CURES FOR THE (SOMETIMES) NEEDLESS COMPLEXITY OF REAL ESTATE DOCUMENTS

Why real estate documents have become so long and complicated and what can be done about it.

JOSHUA STEIN

As real estate documents have grown more complex over the last few decades, they have also grown longer. A mortgage that once might have been 10 pages is now 30. A transaction that once could be closed with 4 brief documents now needs 10. These 10, many of which are generally longer than the Declaration of Independence and the Constitution combined, raise major issues previously not thought of that require time and attention, and create risks and uncertainties that at times actually derail transactions.

Every few years the height of the stack of paper needed to close the average real estate transaction seems to rise by some significant percentage, even after adjusting for greater complexity of new financial structures. It is not clear, however, that more paper produces better transactions or fewer disputes, or happier lenders, borrowers, buyers, sellers, and developers.

It is easy to blame the attorneys for document bloat. To some degree the blame may be well placed. But the attorneys work for their clients, and the clients too are not entirely blameless. Nor are they helpless.

Joshua Stein is a real estate and finance partner in the New York, NY office of Latham & Watkins. The views expressed in this article are his own.

If participants in real estate transactions understand what causes the proliferation of paper, they may be able to control, and perhaps reverse, the "complexification" of real estate documents, negotiations, and transactions.

THE MOST FAVORABLE CONDITIONS POSSIBLE

Document complexification starts with certain assumptions that attorneys often make when they prepare documents. Unless instructed otherwise, attorneys usually assume their clients want the transactional documents to achieve the following goals:

- The documents should address every possible eventuality that may arise from the transaction, as fully and thoroughly, and in as much detail, as possible, to remove all gaps and uncertainty, and thus (hopefully) prevent disputes and litigation.
- The documents should address each eventuality in a way that gives the attorney's client the most favorable outcome.
- The documents should preserve maximum possible discretion and flexibility, in part by limiting any legally binding obligations that the client undertakes and limiting the client's exposure should it fail to perform any of those obligations.

Complexity Is No Surprise

An attorney who works from these instructions, whether the client has expressly requested it or the attorney has merely inferred it, tends to produce long, complex, thoroughly complete, and generally one-sided and overreaching documents. (If this is what the client wants, then so be it, and the attorney has probably satisfied the client.)

The attorney then presents these overly favorable and exceedingly complete documents to the attorneys who represent other side(s) of the transaction who, in turn, assume or know that their own clients want to achieve the same three goals.

The second set of attorneys prepares extensive and detailed "comments" that attempt to undo, and reverse, the work of the first set of attorneys.

Then follows a series of meetings, redrafts, deadlines not met, late-night negotiating sessions, eventual compromises, and finally a closing, assuming that the parties have neither changed their minds along the way nor decided the transaction has become irrelevant or outdated.

In this process, the documents typically expand and multiply far beyond the first drafts prepared by the first set of attorneys.

Once the deal closes, the documents are normally buried in a file drawer, never to be examined again unless a problem or dispute arises. The problems that the documents foresaw and addressed so completely usually do not occur (perhaps a credit to the drafters, or perhaps a demonstration of the low likelihood that many of the issues addressed in the document will become relevant).

No matter how hard the attorneys worked to cover every eventuality and to leave no gaps, sometimes ambiguities and uncertainties do arise. It may seem the attorneys should have worked even harder, as whatever problems ultimately arise relate to issues that the documents did not address thoroughly enough. If that happens, a new paragraph or a new set of provisions find their way into the documents for the next similar transaction and the endless process of document growth continues.

Even when the documents do address a particular point that produces a dispute, the facts of any particular case are often complex enough, often in ways the parties could never have foreseen, that a judge can reasonably rule for either side based on a rough sense of overall "equities." When this occurs, judges often do not have the patience or desire to interpret the tedious details. In some cases, if the document had said less, but more directly and clearly, the judge might have been more likely to read it carefully and apply it in accordance with its terms.

The Courts Cause Complexity

The courts are also partly to blame for ever-growing document complexity. In case after case, judges interpret contracts and other legal documents in ways that force attorneys to use more words to say the same thing, even more convincingly, next time.

For example, consider a recent state court case involving a contract for the sale of vacant land.[1] The contract gave the purchaser 60 days to fully check out the site. After 60 days, the purchaser could proceed on an "as is" basis, or he could cancel and get his money back.

After the purchaser closed, he found the site was in a flood zone and mostly unbuildable. The court allowed the purchaser to unwind the transaction and get his money back. Even though the contract gave the purchaser a 60-day "due diligence" option to cancel and said that after the cancellation option lapsed the transaction was "as is," the courts decided to give the purchaser a better deal than he had negotiated.

This case and others like it teach attorneys who prepare purchase and sale contracts that an "as is" contract should not only say that the real estate is being sold "as is," but say the same thing again and again, twenty more ways. From this and similar lessons thousands of new words of contract language are born.

Thus, today's contracts include long paragraphs (sometimes pages) that state that the seller makes no assurances at all about anything. And not only does the seller make no assurances at all about anything, but the seller *really* does not make any assurances at all about anything.

If a standard contract already contains a long litany of matters about which the seller makes no representation or warranty, the litany should and will, based on the cited case, now be extended to include whether the property is in a flood zone.

A careful attorney might also analyze the rationale this particular court used to justify its result: a "mutual mistake of fact" theory that a dissenting judge characterized as itself a mistaken theory of law. New language might also be added to counter that theory too.

The length and complexity of contract language continue to expand, in part because the court systems of all 50 states regularly issue decisions, like this one, that force the attorneys to say more next time. And they do. Again and again.

Rarely, however, does any court decision suggest that entire paragraphs of standard language are no longer needed and can be deleted. If a court did make such a suggestion, few attorneys would or should take the risk of believing it.

The endless growth of leases and loan documents, two of the most frequently used categories of real estate documents, is particularly driven by court decisions, often unfavorable to landlords and lenders. Each transaction consists of a transfer of something of value (the possession of real property or of money) in exchange for a collection of promises, embodied in either the lease or the loan documents. After the closing, the tenant has possession of the landlord's space or the borrower has possession of the lender's money. The landlord or the lender has only promises and whatever security the documents created. The only way to memorialize, enforce, and secure those promises is through the documents, which is one major reason they are usually prepared by landlord's or lender's counsel.

A landlord or a lender often faces uphill battles trying to enforce the promises they received in exchange for the money or possession they gave up, that is, in trying to enforce the documents. The act of removing a tenant or taking away a mortgaged asset is something that, considered without regard to the larger transaction, has a certain brutality to it. Hence, the courts do not always make it easy to accomplish.

To some degree, however, the process can usually be simplified or streamlined if the lease or loan document contains "magic language"—waivers, remedial provisions, useful rights, and protections for the landlord or lender. If the documents lack the "magic language," the lender or the landlord may find it difficult to exercise remedies after a default.

Word processors facilitate endless changes, additions, and modifications.

Therefore, every time a court rules against a landlord or lender because the documents did not contain language that the attorneys might have inserted, or because the tenant or borrower advanced a creative argument or theory that the attorney might have short-circuited by more words, attorneys will (and should) add yet another paragraph or half-page of new language to their documents. Additions may find their way into common usage and all future similar documents will become that much more complicated.

Legislating Complexity

Congress and the 50 state legislatures, and their regulatory agencies, do their part to increase the length and complexity of legal documents. Every year the thicket of legislative and administrative enactments expands and grows more complex as governments try to solve newly identified problems, try to solve old problems better, try to solve new problems caused by old solutions, add or eliminate tax "loopholes," and eliminate or complicate various other sorts of opportunities.

The ever-growing complexities of regulation and taxation may simply be part of the modern world. Given the fundamental, universal, and immovable nature of real estate, however, this industry sometimes seems to be a particularly inviting target for legislation. So real estate is subject to rent control, statutes providing access for the disabled, species preservation laws, and so on. Many of these new legal advances require new language in documents, which then become that much more complex.

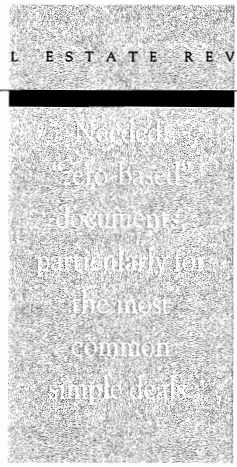
Complexity Becomes Easier

Technology is yet another cause of the ever-increasing complexity of legal documents. Modern word-processing software makes it easier to add words and paragraphs to documents. Because endless additions, changes, and improvements are possible, they become expected, and, eventually, inevitable.

All of these factors make documents and deal negotiations grow longer and more complex every year. On the other hand, few pressures restrain this growth, beyond a general sense that documents and deal negotiations are too long and too complicated.

HOW TO SIMPLIFY

The unease about the growing complexity of transactions rarely translates into specific steps to simplify them. Because transactions have always been negotiated and closed this way, individual participants in particular transactions hesitate to do anything differently. They accept these cumbersome processes because they assume the other side is playing the same game. There are ways to simplify and streamline the documentation process; however, they can impose potential risks and costs of their own that must be balanced against the benefits of speeding up and expediting transactions.



As a starting point, the parties need not commence negotiations from extreme positions. Instead, they can agree to start, and instruct their attorneys to start, from a middle ground with documents that cover the basic points reasonably and do not take the most aggressive possible position on every issue. The documents need not cover every issue as fully and completely as possible, merely adequately.

For example, a contract of purchase and sale need not identify in detail every item of expense or revenue that will be prorated between the parties, and how that proration will occur. It may suffice to say that the proration will be done in the "normal and customary" manner for similar transactions.

If the state's general principles of real estate law already provide for what happens if the property is condemned or burns down before the closing, the contract need not devote five pages to these issues. It may make more sense to express only general principles rather than to try to prescribe for and deal with every possible outcome, however unlikely, in minute detail.

If only one participant in a transaction tells its attorneys to write shorter, simpler, and less one-sided documents, it runs the risk that the opposing attorneys may regard the "reasonable" middle-ground documents merely as a fortuitous starting point for the same volume and intensity of negotiations that they would have undertaken otherwise. The party that started out from a reasonable middle ground might ultimately obtain a less favorable document than if its attorneys had used an unreasonable and one-sided first draft.

The parties therefore need to reach an understanding: a first-draft "prenegotiated" document will be received in the same spirit in which it is offered. When it presents a reasonable resolution of an issue, the other side will not try to shift it to a more extreme position.

Zero-Based Documents

Some clients and attorneys have experimented with what might be called "zero-based documents," particularly for straightforward transactions in which the client repeatedly engages.

When the parties have agreed on the fundamental business terms, one party writes a brief summary. Their attorney, rather than adding to his client's draft every possible provision that might appear in documents for this type of transaction, makes sure that it is legally sound and adequately covers the issues and problems that are likely to arise. As part of that process:

- The attorney includes whatever obligations always appear in the particular document in order to make it work. If there is a standard, straightforward and reasonable way that most of the world usually agrees (after normal negotiations) to deal with an issue, the document will deal with it that way.
- If a contract issue (1) is adequately covered by applicable law, (2) can probably be dealt with as necessary by negotiation, and (3) rarely arises (such as casualty or condemnation before closing), the document might disregard the issue.
- The attorney may set up a simple dispute resolution mechanism in the contract. The mechanism should be simpler and faster than arbitration, which has become so complicated and procedural that it can take as long as litigation.
- The contract should clearly and unambiguously identify the fundamental substantive terms: dollars; timing; allocation of likely risks; scope of personal liability; and termination rights and other escape hatches. By cutting away some of the less important verbiage, attorneys can help the parties (and potentially the courts) focus on the fundamentals and get them right.
- Particular elements of a transaction consistently tend to produce disputes and litigation, such as representations and warranties or lack thereof, or the closing date in a purchase and sale. Similarly, leases and loan documents must con-

tain whatever provisions are essential to prevail in the event of litigation. The attorney may wish to collect this "magic language" in an exhibit so it does not unduly obscure the business terms.

■ The easiest course for attorneys is to copy verbose language from old contracts into new, simpler documents. To make each point simply, briefly, and minimally, however, attorneys should not fear rewriting and simplifying long paragraphs into short sentences when possible, with due regard for language that the courts have "tested" and found adequate. Instead of looking to the Federal Register as a model for contract drafting, the attorney might look to business memoranda or good nonfiction writing.

These suggestions, if endorsed by the client and consistently applied by the attorney, can produce shorter, simpler documents that nevertheless serve the client's business and legal needs. Once a "Lite" version of a document has been standardized, it can, just like the more traditional overgrown documents, be reused for similar transactions.

GOOD DOCUMENTS CANNOT CURE A BAD DEAL

Finally, participants in real estate transactions should consider relying less on documents, and more on such considerations as doing business with people they trust. Over the years, parties to transactions have allowed the documents to assume importance, as if documents could always produce the right results even with the wrong people. In a dispute, a document will function only as well as the judicial system. The judicial system often functions slowly and imperfectly. Even the very best document will never be as good as doing business with reliable and trustworthy parties.

NOTES

1. Reilley v. Richards, 632 N.E.2d 507, 69 Ohio St. 3d 352 (Ohio 1994). This case is cited not because it is particularly unusual or important, but because it is one recent typical example of many similar cases.