AT THE HEART OF THE MATTER: READING CONTRACTS AND DEALING WITH RISK

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Today, I'm going to speak about how to teach students to read contracts. Firms and law schools have typically mangled this issue in four ways.

- *Sink or swim.*
- *Comp Lit.*
- *The walk-through.*
- *Read all about it.*

Sink or swim is a time-honored, legal, form of torture that generations of lawyers have endured, probably dating back to Blackstone. It isn't pretty. Only the strong survive.

Comp Lit is another technique to teach lawyers to read contracts. Here a senior lawyer shows a junior lawyer two similar business provisions and distinguishes them. This differentiation helps the junior lawyer understand the particular substantive provision, but does little to advance the general goal of learning to read a contract. It provides no guidance on how to apply what has been learned to another, as yet unread provision or contract.

Comp Lit has its place. Once a student has learned to read a contract, understanding the idiosyncrasies and subtleties of a specific business provision can be of salient concern. But it is of less help when a student is a novice.

The *walk-through* is particularly popular at firms during the first week of associate training, especially if a firm is performing a core dump instead of real training. Partners generally use an acquisition agreement as an exemplar and dissect it section by section. These training sessions give both too much and too little information. They provide more detail than the junior lawyers can digest and an inadequate foundation to contextualize the information in a user-friendly way.

Read all about it, the final method, is my favorite of the four. It grounded my own learning. My book of choice was *Anatomy of a Merger* by James Freund.[1] It explained the

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[1] James C. Freund, *Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions* (Law Journal Press 1975).

seemingly incomprehensible: why a contract would have three separate sections for the same business point: consents. Other lawyers may favor other treatises. *Read all about it* beats the other three methods because each author presents the information in an organized, lucid way. Nonetheless, *read all about it* is not a pedagogy.

When trying to conceptualize a pedagogy, I recognized that students finished my Contract Drafting course being able to read contracts. So, I deduced, not unreasonably, that somewhere within my drafting pedagogy lurks a reading pedagogy. They overlap significantly, but they differ. A student will surely learn to read a contract if he learns how to draft one, but I don't think that drafting is a prerequisite to learning to read a contract.

That led me to the obvious conclusion that I had to figure out the reading pedagogy. I had to be able to explain how I did what I did. I started with the basics of any pedagogy: What do I want the outcome to be? The answer was simple. The students should be able to read a contract. Not helpful. Not helpful at all. I needed to articulate what it means to read a contract.

So I started to think about what I did when I read a contract. I realized that while I was reading each provision, I was asking and answering at least six questions virtually simultaneously.

- What is the business purpose of the provision?
- Does the provision properly incorporate the agreed-on business deal?
- Can the provision better protect the client and reduce the risk?
- Can the provision further advance the client's goals?
- Are there legal issues?
- Are there drafting issues?

These questions are my short-form framework for contract analysis. My long-form framework has eight questions with a total of 14 subparts.[2] So contract reading, for me, is contract analysis, but contract analysis is not the same as contract interpretation.

Contract interpretation assumes an ambiguity or a lack of clarity. Contract analysis precedes this determination. It asks the questions that provide the insight into the provision's meaning and effect. Contract analysis may well lead you to conclude that a provision is ambiguous, but it goes way beyond and and asks, "What business, legal, and drafting issues are shrouded here?"

The ability to perform contract analysis is a deal-critical skill. To analyze a contract means to disassemble it to understand the other side's objectives and the contract's business, legal, and drafting nuances and the issues raised. Stated differently, a deal lawyer eats what

[2] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* (2d ed., Aspen Publishers, forthcoming 2014).

she kills;[3] that is, she protects her client by determining what must be negotiated after reading the other side's draft contract. Each point found counts as a kill, a point to be negotiated and possibly won. If the lawyer instead concludes, "It all seems good to me," she and her client will not celebrate with a lavish lunch. Instead, the lawyer will starve, having squandered negotiating points that she never found or raised. Because there was no kill, the lawyer has surrendered points not ever subject to negotiation.

So then, how do you teach contract analysis? Now, this is where my talk becomes a little bit weird. Every time I started thinking about how to teach, I kept thinking, "Well, you have to start at the beginning." And then I would visualize Julie Andrews. She had a guitar and was sitting on a hilltop in the pristine Alps, with the Von Trapp kids surrounding her. Each was adorably dressed in curtains that Julie had turned into play clothes. Julie would then sing the magic words and the children would chime in.

Maria:

Let's start at the very beginning.

A very good place to start.

When you read you begin with

Gretel:

A-B-C

Maria:

When you sing you begin with do-re-mi[4]

(You are *so* thankful that I did not sing that for you.)

The song just stuck in my head, and I realized that Julie and the song articulate a pedagogy. Step one: Teach the names of the notes: *do, re, mi, fa, so, la, ti, do*. At first, Julie only speaks the notes. No sounds are associated with them. They are just the notes of the scale, abstractions. Next, she names each note and sings its unique sound. She associates each note with a tone. Julie explains that the notes are "the tools we use to build a song." Julie then sings a lovely arrangement of the notes by singing and naming each note. After the children complain that the tune "doesn't mean anything," Julie demonstrates how to sing a simple song by assigning one word to each note and then beautiful harmony when the singers join together and combine the notes in complex ways.

After envisioning this scene a dozen times, I concluded it was a perfect paradigm of

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[3] The phrase, *a lawyer eats what she kills*, is a play on the large firm method of compensating its partners. When this method is used, a firm pays a lawyer only for the business he has originated; that is, what he killed and brought home to the firm.

[4] Richard Rodgers and Oscar Hammerstein II, *Do Re Mi*, in *The Sound of Music*.

a pedagogy for learning to read. And as I thought about the pedagogy for reading, I began to see a pedagogy for teaching the reading of contracts.

I've divided the pedagogy for learning to read contracts into grade levels and put inside parentheses the *Sound of Music* equivalent.[5]

- Kindergarten, for learning your ABCs. (*Learning the names of the notes and their sounds*.)
- First grade, for simple books with easy, repetitive vocabulary. The *Dick* and *Jane* books[6] were classics. Remember "*Run Spot, Run*?" I'm dating myself. Many of you may have missed those books. (*Singing simple songs with simple arrangements*.)
- Fifth grade, for chapter books; longer stories, more complex story lines, and, importantly, vocabulary. (*Putting words to the music*.)
- Finally, ninth grade for the classics, adult books but with a guiding hand. Who can forget *A Tale of Two Cities*[7] and the inimitable Miss Ray who countenanced no nonsense? Her questions were almost Socratic. (*Being taught how to sing complex harmony*.)

With this progression in mind, let's mush together the pedagogies for learning to read and learning to read contracts. (*Mush* is a technical drafting term, that all seasoned contract drafting professors use.)

As noted, the first thing that children learn when learning to read is the alphabet. They learn the names of the letters by learning the ABCs song. [Sings the ABCs] They don't know what they're doing, but Mommy's making them memorize it; so they sing the letters. So, what's the equivalent of learning the letters when learning to read a contract? It's learning the names of the contract concepts: reps, warranties, covenants, conditions, etc. (I tried to make it melodic and failed.)

After children learn the names of each letter, they learn the sounds of each letter. *A says ă, ă, ă. A as in administrative law*. The corollary at this stage is the *translation skill*[8]: learning which contract concepts to use to memorialize each aspect of a transaction. For example, knowing that a promise requires the use of a covenant. That gets you out of kindergarten.

In first grade, children begin to read books. They learn that most books conform to

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[5] I have taken some liberties as to which skills are learned in which grade.

[6] William S. Gray and Zerna Sharp are typically cited as the joint authors of the *Dick and Jane* series. But controversy surrounds their authorship. Others have claimed the books as their own, and still others have accused the authors of plagiarism. Wikipedia, *Dick and Jane*, http://en.wikipedia.org/wiki/Dick_and_Jane (last modified April 15, 2013).

[7] Charles Dickens, *A Tale of Two Cities* (1859).

[8] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* 10; see generally chs. 3-4 (1st ed., Aspen Publishers 2007).

a typical organization, with a beginning, middle, and end. They also learn to recognize or sound out simple words. With this knowledge, they begin to read simple books.

What students learn in first grade correlates to several steps in the progression of learning to read a contract. First, students learn that contracts also have a fairly set organization with similar beginnings and endings, whether drafted in a traditional or contemporary style. It's in the middle, where the substance is, that contracts and their organization differ. I show this to students through a simple exemplar, a house purchase agreement.[9] It's important when you're teaching students to read contracts to use simple, well-drafted contracts to which they can relate. Teaching foundational material is never easy. A sophisticated agreement with business provisions that the students don't understand compounds the difficulty. Moreover, if you give them something from the real world, inevitably, it's badly drafted. Why start them off with legalese?

Now, you also need, in first grade, to learn to recognize simple words. Those are the *Dick* and *Jane* books. The corollary is reading a contract provision and understanding that its components are a condition to discretionary authority and discretionary authority. To teach this skill, I use the Web Site Development Agreement that is in my textbook.[10] It's actually fairly sophisticated, but it's written clearly, and students can understand the the relatively simple business provisions. I first point out the similarities and differences to the House Purchase Agreement. It too has a beginning, middle, and end, but the middle business provisions are organized by subject matter, rather than contract concept.

With that bare introduction, the students work on an exercise from which the following chart is excerpted.[11]

Contract Part	**Relevant Language**
Preamble	
Recitals	
Words of agreement	
Subject matter performance provision.	

[9] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* (2d ed., Aspen Publishers, forthcoming 2014).
[10] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* 443-449 (1st ed., Aspen Publishers, 2007).
[11] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* (2d ed., Aspen Publishers, forthcoming 2014).

Covenant or self-executing?	
In the monetary provisions, a declaration, a covenant, and discretionary authority.	

The left column lists what students are to find in the contract. The right column provides a place to write the answer. The questions become progressively harder, but the students manage well and complete the exercise able to recognize contract concepts – most of the time. With this, students have successfully completed first grade and skip to fifth.

I call the next stage of the pedagogy *learning the power of words*. What happens with chapter books is that students begin to focus on figures of speech and vocabulary. They learn about similes and metaphors. They learn how individual words can turn a hazy description into a vivid one. Learning how individual words in a contract may have even more power (rights and obligations are contingent on them) is an absolutely critical step in the pedagogy of learning to read a contract. It is not innate to students. They're used to reading paragraphs and drawing a general conclusion. They don't get that every word matters -- that if you change a single word, you have changed the business deal. So students must learn to laser focus on individual words and phrases and use *the close reading skill*.

I use two exercises to teach this skill, both available in my textbook. First, is Exercise 8-3.[12] It is deceptively simple. It consists of six business terms and two contract sections. "All" the students have to do is determine whether the business terms have been properly incorporated. The sections are a mess and the short answer is that only a very few of the business terms are properly incorporated. And for those of you who are practitioners, you know how often drafters inadvertently omit a business term. Here is a perfect example of a deal lawyer not eating what he doesn't kill. Without real focus on individual words and phrases, the lawyer will miss that the draft omitted or misstated salient business terms.

But when reading a contract, deal lawyers must go beyond confirming business terms. They must add value to the deal by going beneath the words and determining whether the transaction creates business issues. Finding business issues is usually the province of partners, but I teach students a framework[13] that they can use as stepping stones until they have garnered more experience. The framework is easy. I've even used it in a first-year

[1212] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* 109-111 (1st ed., Aspen Publishers, 2007).

[13] Id. at ch. 25.

contracts course. Mid-semester, I guest lectured about the framework: five business issues that cut across transactions although they appear in different guises in different agreements. The prongs of the framework are money, risk, control, standards, and endgame. After learning this vocabulary and performing a short exercise, the students' ability to read a provision closely improved significantly. At least as importantly, the professor and the students had gained a common vocabulary to discuss business issues when analyzing cases. Given the students' minimal understanding of business, anything that advanced their understanding was a coup.

The final step in the pedagogy is ninth grade. By ninth grade, students have learned the basics, but they should be able to do more.

In ninth grade when Miss Ray assigned *A Tale of Two Cities*, she didn't assign the whole book at once for homework, but rather several chapters in advance of each class. We would then convene in class, and she would ask questions, her own private Socratic method. Her questions lead us to an appreciation of character depiction, themes, and foreshadowing. Her gentle guidance resulted in a better understanding of the intricacies and the sophistication of the classic novel.

To replicate this experience, I suggest *guided reading* of contracts. To do this, I take contracts and populate them with Word comments in bubbles on the contract's right margin. I use the comments to explain business, legal, and drafting issues and to ask questions. The explanations fill in gaps for students who have little business experience. The questions focus on issues that the students might otherwise have glossed over because of their inexperience. The goal is to facilitate a close reading of the contract and to teach students the kinds of questions they should be asking when they read their next contract.

Here is an excerpt of the Web Site Development Agreement populated with comments (see footnotes for the comments).[14]

Effective Date**. This Agreement is effective on the Effective Date.**[15]

Fees.

Estimate and Cap. The Developer estimates that its fee for performing the Services will be between $12,000 and $15,000.[16] Despite the preceding sentence, the maximum that the Client is obligated to pay the Developer for the Services, as described in

[14] Tina L. Stark, *Drafting Contracts: How and Why Lawyers Do What They Do* (2d ed., Aspen Publishers, forthcoming 2014).

[15] Which provisions need to be effective earlier? (Hint: Think about the practicalities of how the Effective Date comes to be.) How would you make those dates effective earlier?

[16] Is this use of will in the first sentence correct? The second sentence is known as a trumping provision. Why does it have that name?

Exhibit A, is $17,000. If the parties agree to a Change Order,[17] the new cap is the amount the parties agree to at that time. If the parties do not agree to a new cap, but only an estimated range, then the new cap is the higher number of any estimated range *plus* 10 percent of that number.[18]

I think guided reading is particularly useful when students look at a precedent for the first time. Given that they know nothing about the type of agreement, their contract analysis is likely to be facile without any help. One of the textbook's exercises asks students to draft the introductory provisions of an assignment and assumption agreement. The next edition gives students an assignment and an assumption agreement as a precedent.[19] To preclude a mindless mark-up of the provisions, the introductory provisions have associated bubble comments.

Assignment and Assumption Agreement[20]

Assignment and Assumption Agreement (this "Assignment"), dated September 10, 20XX, is between Atlanta Vendors, Inc., a Delaware corporation (the "Assignor"[21]), and Complete Nutrition LLC, a Colorado limited liability corporation (the "Assignee").

Background

[17] Note how the last two sentences work together and that the contract avoids any gap by stating what happens in the two alternative situations.

[18] Even simple financial calculations should use mathematical language.

[19] Id.

[20] This agreement could easily be properly named "Assignment, Delegation, and Assumption Agreement" as a delegation is included. In many assignments, the Assignor only "assigns" the agreement. But both the Restatement (Second) of Contracts and case law interpret a party's assignment of a contract to include a delegation, unless there is evidence to the contrary. That evidence would exist, for example, in a borrower's assignment of a contract to a bank as security for a loan.

[21] One could use "Seller" and "Buyer" for ease of reading.

The Assignor is a party to the agreements [more particularly][22] listed in Exhibit A to this Assignment (the "Exhibit A[23] Agreements").

1. The Assignor and the Assignee have entered into the Asset Purchase Agreement, dated July 15, 20XX (the "Asset Purchase Agreement"[24]), which provides for, among other things,

   (a) the Assignor to assign its rights [and delegate its performance[25]] under the Exhibit A Agreements to the Assignee; and

   (b) the Assignee to assume the Assignor's performance under the Exhibit A Agreements [that arise and are payable after the date of this Assignment].[26]

The parties agree as follows:

Among the bubble questions are two that ask students to differentiate the purpose of the two recitals. Once students figure this out, the substance of their homework assignment should be much simpler because they know the purpose of what they're writing.

Reading contracts is hard work. I hope my talk will make it easier for you to teach the skill.

Thank you.

Addendum:

Knowing the pedagogy to teach contract reading enables a professor to decide what he or she can effectively teach in his or her classroom. A professor also gains the ability to teach the skill in coordination with other teachers. For example, the teaching could be distributed among several courses. Perhaps in Contracts, a professor would teach only kindergarten and first grade, and then second semester, legal writing and property professors could share responsibility for teaching fifth and ninth grades.

Learning to read contracts is appropriate to the first year of law school. It introduces students to transactional work in a circumscribed manner that will benefit a student throughout law school and practice.

But I do not proselytize.

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[22] Is this language necessary, helpful, or legalese?
[23] What is the purpose of this recital? Although the defined term could be "Agreements," using "Exhibit A Agreements" is arguably easier for the reader as "Agreement" generally refers to the agreement being signed. One could reasonably disagree with this.
[24] What is the purpose of the second recital? Does "Asset Purchase Agreement" really need to be defined?
[25] This language is not always included. See Comment 1.
[26] What is the purpose of the bracketed language?