

# REPRESENTATIONS, WARRANTIES AND "AS IS" DISCLAIMERS

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TABLE OF CONTENTS

I. INTRODUCTION..... 1

    A. Lay Understandings..... 1

    B. Competing Public Policies..... 1

    C. Contract Approaches ..... 1

II. REPRESENTATIONS, WARRANTIES AND COVENANTS ..... 1

    A. Representations..... 1

    B. Warranty..... 1

    C. When a Representation Becomes a Warranty ..... 2

III. MISREPRESENTATION, FRAUD AND FRAUDULENT INDUCEMENT,  
DECEPTIVE TRADE PRACTICES, AND NEGLIGENT MISREPRESENTATION..... 2

    A. Misrepresentation ..... 2

    B. Fraud and Fraudulent Inducement ..... 2

    C. Deceptive Trade Practices ..... 2

    D. Negligent Misrepresentation..... 3

IV. DUTY TO SPEAK..... 3

    A. No Duty to Speak..... 3

        1. Silence ..... 4

        2. No Actual Knowledge as to Issue ..... 4

        3. Reasonable to Assume that Other Party Knows Fact..... 4

        4. No Reliance and Immateriality ..... 4

    B. Duty to Speak ..... 4

        1. Confidential or Fiduciary Relationship..... 4

        2. Other Circumstances..... 4

            a. When Other Party Does Not Have a Reasonable Opportunity to  
Discover a Material Fact ..... 4

            b. When Knowledge Party has Knowledge That Other Party  
is Ignorant of Fact ..... 4

            c. Partial Disclosure That Conveys a False Impression  
..... 4

            d. Subsequent Knowledge that Prior Statement is False or Misleading..... 4

V. REAL ESTATE SALES CONTRACTS AND LEASES ..... 4

    A. Typical Contractual Provisions ..... 4

        1. "Free Look" ..... 4

        2. Express Representations and Warranties..... 5

            a. Typical Representations and Warranties ..... 5

            b. Disclosure of Known Facts..... 5

            c. Knowledge Exceptions..... 5

---

3.	Disclaimer of Representations and Warranties .....	6
a.	"As Is-Non-Reliance" Clause.....	6
b.	Merger Clause .....	7
c.	Assumption of Environmental Liability and Indemnity Agreements.....	7
B.	Standard Form Approaches .....	7
1.	TREC and TAR Forms .....	7
2.	<i>Texas Real Estate Forms Manual</i> .....	8
C.	Enforceability of Disclaimers .....	8
1.	"As Is" Clause Negates Reliance on Seller's or Agent's Representations Outside the Contract .....	8
2.	Circumstances Where Not Enforceable .....	9
a.	Fraudulent Representations .....	9
b.	Concealment .....	9
c.	Ability to Learn of Fact is Impaired by Seller's Conduct.....	9
d.	Other Conditions Negating Effect of As Is Clause .....	10
Forms		
1.	TREC/TAR Residential Sales Contract and TAR Seller's Disclosure Notice .....	11
2.	TAR Commercial Contract – Improved Property and TAR Commercial Property Condition Statement .....	18
3.	<i>Texas Real Estate Forms Manual</i> Sales Contract .....	23
4.	Best Practice Forms .....	29
Footnotes .....		37

## USEFUL MATERIALS

Annotations

8 A.L.R. 5<sup>th</sup> 312, *Construction and Effect of provision in Contract for Sale of Realty by Which Purchaser Agrees to Take property "As Is" or in Its Existing Condition.*

12 A.L.R. 5<sup>th</sup> 630, *Vendor's Obligation to Disclose to Purchaser of Land Presence of Contamination from Hazardous Substances or Wastes.*

24 A.L.R.3d 465, *Construction and Effect of Affirmative provision in Contract of Sale by Which Purchaser Agrees to Take Article "As Is," in the Condition in Which it Is, or Equivalent Term.*

73 A.L.R. 3<sup>rd</sup> 248, *Construction and Effect of UCC § 2-316(2) Providing that Implied Warranty Disclaimer Must be "Conspicuous".*

168 A.L.R. 389, *Implied Warranty of Quality, Fitness, or Condition as Affected by Buyer's Inspection Of, or Opportunity to Inspect Goods.*

160 A.L.R. 357, *Necessity of Buyer's Actual Knowledge of Disclaimer of Warranty of Personal Property.*

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13 TEX. JUR. 3D *Consumer and Borrower Protection* § 255 Failure to disclose—Affirmative misrepresentations and failure to disclose distinguished (2004).

41 TEX. JUR. 3D *Fraud and Deceit* §§13 Materiality; 21 "Puffing", 33 "As is"; waiver of reliance (2007).

65 TEX. JUR. 3D *Sales* §§ 223 Implied Warranties—Exclusion; Waiver and 309 "As is" sales (2006).

3 CRAIG B. GLIDDEN AND GREGORY ABBOTT, TEX. PRAC. GUIDE BUS. & COM. LITIG. 112-117 Ch. 19 *Contract Rights and Liabilities* § 19.201 Enforcement of "as is" contracts; § 19.202 Enforcement of "as is" contracts—determination whether to give effect to "as is" provisions (Thompson/West Supp. 2008).

17 WILLISTON ON CONTRACTS Ch. 50 *Contracts for the Sale or Lease of Land – Caveat Emptor, Warranties and Representations* § 50:40 Particular representations—Environmental matters (Supp. 2008).

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#### Seminars

Michael Baucum, *As-Is Update "Prudential 2008"*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE LAW COURSE (2008).

Larry W. Nettles, *Drafting Environmental Clauses*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE DRAFTING COURSE (2007).

Anne Newton, *"As Is" Provisions in Commercial Leases*, in STATE BAR OF TEXAS PROF. DEV. PROGRAM, ADVANCED REAL ESTATE DRAFTING COURSE (2008).

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**I. INTRODUCTION**

**A. Lay Understandings**

*"Darling, I have always told you some version of the truth."*<sup>1</sup> *"Caveat emptor."*<sup>2</sup> *"Prove yourself to be brave, truthful and unselfish."*<sup>3</sup> *"Silence is the virtue of fools."*<sup>4</sup> *"Silence is golden."*<sup>5</sup> *"Honesty is a good thing but it is not profitable to its possessor unless it is kept under control."*<sup>6</sup> *"Honesty is the best policy; but he who is governed by that maxim is not an honest man."*<sup>7</sup>

**B. Competing Public Policies**

Consumer protection.<sup>8</sup>

Freedom of contract.<sup>9</sup>

**C. Contract Approaches**

Risk shifting provisions are contained in all contracts. They are used in an attempt to assure the intended economic objectives of the "deal." The most common methods by which risk is shifted in a contract are by the use of representations and warranties, insurance covenants, express assumption of liabilities, indemnity,<sup>10</sup> exculpation,<sup>11</sup> release<sup>12</sup> and limitation of liability provisions.

Every provision of a contract is either restating the rule that would be supplied by the court in the absence of the provision or is expressly shifting a risk from one party to the other.

Each contracting party's risk-related goals are (1) to accept no more risk than it can reasonably bear or insure, and (2) to transfer the balance of the risk to the other party. The following factors are involved in the ultimate determination as to how much risk a party receives or transfers: (1) which party is in the best position to control the extent of the occurrence of the risk?; (2) does one party have specialized knowledge of the type of risks most likely to occur and how to prevent or identify them?; (3) custom and practice in the particular industry (for example, sellers to buyers; landlords to tenants; owners to contractors; contractors to subcontractors); (4) the bargaining strength of the respective parties; and (5) statutory and common law public policies.

**II. REPRESENTATIONS, WARRANTIES AND COVENANTS**

**A. "Representations"**

BLACK'S LAW DICTIONARY defines "representation" as

A presentation of fact – either by words or by conduct – made to induce some to act, sep. to enter into a contract; esp., the manifestation to another that a fact, including a state of mind, exists [the buyer relied on the seller's representation that the roof did not leak].<sup>13</sup>

Representations are a means for the Buyer to gain information about the property. Representations can be a valuable supplement to a Buyer's investigation of the property, especially as to matters that are not readily ascertainable by a Buyer through normal investigations. Also, time constraints or other practical obstacles (such as evaluating the purchase of multiple properties) may dictate the use of representations and warranties as opposed to in-depth property inspections.

Representations and warranties are also a means of allocating risks between the parties as to matters occurring prior to the sale.

Prudence dictates that a buyer undertake its own investigation of the property as opposed to placing sole reliance upon a seller's representations and warranties.

**B. "Warranty"**

BLACK'S LAW DICTIONARY defines "warranty" as

*Contracts.* An express or implied promise that something in furtherance of the contract is guaranteed by one of the contracting parties; esp., a seller's promise that the thing being sold is as represented or promised. A warranty differs from a representation in four principal ways: (1) a warranty is an essential part of a contract, while a representation is usu. only a collateral inducement, (2) an express warranty is usu. written on the face of the contract,

while a representation may be written or oral, (3) a warranty is conclusively presumed to be material, while the burden is on the party claiming breach to show that a representation is material, and (4) a warranty must be strictly complied with, while substantial truth is the only requirement for a representation.<sup>14</sup>

### C. When a Representation Becomes a Warranty

The distinction between representations and warranties is many times unclear. The test as to whether a representation is a warranty or is a mere expression of an opinion turns on whether the seller asserts a fact of which the buyer was ignorant or merely expresses a judgment about something on which each might be expected to have an opinion.<sup>15</sup>

## III. MISREPRESENTATION, FRAUD, FRAUDULENT INDUCEMENT, DECEPTIVE TRADE PRACTICES, AND NEGLIGENT MISREPRESENTATION

### A. Misrepresentation

Of course, a seller will have liability for false representations.<sup>16</sup>

### B. Fraud and Fraudulent Inducement

To recover on a fraud claim, a plaintiff is required to prove that: (1) the defendant made a material misrepresentation; (2) the representation was false; (3) when the representation was made, the defendant knew it was false or the statement was recklessly asserted without any knowledge of its truth; (4) the defendant made the false representation with the intent that it be acted on by the plaintiff; (5) the plaintiff acted in reliance on the misrepresentation; and (6) the plaintiff suffered injury as a result.<sup>17</sup> Fraud by non-disclosure is simply a subcategory of fraud, because, where a party has a duty to disclose, the non-disclosure may be as misleading as a positive misrepresentation of facts.<sup>18</sup>

In addition to common law fraud, Texas has a statutory cause of action for fraud in a real

estate transaction. Under Texas Business and Commerce Code §27.01, a person that commits fraud in connection with a real estate transaction can be liable for damages, including attorneys' fees, expert fees and court costs.<sup>19</sup> As a general rule, these claims require evidence of intent, knowledge and injury *as a result of the conduct*. The allegations are most often levied against the developer, since the contractor is not likely to have made representations to the residence purchaser at all. In a condominium project, a difficulty a condominium association may have is that these claims are more personal to the unit owner and not "common" to two or more unit owners. Although not resolved by current Texas case law, defendant developers will argue that the condominium association lacks standing to assert these types of "personal" claims.

### C. Deceptive Trade Practices

In 1967, Texas adopted the law known as the Texas Deceptive Trade Practices Act ("DTPA"). Tex. Bus. & Code §§ 17.41 *et seq.* The DTPA lists an number of unlawful practices (referred to as the "laundry list") and creates a cause of action for consumers to sue those employing such practices. For example, the DTPA prohibits any

failure to disclose information concerning goods or services which was known at the time of the transaction if such failure to disclose such information was intended to induce the consumer into a transaction into which the consumer would not have entered had the information been disclosed.<sup>20</sup>

After the passage of the DTPA, plaintiffs found that they had new and additional causes of action for conduct alleged as a false, misleading or deceptive act under the DTPA's "laundry list" of prohibited acts. In the 1970's and 1980's the DTPA created an imbalance that impeded the reasonable resolution of disputes arising from defects in residential construction, remodeling or repair. An example of this is the *Brighton Homes* case where the plaintiff homeowners were successful in obtaining a judgment for 7 times the cost of the house.<sup>21</sup>



The DTPA has been held to be applicable to a seller's failure to disclose information even if the information was discoverable by the buyer (for example, failing to disclose a recorded lien is a DTPA violation).<sup>22</sup>

The DTPA is an attractive cause of action for a because it allows recovery of attorneys' fees. It also provides for mental anguish damages if the plaintiff shows the defendant(s) acted "*knowingly*" or "*intentionally*." Finally, a plaintiff who proves the defendant acted "*knowingly*" or "*intentionally*" is entitled to treble (3x) damages under the DTPA. A defendant commits an act "*knowingly*" if he acts with actual awareness of the falsity, deception or unfairness of the act. DTPA at § 17.45(9). Actual awareness may be inferred where objective manifestations indicate that a person acted with actual awareness. A defendant acts "*intentionally*" if he acts with actual awareness of the falsity, deception or unfairness of the act, coupled with the specific intent that the consumer detrimentally rely on the falsity, deception or unfairness or in detrimental ignorance of the unfairness. Intention may be inferred from objective manifestations that indicate that the person acted intentionally or from facts showing that defendant acted with flagrant disregard of prudent and fair business practices to the extent that the defendant should be treated as having acted intentionally. DTPA at § 17.45(13).

The DTPA has been amended to limit application of the DTPA. Section 17.49(f) and (g) of the DTPA, as amended, provides that the DTPA does not apply to contracts in the following instances:

(f) Nothing in the subchapter shall apply to a claim arising out of a written contract if: (1) the contract relates to a transaction, a project, or a set of transactions related to the same project involving total consideration by the consumer of more than \$100,000; (2) in negotiating the contract the consumer is represented by legal counsel who is not directly or indirectly identified, suggested, or selected by the defendant or an agent of the defendant; and (3) and the contract does not involve the consumer's residence.

(g) Nothing in this subchapter shall apply to a cause of action arising from a transaction, project, or a set of transactions relating to the same project, involving total consideration by the consumer of more than \$500,000, other than a cause of action involving a consumer's residence (Author's Note: note that in this \$500,000 exception, there is no requirement that the consumer be represented by legal counsel).

§17.42 of the DTPA, as amended, permits parties to waive the remedies of the DTPA in certain circumstances. A consumer may waive the DTPA if: the waiver is in writing and signed by the consumer; the consumer is not in a significantly disparate bargaining position; and the consumer is represented by legal counsel in seeking or acquiring the goods or services. The waiver is not effective if the consumer's counsel was directly or indirectly identified, suggested or selected by a defendant or an agent of the defendant. The waiver must be conspicuous and in bold-face type of at least 10 points in size. It also must be identified by the heading "Waiver of Consumer Rights", or similar language, and include language substantially the same as that provided in § 17.4(c)(3).

#### **D. Negligent Misrepresentation**

A cause of action for negligent misrepresentation requires a plaintiff to show that: (1) a representation was made by a defendant in the course of his business, or in a transaction in which he had a pecuniary interest; (2) the defendant supplied "false information" for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffered pecuniary loss by justifiably relying on the representation.<sup>23</sup> As with a fraud claim, a misrepresentation claim will be less successful against the contractor since it does not often communicate directly with a buyer.

#### **IV. DUTY TO SPEAK**

##### **A. No Duty to Speak**

### 1. Silence.

As a general rule, in an arms'-length commercial business transaction, failure to disclose information does not constitute fraud unless there is a duty to disclose the information. Mere silence in regard to a material fact, as to which there is no legal obligation to disclose, will not avoid a contract, although it operates as an injury to the party from whom it is concealed.<sup>24</sup>

### 2. No Actual Knowledge as to Issue.

Sellers have no duty to raise a subject with a buyer, absent actual knowledge of a material adverse condition regarding the subject.<sup>25</sup> Sellers have no liability for failure to disclose what one should have known, but did not.<sup>26</sup>

### 3. Reasonable to Assume that Other Party Knows Fact.

An exception to the imposition of a duty to speak may exist if the ignorant party never asked the seller about the condition and it is reasonable to assume that the ignorant party knew the non-disclosed fact.<sup>27</sup>

### 4. No Reliance and Immateriality.

Non-disclosure is not actionable, if no reliance was in fact placed on the non-disclosed fact.<sup>28</sup>

## B. Duty to Speak

### 1. Confidential or Fiduciary Relationship.

As in many other jurisdictions, early Texas law was "buyer beware".<sup>29</sup> Sellers were under no duty to disclose information as to the property, unless there was a fiduciary relationship between the buyer and the seller. The historical rule in business transactions, absent other circumstances mentioned below, in order to find a duty to speak a confidential or fiduciary relationship must exist.<sup>30</sup>

### 2. Other Circumstances.

Silence may be equivalent to a false representation when the circumstances impose a duty to speak and the knowledgeable party deliberately remains silent.

### a. **When Other Party Does Not Have a Reasonable Opportunity to Discover a Material Fact**

A knowledgeable party is under a duty to disclose material facts which would not be discoverable by the exercise of ordinary care and diligence on the part of the buyer, or which a reasonable investigation and inquiry would not uncover.<sup>31</sup>

### b. **When Knowledgeable Party has Knowledge That Other Party Is Ignorant of Fact**

A duty to speak may be imposed under certain factual circumstances if the knowledgeable party also knows that the other party is ignorant of a material fact or has knowledge that the other party does not have an equal opportunity to discover the material fact.<sup>32</sup>

### c. **Partial Disclosure That Conveys a False Impression**

Several courts of appeals have held that a general duty to disclose information may arise in an arms'-length business transaction when a party makes a *partial disclosure* that, although true, conveys a false impression.<sup>33</sup>

### d. **Subsequent Knowledge that Prior Statement is False or Misleading**

A duty to disclose arises if a party knows, or should have known, its prior statement was false, or later learns that its prior statement was false.<sup>34</sup>

## V. REAL ESTATE SALES CONTRACTS AND LEASES

### A. **Typical Contractual Provisions**

#### 1. **"Free Look"**

It is standard practice for there to be incorporated into a sales contract a so-called "free" look period or investigation or feasibility period. Usually, in such circumstances the buyer is given a period after execution of the contract to conduct an investigation of the property and to terminate the deal, if the buyer

determines that the property is "unsuitable". Such investigations can range from an inspection of the records of the seller to an in depth phase II environmental inspection of the property. In most such cases the buyer's determination of suitability or unsuitability is in its "sole discretion". In order to avoid characterization of the contract as illusory and unenforceable a discernable consideration ("Option Fee") should be paid by the buyer to the seller for this right.

Usually the "look" is not "free", as independent consideration is required to support the termination right. Stipulation of an Option Fee for this termination right may be more to protect the buyer from the seller walking out on the deal than *vice versa*. In essence, a free look is akin to an option. Usually, free looks are granted for a nominal sum whereas options are granted for a significant amount. Earnest money serves a different function. However, if the seller's sole remedy for a buyer's breach of the contract is loss of the earnest money, then the contract is in reality an option.<sup>35</sup>

**2. Express Representations and Warranties**

**a. Typical Representations and Warranties**

Representations and warranties given in the sale of property usually cover 3 areas: (1) the status and authority of the seller; (2) the status of the property; and (3) the operation and maintenance of the property.

One means of limiting the seller's exposure is to limit the scope of representations and warranties to matters under the control of, and that can be verified by, the seller.

**b. Disclosure of Known Facts**

The seller usually takes exception from representations and warranties for known facts and circumstances, such as matters disclosed in environmental reports in the possession of the seller and delivered or made available to the buyer. It is prudent for the seller to make a list or even a copy of all records delivered or made available to the buyer.

**c. Knowledge Exceptions**

Often the seller limits its representations by "to the extent of seller's knowledge" or "to the seller's best knowledge". Such limitations also are subject to question: (a) What does "knowledge" mean?; (b) Does knowledge mean actual knowledge, implied knowledge, or constructive knowledge?; (c) Can a person have knowledge through negligent or blind ignorance?; (d) Does the seller have a duty to find out facts?; and (e) Is suspicion knowledge?

Actual knowledge and negligent ignorance are the same. Actual knowledge includes not only that information of which a party has express knowledge, but also that which would have been gained from a reasonably diligent inquiry and exercise of the means of information at hand.<sup>36</sup>

If a knowledge exception is used, then the term "knowledge" should be defined. The definition should cover the following elements:

(1) Whose knowledge? (*e.g.*, does the term include the knowledge of the seller's employees, former employees, agents, affiliates, etc.?--if so, then what steps will be followed to assure the person making the representation that each of these parties has been contacted prior to making the representation "to the best of the seller's knowledge"?). In large companies it may be difficult to know what every employee knows.

(2) Is knowledge to be limited to actual knowledge? And if so, is reasonable inquiry of seller required or is blind ignorance permitted?

(3) Should the duty of inquiry be limited?

(4) Should the knowledge be limited to the current knowledge possessed at the time of execution of the contract?

(5) Is the seller under an obligation to notify the buyer of matters of which the seller becomes aware after giving the representation, or is the representation limited to the facts as they are known to exist as of giving of the representation?

Sometimes representations are couched in terms of "seller has received no notice" or "no

written notice". A person may have knowledge of a matter but may not have received notice from a third party.

Sometimes knowledge representations are qualified by a materiality standard. A materiality standard attempts to limit the seller's misrepresentations to having materially misstated a condition. The representation may be worded that seller represents that a particular condition exists "except to the extent that the same does not result in a material adverse effect". Like "knowledge", "materiality" should also be defined. This is most often accomplished by a reference to a dollar amount or percentage of tolerance.

Representations are sometimes qualified as to matters occurring during the seller's ownership--for example, as to environmental conditions.

### 3. Disclaimer of Representations and Warranties

Many times if a seller permits the buyer a "free look", the seller also insists upon selling the property "as is", that is without representations or warranties as to its condition. Even honest mistakes in making a representation can result in seller liability.

#### a. "As Is – Non-Reliance" Clause

The following is a typical "as is" clause in a commercial real estate sales transaction.

As a material part of the consideration for this Agreement, Seller and Purchaser agree that Purchaser is taking the Property "AS IS" with any and all latent and patent defects and that there is no warranty by Seller that the property is fit for a particular purpose. Purchaser acknowledges that it is not relying upon any representation, statement or other assertion with respect to the Property condition, but is relying upon its examination of the Property. Purchaser takes the Property under the express understanding there are no express or implied warranties (except for limited warranties of title set forth in the closing documents). Provisions of this Section 15 shall survive the Closing.<sup>37</sup>

The following is a typical "as is" clause in a commercial leasing transaction.

Tenant accepts the Premises "as is." *LANDLORD HAS NOT MADE AND DOES NOT MAKE ANY REPRESENTATIONS*

AS TO THE COMMERCIAL SUITABILITY, PHYSICAL CONDITION, LAYOUT, FOOTAGE, EXPENSES, OPERATION OR ANY OTHER MATTER AFFECTING OR RELATING TO THE PREMISES AND THIS AGREEMENT, EXCEPT AS HEREIN SPECIFICALLY SET FORTH OR REFERRED TO AND TENANT HEREBY EXPRESSLY ACKNOWLEDGES THAT NO SUCH REPRESENTATIONS HAVE BEEN MADE. LANDLORD MAKES NO OTHER WARRANTIES, EXPRESS OR IMPLIED, OF MERCHANTABILITY, MARKETABILITY, FITNESS OR SUITABILITY FOR A PARTICULAR PURPOSE OR OTHERWISE, EXCEPT AS SET FORTH HEREIN. ANY IMPLIED WARRANTIES ARE EXPRESSLY DISCLAIMED AND EXCLUDED. ...THE REPRESENTATIONS, WARRANTIES, COVENANTS, TERMS, CONDITIONS, AND WAIVERS SET FORTH IN THIS SECTION SHALL SURVIVE THE TERMINATION OF THE LEASE.<sup>38</sup>

Other examples of "as is" clauses in standard form real estate documents are found in the TAR Commercial Contract – Improved Property (TAR 1801) attached as **Exhibit 2** to this paper (See paragraph 7A of the form)("Buyer accepts the Property in its present condition....")<sup>39</sup> and in the Real Estate Sales Contract contained in the *Texas Real Estate Forms Manual* Ch. 8 Form 8-1 attached hereto as **Exhibit 3** (See paragraph C of Exhibit B to the form).<sup>40</sup>

The following release language was held to overcome claims by the releasing party that it had been fraudulently induced by the fraudulent representations and non-disclosures of the released party:

[The Swansons release all] causes of action of whatsoever nature, or any other legal theory arising out of the circumstances described above, from any and all liability damages of any kind known or unknown, whether in contract or tort.... [E]ach of us [the Swansons] expressly warrants and represents and does hereby state ... and represent ... that no promise or agreement which is not herein expressed has been made to him or her in executing this release, and that none of us is relying upon any statement or representation of any agent of the parties being released hereby. Each of us is relying on his or her own judgment and each has been represented by Hubert Johnson as legal counsel in this matter. The aforesaid legal counsel has read and explained to each of us the entire contents of this release in full, as well as the legal consequences of this Release ....

An "as is" clause is not the equivalent of an effective indemnity or release, but may be some evidence to be considered by the jury in apportioning negligence liability between the seller and purchaser of property for injuries caused by condition of the property.<sup>41</sup>

An "as is" disclaimer in a sales contract will not shield the seller from liability to the buyer for contributing towards environmental cleanup response costs under CERCLA.<sup>42</sup>

**b. Merger Clause**

Merger clauses seek to limit the scope of representations and warranties by a seller or a landlord to the written representations and warranties contained in the contract or lease. The following is a typical clause, which is found in the *Texas Real Estate Forms Manual Real Estate Sales Contract*, a copy of which is attached as **Exhibit 3** to this paper:

Real Estate Sales Contract

...

M. Miscellaneous Provisions

2. *Entire Contract.* This contract, together with its exhibits, and any Closing Documents delivered at closing constitute the entire agreement of the parties concerning the sale of the Property by Seller to Buyer. There are no oral representations, warranties, agreements, or promises pertaining to the sale of the Property by Seller to Buyer not incorporated in writing in this contract.

Exhibit B

...

8. *No Other Representation.* Except as state above or in the notices, statements, and certificates set forth in Exhibit D, Seller makes no representation with respect to the Property.

9. *No Warranty.* Seller has made no warranty in connection with this contract.

**c. Assumption of Environmental Liability and Indemnity Agreements**

The allocation of environmental risks in a sales transaction through representations, warranties, and indemnities will generally result in a contractual assumption of liability. In cases where a condition is known to exist, a preferable method may be to provide for an express assumption of liability.<sup>43</sup> An environmental indemnity agreement may be employed to shift back to the seller a potential cleanup risk arising out of detected marginal contaminations below reportable levels, but significant enough to trigger agency action if the condition comes to the attention of the governmental agency.

**B. Standard Forms Approaches**

**1. TREC and TAR Forms**

The Texas Real Estate Commission ("TREC") has promulgated forms for use by Texas real estate licensees in the sale of residential, commercial unimproved and farm and ranch property. These forms are found on TREC's website. The Texas Association of Realtors ("TAR") also has published forms for use by its members in the sale or leasing of residential or commercial real property. Attached to this paper are extracts of portions of the following forms published by TREC or TAR: **Exhibit 1** TREC One to Four Family Residential Contract (Resale) and TAR Seller's Disclosure Notice; **Exhibit 2** TAR Commercial Contract – Improved Property (TAR 1801) 10-18-05 and TAR Commercial Property Condition Statement.

The TREC One to Four Family Residential Contract (Resale) utilizes a buyer inspection period (Paragraphs 7A and 23), a buyer option to terminate during the inspection period if buyer's inspections reveal unsatisfactory conditions, delivery by seller to buyer of a seller's disclosure notice in the form required by § 5.008 of the Texas Property Code, and an acknowledgement by buyer that it is accepting the Property in its "present condition" except for the completion by seller before closing of repairs specified in the contract.

The TAR Commercial Contract – Improved Property utilizes a similar framework: a buyer inspection during feasibility period (Paragraph C), a buyer option to terminate during the feasibility period (Paragraph 7B) with retention or payment to seller of an agreed sum ("independent consideration") (Paragraph 7B(1)), delivery by seller to buyer of a seller's disclosure notice (Commercial property Condition Statement), and an acknowledgement by buyer that it is accepting the Property in its "present condition" except for the completion by seller before closing of repairs specified in the contract (Paragraph 7A). This form does not contain any of the following risk assumption/risk transfer provisions: an "as is/nonreliance" clause; an environmental condition indemnity or release; or a DTPA waiver.

## 2. Texas Real Estate Forms Manual

The *Texas Real Estate Forms Manual* includes in Chapter 8 a form of Real Estate Sales Contract for use in the sale of real property, including the resale of a residence, commercial unimproved property and commercial improved property. An extract from this form and the *Manual's* commentary is attached to this paper as **Exhibit 3**.

The Real Estate Sales Contract also utilizes a similar framework as the TREC and TAR forms: a buyer inspection during an inspection period (Paragraph G2), a buyer option to terminate during the inspection period (Paragraph G3) with payment to seller of a nominal \$100 as consideration for the right to so terminate the contract (Paragraph J1a), delivery during the inspection period by seller to buyer of a copy various records (Paragraph G1 and Exhibit C to the contract), and a series of representations as to Seller's authority, the pendency or threat of litigation, Seller's receipt of notice of violation of law; notice of nonrenewal or expiration licenses, permits, and approvals; notice of condemnation, zoning, or land-use proceedings affecting the property; notice of inquiries or notices by any governmental authority or third party with respect to the presence of hazardous materials on the property or the migration of hazardous materials from the property (Exhibit B to the contract).

The *Manual's* contract also contains the following provisions not contained in the TAR form: a disclaimer as to the existence of oral representations or promises (Paragraph M2); an acknowledgement that there is no special relationship between seller and buyer (Paragraph M11); a waiver of the application of the DTPA to the transaction (Paragraph M14); an "as is" clause (Exhibit B, Paragraph B); and an environmental condition and liability indemnity including if such condition or liability arose before closing, whether the condition is known or unknown, even if the condition or liability arose or arises under CERCLA, RCRA, the Texas Solid Waste Disposal Act, or the Texas Water Code, and even if the liability arises out of Sellers negligence, products liability or strict liability (Exhibit B, Paragraph C).

The *Manual's* "as is" clause does not contain an

express disclaimer of buyer's right to rely upon parol statements and assurances by seller or its agents as to the condition or value of the property.

### C. **Enforceability of Disclaimers**

#### 1. **"As Is" Clause Negates Reliance on Seller's or Agent's Representations Outside the Contract**

As held in *Prudential Ins. Co. of America v. Jefferson Assoc., Ltd.*, 896 S.W.2d 156, 163 (Tex. 1995), agreeing to take property in its "as is" condition and subject to latent and patent defects, in a case where buyer acknowledges that it is not relying upon any representation of seller with regard to condition or fitness of property, negates an essential element for recovery against seller for misrepresentations, the element of reliance. Buyer in such cases assumes the risk that buyer's appraisal of bargain is correct.<sup>44</sup> The court in *Prudential* stated the question and answer as follows:

We granted writ of error in this case to decide whether a buyer who agrees, freely and without fraudulent inducement, to purchase commercial real estate "as is" can recover damages from the seller when the property is later discovered not to be in as good a condition as the buyer believed it was when he inspected it before the sale. We hold he cannot.<sup>45</sup>

The following conditions for an effective as is sale (aka the "*Prudential Rule*"):

1. The seller must disclose all known defects. The "as is" clause will be unenforceable if the buyer is induced by knowing misrepresentation or concealment of a known fact.
2. The seller cannot obstruct the buyer's ability to inspect the property.<sup>46</sup>
3. The "as is" clause must be an important basis of the bargain. It cannot be an incidental provision or a part of the "boiler plate" of the contract.<sup>47</sup>
4. The buyer and seller must have relatively

equal bargaining positions, an arms-length transaction with a sophisticated buyer.<sup>48</sup>

*Centre II, Inc. v. Celotex Corp.*<sup>54</sup> did not shield the seller of contaminated property from concealed information:

**2. Circumstances Where Not Enforceable.**

Buyer is not bound by agreement to purchase something "as is" even though the buyer has contracted to purchase the property "as is" under the following circumstances:

**a. Fraudulent Representations**

Buyers are not bound to purchase property "as is" if the as is contract is induced by fraudulent representations.<sup>49</sup> "Puffing" or statements of opinion are not fraudulent misrepresentations, but statements of facts that the speaker knows or has reason to suspect to be incorrect can be a fraudulent representation if material to the transaction and relied upon by the recipient.<sup>50</sup> The court in *Prudential Ins. Co. of America v. Jefferson Associates, Ltd.* found that the statement by Prudential's on-site manger, to the buyer, Goldman, in response to his inquiry as to whether there were any building defects, that the building had "no defects" and that it had only "one problem," the concrete floor in the mechanical room, were neither material to Goldman nor fraudulent, although untrue as the building turned out to have extensive asbestos.<sup>51</sup>

**b. Concealment**

Buyers are not bound to purchase property "as is" where the as is contract is induced by concealment of information by Seller.<sup>52</sup> The supreme court in *Prudential Ins. Co. of America v. Jefferson Associates, Ltd.* found that the seller's on-site manager's mistakenly telling the buyer's inspector that she did not have the plans and specifications for the building but only had the "as-built" plans which she gave him was a concealment sufficient to set aside the "as is" contract. The court found that, assuming Prudential concealed the plans and specifications from the buyer, the plans and specifications did not note on their face that the building materials specified for the building contained asbestos.<sup>53</sup>

The following "as is" provision reviewed by the court in *Warehouse Associates Corporate*

OTHER THAN THE WARRANTIES OF TITLE CONTAINED IN THE DEED, PURCHASER ACKNOWLEDGES THAT SELLER HAS NOT MADE, DOES NOT MAKE AND SPECIFICALLY DISCLAIMS ANY REPRESENTATIONS, WARRANTIES, PROMISES, COVENANTS, AGREEMENTS OR GUARANTIES OF ANY KIND OR CHARACTER WHATSOEVER, WHETHER EXPRESS OR IMPLIED, ORAL OR WRITTEN, PAST, PRESENT OR FUTURE, OF, AS TO, CONCERNING OR WITH RESPECT TO (A) THE NATURE, QUALITY OR CONDITION OF THE PROPERTY, INCLUDING WITHOUT LIMITATION, THE WATER, SOIL AND GEOLOGY, (B) THE INCOME TO BE DERIVED FROM THE PROPERTY, (C) THE SUITABILITY OF THE PROPERTY FOR ANY AND ALL ACTIVITIES AND USES WHICH PURCHASE MAY CONDUCT THEREON, (D) THE COMPLIANCE OF OR BY THE PROPERTY OR ITS OPERATION WITH ANY LAWS, RULES, ORDINANCES OR REGULATIONS OF ANY APPLICABLE GOVERNMENTAL AUTHORITY OR BODY ... (E) THE HABITABILITY, MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OF THE PROPERTY, OR (F) ANY OTHER MATTER WITH RESPECT TO THE PROPERTY, AND SPECIFICALLY THAT SELLER HAS NOT MADE, AND DOES NOT MAKE AND SPECIFICALLY DISCLAIMS ANY REPRESENTATIONS REGARDING SOLID WASTE, AS DEFINED BY THE U. S. ENVIRONMENTAL PROTECTION AGENCY REGULATIONS AT 40 C.F.R., PART 261, OR THE DISPOSAL OR EXISTENCE, IN OR ON THE PROPERTY, OF ANY HAZARDOUS SUBSTANCE, AS DEFINED BY THE COMPREHENSIVE ENVIRONMENTAL RESPONSE COMPENSATION ENVIRONMENTAL RESPONSE COMPENSATION AND LIABILITY ACT OF 1980, AS AMENDED, AND APPLICABLE STATE LAWS, AND REGULATIONS PROMULGATED THEREUNDER. PURCHASER FURTHER ACKNOWLEDGES AND AGREES THAT HAVING BEEN GIVEN THE OPPORTUNITY TO INSPECT THE PROPERTY, PURCHASER IS RELYING SOLELY ON ITS OWN INVESTIGATION OF THE PROPERTY AND NOT ON ANY INFORMATION PROVIDED OR TO BE PROVIDED BY THE SELLER. PURCHASER FURTHER ACKNOWLEDGES AND AGREES THAT ANY INFORMATION [SIC] PROVIDED OR TO BE PROVIDED WITH RESPECT TO THE PROPERTY WA OBTAINED FROM A VARIETY OF SOURCES AND THAT SELLER HAS NOT MADE ANY INDEPENDENT INVESTIGATION OR VERIFICATION OF SUCH INFORMATION. PURCHASER FURTHER ACKNOWLEDGES AND AGREES THAT THE SALE OF THE PROPERTY AT CLOSING SHALL BE MADE ON AN "AS IS, WHERE IS" CONDITION AND BASIS "WITH ALL FAULTS[.]

**c. Ability to Learn of Fact is Impaired by Seller's Conduct**

Buyers are not bound to purchase property "as is" if the buyer is entitled to inspect condition of

what is being sold but is impaired by seller's conduct.<sup>55</sup>

**d. Other Conditions Negating Effect of As Is Clause**

Where the nature of transaction and totality of circumstances surrounding agreement are

considered, such as whether clause is important part of basis of bargain rather than incidental or boilerplate provision and whether parties were not in relatively equal bargaining position, a court may decide not to give effect to the "as is" clause.<sup>56</sup>



FORMS

1. TREC Residential Sales Contract and TAR Seller's Disclosure Notice

PROMULGATED BY THE TEXAS REAL ESTATE COMMISSION (TREC)

ONE TO FOUR FAMILY RESIDENTIAL CONTRACT (RESALE)

7. PROPERTY CONDITION:

- A. ACCESS, INSPECTIONS AND UTILITIES: Seller shall permit Buyer and Buyer's agents access to the Property at reasonable times. Buyer may have the Property inspected by inspectors selected by Buyer and licensed by TREC or otherwise permitted by law to make inspections. Seller at Seller's expense shall turn on existing utilities for inspections.
- B. SELLER'S DISCLOSURE NOTICE PURSUANT TO §5.008, TEXAS PROPERTY CODE (Notice):  
(Check one box only)
  - (1) Buyer has received the Notice.
  - (2) Buyer has not received the Notice. Within \_\_\_\_\_ days after the effective date of this contract, Seller shall deliver the Notice to Buyer. If Buyer does not receive the Notice, Buyer may terminate this contract at any time prior to the closing and the earnest money will be refunded to Buyer. If Seller delivers the Notice, Buyer may terminate this contract for any reason within 7 days after Buyer receives the Notice or prior to the closing, whichever first occurs, and the earnest money will be refunded to Buyer.
  - (3) The Seller is not required to furnish the notice under the Texas Property Code.
- C. SELLER'S DISCLOSURE OF LEAD-BASED PAINT AND LEAD-BASED PAINT HAZARDS is required by Federal law for a residential dwelling constructed prior to 1978.
- D. ACCEPTANCE OF PROPERTY CONDITION: Buyer accepts the Property in its present condition; provided Seller, at Seller's expense, shall complete the following specific repairs and treatments:  
\_\_\_\_\_
- G. ENVIRONMENTAL MATTERS: Buyer is advised that the presence of wetlands, toxic substances, including asbestos and wastes or other environmental hazards, or the presence of a threatened or endangered species or its habitat may affect Buyer's intended use of the Property. If Buyer is concerned about these matters, an addendum promulgated by TREC or required by the parties should be used.

23. **TERMINATION OPTION:** For nominal consideration, the receipt of is hereby acknowledged by Seller, and Buyer's agreement pay Seller \$\_\_\_\_\_ (Option Fee) within 2 days after the effective date of this contract, Seller grants Buyer the unrestricted right to terminate this contract by giving notice of termination to Seller within \_\_\_\_\_ days after the effective date of this contract. If no dollar amount is stated as the Option Fee or if Buyer fails to pay the Option Fee within the time prescribed, this paragraph will not be a part of this contract and Buyer shall not have the unrestricted right to terminate this contract. If Buyer gives notice of termination within the time prescribed, the Option Fee will not be refunded, however, any earnest money will be refunded to Buyer. The Option Fee  will  will not be credited to the Sales Price at closing. **Time is of the essence for this paragraph and strict compliance with the time for performance is required.**

TEXAS ASSOCIATION OF REALTORS®  
**SELLER'S DISCLOSURE NOTICE**

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Section 5.008, Property Code requires a seller of residential property of not more than one dwelling unit to deliver a Seller's Disclosure Notice to a buyer on or before the effective date of a contract.<sup>57</sup> **This form complies with and contains additional disclosures which exceed the minimum disclosures required by the Code.<sup>58</sup>**

CONCERNING THE PROPERTY AT \_\_\_\_\_

THIS NOTICE IS A DISCLOSURE OF SELLER'S KNOWLEDGE<sup>59</sup> OF THE CONDITION OF THE PROPERTY AS OF THE DATE SIGNED BY SELLER AND IS NOT A SUBSTITUTE FOR ANY INSPECTIONS OR WARRANTIES THE BUYER MAY WISH TO OBTAIN. IT IS NOT A WARRANTY<sup>60</sup> OF ANY KIND BY SELLER, SELLER'S AGENTS, OR ANY OTHER AGENT.

Seller  is  is not occupying the Property. If unoccupied (by Seller), how long since Seller has occupied the Property?  \_\_\_\_\_ or  never occupied the Property.

**Section 1. The Property has the items marked below. (Mark Yes (Y), No (N), or Unknown (U).)**

Item	Y	N	U
Cable TV Wiring			
Carbon Monoxide Det.			
Ceiling Fans			
Cooktop			
Dishwasher			
Disposal			
Emergency Escape Ladder(s)			
Exhaust Fans			
Fences			
Fire Detection Equip.			
French Drain			
Gas Fixtures			

Item	Y	N	U
Gas Lines (Nat/LP)			
Hot Tub			
Intercom Systems			
Microwave			
Outdoor Grill			
Patio/Decking			
Plumbing System			
Pool			
Pool Equipment			
Pool Maint. Accessories			
Pool Heater			
Public Sewer System			

Item	Y	N	U
Pump: <input type="checkbox"/> sump <input type="checkbox"/> grinder			
Rain Gutters			
Range/Stove			
Roof/Attic Vents			
Sauna			
Smoke Detector			
Smoke Detector - Hearing Impaired			
Spa			
Trash Compactor			
TV Antenna			
Washer/Dryer Hookup			
Window Screens			

Item	Y	N	U	Additional Information
Central A/C				<input type="checkbox"/> electric <input type="checkbox"/> gas number of units: _____
Evaporative Coolers				number of units: _____
Wall/Window AC Units				number of units: _____
Attic Fan(s)				if yes, describe: _____
Central Heat				<input type="checkbox"/> electric <input type="checkbox"/> gas number of units: _____
Other Heat				if yes describe: _____
Oven				number of ovens: _____ <input type="checkbox"/> electric <input type="checkbox"/> gas <input type="checkbox"/> other: _____
Fireplace & Chimney				<input type="checkbox"/> wood gas logs mock other: _____
Carport				<input type="checkbox"/> attached <input type="checkbox"/> not attached
Garage				<input type="checkbox"/> attached <input type="checkbox"/> not attached

Garage Door Openers				number of units:_____ number of remotes:_____
Satellite Dish & Controls				<input type="checkbox"/> owned <input type="checkbox"/> leased from _____
Security System				<input type="checkbox"/> owned <input type="checkbox"/> leased from _____
Water Heater				<input type="checkbox"/> electric <input type="checkbox"/> gas other: _____ number of units:_____
Water Softener				<input type="checkbox"/> owned <input type="checkbox"/> leased from _____
Underground Lawn Sprinkler				<input type="checkbox"/> automatic <input type="checkbox"/> manual areas covered:_____
Septic/On-Site Sewer Facility				if yes, attach information About On-Site Sewer Facility (TAR-1407)

Water supply provided by:  city  well  MUD  co-op  unknown  other:\_\_\_\_\_

Was the Property built before 1978?  yes  no  unknown

(If yes, complete, sign, and attach TAR-1906 concerning lead-based paint hazards).

Roof Type: \_\_\_\_\_ Age: \_\_\_\_\_ (approximate)

Is there an overlay roof covering on the Property (shingles or roof covering placed over existing shingles or roof covering)?

yes  no  unknown

Are you (Seller) aware of any of the items listed in Section 1 that are not in working condition, that have defects, or that are need of repair?  yes  no If yes, describe (Attach additional sheets if necessary): \_\_\_\_\_

**Section 2. Are you (Seller) aware of any defects or malfunctions in any of the following? (Mark Yes (Y) if you are aware and No (N) if you are not aware).**

Item	Y	N
Basement		
Ceilings		
Doors		
Driveways		
Electrical Systems		
Exterior Walls		

Item	Y	N
Floors		
Foundation/Slab(s)		
Interior Walls		
Lighting Fixtures		
Plumbing Systems		
Roof		

Item	Y	N
Sidewalks		
Walls/Fences		
Windows		
Other Structural Components		

If the answer to any of the items in Section 2 is yes, explain (attach additional sheets if necessary): \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Section 3. Are you (Seller) aware of any of the following conditions: (Mark Yes (Y) if you are aware and No (N) if you are not aware).**

Condition	Y	N
Aluminum Wiring		
Asbestos Components		
Diseased Trees: oak wilt _____		
Endangered Species/Habitat on Property		
Fault Lines		
Hazardous or Toxic Waste		
Improper Drainage		
Intermittent or Weather Springs		
Landfill		
Lead-Based Paint or Lead-Based Pt. Hazards		
Encroachments onto the Property		
Improvements encroaching on others' property		
Located in 100-year Floodplain		
Present Flood Insurance Coverage (If yes, attach TAR-1414)		
Previous Flooding into the Structures		
Previous Fires		
Previous Foundation Repairs		

Condition	Y	N
Previous Roof Repairs		
Other Structural Repairs		
Radon Gas		
Settling		
Soil Movement		
Subsurface Structure or Pits		
Underground Storage Tanks		
Unplatted Easements		
Unrecorded Easements		
Urea-formaldehyde Insulation		
Water Penetration		
Wetlands on Property		
Wood Rot		
Active infestation of termites or other wood-destroying insects (WDI)		
Previous treatment for termites or WDI		
Previous termite or WDI damage repaired		
Termite or WDI damage needing repair		
Previous Use of Premises for Manufacture of Methamphetamine		

If the answer to any of the items in Section 3 is yes, explain (attach additional sheets if necessary): \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Section 4. Are you (Seller) aware of any item, equipment, or system in or on the Property that is in need of repair, which has not been previously disclosed in this notice?**

yes       no      If yes, explain (attach additional sheets if necessary):

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**Section 5. Are you (Seller) aware of any of the following (Mark Yes (Y) if you are aware. Mark No (N) if you are not aware).**

Y   N

- Room additions, structural modifications, or other alterations or repairs made without necessary permits or not in compliance with building codes in effect at the time.

- Homeowners' associations or maintenance fees or assessments. If yes, complete the following:  
 Name of association: \_\_\_\_\_  
 Manager's name: \_\_\_\_\_ Phone: \_\_\_\_\_  
 Fees or assessments are: \$ \_\_\_\_\_ per \_\_\_\_\_ and are:  mandatory  voluntary  
 Any unpaid fees or assessments for the Property?  yes (\$ \_\_\_\_\_)  no  
 If the Property is in more than one association, provide information about the other associations below or attach information to this notice.
- Any common area (facilities such as pools, tennis courts, walkways, or other) co-owned in undivided interest with others. If yes, complete the following:  
 Any optional user fees for common facilities charged?  yes  no If yes, describe: \_\_\_\_\_  
 \_\_\_\_\_
- Any notices of violations of deed restrictions or governmental ordinances affecting the condition or use of the Property.
- Any lawsuits or other legal proceedings directly or indirectly affecting the Property.
- Any death on the Property except for those deaths caused by: natural causes, suicide, or accident - unrelated to the condition of the Property.
- Any condition on the Property which materially affects the health or safety of an individual.
- Any repairs or treatments, other than routine maintenance, made to the Property to remediate environmental hazards such as asbestos, radon, lead-based paint, urea-formaldehyde, or mold.  
 If yes, attach any certificates or other documentation identifying the extent of the remediation (for example, certificate of mold remediation or other remediation).

If the answer to any of the items in Section 5 is yes, explain (attach additional sheets if necessary): \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Section 6. Seller  has  has not attached a survey of the Property.**

**Section 7. Within the last 4 years, have you (Seller) received any written inspection reports from persons who regularly provide inspections and who are either licensed as inspectors or otherwise permitted by law to perform inspections?  yes  no** If yes, attach copies and complete the following:

Inspection Date	Type	Name of Inspector	No. of Pages

*Note: A buyer should not rely on the above-cited reports as a reflection of the current condition of the Property. A buyer should obtain inspections from inspectors chosen by the buyer.*

**Section 8. Check any tax exemption(s) which you (Seller) currently claim for the Property:**

- Homestead  Senior Citizen  Disabled
- Wildlife Management  Agricultural  Disabled Veteran
- Other: \_\_\_\_\_  Unknown

