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BUSINESS TRANSACTION NEWSLETTER

DO YOUR DUE DILIGENCE OR FACE THE CONSEQUENCES

In the case of Abdulsayed v. Hand, the Court dealt with the issue of a lawsuit where the Buyer of a convenience store sought an action for rescission of the contract based on the Seller's breach of contract, fraud, and misrepresentation. The documents described in the Abdulsayed opinion were crude, incomplete, and probably not prepared by a lawyer. When the transaction finally closed, the contract provided that the Seller represented that he had clear and clean title to the property and could convey such to Buyer. It ultimately was proved that there was a first mortgage on the property in the amount of \$225,000.00, a second mortgage on the property in the amount of \$223,000.00, and a security interest in 25 pieces of equipment in the convenience store. None of these liens were released at closing. The purchase price of \$700,000.00 was paid by means of a \$190,000.00 down payment (although the contract called for a \$220,000.00 down payment), with the balance being financed by the Seller in a promissory note.

Prior to the contract, the parties entered into a so-called "Pre-Contract" pursuant to which Buyer could observe the operation of the convenience store and determine if the sales met certain thresholds as represented by the Seller. After closing, when the sales were below the threshold, a lawsuit followed based on the Buyer's claim that the convenience store was not producing sales as represented by the Seller in the Pre-Contract. After that, the Buyer's attorney discovered the two mortgages on the real estate and the security interest in the personal property. The Buyer stopped making payments and amended the lawsuit alleging breach of contract, fraud, and misrepresentation. The Seller denied the allegations, asserted that the Buyer was in a breach of contract, and the Seller filed a counterclaim in which he asserted a claim for a breach of contract. The Trial Court granted a temporary injunction to the Seller, and awarded immediate possession of the property and the right to operate the convenience store to the Seller. The Buyer appealed.

The Court of Appeals reversed the Trial Court's opinion and politely took the Trial Court to task in all aspects of its decision. The Court of Appeals went through the elements of fraudulent misrepresentation or intentional misrepresentation and found that the Seller was guilty of all elements of fraudulent or intentional misrepresentation. The Court of Appeals wrote that intentional misrepresentation is grounds for rescission of a contract and found that the Buyer established its cause of action for intentional misrepresentation resulting in a rescission of the contract. The case was remanded to the Trial Court for proceedings to apply the rescission.

MY RECOMMENDATION: There were a number of unusual things about the Abdulsayed case. First, how did the Seller intend to deal with two mortgages and a security interest that were not released at closing? Second, why did the Buyer not discover two mortgages and a security interest on the property it was purchasing? These things are easily found in UCC searches and title exams. Perhaps the parties were trying to do the transaction without lawyers. The "take away" from this case is that if you are buying a business, make sure you know how to do due diligence, and then do it. Don't be "penny wise and pound foolish."

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