Contracts and Leases

Lesson 2

Contracts Used in Real Estate Practice (Louisiana)

45 Hour Louisiana Post-Licensing

CONTRACTS USED IN REAL ESTATE PRACTICE

A. WRITTEN AGREEMENTS MOST COMMONLY USED:

1. Listing Agreements and Buyer Agency Agreements

a. Listing Agreement. (Agreement between broker and Seller) This is an employment contract; a contract in which the Seller agrees to pay a commission to broker and, in exchange broker agrees to attempt to find someone to purchase owner's property upon the Seller's terms. The Agreement typically contains the amount of the commission, the term of the contract and the terms of the sale.

b. Buyer Agency Agreements. (Agreement between broker and Buyer) Buyer contracts with broker for broker to seek to find property for Buyer to buy. Whether or not a commission will be paid depends on the agreement, as there is no general practice.

2. Relationship Between the Broker and Principal/Mandate.

a. Agent or Mandatary? An agent is commonly understood as someone who represents another. However, the legal ramifications of the term are far more complicated. It is erroneous to think that a real estate agent legally represents another. A true representative is someone who can act for someone in legal relations. *La. C.C. art. 2985.* It is an issue of authority just as discussed above for entities.

(i) Real estate agent. A real estate "agent", as that term is used in real estate law, particularly the Louisiana Licensing Law, is "a licensee acting under the provisions of this Chapter in a real estate transaction," meaning someone licensed to conduct real estate activity in Louisiana. *La. R.S. 37:1431.*

In the case of a listing agreement, the broker can be compared to an employee. The broker accepts the "job" of selling his employer's (the owner's) property, but the broker has no legal authority to bind the owner. His true "job" is to find someone to buy, not to act for the owner and actually transfer the property by signing the act of sale.

b. Mandate (Power of Attorney). Unlike an agent who receives compensation for his services, a mandatary may or may not receive anything of value for his services. That is to be determined solely by the contract.

A mandate is a contract by which a person, the principal, confers authority on another person, the mandatary, to transact one or more affairs for the principal. *La. C.C. art. 2989.*

(i) If the broker in the discussion above were to enter into a contract of mandate with the owner (in this case, the principal), then the broker would become the owner's mandatary and would have the legal authority to act in place of the owner to sign the act of sale transferring the property. In this case, the broker's action could bind the owner.

(ii) The authority of a mandatary to act for his principal with regard to immovable property must be evidenced in writing. *La. C.C. art. 2993.* In cases where the act to be executed by the mandartary requires a certain form, the mandate must be in that form. For example, a mortgage must be in authentic form, therefore the mandate must be in authentic form (rule of "Equal Dignity").

B. AGREEMENTS PREPATORY TO SALE/LEASE:

1. Letters of Intent (LOI).

a. LOIs are not intended to be binding contracts. These letters are most often used in the negotiation stage as an expression of interest. In fact, if written correctly, the point is to prevent a letter of intent from becoming enforceable.

b. Letters of intent are not specifically recognized in Louisiana and there is little case law concerning their use. However, case law from other states suggest that LOIs will be deemed binding if all of the requirements of a contract are found. Factors that courts look at in finding an enforceable contract include:

(i) LOI contains all material terms (i.e., price, property description, closing date).

(ii) LOI obligates parties to execute a subsequent agreement.

(iii) LOI includes references from which a court can determine the material terms.

(iv) Part performance evidences the parties' agreement to be bound by the terms of the LOI.

(v) LOI contains terms that prove intent of parties to be bound. (David C. Camp et.al., *Letters of Intent in Sale Transactions and Loan Commitments,* Practicing Law Institute, Real Estate Law and Practice Course Handbook Series, 468 PLI/Real 627.)

c. Factors often used by courts to indicate the intent not to be bound:

(i) Nature of the LOI itself makes letter non-binding.

(ii) LOI is not sufficiently specific to be binding (e.g., essential terms not included).

(iii) Specific language disavowing enforceability.

(iv) Conduct of the parties after signing the LOI reflect no intent to be bound.

2. **Purchase Agreements.**

a. Placed in context, the Purchase Agreement (or Agreement to Purchase and Sell) is an agreement between the Buyer and the Seller to sell and buy. While there are many rules in the Civil Code specific to Sales, the general rules regarding contracts also apply.

b. The Code Definition is:

> "An agreement whereby one party promises to sell and the other promises to buy a thing at a later time, or upon the happening of a condition, or upon performance of some obligation by either party, is a bilateral promise of sale or contract to sell. Such an agreement gives either party the right to demand specific performance.
>
> A contract to sell must set forth the thing and the price, and meet the formal requirements of the sale it contemplates." *La. C.C. art. 2623.*

3. <u>Elements to be Included or Considered in a Purchase Agreement</u>.

a. Actions necessary to satisfy the condition. (Example – property must be rezoned from residential to commercial.)

b. Time frame within which to perform. (Example – before the expiration of the Inspection period.)

c. Any costs involved, who is responsible for payment. (Example – Buyer shall be responsible for all cost involved in rezoning the property. Seller shall cooperate by signing any required applications; however, Seller shall not be obligated to expend any money in connection with rezoning.)

d. Other typical conditions:

(i) Prior years taxes must be paid.

(ii) Prior mortgages must be cancelled.

(iii) Satisfaction of inspections.

(iv) Other "escape" clauses.

4. <u>Environmental and Wetlands Disclosure and Warranty Issues</u>.

a. Unlike the sale of residential property, Sellers of commercial property are not legally obligated to make any disclosures. Not even the state mandated Property Disclosure Document is required in commercial transactions. For that reason, most Purchase Agreements and leases require the Seller to make certain disclosures during what is termed the "Inspection Period."

b. Disclosures are usually obtained in the form of studies and reports that the Seller is obligated to provide (usually only if these are already in the possession of Seller). The problem with representations and warranties by the Seller is that the Seller can only pass on any studies or reports obtained from qualified professionals. The Seller can only attest to what he knows.

c. Buyer should also take responsibility for using the Inspection Period to cause additional inspections to be made by professionals for the purpose of mitigating potential environmental and wetlands issues. Failure of the Buyer to investigate these issues may subject the Buyer to liability for cleanup. Proper investigation might otherwise provide Buyer with "innocent landowner" status in the event of any future problems.

5. Inspection and Due Diligence Period. Every Purchase Agreement should have a time frame for permitting inspections of the property. The LREC Purchase Agreement addresses this at Lines 158 – 188 and will be addressed later.

The list of "inspections" does not need to be limited to physical characteristics. The Inspection Period can be used to afford the opportunity to the Buyer to seek financing or look into other relevant matters. The important thing is for the agreement to cover everything. The Inspection Period is typically the Buyer's only chance to terminate the agreement and still receive a refund of the deposit, if one is made. There is no such chance if the agreement fails to cover the reason for withdrawal.

6. **Title.**

a. The Seller warrants the Buyer against eviction, which is the Buyer's loss of, or danger of losing, the whole or part of the thing sold because of a third person's right that existed at the time of the sale. The warranty also covers encumbrances on the thing that were not declared at the time of the sale; e.g., mortgage, with the exception of apparent servitudes and natural and legal nonapparent servitudes, which need not be declared.

If the right of the third person is perfected only after the sale through the negligence of the Buyer, though it arises from facts that took place before, the Buyer has no claim in warranty. *La. C.C. art. 2500.*

The Buyer may waive the warranty of title; however, there are statutory limits to such a waiver. The parties may contractually agree upon the extent of the warranty (*La. C.C. art. 2503*). The three most used clauses are:

(i) Full warranty. Eviction permits the Buyer to sue for return of the purchase price and damages.

(ii) No warranty. Eviction permits the Buyer to sue for only the return of the purchase price. No damages.

(iii) "Peril & Risk." The Seller is not liable for anything, except for his own acts. The Seller is always responsible for his own acts.

A better way to say this is "no warranty even for return of purchase price." However, you can design your own warranty.

b. Quitclaim Deed. This term is more often used in common law states. However, it is recognized in Louisiana. In this case, there is no specific transfer of an immovable. Instead, the Seller is only transferring whatever **right** he may or may not have in the thing. Such a transfer does not give rise to a presumption of bad faith. Eviction would not permit any claim for recovery nor is there a claim for lesion. *La. C.C. art. 2502.*

7. Title Clause.

> **Example title clause**. Title shall, as of the date of Closing, be valid and merchantable and not reflect any condition, restriction or servitude which, in the opinion of Buyer or Buyer's lender would impair Buyer's use of, or the value of the Property ("Title Conditions"). If title is not valid or merchantable, or such Title Conditions exist, Buyer may extend the time for Closing by thirty (30) days. In the event title is not valid or merchantable, and cannot be made valid or merchantable, or such Title Conditions exist, which cannot be removed at a reasonable expense prior to the Closing date set forth herein, as it may be extended hereunder, this Agreement shall be null and void at the option of the Buyer.

a. Merchantability. A title examination is usually performed by the Buyer's attorney to determine merchantability. The common definition of merchantability is "not suggestive of serious and substantial litigation." Malcolm A. Meyer, *Meyer's Manual on Louisiana Real Estate* (1992). Consequently, merchantable title does not mean perfect title.

b. Conditions affecting use. While the title examiner may determine that title is merchantable, the title exam may still reflect issues that could hamper the Buyer's plans. Such issues concern restrictions or servitudes that may restrict the Buyer's intended use for the property, e.g., Buyer intends to build a grocery store on the property, but a title exam reflects deed restrictions prohibiting grocery stores. These issues are just as important to the Buyer as merchantability and should be seriously considered.

8. Rezoning / Resubdivision / Regulation. Oftentimes the Buyer may want to have the property rezoned or resubdivided prior to purchase. These are typically drafted as conditions to closing with a specified time frame that is distinct from the time frame set for inspections. The problem is that the Seller (owner) is the party who must sign documents required to rezone or resubdivide, and the Seller is not always available, despite the inclusion of typical language indicating that the Seller will cooperate. For that matter, the Buyer may require the Seller to grant the Buyer the right to sign such documents on the Seller's behalf.

9. Example Regulatory Approval Period Clause. Buyer shall have until _____ (the "Regulatory Approval Period"), to seek or obtain approval from the necessary governmental authorities to rezone and re-subdivide the Property for Buyer's intended use.

Seller agrees to cooperate with the Buyer in connection with any necessary rezoning, resubdivision or other regulatory approvals. Buyer shall be responsible for submitting all necessary documentation to the appropriate governmental authorities for said rezoning and resubdivision and shall bear all costs associated therewith. Seller grants to Buyer the power and authority to sign and execute, in Seller's name and on Seller's behalf, any rezoning or resubdivision application, request or related document, as well as any other application and related documents for any other regulatory approval.

In the event that Buyer is unable to acquire all necessary approvals within the Regulatory Approval Period, as it may be extended, Buyer shall be permitted to cancel this Agreement by providing written notice of said cancellation to Seller during this period, in which case this Agreement shall become null and void. If Buyer so elects to cancel this Agreement, Seller agrees to instruct Escrow Agent in writing to promptly return the Deposit to the Buyer.

10. Miscellaneous Purchase Agreement Clauses.

a. Ratchet clause. In a Purchase Agreement conditioned upon various activities being conducted in different time periods (e.g., inspections, title search, financing), it is advisable to include language that reflects that these may be linked.

> **Example "ratchet" clause**. In the event that any time period set forth in this Agreement is extended for any reason, the time period(s) set for all other matters herein shall likewise be extended by an equivalent amount of time. By way of example, and not of limitation, if the Inspection Period is extended by thirty (30) days, the date of Closing shall be extended by thirty (30) days.

b. Holiday clause. Because so many conditions in a Purchase Agreement are time sensitive, it is important to state whether weekends and holidays should not be considered when calculating any performance date.

> **Example holiday clause**. When any day for notice or performance falls on Saturday, Sunday or a legal holiday, as that term is defined under Louisiana law, then such time for notice or performance shall be extended to the close of the next ensuing business day. (Hurricane clause – when a hurricane occurs during hurricane season it is not "force majeure" and failure to perform because of the hurricane results in breach of the contract. Parties may want to consider adding language that extends time frames additionally for weather related problems.)

c. All owners clause. Without performing a title search in advance of signing a Purchase Agreement, a Buyer may not always be sure of the identity of every owner (e.g., when purchasing from heirs). The agreement should indicate the consequences of failure of all owners to sign the agreement. Example:

> **Example all owners clause.** In the event the Property is owned by more than one owner, and all owners are not signatories herein (whether they are or are not reflected herein as Sellers), Buyer may (a) cancel this Agreement in its entirety or (b) proceed to Purchase the Property from those Sellers that are signatories hereto, in which case the Purchase Price will be reduced in proportion to the ownership interests purchased.

11. Telephone/Fax Negotiations and E-Mail. As indicated above for verbal negotiations, telephone and fax negotiations also create the same "proof" issues. Because of the increasing use of technology in negotiations, parties should indicate whether or not fax and telephone negotiations are acceptable. For example, if Buyer agrees that acceptance may be evidenced by receipt of a signed Purchase Agreement from Seller by fax, then that should be indicated in the agreement.

a. Louisiana Law Regarding Electronic Transactions**.** Applicability of the *Louisiana Uniform Electronic Transactions Act* to Real Estate Transactions.

History of E-Sign.

(i) The first attempt to synchronize the use of technology in business and commerce came with the adoption of the Uniform Electronic Transactions Act ("UETA"), a model act promulgated by the National Conference of Commissions of Uniform State Laws ("NCCUSL"). UETA was used widely, but with many amendment in various states.

(ii) Next, Congress adopted the Electronic Signatures in Global and National Commerce Act ("E-Sign" – 15 U.S.C. §§ 7001 *et seq.*) to harmonize the provisions of the various rules on the subject. States could opt out of E-Sign by adopting UETA entirely.

(iii) Louisiana adopted UETA, with few modifications, in 2001 by Act 244 ("LUETA"). This adoption of UETA, with modest differences consistent with E-Sign, prevents federal law from superseding state law on this subject.

b. What does LUETA do?

(i) It provides for the validity and enforceability of transactions executed by electronic means. This covers all forms of electronic means.

(ii) The effect of LUETA is legal recognition of contracts that are electronically recorded and electronically signed. Laws requiring a record to be in writing or to be signed will be satisfied by an electronic record or electronic signature respectively. *La. R.S. 9:2607*

(iii) Consent is a major issue. The parties involved in the transaction (Buyer and Seller for our purposes) must agree to use electronic means to negotiate and finalize the contract.

c. The rules regarding LUETA do not affect the rules regarding contracts. They simply provide rules for how the contract may be formed and signed.

(i) Parties are free to choose to use LUETA or not. It is notable that so far it is rare to see contracts formed using the provisions of LUETA. While most parties are comfortable using email to negotiate the agreement, most will still choose to physically sign the document rather than electronically.

(ii) LUETA also covers how electronically created documents can be used to satisfy recordation requirements.

(iii) The LREC requires licensees to keep certain documents in their original form. This provision can be satisfied if the parties conduct their entire transaction by electronic means. In that event the electronic record is the "original" record. A record retained electronically will satisfy the records retention requirement. The LREC has the authority to adopt rules for records retention to comply with LUETA.

12. **Deposit vs. Earnest Money.** *La. C.C. art. 2624.* Neither is required by law in connection with a Purchase Agreement or Option.

a. Deposit. The default rule is that an amount given by the Buyer to the Seller in connection with the Purchase Agreement is a deposit towards the amount of the Purchase Price. It is important to note that in Louisiana a Buyer is not required by law to provide a deposit. On the other hand, it is common practice.

b. Earnest Money**.** This is a specific legal term in Louisiana. If the amount given is deemed earnest money, either party may recede from the contract. If the Buyer recedes, the Buyer forfeits the earnest money. If the Seller recedes, the Seller must return the earnest money to the Buyer, plus an equivalent amount.

(i) The use of earnest money is not the norm in Louisiana. This is confusing for people from out of state who use the term earnest money synonymously with deposit.

(ii) It is key to note that the consequences are not "damages" in an earnest money contract. Instead, it is an "alternative" performance and neither party is considered in default.

13. **Escrow Agreements**

a. Escrow is when a third party holds something, e.g., money, until the fulfillment of a condition. When something is held "in escrow", the thing is deposited with the escrow agent for safekeeping. In Louisiana, the escrow is a contract that may be gratuitous (no compensation) or onerous (typically compensated).

The most typical use of escrow in the case of real estate is the holding of a deposit. The third party, in this case, is often a broker or a title company. While a broker is not a true escrow agent, they are acting, in this situation, as a depositary and the contract is gratuitous.

(i) Brokers who accept money must open and maintain a "Sales Escrow Account." LREC §2701. The accounts are non-interest bearing, which is why most deposits made in Purchase Agreements are deemed "non-interest bearing."

(ii) Whether or not the escrow agent is a broker or another party, the agreement should state whether or not the funds will bear interest while being held by the escrow agent.

b. The deposit is held until the terms of the Purchase Agreement are satisfied and the transaction closes. In that case, the deposit is usually released to the Seller as a portion of the purchase price. If the transaction fails, the deposit is usually returned to the Buyer.

c. Escrow is also used often in closings when the parties do not intend to meet to close the transaction or if something remains to be done after closing.

Example. Seller lives in California and cannot be available to close on the scheduled date. Seller signs all of the closing documents and sends them to the title company to be held "in escrow." If Buyer satisfies all of the closing requirements, the documents will be released for Buyer to sign and complete the transaction at Closing.

Example. Builder and Buyer agree to close on March 1. The closing date arrives, but Builder has not completed the landscaping agreed upon in the Purchase Agreement. Builder and Buyer agree to close, but put $5,000.00 of the Builder's proceeds from the sale "in escrow", to be held by the title company. The funds will not be released to Builder until the landscaping is complete. The parties agree that if the landscaping is not complete by a certain date, that the funds may be released to Buyer as compensation for Builder's failure to complete the landscaping.

d. Deposit Disputes. If a dispute occurs regarding ownership or entitlement to the deposit, then the broker is obligated, within 90 days of the scheduled closing date, or determination or knowledge that such a dispute exists, whichever shall first occur, to do one of the following (LREC §2901). This will be discussed in detail later.

e. Disburse the funds upon the order of a court of competent jurisdiction.

14. Liquidated Damages.

a. Parties may stipulate the damages to be recovered in case of nonperformance, defective performance, or delay in performance of an obligation. *La. C.C. art. 2005.*

b. The benefit to a liquidated damages clause is that the obligee does not have to prove actual damages resulting from the obligor's nonperformance, defective performance, or delay in performance. *La. C.C. art. 2009*.

Example. Builder and Buyer enter into a contract to build an office. Builder is obligated to complete the office on or before June 1 or pay liquidated damages in the amount of $100.00 per day. Builder does not complete the office until June 5. Buyer does not have to prove that the 4-day delay caused him any actual damages. Builder owes Buyer $400.00 in liquidated damages.

c. The issue of liquidated damages is wholly separate from the deposit. A Purchase Agreement may provide for liquidated damages, and return of the deposit/retention of the deposit in the case of breach by the Seller or Buyer respectively.

15. Contingencies. Most Purchase Agreements include contingencies or "conditions" that must be satisfied before the Purchase Agreement is enforceable. There may be other contingencies that must be satisfied after the sale.

A conditional obligation is one dependent on an uncertain event.

If the obligation may not be enforced until the uncertain event occurs, the condition is suspensive.

If the obligation may be immediately enforced, but will come to an end when the uncertain event occurs, the condition is resolutory. *La. C.C. art. 1767* (emphasis added).

a. Suspensive Condition**.** If a condition is suspensive, then the performance of obligation is not enforceable until the condition is satisfied.

(i) The most often used suspensive condition in a sales contract involves financing. Buyers typically indicate that the sale cannot take place if the Buyer is unable to obtain financing. The uncertain event is the financing, and the Purchase Agreement is not enforceable until the financing is obtained. For this reason, most Purchase Agreements include a time frame for when this condition must be satisfied so that it won't hold up every other provision in the contract.

(ii) If the condition is not satisfied, the contract is not enforceable and it is as if there never was a contract. However, there must be a good faith effort made to satisfy the condition.

Example. Buyer offers to purchase Seller's property. Buyer's offer includes a condition that Buyer must obtain a Purchase Agreement on his own property in order to buy Seller's property. This condition is suspensive. If Buyer cannot sell his property after a good faith effort, he is not obligated to purchase Seller's property. Any deposit must be returned because the contract is unenforceable.

Example. *Garsee v. Bowie,* 37,444 (La.App. 2 Cir. 8/20/03), 852 So.2d 1156. Garsee agreed to sell Bowie eight multi-family residential properties with the suspensive condition that Bowie obtain a 30-year first mortgage, with a 25 percent down payment at a rate not to exceed 6 7/8 percent interest. Bowie applied to Hibernia National Bank for the agreed upon financing for the properties. Hibernia rejected Bowie's loan application. After the rejection, Bowie declared the Purchase Agreement null and void for failure to fulfill the suspensive condition. Garsee subsequently filed suit to enforce the agreement. Garsee asserted that Bowie did not comply in good faith with the Purchase Agreement because he only made an application to one lending institution. The court held that the condition was suspensive, thus, once the agreed upon financing could not be obtained, the Purchase Agreement was null. Secondly, one attempt to obtain financing was enough to constitute a good faith effort by Bowie to satisfy the terms of the Purchase Agreement.

b. Resolutory Condition**.**

(i) If a condition is resolutory, performance of the obligation is immediately enforceable, but may come to an end if the uncertain event arises. In the case of a sale, the Buyer's obligation is to pay the purchase price. If the Buyer fails to pay the price, then the uncertain event has occurred and the obligation comes to an end.

Example. Buyer purchases a property from Seller and the parties agree upon owner-financing and execute a credit sale. Buyer makes all of his payments to Seller during the first year, but fails to make any payments in the second year. Seller is now entitled to "unwind" the sale and take back the property. (This is a simple example and does not take into account other issues when this situation arises.)

(ii) Waiver. The nature of a resolutory condition requires that its terms be carried into the Act of Sale. Once the sale is recorded, the resolutory condition outranks everything that comes next, most importantly, mortgages. For that reason, most parties will waive the effect (dissolution of the sale) of any resolutory conditions in the Act of Sale.

> **Example.** Seller subdivides his lot into two parts and sells the back part to Buyer. In the Purchase Agreement, Seller agrees to construct a road along a servitude of passage on his property to permit Buyer to reach the frontage road. Later, the Act of Sale indicates that Seller will build the road; however, Buyer waives the resolutory condition and indicates that failure of Seller to build the road shall not dissolve the sale, but permit Buyer only a claim for damages or specific performance.

c. Conditions Generally**.**

(i) Nullity. Once the condition is fulfilled, depending on the type, the contract is automatically enforceable or automatically null and void. It is not an option of the parties. In the case of resolutory condition contained in an Act of Sale, the result is dissolution of the sale.

> **Example.** Parties enter into Purchase Agreement, which contains special provisions clause that states: "any single mechanical item repair that exceeds $2,000.00, the Seller has the option to repair or the contract will be null and void." Inspector found over $25,000.00 in required repairs. Seller refused to make repairs. Parties argued over who had the option to terminate the contract. The court said neither party had that right because the clause contained a condition, not an option, and once the condition was fulfilled (repair over $2,000.00 that Seller would not fix) the contract automatically became null. *Campbell v. Melton*, 2001-2578 (La. 5/14/02), 817 So.2d 69.

(ii) Whim or Will. "A suspensive condition that depends solely on the whim of the obligor makes the obligation null. A resolutory condition that depends solely on the will of the obligor must be fulfilled in good faith." La. C.C. art. 1770. The former statement was historically referred to as a "potestative" condition, but that term is no longer used in the Civil Code. The idea is that fulfillment of the condition should not be based on an arbitrary decision by the obligor, but rather one of judgment.

> **Example.** Buyer offers to buy Seller's property with the condition that "financing must be obtained at an interest rate that is acceptable to me." This suspensive condition is based upon the whim of the obligor because the obligor can decide that any interest rate is unacceptable. The contract is likely null.

(iii) Waiver. Generally, a condition may be waived by the party in whose favor it is written.

16. Covenants, Conditions, Restrictions and Servitudes. Ownership is composed of three basic rights; to use, to receive income and to dispose (usus, fructus, abusus). Servitudes are considered a "dismemberment of ownership" because they permit others to use the thing.

Covenants, conditions and restrictions also affect use by limiting what the owner can do with the thing.

a. Servitudes.

(i) There are 2 kinds of servitudes: (1) personal (e.g., usufruct, habitation, right of use), and (2) predial. *La. C.C. art. 533, 534.* The type to be discussed here are predial.

(ii) Predial servitude = a charge on a servient estate for the benefit of a dominant estate. The two estates must belong to different owners. *La. C.C. art. 646.* There must be a benefit to the dominant estate for there to be a predial servitude (e.g., right of passage). *La. C.C. art. 647.*

(iii) A predial servitude is inseparable from the dominant estate and passes with it. It cannot be alienated, leased or encumbered separately from the dominant estate. The charge upon the servient estate continues even if ownership changes. *La. C.C. art. 650.*

> **Example**. John owns a tract of land adjacent to Bob's tract. John wants access to the public lake located on the other side of Bob's tract from his land. John and Bob enter into a contract in which a servitude of passage is created on Bob's land for the benefit of John's land. Bob's land is the servient estate and John's land is the dominant estate. The benefit to the dominant estate is passage to the lake. The contract creating the servitude is recorded in the public record. Bob sells his land to Jim. Later John sells his land to Charles. Charles may use the servitude of passage on Jim's land because the servitude is predial, i.e., runs with the land, rather than personal to either John or Bob.

(iv) Predial servitudes may be natural, legal, and voluntary or conventional. Natural servitudes arise from the natural situation of estates (e.g., drainage); legal servitudes are imposed by law (e.g., passage); and voluntary or conventional servitudes are established by juridical act (e.g., contract), prescription, or destination of owner (e.g., developer creates a servitude of passage over his land because he intends to subdivide and sell the land). *La. C.C. art. 654.*

(v) A predial servitude may be established by an owner on his estate or acquired for his benefit by conventional act (e.g., contract). *La. C.C. art. 697.* When the parties fail to establish rules for the servitude in the act creating the servitude, the Civil Code rules apply.

(vii) A developer may create servitudes for various uses upon an entire tract of land prior to subdividing the land into lots for sale. The servitudes should be noted on the approved subdivision map, which is then recorded. Such servitudes may be for passage, drainage, utilities, etc.

(viii) Servitudes established by title are governed by same laws governing alienation of immovables. *La. C.C. art. 708.*

b. Covenants, Conditions, Restrictions**.** These are lumped together because they are typically used to mean the same thing in this context. The Civil Code defines "building restrictions" as:

> … charges imposed by the owner of an immovable in pursuance of a general plan governing building standards, specified uses, and improvements. The plan must be feasible and capable of being preserved. *La. C.C. art. 775.*

(i) The most common restrictions are the type a developer imposes upon a new subdivision; these are properly called Building Restrictions. At the time lots are subdivided, the developer records a set of "covenants" concerning how the subdivision will look; how lots can be used, the things that cannot be done upon a lot, how common areas will be used and maintained, etc.

(ii) Deed restrictions are usually contained within the act of sale.

(iii) Restrictions are established by a written act, preferably an authentic act, executed by the owner or by all owners affected and recorded in the public record. Subsequent owners are not affected by the restrictions if they are not recorded. Otherwise owners are bound by them even if they are not mentioned in a Purchase Agreement (note – good reason for researching title).

(iv) Amendment or Termination.

> Building restrictions may be amended, whether such amendment lessens or increases a restriction, or may terminate or be terminated, as provided in the act that establishes them. In the absence of such provision, building restrictions may be amended or terminated for the whole, or a part of the restricted area by agreement of owners representing more than one-half of the land area affected by the restrictions, excluding streets and street rights-of-way, if the restrictions have been in effect for at least fifteen years, or by agreement of both owners representing two-thirds of the land area affected and two-thirds of the owners of the land affected by the restrictions, excluding streets and street rights-of-way, if the restrictions have been in effect for more than ten years. *La. C.C. art. 780.*

(v) Building restrictions may be enforced by mandatory and prohibitory injunctions. *La. C.C. art. 778.*

> No action for injunction or for damages on account of the violation of a building restriction may be brought after two years from the commencement of a noticeable violation. After the lapse of this period, the immovable on which the violation occurred is freed of the restriction that has been violated. *La. C.C. art. 781.*

(vi) Zoning ordinances neither terminate nor supersede existing building restrictions. *La. C.C. art. 782, comment (c).*

17. Purchase Price and Financing.

a. "Real" price. There is no sale unless the parties intended that a price be paid. The price must be in proportion to the thing sold (think – lesion). "Thus, the sale of a plantation for a dollar is not a sale, though it may be a donation in disguise." *La. C.C. art. 2464.* If a proper price is not paid and the "sale" is viewed as a "donation" then issues regarding form arise. (Note – the term "other valuable consideration" is not acceptable in Louisiana, although it is often used in common law states to maintain privacy if the parties to the sale do not want the purchase price to become a part of the public record.)

b. Determination by third party. The price may be left to the determination of a third party, e.g., an appraiser. If a third person is not named, or the named person fails to or is unable to determine a price, then it may be set by the court. *La. C.C. art. 2465.*

c. Financing. In most cases, the Act of Sale does not reference financing. Typically, if the Buyer obtains a loan from a third party, the lender provides cash for closing and financing conditions are contained in separate documents (e.g., mortgage and/or loan agreement). Financing terms should be included in the Act of Sale if the sale is to be owner-financed.

18. Warranties and/or "As Is" Clauses. The Seller generally warrants three things to the Buyer: condition, use and title.

a. Redhibition (hidden).

The Code provides that the Seller warrants the Buyer against redhibitory defects, or vices, in the thing sold. This automatically applies unless the contract alters it.

A defect is redhibitory when it renders the thing useless, or its use so inconvenient that it must be presumed that a Buyer would not have bought the thing had he known of the defect. The existence of such a defect gives a Buyer the right to obtain rescission of the sale.

A defect is redhibitory also when, without rendering the thing totally useless, it diminishes its usefulness or its value so that it must be presumed that a Buyer would still have bought it, but for a lesser price. The existence of such a defect limits the right of a Buyer to a reduction of the price. *La. C.C. art. 2520*.

(i) Redhibition concerns the condition of the property. The Seller does not owe any warranty for defects that were known to the Buyer or "for defects that should have been discovered by a reasonably prudent Buyer of such things." *La. C.C. art. 2521*. This is exactly why an inspection is so important.

(ii) The Seller must be notified of any defects in the thing sold in order to give the Seller an opportunity to make repairs. Failure to give notice may reduce the Seller's liability unless the Seller has actual knowledge of the redhibitory defect. *La. C.C. art. 2522*.

(iii) "As is" and Waiver. This term is somewhat of a misnomer. Including this, by itself, in a Purchase Agreement or Act of Sale is insufficient as a waiver of the warranty of condition and fitness for use (discussed below), despite the intentions of the parties. Essentially every sale is "as is." The Seller sells what he has. If the intent is for the Buyer to waive the Seller's liability, the waiver must be explicit. The following is an example of a sufficient waiver.

> The property is sold "as-is, where is" without any warranties whatsoever as to fitness or condition, whether expressed or implied, and Buyer expressly waives the warranty of fitness and the guarantee against hidden or latent vices (defects in the property sold which render it useless or render its use so inconvenient or imperfect that Buyer would not have purchased it had he known of the vice or defect) provided by law in Louisiana, more specifically, that warranty imposed by Louisiana Civil Code art. 2520 et seq. with respect to Seller's warranty against latent or hidden defects of the property sold, or any other applicable law, not even for a return of the purchase price. Buyer forfeits the right to avoid the sale or reduce the purchase price on account of some hidden or latent vice or defect in the property sold. Seller expressly subrogates Buyer to all rights, claims and causes of action Seller may have arising from or relating to any hidden or latent defects in the property. This provision has been called to the attention of the Buyer and fully explained to the Buyer, and the Buyer acknowledges that he has read and understands this waiver of all express or implied warranties and accepts the property without any express or implied warranties.

b. Fitness for Use. Anything sold must be fit for its "ordinary use." This warranty is wholly different from redhibition.

> The thing sold must be reasonably fit for its ordinary use.
>
> When the Seller has reason to know the particular use, the Buyer intends for the thing, or the Buyer's particular purpose for buying the thing, and that the Buyer is relying on the Seller's skill or judgment in selecting it, the thing sold must be fit for the Buyer's intended use or for his particular purpose.
>
> If the thing is not so fit, the Buyer's rights are governed by the general rules of contracts. *La. C.C. art. 2524*.

19. Prorations. Typically the Buyer and Seller agree to prorate the cost of any expenses related to the property that may be due in the year of the sale, e.g., taxes, homeowner's association dues and condominium association dues, rent, utilities.

20. Date and Signature – Authentic Form. The Act of Sale must be dated and signed by the Buyer and Seller. Authentic Form was previously discussed at Section I.A.6.

21. Recordation. The sale of an immovable does not affect third parties until the Act of Sale is recorded in the public records of the parish in which the immovable is located. *La. C.C. art. 1839.* The Act of Sale should be recorded as soon as possible after the transaction is complete.

22. **Certified Funds Requirement at Closing**. The following requirements are necessary if title insurance is involved.

Settlement agents may not accept personal or commercial checks in excess of $2,500.00, in which case the funds must be by certified check. *La. R.S. 22:532(B)(3)(h).*

a. Checks that may be drawn on the trust account or sales account of a licensed real estate broker are limited to less than $20,000.00. Otherwise they must be certified funds. *La. R.S. 22:532(B)(3)(g).*

23. **Options/Rights of First Refusal Agreements/Right of First Offer**. Options and Rights of First Refusal are considered "agreements preparatory to the sale" by the Louisiana Civil Code.

a. Option Contract. An option is a contract that gives a party the right to accept an offer to sell or buy a thing within a stipulated time. *La. C.C. art. 2620.* An option must set forth the thing and the price, and meet the formal requirements of the sale it contemplates. *La. C.C. art. 2620*.

An option is a contract whereby the parties agree that the offeror is bound by his offer for a specified period of time and that the offeree may accept within that time. *La. C.C. art. 1933*

The rights granted by an option include; the right to accept the option, thus turning the agreement into an agreement to purchase. *La. C.C. art. 2620, comment (e).*

Acceptance (usually called "election") or rejection is effective when received by the grantor.

The parties to an option should realize that acceptance of the Option automatically turns the option contract into a Purchase Agreement. The option must be complete enough so that, if accepted, the document will stand as a fully completed Purchase Agreement.

The option agreement contains the terms of a true Purchase Agreement with a provision that if the Buyer elects to exercise his option to buy the property that the terms of the Purchase Agreement "take over."

In the real estate business, an option contract usually involves the payment of money for the benefit of obtaining such a period of time within which to accept. However, unlike in many common law states, no price is required in Louisiana.

b. Right of First Refusal.

(i) A Right of First Refusal is an agreement in which a party promises not to sell a thing without first offering it to a certain person. La. C.C. art. 2625. The right given is the right of first refusal, which may be enforced by specific performance.

(ii) The grantor of the right cannot sell the property unless and until it has been offered for sale to the party who holds the right.

(iii) Unless otherwise stipulated, the time for acceptance of a right of first refusal is thirty (30) days. La. C.C. art. 2627. If the property is not sold within six (6) months, then the right subsists in favor of the grantee who failed to exercise it when the offer was made to him.

(iv) Enforcement of Right of First Refusal. The Civil Code Right of First Refusal may be enforced by specific performance. La. C.C. art. 2625.

(v) Issues.

(a) The Civil Code leaves many areas unanswered, so it is important that parties cover these in the agreement.

(b) The right of first refusal becomes operative only if the owner has an offer he desires to accept. Usually, the holder of the right of first refusal must exactly match all terms of the offer the Seller wishes to accept.

(c) Unanswered questions.

(1) What if the Seller gets an offer for part of the Property?

(2) If part is sold, does the right of first refusal continue to apply to the remainder of the property?

(3) Can the right of first refusal have its own terms, i.e., will meet offered price, but will be owner financed if holder of right of first refusal elects to buy.

c. Term. Options and Rights of First Refusal may not be granted for a term longer than ten (10) years, unless the right is granted "in connection with a contract that gives rise to obligations of continuous or periodic performance" (e.g., lease) in which case the Option or Right of First Refusal may be granted for as long a period as required for the performance of the obligations (e.g., a lease with an option provides for a twenty-year term. The right to the option lasts for twenty (20) years because the lease term is 20 years). If a longer time is stipulated in the contract, then it is reduced to ten years.

d. Effect against Third Persons. These rights, if they affect immovables, effect third persons only from the time of recording notice of the right in the public record. *La. C.C. art. 2629.*

e. Distinction. An Option is the right to accept an offer, whereas, a Right of First Refusal is to right to receive an offer. In the case of an Option, the grantor must give the grantee a stipulated time to accept or reject an offer. On the other hand, the grantor of a Right of First Refusal only has to give the grantee the offer before giving it to another party, or before accepting an offer from another party.