Transactional Documents

Roadmap

- Transactional documents create a record of the parties' deal while simultaneously creating mechanisms to foster agreement, encourage performance, and provide for enforcement and dispute resolution.

- Transactional documents represent the documentation of the terms and stages of the parties' relationship and range from early agreements on fundamental terms, to interim documents such as term sheets and letters of intent, and the final, binding transactional documents.

- Transactional documents have a distinct structure like other forms of legal drafting, and that structure should be followed and employed to produce practical, precise contracts and instruments.

- Contractual precision requires accuracy, completeness, and exactitude—which refers to an absence of ambiguity and unintentional vagueness. Much can be accomplished in this regard by focusing on using the active voice and uniformly using the word "shall" for duties and "may" for rights and privileges.

- Transactional documents generally contain these components: title; introductory paragraph; recitals; definitions; core provisions —consideration, covenants, conditions; risk allocations— representations and warranties; closing provisions; events of

default and remedies; boilerplate; signature blocks; and exhibits and attachments.

- Preparing transactional documents requires constructive collaboration of attorneys and clients from all sides of the deal in commenting on and revising drafts.

A. Purpose, Audience, and Goals of Transactional Documents

Drafting transactional documents like contracts and other instruments such as deeds, bills of sale, security agreements, and deeds of trust, is a process of creating a record of the parties' deal and simultaneously creating mechanisms to foster agreement, encourage performance, and provide for enforcement and dispute resolution. This means that there are at least three audiences that you must bear in mind while drafting: the parties' lawyers, the parties themselves, and an unidentified future decision maker, like a judge or a jury.

These goals and the different audiences are in a state of conflict and must be balanced. In the first instance, contract drafting and negotiation is a process in which the legal drafter seeks to memorialize the terms of the parties' deal and gain mutual agreement to all of its terms. At each stage in the contract drafting process, the deal is being subtly adjusted and renegotiated. It is a process of fostering agreement and making a record of that agreement.

Once that is accomplished, however, the transactional document must encourage performance. In other words, there have to be enough conditions and other provisions ordering performance in the document to act as carrots and sticks to encourage the parties to voluntarily perform their side of the deal. These carrots and sticks are not just events of default and remedies provisions. Rather, the contract should feature conditions to each party's performance based

upon the other party's performance, time lines, walk-away rights, and price adjustments if compliance is not forthcoming in a timely manner, escrows to hold funds beyond the sole control of one party, and the like. Generally, the drafter should seek to provide for enforcement and dispute resolution on terms agreed to by the parties and *not* under the default rules that are provided by statutes or the common law. The contract drafting process is one in which you can define most if not all of the terms of the parties' relationship from beginning to end if you choose to do so. It is an opportunity not to be wasted.

There is, however, an unhappy truth: after the contract is negotiated and signed, the next thorough review of its provisions will likely be by someone trying to break the contract or sue over the transaction. This is especially the case today, when contracts are chopped, sliced, diced, packaged, bundled with others and sold or assigned to a trustee or agent whose job it is to seek enforcement at a later date, when none of the original parties are involved. They have all moved on or, if still involved, their memories will have grown hazy. You will be left having to seek enforcement of what is on the page, the terms that are included in the document—and somebody is going to be trying to break or avoid those terms. Given this situation, it is imperative that you have drafted the document so that it can stand up *on its own* to hostile critical review. An essential means of ensuring that the document survives this sort of scrutiny intact is to ensure that a person of reasonable intelligence who knows nothing about the transaction can understand the deal after one reading of the contract. That is likely to be all the time a judge, law clerk, court attorney, or jury has to devote to it.

This can be achieved by drafting practical, precise documents in plain English that reflect all the terms of the deal and are devoid of ambiguity and the unintentional use of vagueness. The specific methods for achieving this are discussed later in this chapter.

B. Structure and Context of Transactional Documents

The structure of the contract is essentially the same as that of other work product of legal drafting: introduction, statement of facts, statement of rules and application of the rules to the facts, followed by a conclusion. For this reason, just as most letters, motions, briefs, and opinions have the same structure, so do most contracts.

1. The Form of Transactional Documents

The standard sections of a contract are listed below and are not subject to that much variation, although they may be reordered. The definitions section, for instance, often is moved to the end when it is very lengthy.

A. Title
B. Introductory Paragraph
C. Recitals or Background Facts
D. Definitions
E. Core provisions—Consideration, Covenants, Conditions
F. Risk Allocations—Representations, Warranties, Indemnities, Guaranties
G. Closing Provisions
H. Events of Default & Remedies
I. Boilerplate
J. Signature Blocks
K. Exhibits & Attachments

2. The Context of Transactional Documents

Each of these components of a contract is discussed below in more detail, but first consider the context of transactional documents.

Transactional documents represent the documentation of the terms of a relationship between parties. Like all relationships, the parties' relationship has a beginning, middle, and an end. Transactional documents are drafted to reflect the stage of the relationship to which they relate. Therefore, the legal drafter must

keep in mind the present stage of the relationship as well as those stages that are to come in the future.

For example, in the purchase and sale of a substantial asset such as a business or a home, there are typically seven stages of the parties' relationship. First, the parties meet and, second, reach a preliminary agreement on fundamental matters like the identity of the assets to be sold and the purchase price and method of payment (cash, stock, deferred payments over time, etc.). It is usually at the third stage that legal drafters become involved, although many benefits can accrue to parties that involve legal counsel earlier in the process, or at least consult with them for coaching on what their strategies and tactics may be in steps one and two.

The third stage is the preparation of interim transactional documents, such as term sheets or letters of intent. The key issue at this stage of the relationship is to determine whether or not the interim transactional documents are meant to be binding or if they are simply tentative reflections of the terms and deal structure that the parties have been discussing and are intended to promote clarity and understanding in those discussions, but not bind the parties. Often even the most tentative term sheets contain some provisions that are intended to be binding, such as confidentiality provisions and covenants to return documents and other things if the transaction is terminated. Whatever the degree of bindingness that is intended, the preliminary documents should make that explicit in their provisions. Due diligence—the process of factual and legal verification of things like the parties' due formation, their capacity to contract, the legal state of title to assets, the number, amount, and status of claims against a party or its assets, and the like—usually begins at this stage of the relationship.

The fourth stage of the typical transaction is the preparation of final, binding transactional documents, such as a purchase and sale agreement. These final documents contain all the operative provisions and will either be structured as a *sign and close* deal where the parties sign the agreement and almost immediately exchange consideration (think of buying a used car for cash under a sale contract) or a *delayed closing* deal where, after the signing, the parties have pre-closing duties to perform that are conditions to the

closing. These duties and conditions typically include access agreements and due diligence rights as well as conditions based upon third party reports or approvals. Due diligence typically continues after these final documents have been signed by the parties.

The fifth stage of the typical transaction is closing, which will have happened simultaneously with the fourth stage in a sign and close deal. But closing is not the end of the story. Most sophisticated purchase agreements include post-closing covenants and conditions that provide for post-closing adjustments to the purchase price, post-closing indemnities for breaches in representations and warranties, and the like. So, the sixth stage of the typical transaction is the post-closing adjustment period.

The seventh stage of the transaction is, hopefully, not typical at all: litigation over the deal. At this point, the litigators will review the record that the transactional attorney has created in the first six stages of the parties relationship, which will form the basis for this seventh stage.

It is helpful to keep these observations about the typical form and context of transactional documents in mind when drafting them. This will allow you to prepare the proper sort of document, in the proper form, at the proper time. All of this is very useful in bringing the transaction safely through the first six typical stages and also to allowing your client's rights to be vindicated should the transaction enter the seventh stage.

3. Macro-Organizational Tips

The same organizational and drafting rules applicable to other forms of legal drafting and discussed in prior chapters apply with equal force to contracts and other transactional documents. Include general provisions before specific ones, e.g., state the "what" before the "how." Place important provisions before lesser ones. State rules before exceptions. Use separate sections/subsections for each concept, and include meaningful headings for each section. For

further discussion regarding drafting organizational strategies see Chapter 2, section A.

4. Practical and Precise Documents

Contractual precision requires accuracy, completeness, and exactitude. Exactitude refers to an absence of ambiguity and unintentional vagueness. The terms “ambiguity” and “vagueness” should not be confused.

Ambiguity occurs when a word or phrase is capable of meaning two or more things. For example, if a contract provides that one party “shall pay x and y $100,000.” It is unclear whether x and y are *each* to receive $100,000 or if x and y are to receive a *total* of $100,000 to share. Another common source of ambiguity is the unclear pronoun reference. When the transactional drafter sees a pronoun, it is best to ask whether a defined term for a party cannot be inserted in its place. Defined terms are, after all, a sort of very specific, private pronoun created by the drafter.

Vagueness, on the other hand, is a lack of clarity. It is often intentionally used in legal drafting when the parties are unable to agree on a provision governing what is thought to be a rare or unexpected event without incurring costs that are not justified due to the low probability of the event happening. Consider, for example, the standard prevailing party attorney fee shifting clause, which provides for an award of “reasonable fees and costs.” While a party may want to quantify or cap the amount of a fee award by specifying a not-to-exceed figure, this is likely to be unacceptable to the other party. Rather than running up their current fees negotiating a provision that everyone hopes will never be used—everyone is optimistic at the inception of most deals—the attorneys comprise on the “reasonable attorneys fee” language. But vagueness should not be used inadvertently or unintentionally. Transactional drafters should closely examine their documents and question the impact and wisdom of including every “reasonable” or “material” or similar word that is used. In fact, a good general rule is to examine and question the impact of and need for all adverbs or adjectives in a transactional document.

Much can be accomplished in the way of producing practical, precise documents simply by focusing on using the active voice and uniformly using the word “shall” for duties and “may” for rights and privileges. The standard conventions are:

- “Shall”—Specifies duties (mandatory, imperative).
- “Shall not”—Specifies prohibitions.
- “May”—Specifies rights, options (permissive).
- “Will”—Reserved for the predictive (future).
- “Is”—for statements involving no actor (*e.g.*, choice of law).

A prominent enemy of contractual precision is the overburdened provision, the provision that attempts to do too much. Just as in other drafting tasks where you use separate IRACs, CRACs, and paragraphs to explore or explain each sub-issue, transactional documents should contain separate sections for each task they are to accomplish. The rule should be to subdivide as much as possible rather than the opposite. Defined terms, information schedules, and supplemental documents and worksheets can be used to unpack overburdened provisions.

5. Consistency

Consistency, consistency, consistency is the rule in all legal drafting, and especially so when it comes to transactional documents. If you are going to say something one way in one part of the contract,

say that something the same way every time you say it in the contract.

Further in this vein, question the need for strings of synonymous or nearly synonymous words like “sell, transfer, and convey.” Would the word “transfer” or “transfer ownership” cover the topic? But not all doublets and triplets can be discarded easily. An example is the requirement the seller of real estate “execute and deliver” a deed to the property to the other party. A deed that is executed but not delivered (or delivered but not executed) is ineffective to transfer title. But examine doublets and triplets and other lawyerisms to make sure that they are necessary and that you understand what they mean and accomplish.

C. Contract Components

1. Title

The title of any contract is generally found on the first page, top, center of the contract in all caps. Generally accepted format is to use a generic title such as “Employment Contract” or “Agreement and Plan of Merger” augmented by the parties names or, in the case of real estate, the address of the building or other project. Often the date is included. For example, “Lease,” or “Lease of 1111 B Street,” or “Lease of 1111 B Street by and between Tricor Real Estate Holdings LLC and Hubble Eyewear dated as of November 1, 2011” would all be generally accepted forms. Use of the “as of” form for dates avoids the need to make sure dates are updated or changed when negotiations take longer or shorter than expected.

2. Introductory Paragraph

The introductory paragraph is not numbered and usually includes the full names of the parties, the date of the agreement, and the nature of the agreement. Many times the introductory paragraph is

used to define the agreement, the parties, and other matters. The generally accepted form is:

> This [name of agreement] (the "[defined term]") dated as of [date] is between [name of party 1, including form (LLC, Inc., etc.)] ("[defined term]") and [name of party 2, including form] ("[defined term]"). So, this Real Property lease of 101 Magnolia Boulevard (the "Lease") dated as of June 1, 2010, is between Alden Realty, LLC ("Landlord") and Deloit Chicken, Inc. ("Tenant").

3. Recitals

Recitals are generally included after the title and before the substance of the agreement, usually in lettered paragraphs. This section sets the context for the transaction. Recitals are a place where the background facts of the transaction and the relationship of the parties can be stated, where additional terms can be defined, and where additional agreements and instruments can be referenced if they are important to the overall context of the transaction of which the particular agreement is a part. Keep in mind that recitals may be treated as stipulated facts or admissions of a party in later litigation.

It is common for the recitals to close with a statement in an un-numbered and un-lettered paragraph to the effect that "[Wherefore] the parties agree as follows:". The "wherefore," although common, can be eliminated as an anachronistic transition.

The agreement then continues with numbered paragraphs, often after the centered title, in all caps "AGREEMENT." One school of thought is that the first of these numbered paragraphs should be a statement that the parties agree that the recitals, above, are true and correct, because they appear above the title "AGREEMENT." Although this is also probably anachronistic, formalist legalisms die hard.

4. Definitions

Defined terms are tools that can increase the clarity of contract provisions by removing extraneous matter that is not essential but is necessary to the provision. They also can decrease the length of the document if, but for their use, long, detailed descriptions would need to be repeated often.

If the agreement is to feature many defined terms, it is useful to collect them and locate them in a single section, generally at the beginning or end of the agreement, where they are listed in alphabetical order. When defining terms, use common sense. Do not include substantive terms—those that create rights, duties, privileges, or immunities—in the definitions. That is not what defined terms are for, and doing so will make the agreement confusing and possibly deceptive. Do not define terms that are used in their normal English sense, and do not define terms to mean something completely different than they mean in their normal sense. The first is unnecessary; the second is confusing.

Define terms to narrow their meaning from their normal sense to the specialized sense in the agreement at hand, e.g., defining "affiliate" with its securities regulation meaning of "controlled by," "controlling," or "under common control with" sense. Define terms to broaden their technical meaning to match their normal sense, *e.g.*, defining "trademarks" to include trade dress, service marks, and goodwill. Also, if a term has been defined, use it only in its defined sense in the balance of the document. To do otherwise creates ambiguity.

Defined terms can also be used—although they should not be—to cloud meaning and create misimpressions. They do this by preying upon the natural tendency of most people to read a document and give the words meaning at face value rather than stopping and checking meanings by referring to a long list of complicated definitions in another part of the document. Examples could include terms like "Paid in full," which is defined as payment in stock of a non-public company, valued by an arbitrator, or "Immediately," defined as within 90 days of receipt of a written request.

5. Core provisions—Consideration, Covenants, Conditions

Covenants are the parties' promises and duties under the agreement. They should be contained in provisions that are clearly labeled and structured as covenants and should include a specified consequence for failure to perform.

Covenants should be drafted in the active voice—subject, verb, then object—and should be based on the convention of using "shall" to designate duties—"may" is used to designate rights or privileges. For example, "Seller shall deliver the deed to Blackacre to Escrow Agent no later than December 1, 2011; failure of Seller to do so shall be cause for Buyer to terminate this agreement under section 10.08."

Covenants should clearly state what party is to do what, for whom, when and the like.

i. Major Covenants: Consideration

Consideration

The next section is the meat of the contract, at least from the client's point of view. This is the section that contains the main promises of the contract, the covenants that constitute the bargained-for consideration. Examples include payment of rent in exchange for the right to use a space, payment of the purchase price in exchange for the right to receive goods, and the like. These major covenants are usually straightforward and the simplest provisions to draft.

ii. Other Covenants

Apart from the major covenants that form the heart of the deal, especially in the minds of the clients, most agreements contain additional covenants, especially if there is a delay between the time the agreement is signed and when it closes, such as with the typical sale of a home or business. This structure is called a "delayed closing" deal to distinguish it from a "sign and close" deal such as the purchase of a used car for cash where one signs the contract of sale, hands over the cash, and the dealer hands over the car keys and

causes the buyer's name to be placed on the car's title. For example, in the typical sale of a home, the buyer and the seller sign a contract of sale, but the closing usually takes some time later. This allows the parties to take care of document preparation and to clear the various conditions to closing that prudent home buyers and sellers include in the contract. These conditions to closing are either satisfaction of covenants (promises) by one or both of the parties or the occurrence of an event, such as receipt of a third party approval, like a bank's approval of a loan application.

These other covenants are typically the province of the lawyers, not the clients. They are part of the lawyer's job in structuring the transaction so that the parties are obligated, at the right time, to undertake all their duties, make applications, permit and conclude inspections, give approvals, and the like.

iii. Conditions

Conditions are events, including performances by the parties, that must occur before a duty becomes ripe or is discharged or modified. They are contractual switches that, when flickered, turn duties on and off. In contrast, covenants are the duties themselves. Continuing with the sale of a home example from the last subsection, typical conditions to closing include the buyer obtaining financing for a portion of the purchase price, the seller providing evidence of marketable title, the buyer obtaining a title policy, the seller obtaining and the buyer approving a termite report, and the like. For each of these conditions, there should be a corresponding covenant by one or both parties to take steps to ensure that the condition will be met. So, if the buyer obtaining financing is a condition, the seller should also insist on a covenant that the buyer will promptly and in good faith submit an application for that financing and use its best efforts, or commercially reasonable efforts, to gain approval. It is also wise to include an "out" or a termination provision if one party does not perform its pre-closing covenants within a certain time or it becomes clear that a condition to closing will not be met. Remember, in most jurisdictions, if it is unclear if a provision is both a covenant and a condition or simply a covenant, it will be construed as merely a

covenant. This means that performance of the duty can be excused and non performance merely compensated with damages, if provable. The lesson: make conditions explicit. If the satisfaction of a duty of a party is a condition to the other party's duty to itself perform, say so.

Conditions—and, remember, satisfaction or performance of a covenant can be a condition—are transactional mechanisms that control the performance of the parties under the contract. They should be crafted to give rise to additional duties at the appropriate time, which, in turn, are conditions to further covenants and duties. To continue the example, a contract for the sale of a home may be contingent (conditioned) upon several steps of performance. The buyer's obligation to close may be conditioned upon several items, such as:

A. The seller providing a termite report on the home from a licensed termite inspector showing no "Part B" or serious, ongoing infestation;
B. The buyer approving a home inspection report from a qualified, licensed home inspector, with that approval not to be unreasonably withheld;
C. The seller being able to furnish good and marketable title as demonstrated by providing a title insurance policy with no exceptions from a nationally recognized title company with the buyer and its source of financing as beneficiaries.

In that case, the contract should also impose a duty upon:

A. The seller to engage a suitable termite inspector within 10 days of the parties' signing the contract and to arrange for the inspection within 30 days and delivery of the report within 45 days.
B. The buyer to engage a suitable home inspector within 10 days of the parties' signing the contract and to arrange for the inspection within 30 days and delivery of the report within 45 days;
C. The seller to cooperate reasonably with the buyer and the home inspector to allow the buyer to satisfy its obligations in item "B" above.

D. The seller to obtain the requisite title insurance policy within 30 days of the parties' signing the contract.

Each of these additional duties should be a condition to the other party's duty to perform its pre-closing duties. Should either of the parties fail to complete these additional duties within the prescribed time periods, the other side should be excused from performing its covenants and have the option of backing out of the contract, perhaps receiving some form of liquidated damages as a result of the party's breach. Of course, the party in whose favor a condition runs may always grant a waiver or an extension of time within which to satisfy the condition.

Generally, one party wants to impose many conditions and the other only a few. Also, typically, the party with the least leverage or bargaining strength will want those conditions to be objective and the other, with more leverage, will favor more subjective conditions that make performance or closing subject to its (good faith) satisfaction of the subjective standard. In an agreement for the sale of a company, for example, the seller generally desires to have very few objective conditions—it views the transaction as its time to harvest its rewards and wants the deal to close and to obtain the purchase price—while the buyer will favor an approach that gives it as many subjective conditions that it can deem satisfied in its discretion as possible—by doing this, the buyer obtains more control over the transaction and can determine that it wants to abandon the transaction or renegotiate the purchase price as pre-closing due diligence progresses.

When drafting conditions, especially subjective ones, take care to define the standards to be used and the identity of the person that will make the determination as to whether the condition has been met. Often terms like "material adverse change," "material adverse event," "best efforts," "commercially reasonable efforts," and the like are left vague and undefined. If this is done intentionally because the cost of reaching agreement on their definitions is too high relative to the benefit to be gained by doing so, that is fine. But they should not be left inadvertently undefined, which is an invitation to unforeseen litigation with its attendant expense and delay.

Finally, remember that conditions must be workable. Consider the notion of a "no material adverse change in financial position as of

the closing date" condition to closing in the acquisition of a business. In any business other than the most tiny, there is no way to know the financial condition of the business on a particular day. There are reporting delays and the time needed to process the information reported into financial statements. As a result, the material adverse change condition in this example can never work; it will be waived at closing. Better would be a no material adverse change as of a pre-closing date coupled with a bring-down certificate restating the representatives and warranties as of the closing date and a post-closing adjustment to the purchase price of any pre-closing material adverse changes that come to light in the next accounting period, perhaps to be funded out of an escrow into which a portion of the purchase price is placed.

6. Risk Allocations—Representations and Warranties

Although covenants and conditions can and are used to allocate risk, such as by placing the duty to obtain third party consents or financing on a particular party, the primary contractual mechanism for allocating risk is through the use of representations and warranties. Although the distinction between the two is blurring, it is good to know the classic, common law definition of a representation and a warranty and to focus on the purpose that each was developed to serve. One can then master the modern draft-around techniques that alter the traditional rules.

A "representation" is a statement of presently existing facts that is intended to induce reliance and action by a party, such as entering into a contract. Think of a representation as an advertising claim. An incorrect representation will give rise to a cause of action for rescission or damages in most jurisdictions. Unless otherwise specified, classically, representations terminate at closing.

A "warranty" is a statement made about certain facts whereby the warrantor promises to ensure that those facts are as stated. A breached or incorrect warranty will give rise to an action for damages. Unless otherwise specified, classically, warranties survive closing.

That said, transactional lawyers have been drafting around these distinctions for a long time. First, often the representations and warranties in a contract are combined so that, for example, a seller "represents and warrants that [statement of fact]." The combined provision is the first step in blurring the distinction between representations and warranties drawn by the common law. The second step is for the drafter to provide that "all representations and warranties will survive closing." The blurring is then complete.

Keep in mind that it is certainly possible to qualify representations and warranties and to provide that specific representations and warranties terminate at or survive until particular times. For example, the seller of land may be willing to represent and warrant that there is no contamination on the property as long as that representation and warranty does not survive closing—the buyer will have time by then to have had tests done to confirm the condition of the land and can rescind pre-closing if he desires, based upon the representation. Further, the parties may contract to specify or narrow the remedies that will be available for breach of a representation or a warranty. In most jurisdictions—and with certain exceptions, notably under certain sections of the Uniform Commercial Code and some consumer protection laws—the representations and warranties in a contract are subject to almost boundless possibilities for modification and customization.

The normal development of representations and warranties in the transactional drafting process is for the party with the most leverage in the deal to have its attorneys draft the initial proposed documents, including blanket, clean representations and warranties, *i.e.*, broad ones with no qualifications or outs such as "there are no claims outstanding or threatened against the company." The other side typically responds by proposing limits on those representations and warranties by inserting materiality thresholds ("there are no claims for more than $5,000 outstanding or threatened against the company") or referencing schedules with exceptions on them ("other than as listed on schedule 2.3.4, there are no claims for more than $5,000 outstanding or threatened against the company").

Knowledge qualifiers, especially those that define a company's knowledge to mean that of an individual or set of individuals, are also

common (“To the best of the seller’s knowledge,….”). When using a knowledge qualifier in a deal between non-individuals (companies), it is important to specify what the knowledge of the company consists of and whether or not the company has any duty to perform a review or investigation to inform itself prior to making the representation. Undefined references to a company’s “knowledge” are a recipe for discovery fishing trips and litigation should disputes later arise.

7. Closing Provisions

Closing provisions are a simple but important matter. These are the provisions that provide who is to deliver what documents to the closing or escrow, in what condition, signed or approved by whom, when, and the like. They are generally a series of covenants and conditions, performance of which trigger other covenants and conditions, until all the consideration has been assembled and is ready to be exchanged or distributed from escrow.

8. Events of Default and Remedies

Contracts often feature specific sections that specify events of default, procedures for declaring a default, and remedies available to the non-defaulting party upon declaration of default. In contracts courses, law students study common law rules regarding remedies, calculations based on expectation measures, limits on damages such as the need to prove that the damages were reasonably foreseeable at the time of contracting, and can be proved with certainty, and the availability of specific performance. This is all well and good, but the events of default and remedies section of the contract is a chance to draft around the common law rules or harness them to your client’s advantage.

Default is a broader concept than breach. Begin the default section by listing what events are “events of default.” Events of default usually include things that would be a breach of the contract—

like non-payment of an amount due, but they can include many things that would give your client insecurity but not be considered a breach. Examples include failure to insure collateral, declining financial performance ratios, defaults under contracts or obligations, termination of licenses or permits and the like. When you read in the business press that a company had to negotiate a waiver of a "financial covenant default," the reporter is saying that the company's financial condition had changed so that it was no longer in compliance with a financial covenant—maintaining a current asset to current liability ratio of 1.75:1, for example—and had to negotiate a waiver of the lender's right to declare a default for that failure. Cross-default clauses, where a default under another contract can be an event of default under your contract, even if the other agreement is one entirely separate from the one that you are working on, are also common. For example, a working capital loan from a bank might feature the termination of a franchised business's franchise agreement as an event of default. Breach of a representation or warranty can also be an event of default. These examples do not exhaust the possibilities.

Although it is possible to draft the contract such that the occurrence of an event of default automatically puts the other side in default, this is not the norm and it is generally not prudent. Better to retain flexibility by requiring the default-declaring party to issue a notice of default concerning the event of default in order to place the other party in the legal state of "being in default." As a practical matter, most if not all jurisdictions require some form of notice of the default prior to exercise of remedy. The content, manner, and method of providing this notice can be specified in the document. It is also possible to include a period in which the defaulting party may cure or correct the event of default, in which, case the defaulting party can reset things and no longer be considered in default. These provisions should be followed by ones that specify the available remedies, how remedies are to be selected, and whether they are cumulative or mutually exclusive. Remedies include termination, foreclosure or surrender of collateral or other property, and the like.

9. Boilerplate

‘’Boilerplate’’ refers to the seemingly standard provisions at the end of a transactional document, before the signature blocks. Calling them “boilerplate” is misleading in that they can be very important, especially when a dispute later arises under the contract. These terms commonly include choice of law, choice of forum (note that choice of venue provisions are unenforceable in some jurisdictions), severability, integration or merger, execution in counterparts, notice, and the like.

Do not simply incorporate standard provisions into your boilerplate without thought and analysis. When reviewing contracts drafted by others, do not just skim the boilerplate. Pay attention to these provisions, think them through, and draft them to aid in the interpretation of the contract and its enforcement in favor of your client.

10. Signature Blocks

Signature blocks are the place in the document where the parties indicate their assent to the deal. There are only a few issues that must be addressed with regard to them. First of all, the right parties must be named—simple as this sounds, in this day of separate entities in conglomerates, joint ventures, and hastily formed acquisition subsidiaries, it is easy not to know the exact name of the entity until shortly before signing. It is even a good idea to confirm that each non-individual entity listed as a party has been properly formed prior to its signing the agreement.

Signature blocks for an individual person, look like this:

	Example:
[defined term for the party]	Seller
_____	_____
[party name, typed], [capacity if other than self] [if the party’s address does not appear elsewhere,	Peter J. Gurfein 300 Walnut Street San Francisco, CA 94158

include it here to assist in identification]

Signature blocks for an incorporeal entity (LLC, Corp., Partnership, etc.) look like this:

	Example:
[defined term for the party]	Lender
[name of party entity]	Penultimate National Bank, Inc.
_____	_____
[name of person signing], [title]	Michael Lesseney, President

11. Exhibits and Attachments

In the typical contract, last come the exhibits and attachments. These are useful places to incorporate lengthy, detailed material that would otherwise disrupt the flow of the main contract. Examples of this sort of information include the exception schedules relating to the representations and warranties in the contract referred to above, as well as detailed lists of property involved in the transaction, *e.g.*, a list of patents and copyrights in the sale of a technology, company.

Another popular use for exhibits is to provide the form of various instruments and other documents that may be needed in the course of performance of the contract. Examples include bills of sale, assignments of contracts, deeds of trust, security agreements, and the like. By providing forms of these instruments, drafters avoid any later dispute as to whether the form selected by a party is sufficient.

12. Exemplar Considerations

A final word in this section of the chapter is reserved for exemplars, forms or prior contracts of the type one is drafting. These

may be found in an attorney's files, in form books, or on the Internet. They all must be viewed with suspicion. At best, these documents were right for the prior deal in which they were used. They are all negotiated documents that need to be customized for the current transaction. Never leave in a provision that you do not understand, thinking "that looks pretty official"—figure it out and determine if the provision should be retained, deleted, or modified for this transaction. Pay particular attention to the qualifications, carve-outs, materiality thresholds and the like in the representations and warranties; they were negotiated for the prior deal and may need to be deleted or modified for the current transaction.

D. Collaborative or Contentious Drafting

Transactional drafting and lawyering is different than litigating. Litigation requires minimal collaboration and cooperation with opposing counsel. One drafts one's complaint, motion, or other pleading and files and serves it. The other side responds. One replies. Oral argument is held, with counsel often staking out positions as far apart as possible in order to maximize the chance of an acceptable compromise decision by the judge. Indeed, the contentious nature of litigation, despite appeals from the bench and bar to maintain civility and professionalism, is one factor that motivates many to pursue a transactional practice. This is not to say that transactional practice is not contentious and, at times, filled with antagonism between opposing counsel. Rather, because there is seldom a third party decision maker for the parties to curry favor with and appeal to in order to resolve their disputes, they must resolve those disputes themselves or the transaction will not be finalized, and the lawyers will be blamed for killing the deal. As a result, it is necessary for counsel on both sides of the table to be able to give and take comments and revisions to their draft documents in a constructive, collaborative fashion.

The first level of comments that the transactional drafter is likely to receive are those from inside her own firm and from her client. These comments are meant to improve the document and make it more accommodating to your client's position. They are constructive

comments and the drafter should welcome them as input from a new set of eyes, from a different, perhaps more experienced, perspective. Of these comments and edits, adopt those that actually improve the document and even those that do no harm. If there are others that you disagree with, omit them with explanation to the source of the comments. This is especially true with regard to comments from the client. The only wrong reaction to a comment from a client is to ignore it. If you disagree, explain yourself to your client and bring them along. It is also possible that the client has a concern that is not addressed in the document and the client was trying to address it. If that is the case, determine what the concern was and decide how to address it effectively if appropriate.

The next level of comments is the potentially contentious part, review by opposing counsel. When transmitting the documents to opposing counsel, invite them to provide specific line edits using black lining or Microsoft Word's "track changes" and "comments" features rather than composing a response letter detailing changes that are desired, sometimes in vague terms. The goal is to force opposing counsel to be as specific as possible to avoid any ambiguity or possibility of argument over different interpretations of the comments and reactions.

When comments from opposing counsel are received, make or accept all of them that are beneficial to the deal as a whole. As to matters of style that do not impact your client's rights or benefits, consider making them out of courtesy to the other side; on the other hand, if you are in a negotiating dynamic where opposing counsel is using these sorts of small, inconsequential suggestions to attempt to dominate you, you may need to push back and inform them that the requested changes are not necessary, are inconsequential, and appear to pertain to matters of style that are not consistent with your firm's style for transactional documentation.

As to comments or changes that are detrimental to your client's position, examine them carefully. Are they valid requests that deserve consideration, like a request that the materiality threshold of "of more than $50,000" be added to an otherwise clean representation and warranty that there are no outstanding claims against the company that is being sold? Is this the sort of qualification to the representation

and warranty that is acceptable to your client, or would it be better to respond by striking the requested materiality threshold and suggesting a carve-out of “except as disclosed on schedule x” to the otherwise clean representation and warranty? This is the sort of back and forth that is to be expected in the negotiation of transactional documents.

Finally, other comments and requested changes may address wholly new matters that are valid points for future negotiation. Consult with your client and respond appropriately, probably always asking for something in return. It is unwise to acquiesce to such a request without obtaining something in return unless your client has everything it could ever want out of the deal. The other side should have to give you something to get the benefit that it desires.

E. Contract Guidelines

Most problems in transactional documents can be traced to one or more of three things:

(1) Blurring distinctions between types of contract provisions and using the wrong one for the purpose to be achieved;
(2) Provisions that attempt to accomplish too much; and
(3) Word choice and punctuation problems.

All of these are quite basic and can be prevented by focusing on a set of fundamentals that, if adhered to, will produce better, well drafted transactional documents.

1. General Rules of Organization

(a) General provisions before specific ones.
(b) Important, central provisions before others.
(c) Rules before exceptions.
(d) What (duty, condition, etc.) before how.
(e) Separate provisions for each concept.

(f) Technical, boilerplate, housekeeping, and miscellaneous provisions grouped together at the end, before the signature blocks.

2. Titles

Is the title to the document generic, *e.g.,* “Lease,” “Stock Pledge Agreement,” and the like? Does it include the names of the parties and the date, *e.g.,* “by and between Kelson Corp. and Jeffery Davis dated as of June 24, 2010.”

3. Introductory Paragraph

Does the introductory paragraph introduce the parties, provide a defined term for each of them, specify their capacities under the agreement, and, if needed, include the date of the agreement?

4. Recitals

Are the recitals sufficient to provide the context of the transaction for the unfamiliar reader, especially a later decision maker, like a judge? Are there fundamental concepts or items that can be the subject of defined terms if they are discussed in the recitals? Do the recitals provide reference and descriptions of other documents and agreements that are relevant to this transaction but not strictly a part of it?

5. Definitions

When using defined terms, take great care. Overly broad or narrow definitions can create ambiguity or unintentionally reallocate benefits and burdens under a contract. Three key principles apply to defined terms:

a. Do not define terms that are used in the ordinary sense of the word.
b. Do not define terms in a way that is contrary to its ordinary meaning.
c. Do define terms to narrow or broaden the scope of the term as used in its ordinary sense, e.g. “Trademark” includes “Service Mark” and “Certification Mark.”

Once you have used a term as a defined term, it is best to eliminate all other uses of that term to avoid confusion. Resist the urge to include obligations within defined terms—*e.g.*, The “Financial Statements,” which Little Co. will deliver to Big Co. within 10 days of the Effective Date of this Agreement shall include …. Use affirmative covenants in the main body of the document for those obligations and limit the definition of the term to the merely descriptive.

6. Covenants

Are the covenants—the promises, the parties’ duties—contained in provisions clearly labeled and structured as covenants? Are they phrased in the active voice, using the verb “shall”, and do they fully state which party is to do what to or for whom, when? (When creating a privilege or a right, rather than a duty, the same rules apply, but “may” should be used rather than “shall.”)

Is there a consequence specified for a failure of the party to perform its covenant in a timely manner? This is especially important as, especially with more minor covenants, reasonably foreseeable damages from a failure to perform may be difficult to prove with certainty. Take the opportunity when drafting to put some teeth into your covenants by specifying the consequences that will attend a failure to perform.

7. Conditions

Are the conditions—the events that must occur before a duty becomes ripe or is discharged or modified—explicitly set out and labeled as conditions? Have the parties thought through and provided for each of the fundamental assumptions underlying their deal to be a condition to the deal itself? Are consequences for a failure of a condition to be satisfied explicitly stated? Do not rely upon events of default and remedies provisions alone to address failures in performance or changes in fundamental underlying events.

Conditions are the best contractual mechanism to address events that are both under or outside of the parties' control. But, if addressing actions that are under a party's control, use a pre-closing covenant to require them to take the action, in addition to a condition.

Finally, are the conditions workable?

8. Representations and Warranties

Are the representations and warranties made as of a particular date, generally the date of the signing of the agreement? Does the agreement require a bring-down or re-issuance of the representations and warranties as of the closing date as a condition to closing in a delayed closing deal? Are there appropriate qualifications to the representations and warranties such as materiality thresholds, carve outs, or exceptions listed on schedules? Do the representations and warranties terminate on particular dates or upon the happening of certain events or do they survive closing. Make termination or survival of representations and warranties explicit so that there is no need to turn to case law to answer this question.

9. Termination

Give some thought to termination of the agreement. Think through how it can and should terminate if necessary. Possible mechanisms for termination are termination by agreement, termination if there is no closing by a date certain, termination if a party is not satisfied with due diligence, termination if representations are found to be inaccurate, termination if events have occurred that will prevent the closing, and breach of a pre-closing covenant or failure of a condition precedent.

Also, what occurs upon "termination"—which is different from "breach." Are there items or information that must be returned by one party to another? Do some provisions of the contract remain in force, e.g., confidentiality provisions or a termination fee?

10. Closing Provisions

Examine the closing provisions carefully. Do they provide, as a condition to closing, for all acts and deliveries that your client expects to receive or benefit from? Are each of these acts and duties also the subject of affirmative covenants by the other side?

11. Events of Default and Remedies

Have you listed appropriate events of default, looking beyond mere non-performance of the contact to include early warning signals that could cause insecurity or signal liability non-performance? Are appropriate notice provisions included so that, when it is time to give notice and declare a default, there is no doubt exactly how to do that? Are appropriate remedies in place? Will your client be in a position to regain its property, especially confidential information and trade secrets? Is there proper support for the other side's obligations, such as collateral, guaranties, letters of credit, and the like? Is it clear whether the remedies are cumulative or must be elected as an exclusive remedy? Is it clear whether to resort to state or federal contract, tort, or other causes of action is permitted?

12. Boilerplate

Review boilerplate carefully as it is often overlooked. Specific attention should be paid to severability, arbitration or other dispute resolution, and attorney's fees provisions. Do these terms, if literally applied, make sense for this transaction?

13. Signature Blocks

Silly as it sounds, is the document ready for the right party to sign it? In this era of conglomerates and affiliated groups of artificial entities whose names often only vary by a single number or word, it bears checking carefully that the right party, represented by the right officer with authority to bind the company, is listed.

14. Plain English and Clarity

Contracts should be readable. As noted earlier in the chapter, the standard to strive for is that a person of reasonable intelligence who knows nothing about the transaction can understand the deal after one reading of the contract. This is not always attainable, but it is a good aspirational goal. Examine the contract for plain, simple, direct English; use of the active voice; clear identification of who is to do what to or for whom, when. Have excess words, especially adjectives and adverbs, been eliminated?

15. Accuracy and Completeness

Is the document accurate, in the sense that it correctly expresses the transaction at issue? Is it complete, *i.e.*, does it address all possible courses of action pre-closing and during its performance? Is

it exact, meaning that it is not ambiguous or unintentionally vague (intentional use of vagueness may be needed to reach agreement, but vagueness should never appear without the intent or need for it). Will this document be able to withstand hostile, critical review by a third party decision maker assisted by opposing counsel?

16. Technical

Finally, proofread the transactional document carefully. Beware, especially of those misspellings that are not caught by word processor spell checkers because they are correctly spelled wrong words. Reading the document aloud can help in this regard. Check all citations and references to other documents and laws that are incorporated into the document. Also, check internal cross-references within the document carefully. For the document to govern the parties relationship well, all these things must be correct.

Checkpoints

- Transactional documents create a record of the parties' deal and simultaneously creating mechanisms to foster agreement, encourage performance, and provide for enforcement and dispute resolution.

- Transactional documents have a distinct structure like other forms of legal drafting, and that structure should be followed and employed to produce practical, precise contracts and instruments.

- Transactional documents represent the documentation of the terms of a parties' relationship, and are drafted to reflect the stage of relationship to which they relate.

- Stages of the parties' relationship include:
    - The first meeting of the parties;
    - Reaching a preliminary agreement on fundamental matters, such as price and method of payment;
    - Preparation of interim transactional documents such as term sheets and letters of intent and initial due diligence;
    - Preparation of the final binding transactional documents and final due diligence;
    - Closing;
    - A Post-closing adjustment period which may involve post-closing covenants or conditions; and
    - Later litigation, which hopefully does not occur.

- Keeping these stages in mind will help drafters to ensure they prepare the proper sort of documents and the proper time.

- The same organizational rules that apply to other forms of legal drafting apply with equal force to transactional documents. Including:
    - place general provisions before specific ones;

    - place important provisions before lesser ones;
    - state rules before exceptions;
    - use separate sections/subsections for each concept; and
    - include meaningful headings for each section.

- Contractual precision requires accuracy, completeness, and exactitude.
- Exactitude, which refers to an absence of ambiguity and unintentional vagueness.
- Ambiguity occurs when a word or phrase is capable of more than one specific meaning.
- Vagueness is the lack of clarity—where the specific meaning is unclear.
- Vagueness is often used in transactional documents when the parties are unable to agree on a provision governing what is thought to be a rare or unexpected event.
- Vagueness should not be used unintentionally or inadvertently.
- Much can be accomplished in producing practical, precise documents by focusing on using the active voice and uniformly

using the word “shall” for duties and “may” for rights and privileges.

- Transactional documents generally contain these components:
  - Title;
  - Introductory paragraph;
  - Recitals;
  - Definitions;
  - Core provisions—Consideration, Covenants, Conditions;
  - Risk allocations—Representations and Warranties;
  - Closing provisions;
  - Events of default and remedies;
  - Boilerplate;
  - Signature blocks;
  - Exhibits and attachments.

- Preparing transactional documents requires constructive, collaboration of attorneys from both sides of the deal in commenting on and revising drafts.

- Most problems in transactional documents can be traced to
    - blurring distinctions between types or contract provisions and using the wrong one for the purpose to be achieved;
    - provisions that attempt to accomplish too much;
    - word choice and punctuation problems.
