

CONTRACT DRAFTING IN 90 MINUTES

JANE SCOTT¹ THE KEY CONTRACT CONCEPTS
CHARLES FOX² CONTRACT ORGANIZATION AND DRAFTING
TECHNIQUES

JANE SCOTT
THE KEY CONTRACT CONCEPTS

Introduction

Good afternoon, and welcome to contract drafting in 90 minutes. This is a panel for people who really want to know What's Next in Transactional Education, but who would first like a little transactional education themselves.

We propose to give you a primer in how to draft a contract in 90 minutes, maybe even a little less. And so if you're interested in teaching contract drafting or other transactional skills courses, but your own practice background is in another area, then this is the panel for you. Charles Fox and I plan to give you a great spring- board for making the most of the next day and a half of this wonderful conference at Emory.

Charles Fox is a transactional lawyer with over 22 years of experience in drafting and negotiating complex commercial agreements. He's the author of *Working With Contracts: What Law School Doesn't Teach You*.³ Of course, the purpose of this conference and others like it is to make sure that law school does teach you how to work with contracts. But in the meantime, Charles' book is a handy way to learn it. He is an adjunct professor of law at Pace Law School and the founder of Fox Professional Development, which provides training programs, in contract drafting and transactional skills, to lawyers in practice, both junior and experienced lawyers at law firms all over the country.

My name is Jane Scott, and I am an associate professor of legal writing at Saint John's University School of Law at Queens, New York. I practiced real estate and development law for 17 years in New York before going into teaching, and it was my dream in those years of practice, during which I spent all of my time drafting and negotiating contracts, to some day teach a course on the topic. I will never forget the excitement of

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³ CHARLES FOX, *WORKING WITH CONTRACTS: WHAT LAW SCHOOL DOESN'T TEACH YOU* (Practising Law Institute 2d ed. 2008).

getting a flier in the mail announcing the publication of Tina Stark's first book, *Negotiating and Drafting Contract Boilerplate*.⁴ I just thought that was the most exciting book to come down the pike in a long time. I was finally able to realize the dream of teaching a course on drafting contracts last year at St. John's, where I now teach a one-semester course for upper level students in contract drafting. The book we use in that course is Tina Stark's book, *Drafting Contracts: How and Why Lawyers Do What They Do*.⁵ The materials I'll be presenting to you today are drawn from her work.

Key Contract Concepts

I'm going to start by covering the key contract concepts, and Charles Fox will then discuss contract drafting techniques and contract organization. Let me just ask you how many of you have ever signed a contract? I know many of you probably signed a contract without reading it. But that's so embarrassing to admit when you're a lawyer that I'm going to assume that you've read some of the contracts that you signed.

How many of you have ever reviewed a contract for someone else? A client? Or one of those non-paying clients, which we also call family members and friends, who know there is something at stake if they are going to sign a contract and want you to look at it first and advise them? How many of you have ever litigated a contract? Been involved in the resolution of a dispute arising out of a contract? It's pretty hard to be a lawyer and not have something to do with contracts even if you're not a transactional lawyer.

The difference is that if you are a transactional lawyer, you don't encounter a contract in its final written form. You have to create it. It comes to life in your practice as a term sheet—a set of business terms that the parties to the deal have agreed to already and that you need to translate into one of those full-blown contracts that someone is going to read and review before signing.

So, our initial task as transactional lawyers is to translate these business terms into legal concepts—into contract concepts. From there, we go on to organize and draft the contract to make it effective and clear. What I'm going to go over with you is what those concepts are and how to recognize them in business terms. The key contract concepts are representations, warranties, covenants, rights, conditions, discretionary authority, and declarations.

Representations

Let's suppose that I have a used car that I want to sell, and Charles is interested in buying it. Assuming that he wants to drive the car, rather than just look at it, the thing he's probably going to be most interested in is what condition it's in. So, he's likely to ask me questions like: How many miles are on the car? I'm going to say 75,000. What kind of condition is it in? It's in good condition. I've never had any problem with it. Has it ever been in any accidents? Well, my daughter tore the front fender off backing it out of the garage but other than that, no. Has it been well maintained? Yes. I've always kept it serviced in accordance with the owner's manual.

⁴ TINA STARK, *NEGOTIATING AND DRAFTING CONTRACT BOILERPLATE* (ALM Publishing 2002).

⁵ TINA STARK, *DRAFTING CONTRACTS: HOW AND WHY LAWYERS DO WHAT THEY DO* (Aspen Publishers 2007).

These are all statements of fact as of a moment in time—intended to induce reliance by Charles. They are representations. And, when drafted, they look something like this: “Seller represents that the car is in good condition.”

Now, even if you're not a transactional lawyer, you're probably noticing that something is missing from this statement. There is another verb that we're used to seeing in conjunction with represents. What is it? “Warrants.” We would typically expect to see “Seller represents and warrants that the car is in good condition.” And this is not an example of using two words to draft something that can be said with one, which is a feature of many traditionally or poorly drafted contracts. For example, a contract is likely to say, “seller sells and conveys,” when only “sell” would do, or “suffer and permit” where only one would be sufficient. Representation and warranty mean two different things.

Warranties

A warranty is a promise that a statement of fact is true.

In the real world, what that means is that the maker of the statement will pay damages to the recipient if the statement isn't true and the recipient suffers damages. Why should a person receive both a representation and a warranty with respect to a particular statement of fact? Because they differ as to the requirements for a cause of action and the remedies available if the statement is not true.

Remedies for misrepresentation differ depending on whether the misrepresentation was honest or negligent, on the one hand, or fraudulent, on the other. For honest or negligent misrepresentation, the remedies are avoidance and restitutionary recovery: you can get out of the contract and get back what you paid.

Suppose the car needs new brake pads, and I didn't know that. But I reasonably should have known it, if I really had been taking that car in for servicing as I claim to have done. So, it's a material misrepresentation. It's negligent misrepresentation, and Mr. Fox can avoid the contract and obtain restitution.

Fraudulent misrepresentation provides a choice for the injured party between avoidance and restitutionary recovery, and damages. But damages may be out-of-pocket damages rather than benefit of the bargain damages, depending on the jurisdiction in which the action is brought. Plaintiff also has to show scienter: that seller knew the brake pads needed to be replaced. A cause of action for breach of warranty, on the other hand, relieves the plaintiff of the obligation to show reliance or to show scienter on the representor's part, and the damages available are the benefit of the bargain damages regardless of the jurisdiction.

So why receive both of these in your contract? Because it gives you a choice of remedies and a choice of causes of action, which may be important based upon the facts available.

Covenant

Suppose Charles and I reach an agreement over the condition of this car. He hasn't figured out yet that it needs new brake pads and he agrees to buy it. The term sheet that you would get from the client might simply have a purchase price of \$5,000.00. That's what he's agreed to pay me for the car. But what does that translate into as a contract concept? It's a covenant.

A covenant is a promise to perform. It can be a promise to do something or to not do something. It creates a duty or obligation to perform. Obviously, most of what contracts consist of and contain are covenants: Seller shall sell the car to buyer. Buyer shall pay seller \$5,000.00 for the car. That's what we translate that one little business term, purchase price of \$5,000.00, into. And, the contract may well contain other covenants not having to do with the price of the car, such as "seller shall not drive the car more than five hundred miles before the closing date." There may be any number of things that the seller has to promise buyer she will do before the contract is signed. All those take the form of covenants.

Right

A right is merely the flip side of a covenant. If I'm obligated to repair the car, then Charles has the right to my performance of that promise to repair the car. I promise to maintain the car in good condition until the closing—that's a covenant. Charles has a right to my performance of that obligation. Each covenant creates a corresponding right. But the right need not be separately expressed in the contract. The better practice is to draft an obligation as a covenant rather than as a right to receive the obligation.

Condition

Suppose that Charles finds out about the brake pads and insists that I fix them before the sale takes place. The term sheet might require the seller to replace brake pads before closing. That's a covenant on my part to fix the brake pads. But suppose Charles, being a savvy transactional lawyer, wants something more than that. He just doesn't want my promise. He wants to make it a condition of his obligation to buy that I have actually fixed the brake pads. And that brings us to our next contract concept. The condition to an obligation is a state of facts that must exist before a party has an obligation to perform. The contract might say, for example "buyer is obligated to purchase the car only if the following conditions have been satisfied or (less likely) waived by the closing date," and then among the conditions listed is "seller must have replaced the brake pads." That way, he's not obligated to buy the car if I haven't done so.

Conditions can be on-going conditions, not just walk-away-from-the-deal conditions. Here's an example. Suppose Charles wants to look at the car's warranty. I don't have it handy at the time we signed the contract, so I agree. I covenant that I will give him a copy of the warranty. But there is a condition to that covenant on my part, and that is, he has to notify me, perhaps in writing, that he wishes to see it. So we've got conditions of various kinds to these covenants.

Let's take a look at the interplay between these concepts in the context of the mileage of the car. I've represented and warranted that it's only been driven 75,000 miles, and I've also covenanted that I won't drive it more than an additional five hundred miles before the closing date. And, it's a condition to his obligation to buy it that I've complied with all the covenants in the contract, including not driving the car more than five hundred miles.

Discretionary Authority

Now the parties may have agreed, as part of this contract for the sale of a used car, on a closing date. Let's say we picked June 14th, 2010, but Charles is such a busy guy, with all these seminars he teaches and all these conferences he attends and presentations that he makes, that he needs the right to postpone the closing date if necessary by a little bit. So the

term sheet—that business term sheet that you get from your client – might say something like: “Closing to take place June 14th but Fox may extend the date on written notice to Scott.” What's that? That's discretionary authority. It's not a right on his part to extend because a right is the flip side of a covenant. It's authority on his part to do or not do something, as he chooses. He's not covenanting to extend the closing date, but he has the right to do so if he chooses. Discretionary authority gives a party a choice or gives a party permission to act sometimes when it's been otherwise denied. “Buyer may extend the closing date by up to one week by sending written notice to seller.” That's his discretionary authority, and the key verb is “may.”

An example of the sort of permission to act where it's otherwise been denied would be “seller shall not paint the car before the closing.” That's a covenant. But suppose we add, “Except that seller may repaint the car its existing color and shade.” That's discretionary authority. And we can have conditions to discretionary authority the same way as we can have conditions to covenants. They are simply statements of facts that must exist before the discretionary authority can be exercised.

Charles might want to have this car inspected by a mechanic before he buys it, but he's not sure he's going to do that. It is discretionary authority; it's not a covenant on his part. It is subject to a condition, because if he wants to have it inspected he has to notify me of the date of the inspection at least five business days before the date of the event so I can make arrangements to get it there. So, we've got a condition, but it's a condition here to discretionary authority rather than to a covenant.

Declarations

And, finally, we have declarations. Declarations are statements of policy that the two parties of the contract have agreed to. They don't entitle either party to any right or remedy, but they express the policies that the parties have agreed will govern their contracts. An example are all those types of provisions that appear in that wonderful boiler plate language that Tina Stark wrote about in her first book—provisions relating to choice of law, choice of forum, and dispute resolution. “Any dispute arising under this agreement is to be resolved by arbitration.” That's a declaration. “The laws of Georgia govern all matters relating to this agreement, including torts.” That's a declaration.

Declarations are also how we categorize definitions. And, as you all know, contracts are filled with definitions. They are a housekeeping tool, a tool for clarity and consistency, and a definition like “Purchase Price means ten thousand dollars” is a declaration. It's kicked into effect by the covenant. “Buyer shall pay seller the Purchase Price at the closing.”

So there you have it. Our 7 contract concepts: representations and warranties, covenants, rights, conditions, discretionary authority and declarations. And, just as a reminder, conditions can be a condition to an obligation or covenant, a condition to discretionary authority, or a condition to a declaration.

Speaker Exercise

Now what I'd like to do is give you a little test. I want to show you some business terms on the screen and see if you can tell me what contract concepts you would put them into.

Let's start with this one: “Mr. Alvarez will be reimbursed by the firm for all expenses incurred in performing the job.” Which of the seven contract concepts would you categorize this as? It could be more than one.

SPEAKER

Covenant.

JANE SCOTT

It's a covenant, right. Who is covenanting?

SPEAKER

The firm.

JANE SCOTT

The firm. It's written almost as if it were a right on Mr. Alvarez's part. We'd be better off writing it as a covenant on the firm's part, so we'd say "The firm shall reimburse Mr. Alvarez for all expenses incurred in performing the job." Right?

SPEAKER

You are making a distinction between "the drafting aspect" rather than "the legal aspect" when you say write it as a covenant. As far as I am concerned, if I covenant to you, you've got that right.

JANE SCOTT

Well, that's right.

SPEAKER

I just wanted to get that clear.

JANE SCOTT

Right. This statement from the term sheet amounts to a covenant with its corresponding right unexpressed, and we draft it as a covenant for greater clarity, especially if we are representing Mr. Alvarez.

How about this one? "The firm can withdraw the offer of employment if Mr. Alvarez does not receive his MBA degree by June 15th 2010." It's a condition, but a condition to what? Discretionary authority. The firm has discretionary authority to withdraw the offer of employment if he doesn't receive his MBA. They don't *have* to withdraw the offer, but they have the discretionary authority to do so. The condition to that authority is his not getting his MBA degree on the 15th. This is a rather easy one.

SPEAKER

Declaration.

JANE SCOTT

It would be translated into a representation and warranty. We would draft it as "seller represents and warrants to buyer that the property is zoned for commercial use, has a sewer, and water service." Why is it not a declaration? Because if it's not true, a party, the buyer, should have a remedy. The buyer's relying on this statement.

SPEAKER

But it doesn't say which party.

JANE SCOTT

No, but that's the thing about a term sheet. When you get a term sheet from your client, that's the kind of abbreviated language it's written in.

SPEAKER

Right. I would have put it in the statement of purpose as I read it. That's the way that I would have classified it.

JANE SCOTT

In the statement of purpose?

SPEAKER

I didn't read based on what you have that it would be a rep. or warranty because it doesn't seem to me that it's a promise that this is the case.

JANE SCOTT

Right. It would all depend on the context. Where it appeared in the term sheet. If it were a sale of commercial property, it might be more clear that it was a rep or warranty, and sometimes the client will very clearly say, seller to rep and warrant the following.

You had a question, sir?

SPEAKER

Well, I guess the only thing I'm thinking about is the question for recital, which is very important but also very dangerous because of the fact that they can turn to representations. It seems to me that is clearly a warranty and a representation. There are cases that say you have got to say "warrant." But I wouldn't let anybody sign it unless they knew that it was a representation. Otherwise they would get in a lot of trouble with that.

JANE SCOTT

Right. We translate this as a rep and warranty. We draft it as a rep and warranty. And if it was recited in the recital section, which Charles is going to talk about, that might be superfluous and certainly wouldn't be sufficient to create the representation and warranty. You had a question?

SPEAKER

I was just going to say I think that's exactly the point that you're making is that how you write it if it is a representation, then you write it as if it is a representation and then you can recognize it from the terms. I think that is exactly what you are saying.

SPEAKER

I also want to cast it as a condition. Unless the property is zoned for commercial use, and has sewer and water service then the buyer –

JANE SCOTT

Right. And typically it will be a condition to closing that all the seller's representations and warranties must be true, which picks it up. Yes.

SPEAKER

I was just going back here to your list before, Jane. The arbitration provision— isn't that really a pair of covenants?

JANE SCOTT

Yes, it is. And to kick it into effect you'd have to have multiple covenants on each party's part as to how they are going to select the arbitrators, how they are going to pay for the arbitration –

SPEAKER

Yeah, unless the court ends up having a question of whether it is enforceable with all those details, but what's happening is each party is agreeing together to arbitrate any dispute that isn't settled with a formal letter.

JANE SCOTT

That is correct. So, as a drafting matter you'd have it as a declaration, and you'd also need to create specific covenants to implement it and make it a reality. But the –

SPEAKER

To me it's going to hit the road if there is a dispute that doesn't settle formally and one of the parties wants to arbitrate and the other one doesn't.

JANE SCOTT

Right.

SPEAKER

And so then the purpose is going to say this is an arbitration agreement, and it is enforceable under the FANA or the state's arbitration laws. So one of the parties may be compelled to arbitrate.

JANE SCOTT

If you get a term sheet from your client, which purports to set forth the agreed upon terms by both parties, and it says “all disputes are to be resolved by arbitration,” then what that's telling you is that, as a policy matter, the parties have decided to resolve disputes by arbitration. You as a drafter need to include that declaration as well as the covenants that will make it enforceable and address the practicalities of arbitration.

Let's do just a few more of these, and then I am going to turn you over to Professor Fox.

“The publisher can accept or reject the final manuscript or accept it with changes.” Discretionary authority. “If the company terminates the executive without cause, executive will be paid one hundred thousand dollars.”

SPEAKER

Covenant and condition.

JANE SCOTT

It's a covenant and a condition. A covenant on the company's part to pay the executive one hundred thousand, subject to the condition that he's been terminated without cause.

Conclusion

Well, I think you all deserve an A, and you're ready for Professor Fox's presentation. Thank you very much.

CHARLES FOX**CONTRACT ORGANIZATION AND DRAFTING TECHNIQUES****Introduction**

Hello everybody. Talking about reps and warranties, I'd like to just follow up on one of the topics Jane covered before I get into my scheduled presentation. And actually when I teach this subject, I'm usually teaching, not law students, but first year lawyers. But guess what? They don't know anything more about contract drafting than law students do, so it's the same thing, except they are being billed out at two or three hundred dollars an hour for that lack of knowledge.

Personal Example on Representations and Warranties

But when I talk about reps and warranties, I usually start with a personal anecdote which has to do with the sale of a used car. But this actually happened to me. When I got my first job as a lawyer, it was very exciting to be making a paycheck. And my wife and I decided to sell our car, which had been breaking down more and more frequently. So, we're going to sell our used car and buy a new car. We put an ad in the Penny Saver selling our Buick Sky Hawk, and we asked for eight hundred dollars. We hoped that we would get four hundred dollars for the car because it really was not such a great car. So, the first guy who answered the ad came over. He kind of walked around the car. He got in, sat in the driver seat and started it, and we were hoping, holding our breath because it didn't always start. But this time it did start. And, he gets out of the car, and he pulled out his checkbook said, "Who do I make the check out to?" And my wife and I gave each other these glances like that and we took his check.

And later on that evening my wife was very upset. She felt that she had done something wrong. She said we did something wrong. We should have told him about the problems that the car had. And I said we didn't do anything wrong. Of course, I was answering that question as a lawyer, and not as a human being because that's how I have been trained in law school. I said we didn't do anything wrong.

The rule of caveat emptor says that it's up to the buyer to ask questions and to get information. So in this case, in this transaction, the buyer should have done due diligence – taking it to a mechanic – and he also should have asked us questions. He should have asked us the following question. How does the car run? And at that point we would have had three options. We could have said the car runs great. What do we call that? Fraud.

You'll be surprised how many first year lawyers would have answered that question by saying lying. Yes it is lying. But we lawyers call it fraud. That would have been fraud. Our second option would have been to say we choose not to answer your question, which we would have every legal right to do. But I think this guy would have gotten the message and, at that point, he would have walked away. Third, we would have told him the truth, which is what we would have done if he asked us the question. It was his job to ask us the question. That is what reps and warranties are; it is asking the other person to the contract to stand behind the facts that you're relying on in deciding to enter into the transaction.

I have found that to be sort of a very effective way of getting people to sort of understand what reps and warranties are because those terms sound very mysterious. They are not mysterious. Just like the term due diligence. And by the way if anybody out there knows where the word due diligence came from, I'd really like to know because I have been trying to figure it out. But due diligence—all we are talking about is doing a reasonable investigation of the facts. So these are just examples of how we lawyers have cloaked things in terminology that's mysterious but is really very much just common sense.

SPEAKER

I have a question for you.

CHARLES FOX

Certainly.

SPEAKER

So, how did your wife respond to that?

CHARLES FOX

How did my wife respond to that? I think it might have been the only time in our marriage that she was glad that I responded like a lawyer. We're okay. So, yes, she was relieved.

SPEAKER

Did the check clear?

CHARLES FOX

The check cleared.

SPEAKER

I wasn't going to interject but now people have interjected. The real answer, from a negotiation standpoint, is you did make a statement when a buyer gets their check out that fast. You left money on the table is what you did. \$1,000 is what you should have asked for.

CHARLES FOX

Drafting Contracts

I might have felt bad about that. So, the remainder of my comments really are going to be focusing on one overall theme, which is how drafting contracts is different than other kinds of writing. That's the general theme. Where I'd like to start is about how contract drafting, specifically, is different than most other kinds of writing that your students

do all the time. Your students know how to do expository writing and in their legal writing class, for the most part, they are learning together how to write briefs and memos.

Expository writing can be illustrated in the following way. Now, I have two guys here. And it is interesting because my usual audience, they know who the guy on the right is they are not so sure who the guy on the left is. Maybe in this audience it's turned around. But here we have Alan Greenspan writing a letter to Bono. I once called him Bono, and my kids were so dismayed when I called him Bono. He's Bono. So, Alan Greenspan is writing a letter to Bono, and he's saying to Bono attached is an article that I'm about to publish on the effects of credit scores on long term interest rates, which I thought you might be interested in reading. And by the way, I saw you guys in Toronto, and you were awesome. So he's writing that letter, and that is an example of expository writing. We think we can chart it out effectively as taking something in the brain of the writer and conveying it into the brain of the reader. You are either trying to convey information, trying to persuade, trying to amuse, but you are essentially conveying something from one brain to another.

Meeting of the Minds

Now, let's say Greenspan and Bono are entering into a joint venture and they need to negotiate a contract. The paradigm of contract drafting is different because in contract drafting that arrow changes to a two-sided arrow. This is the so-called meeting of the minds, which everybody knows about from contract class. I believe that getting to a true meeting of the minds is one of the lawyer's most important functions in getting a transaction done. Why? Because our clients, more often than not, think they have a meeting of the minds when they just have the beginning of a true agreement. And it's our job as lawyer to force them to think about and address the more difficult issues. It is human nature to want to try to not think about the hard stuff. We have to force our client to think about the hard stuff. And I'm going to skip a couple of slides here to look at this slide, which is a pretty common example of the way clients are.

Your client calls you up and says we've just agreed to acquire this piece of used equipment for fifteen million dollars. Draft up a purchase agreement but don't spend a lot of time on it because we want to close tomorrow. Well, I used this example for a couple of purposes. I use it as a way to start to show my students that our job as lawyers is often to push the client in a direction that they don't really want to go—not necessarily just to blindly do what they tell us do, but also to illustrate how we as lawyers add value not just by dealing with legal issues but by forcing the client to think about business issues.

So, I'm just going to ask you folks the same way I'd asked my students.

CHARLES FOX

What does the client need to be thinking about here? They are telling you they just want a one page purchase agreement, and if you do that, you probably are not serving your client properly because there is a whole bunch of issues which they haven't thought about and they should be thinking about and there should be an agreement on. None of you I think are in the business of selling old and used magnetic glue fixtures but you all know what some of issues are.

SPEAKER

How are the payments going to occur? Is it going to be cash, is it going to be notes, is it going to be a check, is it going to be an exchange of services? What does this thing do and how do we know whether it is going to work? How do we know whether it is working

the way the client has expected it to work? How do we know it is working the way the client has expect it? Do you want a right of inspection? Do you want some representation about how many gallons it gets per mile, exactly. What else?

SPEAKER

What happens is if it stops working two days after you get it?

CHARLES FOX

Right. Is there going to be any kind of warranty on it or any promise that it will perform that certain way? What else?

SPEAKER

Does he own it?

SPEAKER

Yeah, cause if he doesn't, the owner --

CHARLES FOX

Does he own? That is always a good thing: for a seller to own the thing he sells. In fact, if you drafted the purchase agreement without getting a rep as to title and it turns out after you buy it that there is a cloud on the title, do you think you've committed malpractice? Maybe? Probably? What else?

SPEAKER

Will the seller remember to deliver it to you or --

CHARLES FOX

Delivery, right. Big question. How is it delivered? Are they going to hook it up? Are they going to put the glue connection in or whatever? Well, we can go on and on. But the point here is that as lawyers we play a huge important role in getting this first step of doing a contract which is making sure there is a true meeting of the minds. Making sure that all of the necessary issues have been thought about and addressed. It's not easy because clients usually would just as soon not have to be on the phone with their lawyers. But we make them. Okay.

Then, once we have a meeting of the minds, then the next step is to draft the contract in a way that precisely reflects the meeting of the minds. In an ideal world it is so precise, the words so precisely reflect that meeting of the minds, that the parties could never disagree about what the contract said. And the contract has to be so precise that every future reader of the contract interprets it to mean exactly the same thing as the parties intended. Those future readers could be the clients themselves, could be some litigator who's been asked two years down the road to help the client fight the other party over the contract, and ultimately could be a judge. And one of the key aspects of contract drafting and contract negotiation is not only are you trying to create a clear and precise road map for a business relationship, but you're also trying to do it in a way that precludes arguments.

I believe that deal lawyers and litigators are kind of natural enemies in the jungle because our job is to keep there from being work for the litigators and the litigators' job is, when they are handed a contract, to read through it and find every ambiguity, every soft spot, every bit of infelicitous wording in order to try to achieve a benefit for their clients.

So, the ideally written, precisely written, contract is one that doesn't give that tough litigator any wiggle room to argue that the contract really says something other than what it was intended to say

And the contract formation process performs all these very valuable functions. It forces people to realize what they have to give up in order to get what they want. Now, if we followed the traditional Japanese method of doing transactions between say, big companies, it is changing but in the old days they'd sign a five page agreement and say, well we will worry about all those other issues when they come up. And that works within that culture because that culture is a very collegial culture. American culture isn't collegial. No one wants to give up something for nothing. So by thinking of all the possible issues up front and addressing them, you're facilitating a much easier relationship. If the contract doesn't address some important issues and it comes up afterwards, one party is going to go to the other and say how about doing this for me, and the other party is going to say no, I demand a quid quo pro. It is much easier to get those issues resolved when everybody is in the negotiating mode and in the negotiating spirit.

When I started practice back in 1983, I actually had a wonderful experience. I went to work for a firm, and the firm was working on small deals and I was just right out of the box told to start drafting agreements. So, I was doing a lot of drafting from the very start, which is unfortunately very rare these days. And when my friends, who weren't lawyers, would ask me what do you do all day, I said I write credit agreements. My client is lending some company ten million dollars. Back then that was a lot of money, and I write an agreement that governs that. And they would say to me, well what's the law? What's the law? And I would say: that's the great thing. There is no law. I'm just writing stuff and the words that I write become private law between the parties, which govern these big well-known companies. I mean, I thought I was pretty hot stuff. Now, of course, we know that's not true. There is law, but in fact, for many transactions, the law is quite secondary to the business issues.

I tell students that all that stuff you learned in contracts class is not going to come up all that often. I worked on deals for 22 years and not once did I have to scratch my head and say is there consideration here. It's important to know that stuff but the basic contract law things are not what governs. The law that is most important to you when you are you a drafting or working on a contract, are these two rules of contract interpretation, which are actually both rules of evidence, as opposed to contract law rules, per se. The parole evidence rule, no?

SPEAKER

They are both substantive rules of contract.

CHARLES FOX

All right then, fair enough. So they are contract law. That's good. I'm glad to know that, but these rules taken together are what make it so important for lawyers to get the words right in the contract. You always want writing to be precise. In contract drafting that rule is paramount, and if you don't follow that rule, that's where you get into problems because, based on these two rules and others, most often if you're in a dispute about what the contract does, you're going to be prevented from trying to convince the court or the trier of fact that the contract actually means something other than what it says.

So, for example, let's say, you are drafting a brief and, on the last page of the brief the last sentence you write says: "For all the reasons set forth above, this court should not grant plaintiff the relief that plaintiff is seeking." And somehow the word "not" is dropped from that sentence the night before it gets submitted to the court, so you have a brief where the last sentence of the brief you are asking the judge to do the opposite of what you have spent the last 49 pages of trying to convince him to do. Is a reasonable judge going to decide the case against your client based on that sentence? Of course not. Now, it is not a good thing. It would be very embarrassing but it is not going to affect the outcome of the case.

Contrast that with a contract term where the word not is omitted accidentally. What happens then if the parties end up having a dispute about that? The party who is saying that it was supposed to be written that way is going to win. We live and die by the words on the page, and --

SPEAKER

There is a doctrine of reformation.

CHARLES FOX

Yes, but okay. And my response to that is that you don't – believe me – you don't want to explain to your client why you're in court trying to make those kinds of arguments.

SPEAKER

Yes. I think that's the point. There is exemption to parol evidence but who wants to litigate that point?

CHARLES FOX

Law students have learned to make arguments, and I always tell the people I teach and told the people who work for me, "I don't want arguments." You tell the client when they are in litigation because the contract is not clear, oh, don't worry, we've got a good argument—that's not going to get you very far. You always, always do it the way that's not going to lead to an argument. So yes, there are always exceptions to rules, but you don't ever want to get there. It's like the implied covenant of good faith. People ask me about the implied covenant of good faith. My response to that is if, as a deal lawyer, you are relying on the implied covenant of good faith, you're out of your mind. Right? The implied covenant of good faith is something litigators use when you've got nothing else to argue. You don't want to rely on that when you are putting the deal together.

SPEAKER

It also depends on your perspective. If your client—if you are writing the language the way you want it in the contract from your client's point of view, but your client is out there making contrary representations at the same time, your client has problems as a result of that. In other words, sometimes I listen to lawyers who draft contracts talk about how frustrated they are because their merger clauses don't work completely and the clients don't always get what they want because the client is doing things that are undermining what the document says.

CHARLES FOX

Yes. Absolutely, and I will make two comments on that. Number one is the old saying that practicing law would be great if it weren't for clients. And, number two, when I

was a first year associate at Kaye Scholer, the head of the banking department was this really classic, older New York garment center lawyer. And one day, we were walking down the hall and he put his arm around me and he goes, "Charlie," he says, "you are going to be working on deals." He says "I am going to give you the best single piece of advice I can ever give you. You are going to be working on deals and you are going to be negotiating with some lawyers on the other side and you are going to be thinking that other lawyer is your enemy." He says "don't ever think that. That lawyer is not your enemy. Your *client* is the enemy. Never forgot it. Your *client* is the enemy." And I thought he was nuts. But over time I realized that he wasn't nuts and so that's just one example of that.

Yes, I mean, if your client is going off and doing things like that it's almost impossible to protect them from themselves.

SPEAKER

I've spent 11 years writing a courtroom volume on parol evidence that's going to the printer next month, and I've got a whole book about the problem with these things. And I believe strongly in allowing extrinsic evidence. As a draftsman, I want to be as complete as I can. I want to get everything on paper. I don't ever want to end up with those things, and as a judge I might feel differently. But as a draftsman, I absolutely agree with everything you are saying there. And for example, one of the things we were doing now, in other words is there a duty to work. If you don't put that in the papers about a duty to work, may be you will win, but --

CHARLES FOX

Who wants to have to fight that fight? I mean that is a covenant of implied faith argument that you are not going to want to rely on.

SPEAKER

I was the general counsel at a public company, so I want to speak for the clients. I'm curious, Charlie, if you are as precise in your drafting and both sides are precise as you make it out to be, your client looks at it and says I'm not going to engage in contrary representations for purposes of full evidence rule. But I have got a one hundred million dollar acquisition here that ought to be resolved in less than a five hundred page agreement because the lawyers are so precise that every representation is negotiated as though it were aggressively the enemy. So what's the response to that?

CHARLES FOX

Well the response to that is --

SPEAKER

Is the client still the enemy?

CHARLES FOX

In that case, I am totally with the client. My response to that is to me that is the dividing line between the good lawyer and not so good lawyer is that the good lawyer knows what's important and knows when to fight the battle. As you will see later, I've got some slides later on which talk about this tension between trying to achieve this holy grail of precision and knowing when enough is enough. And the image I use to illustrate enough is enough is the "line of dust." Where you take a broom and a dust pan and you do this and

then you do that, and no matter how hard you try there is always that little line of dust and a good lawyer needs to know when to take the broom and just go like that.

So, a good lawyer working together with a good client will be able to figure out what the proper level of precision and care is because, in fact, if you were to try to create something that was a hundred percent precise where every term was defined to the nth degree, it would end up being this thick. So you have to find the balance. I definitely agree with that. Mark.

SPEAKER

This may be an observation for teaching purposes, but it strikes me as it comes out here. I spent most of my time for teaching first year MBA's commercial law, so we go off basic contracts and they frustrate me and anger me because so much of that is not fair. They think it is going to be fair at the end of the day. And, I remember back in law school when we started with the UCC that so many rules we talk about the balance between certainty and fairness. I've used that a lot in contract teaching about contracts and contract drafting and I think that's a valuable vehicle for teaching basic contract drafting. The parol evidence rule is a great example, the rule itself is about certainty. It may have unfair consequences if your client is running out there making representations that are contrary to what went into the agreement, so you try with this merger and integration clause to nail down what's in the agreement as opposed to you having something that certainly won't be legitimate parties who won't spend much money in litigations and discovery on because the document says what is it says. But that certainty comes with a compromise of fairness. I think so many of the contract rules fall across that spectrum.

CHARLES FOX

That's a really good point. So, we have got two balancing acts here. Precision versus just getting things done and practical necessity and the balance between fairness and certainty.

Contract Drafting Mistakes

Let me keep going. What I'd like to talk about now are the four most common ways that contract drafting gets screwed up: ambiguity, use of unnecessary words, vagueness and inconsistency.

Ambiguity

Let's start with ambiguity. Ambiguity exists when you have a contract provision that can be read to mean two completely different things by two reasonable readers. And obviously that is not a good thing. The way I like to visualize this is to think about those optical illusions you've seen where there is a drawing and if you look at it one way it looks like an old woman and you turn your head and look at it this way it looks like a young woman. Same thing. And what I have up here on this slide are three examples of provisions that are flawed by ambiguity. What's the problem with the first sentence in terms of an ambiguity in it?

SPEAKER

You are talking about quarterly delivery of sales reports and litigation reports, or are you talking about quarterly sales --

CHARLES FOX

Right. The word quarterly is a modifier. It clearly modifies the phrase sales reports, but does it also modify litigations reports? Maybe yes? Maybe no? Yes.

SPEAKER

If requested by licensor, Licensor has to request the quarterly sales report in order to get them.

CHARLES FOX

Same problem. What we have here is a series. It is only a two item series. Sales reports and litigations reports, and there are modifiers on either end. The modifier at the end “requested by licensor” clearly modifies litigation reports but may also modify sales reports. We don't know, so this provision can actually be read to mean a whole bunch of different things.

Now can I stick with you? Okay. We're going to rewrite it. So, let's just say that here's the deal. What this is supposed to say is, that licensee has to deliver two things: one, they have to deliver sales reports every quarter, and two, when requested by the licensor, they have to deliver litigation reports. That's the deal. Now, one of the problem is this sentence says that. It also says a bunch of other things. So how can we rewrite this to make it clearer—to make it clearly reflect the deal?

SPEAKER

Two sentences.

CHARLES FOX

Okay. Now. In my old days, I considered myself a prose stylist, and in my capacity as a prose stylist I might say to you two sentences that's awfully choppy, to which my response as a contract drafter is, I don't care. It's clear. That's all I care about. It's not about style. If it's clear, that's what we need so you can make it two sentences. How else you could do it?

SPEAKER

Roman numeral one after the first licensor, Roman numeral two before litigations report?

CHARLES FOX

Well, think about that. Isn't there a risk if we do it that way that the phrase “requested by licensor” might still apply to the first item in that series. I think there is enough of a risk that I'd want to tweak it a little bit further.

SPEAKER

So put licensee shall deliver to licensor --

CHARLES FOX

Colon. With B and then B. That works. Right? Because that eliminates the possibility that requested by licensor, which is now clearly attached to the second item from being read and applied to the first item.

There's numerous ways to fix the problem. Identifying the problem is the hard part. And why is identifying the problem so hard? Because if you have written this, you're happy with it because it says what you mean. It also says some other things, but it's very difficult to see that and this is where the concept of editing one's own work comes in. And, I try to impress on people how important it is—just like with anything else you write—if you have the time, write it, put it away and then let some time elapse between the time you write it and the time you review it. And I also tell people you need to recognize the fact that these kinds of problems, 9 times out of 10 or even a higher percentage, are not ever going to be a real problem because if the parties to the business deal are otherwise getting along with each other, in many cases it almost doesn't even matter what the contract says.

But one of our jobs is to protect our client against that 10 percent probability or possibility that there's going to be a dispute. If there is a dispute and the parties each hand the contract to their litigators, and they say to the litigators, we're having a dispute over section 7.2(d). Is the litigator only going to read section 7.2(d)? No. They are going to read the entire contract, and they are going to be looking for every provision that is kind of soft and squishy. Every provision where they can make an argument that improves their client's case. And that is the when your work as a contract drafter is going to be tested. It doesn't happen that often, but that's one of our main goals is to prevent that from happening by being clear.

CHARLES FOX

All right. What's the problem with the second example?

SPEAKER

It.

CHARLES FOX

It. Who is it? The “it” there could refer to either the contractor or the owner. We don't know who “it” is. Very common problem. You've got a pronoun without a clear antecedent, so you just need to be careful about that. If you are going to use a pronoun, you have got to be absolutely clear what the pronoun is referring back to.

CHARLES FOX

What's the problem with the third sentence? Anybody?

SPEAKER

Well, I can't tell if the stock you were talking about meant the shares of stock or if it's cattle.

CHARLES FOX

Yes. Stock there—the word stock is ambiguous because of the context. It could mean capital stock or it could mean calves.

SPEAKER

I'm concerned with the word “exist.” What happens if we are going to oppose after the signing of the contract. This says exist suggests it's already in existence and then no one may violate it.

CHARLES FOX

I disagree with that because it's a covenant and it says answer shall not be permitted. My reading of it is if a lien comes into existence after there is a breach of that. I think if it was intended to just pick up liens that existed at the time of the signing, I think it would be, instead of statement of fact, that like a representation that there are no liens on the stock today.

SPEAKER

To exist or to be imposed after exist.

CHARLES FOX

To exist or be imposed on --

SPEAKER

Or some wording like that.

CHARLES FOX

Yeah, well, you often see this kind of provision say “renter shall not create, incur, permit to exist or allowed to be imposed.”

SPEAKER

Well, I don't like to go into those long lists, but I think in this case—it's funny because I looked at stock and thought of cattle. But you are right. I can see –

CHARLES FOX

Because you saw ranch here first.

SPEAKER

Absolutely. And maybe I'm over—maybe you are right. I'd be able to consider the word exist, but can I just say that as the client, I'd be asking the question, now, am I paying for this?

CHARLES FOX

Which is, by the way, why I would always tell the young lawyers that were working for me: if you're going to have a discussion with the other side about the difference between could and would, don't do that when the client is there because they are not going to like that very much.

So this kind of conversation is clearly better off not with the client sitting there wasting time.

Okay. Now we get to a principle of contract drafting.

SPEAKER

Some of us who do transactional contracts, I can see the problem that you are talking about. If you are dealing with multi-cultural complex contracts and then you get stuck on an agreement on 80 or 90 percent of the deal and you are stuck on a few things. The treaty is the same type of force that saves the deal. The bad situation for --

CHARLES FOX

A false compromise.

SPEAKER

Yeah, it is a false compromise.

CHARLES FOX

What is a false compromise?

SPEAKER

A false compromise is an agreement that appears to be an agreement but it is not an agreement. It says it is but it has conditions. So the issue may come up or it may never come up. If it comes up in the future, by giving our wording a shift, I think it can be resolved.

CHARLES FOX

There is a recent case called *United Rentals* where two major law firms in New York did exactly that, where they had a disagreement and at some point it was pretty clear based on the description of the facts, that at some point they just sort of said let's just close, and it came back to bite them. Yes.

SPEAKER

I think there is some argument for using vague terms in that situation.

CHARLES FOX

Vague. Absolutely.

SPEAKER

Because it is not an ambiguity.

CHARLES FOX

And we are going to talk about vagueness in a second. Absolutely. There are times when vagueness is fine, but I don't think it's fine to have a term that is clear but where the parties don't really agree to or have completely opposite interpretations of. I think that way you are asking for a lawsuit.

SPEAKER

Just to take issue. The *United Rentals* case was a surplus case and it wasn't a question of just putting it off on ambiguity. I think the argument was they were trying to be ultra precise and what you end up is with a provision a lot like the one Jane showed, in which he gave with the left hand and took away with the right hand. That is this, this and this provided, however this contradicted that. And you can make the argument that that is either an agreed ambiguity or it is an attempt to be over-precise, which somebody afterwards interprets as ambiguity.

CHARLES FOX

I read the case in a slightly different way. It seemed to me like it was the night before closing and they just threw up their hands, but we will get to some of that in a minute or two.

Okay. So, one of the hallmarks of good writing we all know is, in fact this is rule number 3 in Strunk & White, is you take out every word that doesn't need to be there. In contract drafting, that rule or that principle is extremely important because not doing it has a potentially substantive impact. So, here are three examples of sentences that have unnecessary words in them. What are the unnecessary words in this first sentence? Almost all of it.

SPEAKER

All payments shall be made by wire transfer.

CHARLES FOX

Wait. Oh, you are saying what it should say. So let's start with the first -- here is one of my pet peeves; "the parties hereto hereby agree that." Now, this introduces us to a kind of concept which is tricky, which is the concept of legalese. We all know legalese is bad and the hereby's and the hereto's usually can be omitted. But you have to be careful. You do not want your students to learn these lessons of what is a best practice of contract drafting and then go to work and start telling the partners they are working for that their style of writing is wrong. There has to be a certain accommodation to the real world. With words like hereto and hereby, you can change them to make them better, but I think it's a mistake to say never, ever use it, right? Because they are used.

So, for example, where it says "payments made hereunder," you could say "payments made under this agreement." I don't have a problem with "hereunder." I certainly wouldn't advocate that some first year associate correct that language if it was written by the person who they are working for. But, this first phrase, "the parties hereto hereby agree that." You will see many sentences in contracts start that way, to which my response is wait a second, this is an agreement, right? By definition, the parties are agreeing to every word in it. So, why introduce one sentence by saying "the parties agree that"? Does that suggest that they are not agreeing to everything else?. I don't think anybody can make that argument. But unnecessary words—get rid of them. Alright, I don't think that is that substantive, but it's still very important.

What's the unnecessary verbiage in the second example? It is a little tricky. At any time. As Jane pointed out when she was first talking about reps and warranties, reps and warranties are statements of fact that get made as of a point in time, and in some contracts as of multiple points of time. They are made at the signing, and then they are made again at the closing. But they are not supposed to work so that they have to be true at all times. The words "at any time" here have the effect of converting those reps and warranties into covenants. If a rep and warranty says party A is not subject to any material litigation and the purpose of that was to create a factual basis for the signing at the closing, this language means that, if after the closing they are subjected to material litigation, there is going to be a breach. That's not the way reps are supposed to work. So those words "at any time" may seem innocuous, but they change the entire purpose of the provision into something else.

SPEAKER

If you strike "shall be untrue at any time," what's the purpose of the balance of it? Is it then necessarily a breach if it is a rep and warranty or --

CHARLES FOX

I would write it to say it shall constitute a breach under this agreement if any representation by the obligor shall be untrue when made.

SPEAKER

Why isn't that already the case without that sentence in there if it is true in the rep and warranty?

CHARLES FOX

Why what?

SPEAKER

Why is the untruth of a rep and warranty not necessarily already a breach without that additional language in there saying that it isn't?

CHARLES FOX

That's fair point. It would be a breach.

SPEAKER

When you strike "untrue at any time" then you can strike the entire sentence?

CHARLES FOX

You are right. That is a fair point. In credit agreements, for example, there is a defined term for an event of default. The event of default then you have A, B, C and D. But, I take your point.

SPEAKER

There is such thing as representing as the party explicitly extends into the future performance. So, the default would be that they don't, and there is that expression.

CHARLES FOX

Right. And then there you would want to make it very clear that you were making a rep that did that. When I wrote this that certainly wasn't my intention and most reps don't work that way.

How about this last example?

SPEAKER

So and significant. You don't need to say so to comply and you don't have to say significant. They both have material adverse affects. It doesn't define --

CHARLES FOX

There is an even bigger problem with this.

SPEAKER

The exception seems to be talking about a condition and the first part is a covenant. I mean you wouldn't have an exception to the covenant to comply with laws, rules and regulations, but you might say that the failure to comply if it's immaterial but is not a breach of condition.

CHARLES FOX

Well, I hear what you're saying but I think this works. Another way to write this is: lessee shall comply with all laws, rules, regulations where – none—well it is sort of the same thing. But, okay. I mean, I'm not sure how to respond to that.

SPEAKER

It is just a different approach.

CHARLES FOX

But the gentleman in the back said there are two other things that don't belong there. The word so. I agree. Take that out. That's not substantive. There is also the word significant.

SPEAKER

It is redundant.

CHARLES FOX

Well it is redundant. Well it is probably redundant to material, but we don't know because we don't have the defined term material adverse affect, but we can assume that it has some concept of materiality in it. So here's the problem. Because material adverse effect is a defined term, we know that it is used in at least one other place in the contract. What is the potential substantive effect of having this word significant appear here and not appear in front of material adverse affect where it's used elsewhere?

SPEAKER

It certainly sounds as if significant is saying not every material and adverse effect is covered by this. You are chopping something out that people didn't intend.

CHARLES FOX

You've clearly created an argument that this material adverse effect here or the standard here is higher than it is where material adverse effect is used elsewhere. How does a mistake like this creep in? It is very common. Because in the first draft of this agreement, maybe the term material adverse effect hadn't been defined. Maybe the language just said failure to so comply would not have a significant effect on the business of the lessee. And, then because in the second draft, other similar concepts were introduced, they said well let's create a defined term. Let's create material adverse effect. Then, they stuck that in here but forgot to cross out the word significant. Now, if you could show the judge that, if you were trying to convince the judge that the word significant really didn't belong here, that might be nice, but you are probably not going to be able to.

Vagueness

Now we get to vagueness, which I think a few people have already touched on. Ambiguity, I think, is always bad. You should never have a provision which two people can read to mean completely different things. Vagueness is different though. Why? Because there is an element of vagueness in everything we write. It is just inevitable. You can't define things down to the nth degree. In fact, going back to the earlier discussion we had about the client saying, come on, let's just get this done. There are many situations where we have to sacrifice precision just in order to get the deal done. In order to achieve the client's objectives. And here is an example. Doug, I'm going to ask you to volunteer. Thank you.

Okay. So, Doug represents the company that here is called the issuer, and I'm representing the insurance company who's lending Doug's client one hundred million dollars by purchasing five-year notes. So, I do the first draft of the note purchase agreement and here's a covenant in the agreement. A promise by Doug's client, which is a big complex multinational company with subsidiaries in 23 different countries. So here's a covenant I'm asking Doug's client to agree to and they've got to be in compliance with this covenant at every moment for the next five years or they are going to be in default, the debt can be accelerated, all kinds of bad things would happen. So, we are now getting on the phone to talk about my first draft. What do you think, Doug?

SPEAKER

I don't think my client can live with this covenant.

CHARLES FOX

Are you telling me your client wants to violate the law?

SPEAKER

I think it's quite possible that there is some minor law in some jurisdiction that's being violated at this very minute.

CHARLES FOX

I'm not sure my client really wants to --

SPEAKER

If one of the drivers delivering a package gets a speeding ticket, you think this transaction should collapse because of a speeding ticket?

CHARLES FOX

Okay, Doug. Here is what I will do. I will revise this covenant to say except to set forth on schedule D, issuer shall not violate any laws. Then, you can list on the schedule --

SPEAKER

And I'm supposed to go through the laws and rules and regulations of 50 states and every municipality and every country and figure out every possible minor infraction that might be permitted between now and the closing?

CHARLES FOX

Okay. I don't have enough to do that --

SPEAKER

I don't have enough lawyers in the world to do that.

CHARLES FOX

Besides, it is not a good idea to put that in writing the laws we plan to violate. Now, Doug's approach could be to go exactly in the opposite direction. He could say this is overbroad and put a big X. At which point, I could say, well, wait a second. Clearly, if somebody gets a speeding ticket I shouldn't be able to accelerate the loan. But if you are out there doing really, really bad things I should have a remedy. So, how do we cut this baby? How do we create a covenant that protects my client against his client doing really bad

things and protects his client from a foot fault, which could bring the whole debt structure down for something that really doesn't matter?

SPEAKER

I think we can talk about material violations.

CHARLES FOX

There we go. We talk about materiality. And, in fact, where we often end up is something like this. It's funny. I often found myself on the opposite side of the same people from deal to deal. And you do the first draft, and we'd get on the phone and I'd say okay Chuck. You know what I am going to say. I know what you're going to say, and you know what I am going to say and we both know where we are going to end up. So, let's just agree to -

SPEAKER

But it never works out the way you expect it. I have been there a hundred times and it never quite works out how I anticipate it.

CHARLES FOX

That's right. So, this is where it's likely to end up. We've now limited the effect of this covenant to violations of law that could reasonably be expected to have a material adverse affect on the financial condition of the issuer and its subsidiaries taken as a whole. That protects my client against his client doing really bad things. It protects his client against being in default for really small things. But it's not crystal clear. Material adverse effect: this is a notoriously slippery concept. And there is litigation on it, but there hasn't been enough decided cases on it to know what that means at the margins.

SPEAKER

When you were talking to your clients when you were still practicing law and they wanted some guidance from you about how bad it had to be to be material adverse affect, what would you say?

CHARLES FOX

I'm not going there. I'm just not, because it always depends on the context, and you know the cases. There are cases which say completely different things depending on the context. So, I don't even want to get into that discussion.

SPEAKER

Well, I was thinking, in your earlier example you defined material adverse effect because it was capitalized. You didn't give the definition. That's a real question whether you want to go with a vague term that you want to argue or if you try to find --

CHARLES FOX

It's almost impossible. In fact, there is another recent case. A busted LBO and the Sally Mae case where they actually tried to craft a material adverse change clause that was precise with respect to certain legislation that Congress was considering saying that litigation, if it's passed, will not be a material adverse change. But then, of course, they passed some legislation which was a little bit different.

SPEAKER

If I could just add one other point. I don't know if vagueness is the question. The reasonable – could reasonably be expected protects the issuer but not necessarily the other guy because what if they violate the law and it really brings down the company but it doesn't violate this provision because it could have reasonably been expected to do that but it does it.

CHARLES FOX

Well, there are really two elements here that could easily be litigated. And my point here is that in order to get this deal done and in order to protect both clients' interest, we've been forced to use terms that are ripe for litigation if the parties start fighting with each other.

SPEAKER

If you use reasonably expected, what you are suggesting that if you look at current business methods and business conducts and current expectations among people who are in this line of business. It is to be expected. Or if something unusual happens, then it falls outside this provision.

CHARLES FOX

I'm not sure I agree with that. I think if something unusual happens, it is not a question of whether the thing that happened was reasonably expected, but whether the thing that happened—whether a reasonable person can look at that and say, well, I expect that is going to or could have a material or adverse effect on the company. But it's just another example of how words like this, phrases like this, inherently vague phrases, can lead to different interpretations and potential disputes. But the takeaway is sometimes we are just forced to do it.

Now, from the client's perspective, Doug, if the client agreed to this language and the client called you up two years after the deal closed and said we just got a speeding ticket, at one of our small subsidiaries. Have we violated the covenant?

SPEAKER

No.

CHARLES FOX

No. I love the way you answered that. When you ask first year associates that, they are almost never willing to say no. No, you haven't.

Okay, a week later the client calls you and says Doug, something really peculiar just happened. The FBI and the SEC came to visit us unannounced, they took the CEO and the CFO away in handcuffs and they impounded all our books and records and they are charging us with 73 violations of the security laws, which, by the way, we committed.

SPEAKER

Yes.

CHARLES FOX

Yes. But, guess what?

SPEAKER

Hold up, how does he know that without looking at the financial --

CHARLES FOX

Okay, you are right. Well I --

SPEAKER

Well, I know if they have taken away all the senior management and impounded all the books a records of the company, that is going to have a --

SPEAKER

I didn't hear impound the books and records.

CHARLES FOX

Well, let's just say it is pretty clear that it is a yes. But those are never the questions you are actually asked. You are asking the questions in the great middle area where the client's going to ask you and you're going to say something like there are arguments both ways. Or, it's gray area and that's when the client starts saying to himself, we are paying you hundreds of dollars an hour and you cannot write a sentence that's clear. But it was no better way to do this, right? I mean --

SPEAKER

You're asking me?

CHARLES FOX

No, I'm asking you the client. You don't know --

SPEAKER

Well, what I would say as both the lawyer and the client is this is a back up mechanism and it's only the lawyers who think that they can act out this fantasy where they draft things clearly and with the great contingency of the world. And what this is a back up mechanism, and if we can't come up with an amicable agreement, you are going to spend millions of dollars while the lawyers litigate themselves to death.

SPEAKER

One way to handle it is by using definitions. I have used monetary amounts defining exactly what resulted in a material adverse effect.

CHARLES FOX

Any time you can do that you are better off.

SPEAKER

They don't usually accept it.

CHARLES FOX

But, you see, my argument from his—from my perspective would be dollars are not always captured. You could violate the law in a way that destroys your business, right? You could be a financial firm and get in trouble for a crime that has a thousand dollar fine and you are out of business.

CHARLES FOX

Right. There could be all kinds of non-economic affects and I would say that just doesn't do it for me. It's a situation where it is really hard to do it precisely.

SPEAKER

Can I ask a question whether the recent Goldman Sachs situation violates that provision?

CHARLES FOX

That's a good question. Some day we will find out. All right, you know what, we're running short on time. I am not going to get to everything but I want to do a few examples of vagueness that are unacceptable. Right? We talked about how sometimes—vagueness—you just have to accept it in order to get things done. There is a level of vagueness that is so bad that a provision doesn't mean anything -- it doesn't have any meaning. And here are three examples of that: First example, seller shall maintain adequate insurance on the subject assets. How do we determine what's adequate? It's not clear.

SPEAKER

And that's something you could make perfectly clear.

CHARLES FOX

Of course. Well, in a leveraged lease or in a project finance you have insurance provisions that goes on for ten pages. Or, if you want to shorthand it, you could say seller shall maintain insurance on the subject assets that is comparable in amounts with terms that are customary in the industry. Now, obviously there's room on the margins to argue what that means, but there is enough there for a trier of fact to actually determine it. Here, the way it's written, it is just totally open-ended.

Next one, the company will not be required to close if there's been a material adverse change. Material adverse change to what? It is not a defined term, so it doesn't really mean anything. And last, at the request of any investor, a satisfactory legal opinion shall be delivered. I tell my students when you are talking about performance obligations under a contract you need to be thinking about who, what, when, and where. Not usually why. Sometimes why. Who is supposed to deliver it? The subject of the sentence is missing. Who is entitled to delivery? The object of the sentence is missing. Who determines what satisfactory is? When is it delivered? I mean, all this stuff is missing, so this is just so vague that it is unenforceable and that's never a good thing.

Inconsistency

I just wanted to mention my last category of areas of bad drafting and that is where terms that should be consistent are inconsistent. And to illustrate that, I've got two sentences here from a residential real estate lease. The tenant wakes up one morning and she looks out her window and she sees electrical workers stringing a huge power line across the middle of her backyard. So she calls up the landlord to tell the landlord, and the landlord says I know. I granted an easement to the power company to do that. So, she pulls out her lease and she says wait. Look, you said this is a rep—by the way—the first provision is a rep, it is a statement of fact. You said that there were no easements, and the landlord says well, when you signed the lease there weren't any easements. I granted that easement a week ago. So, she thinks to herself I remember seeing that. She didn't know it was a rep. I

remember seeing that provision and noticing it didn't have any protection going forward on that subject, and I remember asking my lawyer to fix that for me. So, she flips through the lease and she finds the second provision, which she doesn't know this, but what was done is a covenant. She says to the landlord, look, you promised. What does the landlord say? The landlord says, I don't see easement in that sentence. So, at this point the tenant covers the phone up. She curses out her lawyer. She gets back on the phone and says, well, okay. But I think the word encumbrance is extremely broad and would include easements. And what does the landlord say, well, obviously we didn't intend it to include easements because if we had, why did we specifically refer to easements in the first provision?

The landlord probably wins this one. Now, was that intentional that those two provisions are worded differently? No. It was a mistake. How I do know this? Because I made up the story. So I will tell you how this came to be. The tenant's lawyer, in response to her request, was drafting a rider to create this covenant one night, and as he's basically copying the words from the rep, right after he writes the word encumbrance his phone rings. And his wife is on the phone and he's extremely upset because their 15 year old son Timmy just came home with a ring through his nose like this. This happened to me. I wasn't drafting a rider, but it did happen to me. It's a very upsetting phone call, and so he gets off the phone and he just makes a mistake. All right. Inconsistency. He should have probably created a defined term.

Conclusion

All right. I apologize. I didn't really get a chance to get to all of my materials and we are already past time. We are supposed to have Q and A, but there was plenty. So I think we are done, but if anyone wants to talk further, we are going to be here.