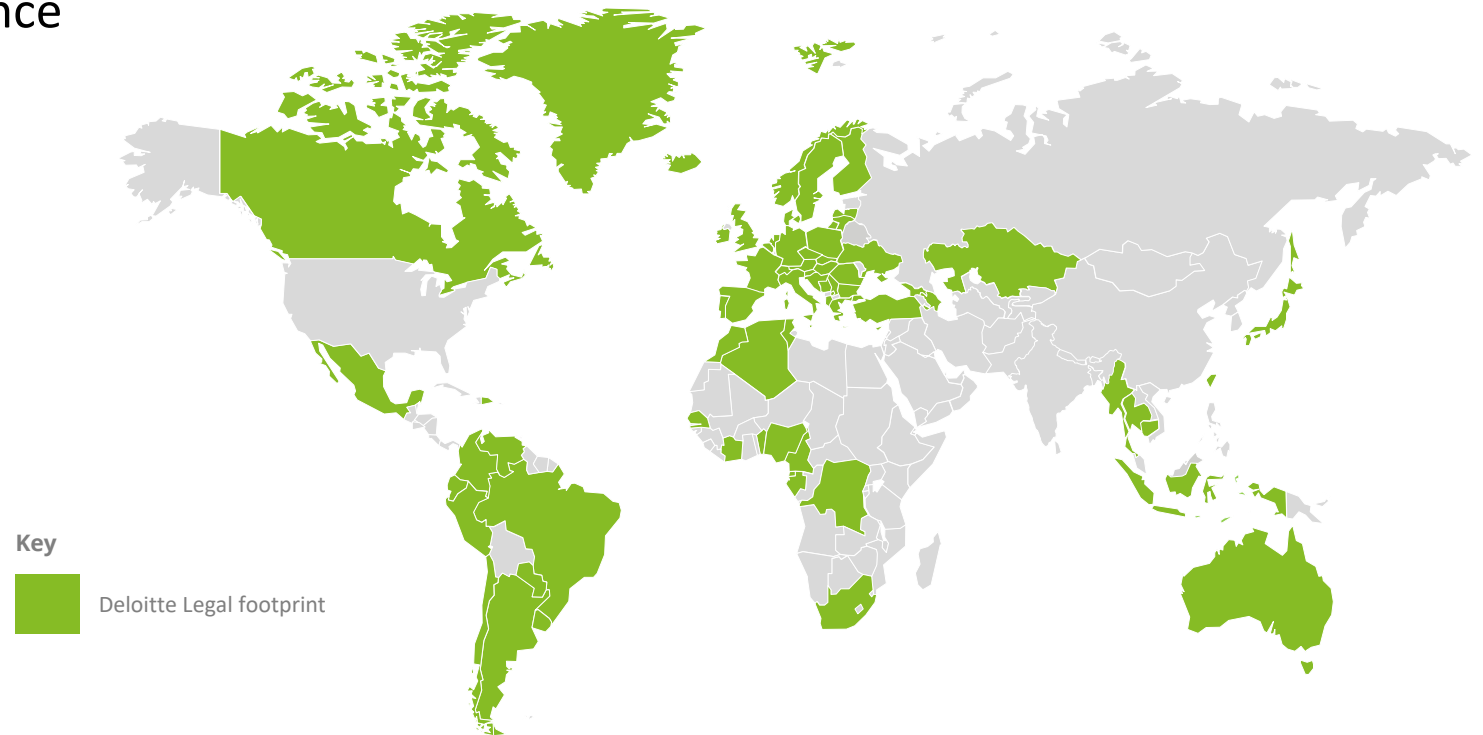


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