

Due Diligence

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Commercial Real Estate Transactions

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DUE DILIGENCE

Thoroughly conducted due diligence is an essential part of successful commercial real estate transactions. Fundamentally, your client is a stranger to the subject property and does not have the tools that lawyers have, to literally (and figuratively) “test the foundations” of a given site. While it is not the responsibility of a commercial real estate lawyer to personally undertake all possible searches, tests and enquiries, a lawyer should not be afraid to take ownership of the due diligence process to ensure that all reasonable enquiries – whether undertaken by the client, the lawyer or a third-party expert – are made. Ultimately, the thoroughness of the due diligence undertaken, the efficiency with which issues uncovered in the due diligence process are dealt with, and the resulting comfort level and satisfaction of the client will largely depend on the careful consideration and organization of the lawyer. When properly planned and executed, due diligence can reduce the likelihood of mistakes and unnecessary delays at closing, and ultimately result in tangible benefits to both the Vendor and Purchaser.

Pre-Offer Due Diligence

At a pre-offer stage, the extent of due diligence conducted and the advantages derived therefrom, must be balanced with cost considerations. While many Purchasers may not wish to invest time and money into preliminary due diligence for a potential transaction, early insights in to the possible deficiencies of a given property can ultimately reduce the time and money associated with dealing with unexpected surprises unearthed in the post-offer due diligence process.

A title search is a cost-effective place to begin. Registered ownership of the property should be confirmed and any evidence of beneficial ownership should be identified early on, as it will be relevant to other due diligence searches. Moreover, the type of entity registered on title as owner can impact the scope of due diligence. For example, if the owner is a partnership or joint venture, the relevant documentation of the business association will likely need to be reviewed to ensure all notice requirements have been properly given, and any buy-sell rights or required consents have been addressed.

Encumbrances on title can also be reviewed at a pre-offer stage. A Purchaser will want to consider whether there are any potentially onerous encumbrances registered against the property such as leases, options, restrictive covenants or easements, as well as any charges and liens or other interests which will need to be discharged.

Certain other property information not requiring the authorization of the owner is often available from the municipality, such as zoning, property taxes, development agreements and expropriation

proceedings, among others. A basic Due Diligence Search Checklist is attached for your reference as Schedule "A" (some of the searches will likely be performed, or repeated, post offer).

Although it may be more cost effective from the perspective of the Purchaser to engage in pre-offer due diligence prior to negotiating and drafting the PSA, practical considerations such as the nature of the property and transaction, as well as cost will likely dictate timing and the extent of any due diligence conducted.

Post-Offer Due Diligence

Once a letter of intent ("**LOI**") has been delivered or a Purchase and Sale Agreement ("**PSA**") has been executed, the task of conducting more exhaustive due diligence in respect of the Vendor and the property begins.

The PSA should outline the basic parameters of the due diligence process and the conditional period in which due diligence can be performed. The Vendor will typically be desirous of a shorter conditional period to limit the amount of time the Purchaser has to conduct its due diligence, and may want to provide that the time to deal with any issues or deficiencies that may be uncovered in the due diligence process will be after conditions are waived (but prior to closing).

A Purchaser should remember that because the Vendor has no general duty of disclosure in connection with the sale of the property - subject to the duty to disclose latent defects which render the property dangerous, and those items expressly addressed in the representations and warranties in the PSA - the onus is on the Purchaser to protect itself through careful drafting of the PSA and through its due diligence investigations. Due diligence searches should not only uncover unforeseen issues, but also test the representations and warranties the Vendor has put forward in the PSA. If the search results do not match the information presented in the Vendor's representations and warranties there is an issue!