The Problem

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The buyer liked the revenue stream from the property. The buyer liked the credit profile of the tenants. The buyer and the seller agreed on a price.

Then the buyer and its counsel drilled down into the details. The title report disclosed a somewhat unusual agreement with a neighboring property owner. Exactly what the agreement said doesn't matter. But it created a risk. If a strange but remotely possible set of circumstances occurred, 15 or 20 years in the future, the property might have no income for up to six months, but the owner would still need to keep paying to pay real estate taxes.

It was hard to determine the probability that the agreement would cause a real problem. Practically speaking, though, it seemed unlikely.

The buyer's counsel flagged the problem, helpfully suggesting that the seller should go get the agreement amended. In fact, the buyer's counsel went a step further and offered up an amended and restated version of the agreement, a version that would have eliminated the risk completely. It was a simple matter of getting the new document signed.

But the seller had no relationship with the counterparty to the agreement in place. It was what it was. It wasn't going to change. The seller laughed. And there were other buyers waiting in the wings. The buyer quickly decided to proceed and live with the risk. The problem was unlikely enough, and far enough in the future, that it just wasn't relevant.

Did the buyer's counsel do its job? Probably. Counsel's job is to identify risks and potential problems with the transaction before the client becomes obligated to proceed. If the lawyer hadn't noticed this strange agreement and it actually caused problems down the road, then the buyer would blame its lawyer later.

Maybe counsel could have saved some time and money by not coming up with a new agreement to replace the one in place, since it turned out to be a futile exercise and a waste of legal fees. But maybe it didn't take much time to think through what was wrong with the agreement and how to fix it.

Once counsel has identified any problem, though, it's up to the client to evaluate the risk and decide whether they can live with it. If it's a tiny risk, it probably shouldn't tip the scale. And if a risk can't arise until 15 or 20 years in the future and probably won't hit anyway, it's easy for the buyer to discount it almost to zero. The transaction should make enough sense that a risk so small – discounted to present value and further discounted by improbability of occurrence – shouldn't matter.

Any smart lawyer can identify risks, problems, and possible issues in anything. One can often even quantify each of them. But choosing whether to let them derail a transaction or treat them as background noise is ultimately a business decision. In this case, of course, it made sense for the buyer's counsel to at least raise the problem as a subject for discussion. But it also made sense for the principal to decide to live with the risk, a decision helped along by the presence of other buyers who were ready to pounce on the property in a seller's market. The outcome might have been different in a different market.

The seller could have prevented the whole dramatic episode by recognizing that the agreement in question could give buyer's counsel a hook on which to hang a concern and perhaps even a retrade of the business deal. If the offering materials for the property had disclosed the risk — making it clear that the seller had no intention to do anything about it — then bidders might have been more willing to ignore the issue when they did their numbers and prepared their bids. In the competitive heat of the moment, bidders probably would have overlooked the problem.

By leaving buyer's counsel to discover the risk and make a fuss about it, the seller mismanaged the process a bit. In today's world, it's not realistic to think that a buyer's counsel will miss anything like that. A seller might as well present the problem, put it on the table, and deny the buyer's counsel any opportunity to delay the transaction over it later. Early disclosure during the bidding process can create immunity down the road.

Problems like the unusual agreement described earlier come up all the time. Sellers can be strategic about making sure they don't hold up the transaction. Sometimes problems like these can give buyers and their counsel opportunities to delay the transaction, demand things, and sometimes even retrade the deal. The success of that strategy will depend on the larger market. And it often won't work anyway.

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