

How And Why Real Estate Documents Grow

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The owner of a building in the New York suburbs (let's call it the Julex Tower) opened negotiations with a possible buyer. As is customary, the owner and possible seller asked the possible buyer to sign a confidentiality agreement, agreeing not to share information about Julex Tower or the possible sale. Like most other confidentiality agreements, this one carved out an exception, allowing the buyer to share information with prospective investors.

A couple of weeks into negotiations, the possible seller was shocked to get a phone call from one of his neighbors about Julex Tower. The neighbor had received something from someone else, who had received it from someone else: an offering memo for Julex Tower. It presented the opportunity to invest in the purchase of the tower. It disclosed all the detailed rent roll and other financial information—including rents, lease expirations and renewal option terms—that the seller had delivered to the possible buyer. The offering memo declared that the seller had chronically undermanaged Julex Tower. The buyer planned to do a better job managing the building. He would undertake a strategic capital improvement program, exploiting opportunities that the seller had missed or ignored. The buyer said all of this would double the building's net operating income. Buyers often say all of these things to prospective investors.

Did any of this violate the confidentiality agreement? Not really. The neighbor was, in fact, a prospective investor. He might have invested in a small percentage of the acquisition of Julex Tower. The same could be true of every doctor, dentist and lawyer (or anyone else with a significant bank account) in town or anywhere else in the United States or the world. The buyer remained in technical compliance with the confidentiality agreement, because the information on Julex Tower was shared only with prospective investors, though potentially thousands of them.

The confidentiality agreement at issue was no different than hundreds of similar agreements in circulation today. They typically allow disclosure to "prospective investors," without further restrictions.

In response to the experience just described above, maybe tomorrow's careful seller, or its counsel, should add some language to any standard confidentiality agreement. Maybe the confidentiality agreement should limit the number of prospective investors. Maybe each prospective investor must be someone who the buyer's principal already knows from previous deals. Maybe the buyer should only give prospective investors "teasers" with limited information unless a particular prospect shows serious interest in the deal. Maybe each prospect should sign their own confidentiality agreement, and also agree not to share the

confidential information any further. Maybe the buyer should keep a roster of prospective investors and share it with the seller to show that disclosures to prospective investors didn't violate the confidentiality agreement.

If the next careful seller added some or all of those concepts to their confidentiality agreement, it would grow by a couple hundred words. Prospective buyers and their counsel would probably object to these restrictions, or want to fine-tune and negotiate them. This would lead to multiple drafts, phone calls, discussions, and other back and forth, which would lead to more legal fees and delays in substantive negotiation of any possible transaction.

For a recent transaction, our client asked us to take a look at their existing confidentiality agreement. Sure enough, it allowed disclosures to any and all potential investors, creating the exact same opening and potential risk that the seller of Julex Tower had faced. So did a whole pile of other (different) confidentiality agreements this client had used for other transactions.

We told the client the story of the seller of Julex Tower whose neighbor found out all the seller's secrets through the prospective buyer's offering memo. We noted that we could adjust this client's standard confidentiality agreement to try to reduce the risk along the lines suggested above. We also noted, though, that the story of Julex Tower had occurred only once. It was an outlier.

Just because this problem had happened once, did today's seller want to complicate their standard confidentiality agreement and related negotiations? This seller had never experienced a similar problem. Ultimately, the seller decided to leave their standard confidentiality agreement alone and live with the risk. It was a close call, though. Often these close calls turn out the other way. This is how real estate and other legal documents just grow and grow, and rarely shrink.

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