WORKING WITH CONTRACTS

What Law School Doesn't Teach You

SECOND EDITION

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PRACTISING LAW INSTITUTE
NEW YORK CITY

#17186

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Library of Congress Control Number: 2008926691

ISBN: 978-1-4024-1060-4

Chapter 1

Introduction

§ 1:1 What Law School Doesn't Teach You

Linda, a new associate in a mid-sized law firm, gets her first assignment. She receives a call from a partner who tells her: "Our client, Unibanc, has a customer, Barnes Inc., that is considering a major acquisition of a company called Ashley Enterprises Corp. You're going to be working on the financing team with me and a senior associate. Come down to my office right away—we're going to rough out the closing checklist."

In the partner's office, Linda listens to the following discussion between the partner and the senior associate:

"This will be a syndicated loan with both a revolver and two or three term facilities. Barnes is currently financed by Minibank, so we'll need to review the existing credit facility, understand the prepayment provisions, and arrange to terminate all Minibank's existing liens and lien filings. Linda, that will be your job."

"Also, Ashley has twenty subsidiaries—we'll need to diligence them and make them a part of the credit package. One of them has an existing mortgage financing on its plant. Barnes wants to keep that financing in place because the pricing is cheap, so Linda, you'll need to review those agreements to determine whether there are any covenants that would prevent that subsidiary from executing a guarantee and security agreement."

"And speaking of guarantees and security agreements, why don't you take a first cut at drafting the guarantee that all of the subsidiaries will sign and the security agreement that the guarantors and the borrower will sign, Bob will show you the precedents to use—the ones

from the Romero transaction. All of the representations in the existing agreements will need to be modified to reflect the new parties."

Within the hour, Linda has the Minibank credit agreement, the subsidiary mortgage and the guarantee and security agreement precedents on her desk. She is doing her best to maintain her sense of confidence and optimism; nonetheless, her complexion has taken on a pasty green look.

Meanwhile, her next-door neighbor, also a first-year associate, is down in the library beginning work on his first assignment. He was told that the client was being sued for breach of a supply contract and was instructed to research and write a memorandum of law on the enforceability of a liquidated damages clause in the contract.

Why is this other associate in an entirely better mental state than Linda? Like many first-year litigation assignments, his assignment is something that *law school taught him how to do*. The case method of study familiarizes law students with the language and process of litigation. Legal research methods are taught starting in the first year of law school. Most law students are required to take a legal writing class, which inevitably includes only litigation-oriented writing projects—memoranda of law and briefs.

Conversely, law schools do a woefully inadequate job of preparing non-litigation lawyers—corporate, financing, commercial and real estate lawyers—to perform the most fundamental tasks that are expected of them. This is because much of what these practices entail does not involve "the law." Of course, there are strictly "legal" aspects of many transactions: a company making a public offering of equity must follow the securities laws; a merger of two corporations requires compliance with corporate laws; a secured financing must conform to the requirements of Article 9 of the Uniform Commercial Code. But these issues usually comprise a modest fraction of the time spent by transactional lawyers.

The law of contracts as covered by a first-year contracts class—offer and acceptance, consideration and the like—rarely poses any issues in sophisticated commercial transactions. The majority of a transactional lawyer's time is spent on structuring the transaction, advising the client on strategy, negotiating and drafting the contracts, orchestrating the closing, and throughout the life of the deal keeping the transaction organized and moving forward.

How is a new lawyer supposed to learn these skills? By doing and observing—in other words, "on the job" training. There is an awful

lot that starting lawyers need to absorb before they become capable lawyers in their fields. However, the learning process for litigators is significantly easier because they start their careers knowing the necessary vocabulary and tools of their craft.

This book will provide the beginning transactional lawyer with an operative understanding of the vocabulary and building blocks of contracts. This will not solve all of the struggles of Linda or any other junior associate who is faced with the challenge of learning her craft, to one degree or another, by osmosis. Learning is an accretive process: the more one knows, the easier it is to learn, because there are reference points that new information can "stick" to. It's like a crystal. Once the seed of a crystal is formed, it grows quickly by accretion. I hope this book will provide the beginning transactional lawyer with some basic knowledge on which a larger set of skills can grow.

§ 1:2 The Role of Contracts

A long-term personal relationship (as anyone who has had one knows) is governed by a complex but unwritten set of rules. Certain behaviors are encouraged, some required, some forbidden. Disclosure is routinely necessary. Some actions are conditioned on the occurrence of other actions or circumstances. Wrongful behavior is punished and good behavior is rewarded.

All of the same dynamics are present in business relationships, the primary difference being that the rules of most long-term, and many short-term, business relationships are governed by written contracts. This is dictated by an interest in efficiency: although there is an initial expenditure of time and effort in creating the contract, the reduction in negotiation and disputes over the term of a well-written contract outweighs these initial costs. The process of contract formation also forces the parties to understand what they must give up to get what they want. This process results in more realistic expectations as to the risks and rewards of the transaction.

A contract creates a private body of law between its parties. Each party has the legal right to enforce the obligations and restrictions that the other party has agreed to. Many of the provisions of a complicated agreement go well beyond what clients consider the "business deal," and, as a result, some clients are prone to disregard these provisions as legal boilerplate. It is the responsibility of the lawyer to en-

sure that the client understands the impact that the contract will have on its business and its business relationships.

§ 1:3 Contracts: A Unique Type of Writing

Contract drafting is unlike other forms of writing that are familiar to beginning lawyers. The writing that we are exposed to on a day-to-day basis (even in law school) is almost entirely expository writing, the goal of which is to persuade or provide information to the reader. A contract is different: the goal of a contract is to describe *with precision* the substance of the meeting of two minds, in language that will be interpreted by each subsequent reader *in exactly the same way.*

This is no small order. A prerequisite for a precisely written contract is a clear understanding between the parties, which is often achieved only after significant effort. One of the lawyer's most important functions is to help her client think through all the relevant issues that lie beneath the surface of the client's business goals. Lawyers are trained to spot issues, and a good lawyer will protect her client's interests by spotting and analyzing all of the potential issues that arise in connection with each element of the transaction.

Each of these issues will then be the subject of a negotiation. The result of the negotiation may in turn give rise to additional issues to be negotiated and resolved. Then the outcome of each negotiated point must be reduced to language that each party (and its counsel) concurs accurately reflects their agreement. The process of drafting the appropriate language results in yet another negotiation between the lawyers, because there are many (perhaps even an infinite) number of ways to express any concept. Each lawyer will advocate wording that he believes most accurately reflects his client's understanding of the issue. These negotiations over language often demonstrate that points agreed to in principle still include areas of disagreement.

Ambiguity is the contract lawyer's enemy. Any term that can be interpreted more than one way can become the basis of a dispute, and eventually litigation, between the parties. Unfortunately, the qualities of the English language that make it a wonderful tool for poets—its rich supply of synonyms, its reliance on both latinate and germanic roots, its complex syntax and grammar—make it a challenge for lawyers to draft with precision and clarity.