

## Warning: Warranties Can Survive Close of Escrow Even When You Think They Won't

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As the seller of real property, you might have heard: "Don't worry, that warranty won't survive the closing." Or, you may have assumed that because the purchase agreement stated that certain representations and warranties did survive the closing, all of the others did not. In the recent *Ram's Gate Winery v. Roche* case (235 Cal.App.4th 1071 (2015)), the sellers may have heard or assumed the same things with regard to their warranty to disclose known geological hazards, which was silent as to whether it survived the closing. Indeed, the trial court agreed that the sellers' warranty merged into the deed at closing, and ruled against the buyer's breach of contract claim on summary judgment. But, the court of appeal reversed and sent the case back for trial along with a few legal reasons why the sellers' warranty, and liability for breaching it, may have survived the closing.

The general legal principal at issue here is the "merger doctrine" which, in essence, holds that when parties convey real property by a deed, all prior covenants, agreements, proposals, stipulations, etc. between the parties regarding the conveyance are merged into the deed and superseded. The rationale for the doctrine is that the object of the prior promises (the conveyance of property) has been realized with the execution of the deed, which is deemed to be the final and entire contract between the parties. So, if the doctrine is applied strictly, when the deed is executed at closing, the prior promises are merged into the deed and do not "survive the closing." However, as the *Ram's Gate* case demonstrates, the merger doctrine has limitations that all parties to a real estate purchase transaction must carefully consider.

In November 2006, Ram's Gate Winery, LLC ("Ram's Gate") entered into a purchase agreement with Joseph and Genevieve Roche (the "Roches") for a Sonoma County, California, property upon which Ram's Gate was planning to build a new winery. In Paragraph 10 of the purchase agreement, the Roches agreed to provide to Ram's Gate, within 10 days after the effective date of the purchase agreement, a written disclosure of any information known to them regarding, among other things, known geological hazards, soil reports, and geotechnical reports and "all other facts, events, conditions, or agreements which have a material effect on the value of the ownership or use of the Property..." It is important to note that the purchase agreement expressly provided that certain representations and warranties of the Roches survived the close of escrow: Paragraph 23 specifically provided that the buyers' warranty of authority "shall survive the Close of Escrow and execution and delivery of the Grant Deed and Bill of Sale." However, the purchase agreement was silent as to survival of others, including those in

Paragraph 10. Once the Roches' 10 days to provide the Paragraph 10 disclosures had run, Ram's Gate had two weeks to inspect the property and either approve or disapprove of the condition of the property or terminate the purchase agreement, in its sole discretion.

Thereafter, Ram's Gate approved the property condition, and escrow closed on the sale of the property on December 14, 2006. The grant deed was recorded the same day. Then, according to Ram's Gate, in mid-2007, it discovered the existence of two documents that reflected an active earthquake fault trace on the property—a geological report prepared in 1987, and a site plan prepared in 1987-1988. Indeed, the Roches had to move the location of their own winery building to provide a setback from the fault trace. Ram's Gate's costs of development increased substantially as a result of the fault trace.

In 2012, Ram's Gate sued the Roches and their brokers for, among other things, breach of contract. Ram's Gate alleged that the Roches had breached Paragraph 10 of the purchase agreement by failing to disclose information about, and documents relating to, the earthquake fault trace. The Roches countered that Ram's Gate knew about the earthquake issue from conversations before the sale, or should have known about them from due diligence because the two documents were in the Sonoma County records. Despite this factual dispute, the Roches filed a motion for summary judgment, claiming that, as a matter of law, the purchase agreement did not specifically provide that the warranty related to disclosures in Paragraph 10 would survive the close of escrow, and thus it merged into the deed and was not actionable after recording. The trial court agreed and ruled against Ram's Gate's breach of contract cause of action, finding that the purchase agreement expressly provided that certain representations and warranties would survive the closing, and the Paragraph 10 disclosure warranty was not one of them. Accordingly, the trial court treated the Paragraph 10 warranty as extinguished and unable to give rise to liability.

The court of appeal reversed and expressed three reasons why the trial court misapplied the merger by deed doctrine:

First, the court of appeal found the trial court's expression of the merger rule—when a contract does not provide that the representations and warranties survive the closing of a transaction, the representations and warranties made in the agreement are extinguished as of the closing date—to be overstated. The court of appeal found the more appropriate rule to be: "[W]hen a provision in a deed is certain and unambiguous it prevails over an *inconsistent*

provision in a contract of purchase pursuant to which the deed was given." Thus, the court of appeal said that rather than strictly applying the merger doctrine, courts must (1) analyze the deed and contract to determine if there is inconsistency between the two, and (2) examine the parties' intent as to whether the provisions of the contract were intended to continue in force after the transfer of title.

The court of appeal analyzed the deed and found that it was a "pedestrian instrument" addressing only the mechanics of transferring title and containing a legal description. It did not address the survival of warranties at all, much less contain a certain and unambiguous provision regarding survival. Accordingly, the court found that there was no "obvious conflict" between the terms of the purchase agreement and the terms of the deed that would show the Paragraph 10 warranty was merged into the deed. In short, the language of the deed itself did not trigger the merger rule and resolve the conflict.

The court, therefore, examined the parties' intent regarding the survival of the Paragraph 10 warranty. The court of appeal looked to a written declaration from Ram's Gate's managing member stating that Ram's Gate understood that the Paragraph 10 warranties would continue after close of escrow and that there was no agreement that warranties would merge into the deed and be extinguished. The Ram's Gate declaration created a triable issue of fact as to survival, so the appeals court overturned the trial court's summary judgment ruling and sent the case back to trial. The court stated: "The fact that several paragraphs in the purchase agreement specifically provided for their survival does not, as a matter of law, compel the conclusion that no other provision could survive without a similar recital."

Second, the court of appeal found that even if the merger doctrine were applicable as a preliminary matter, an exception to the doctrine for contractual provisions that are "collateral to the deed" applied. The court held that the deed's function was limited to conveying title, and the Paragraph 10 warranty in the purchase agreement was unrelated to, and thus collateral to, the conveyance of title. The court said generally that contractual obligations that do not pertain to the passage of title are less likely to be subject to the doctrine of merger. The court of appeal rejected the Roches' argument that for the collateral rights exception to apply, the contractual provision in question had to be collateral to the sale transaction as a whole. The court agreed with Ram's Gate that the trial court's ruling gives sellers "a perverse incentive to breach the contract" because sellers could conceal relevant information despite their warranty, and if the buyers do not discover the breach before closing, the sellers reap excess profits and avoid liability.

Third, the court found that the Roches breached their disclosure obligation in November 2006, at the time of the deadline in the

purchase agreement for them to make the required disclosures and before the close of escrow. Thus, according to the court of appeal, Ram's Gate's cause of action for breach of the disclosure covenant accrued before, and thus survived, the close of escrow.

While Ram's Gate won this round of the litigation (and its attorneys' fees), the litigation is headed back to the trial court and appears to be far from over—almost a decade after the initial sale. And there is no guaranty that the ultimate outcome at trial will favor Ram's Gate. Only much more litigation will determine that question. Could this litigation expense and heartache have been avoided? Note that the appellate court began its analysis by simply examining the deed and purchase agreement. It is quite possible that more careful drafting of these documents could have ended the court's inquiry there. The deed could have been drafted to include certain and unambiguous language regarding the survival or non-survival of representations and warranties. The purchase agreement could have specifically stated which representations and warranties did *not* survive closing and that the parties could not pursue claims on such non-surviving representations and warranties after closing. The Roches could have attempted to limit their disclosures to preclude information or documents that they did not have in their actual possession at the time of the purchase agreement, that they forgot about, or that were equally available as public records to the other party.

To avoid future litigation, both buyers and sellers of real property should have the appellate court's decision in *Ram's Gate* in mind when making and documenting representations and warranties. The overarching lesson from this case is that seller representations and warranties that are *not* intended to survive the closing must be as carefully considered, drafted, and addressed as their counterparts that expressly are intended to survive the closing. If you have any questions about the impact of the *Ram's Gate* case on a specific transaction, or if you need help with careful drafting of representations or warranties, do not hesitate to contact us.



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