Chapter 3

The Lawyer's Functions

§ 3:1 The Contract Formation Process: A Breeding Ground for Issues

The documentation of a business deal is where the worlds of business and law most clearly intersect. The business person often views lawyers as a necessary evil—in his view, he is capable of working out the terms of the business deal himself, and the lawyers are just there to wordsmith and make it legal. The lawyer, on the other hand, may view her role as preeminent—yes, the business people may have agreed to the nine or ten economic points that are the basis of the deal, but they

have failed to consider the myriad other issues that flow from those key points, much less how to resolve these issues.

Something between these two extreme viewpoints is actually closer to the truth. Obviously, there would be no deal to document without clients. On the other hand, if business people were to document their transactions by writing down only the points *they* consider to be the business deal, a stream of unanticipated issues and problems that the documents didn't address would likely have to be resolved over time. Even between parties whose relationship is good, working out mutually agreeable solutions to these problems on an ongoing basis would be a constant and increasing source of stress. If compromises couldn't be worked out, the result might be litigation and the end of the business relationship.

There is another important advantage to resolving issues in advance as a part of the contract formation process. It is a time when both parties want a deal and therefore are more likely to reach a compromise. For example, during the negotiation of a trademark license agreement, the licensee may agree to a provision that a more rigorous set of quality testing requirements will apply to any overseas production. This is a concession that the licensee may be willing to make as one element of the overall negotiation process. On the other hand, if this provision weren't included in the contract, and the licensor requested more stringent overseas testing a year after the contract was signed, the licensee would be unlikely to agree. This will be the case even if the change is not that significant from the licensee's point of view, because of a fundamental tendency of human nature and business conduct: no one wants to give up something for nothing. The compromise that the parties might have easily agreed to if the issue were broached during the initial negotiation will be much more difficult to achieve after the contract has been entered into when all leverage is gone.

The time to anticipate and resolve potential issues is before the parties have bound themselves to the transaction, when deal momentum and mutual interest in completion greases the skids. Among the lawyer's most important functions are to help orchestrate this process, to identify issues, to propose solutions, to help identify workable compromises and to put it all into words that clearly express the parties' intent.

§ 3:2 Identifying Issues

A skillful lawyer is adept at sniffing out, sizing up and solving issues. Let's take a simple example. A client calls up his lawyer with the following instructions: "We've just agreed to acquire a used Model 780 pipe threader from Sellco for $3 million. Draw up the papers, but don't spend a lot of time on this."

The good lawyer will resist the suggestion that he shouldn't take up her or her client's time, and will ask the following questions:

- Is it a *particular* Model 780 (if Sellco has more than one), and, if so, how can I get the serial number to identify it in the contract?
- Have you examined the equipment and found it satisfactory? If not, what are the repairs or replacements that need to be made and which party is responsible for making them?
- Who is responsible for moving the equipment from Sellco's plant to yours? If Sellco, what is the method of transportation and delivery? When does the responsibility to insure the equipment shift from Sellco to you? Who is responsible for making the insurance arrangements?
- What rights do you want to have to inspect and approve the equipment after it has been installed in your plant? What if it is not working properly at that time?
- When is the sale expected to take place? What are each party's considerations as to the earliest and latest permissible delivery dates? Should either party be able to walk away from the contract if the other side doesn't perform by a specified date?
- Is the purchase price paid entirely in cash? Is Sellco requiring any portion of it as a deposit when the agreement of sale is signed? If a portion of the purchase price is a promissory note, what are the terms: interest rate, maturity date, amortization, interest payment dates, rights of setoff?
- When does the cash consideration get paid? What form of payment is expected—check or wire transfer? What is the source of the payment? Are you borrowing to pay the purchase price?

- Are there any special undertakings with respect to the equipment that you expect to get from Sellco? Is Sellco willing to warrant its performance for any period of time? Are there existing warranties from the manufacturer, and if so do you expect to be able to enforce them directly?

These are all issues that the client should care about. They may not be as fundamental to the deal as the purchase price, but they should all be of interest to the person buying the equipment. However, if the client in this example is not involved in buying and selling used equipment as a regular part of his job, he may not have considered all the necessary angles to make the transaction a success.

Many business people will take the view that any issues raised by a lawyer are legal issues and are therefore not worth spending their time on. The above example illustrates that this is most definitely not the case. (Note also that this example involves the simplest of fact patterns. Imagine how that list of questions would grow if the proposed transaction involved an acquisition of multiple businesses located in several countries for consideration consisting of a combination of cash and securities, and which is financed with senior secured bank financing and a public high-yield debt offering.) A good business lawyer, through training and experience, is skillful at spotting issues that have economic and practical significance for her client. It is one of the lawyer's most important functions.

§ 3:3 The Lawyer as the Client's Guide

It is often necessary for a lawyer to guide his client through the contract negotiation and drafting process. This, of course, depends on the circumstances. A lawyer in a commercial lease transaction representing a banker who has spent her last ten years doing these transactions will not be able to identify many issues that the client hasn't seen before. On the other hand, a lawyer representing a client who is negotiating her first commercial lease transaction will have to educate the client as to the terms, risks and contractual intricacies of the transaction.

Agreements that involve significant ongoing obligations after the closing create the greatest challenge in this regard, as illustrated by the kinds of provisions that are found in many financing agreements: affirmative covenants, negative covenants, financial covenants, financial

reporting requirements, representations that need to be brought down, and obligations regarding the maintenance of collateral. The lawyer must make sure that the client understands and has a reasonable expectation of being able to comply with these requirements.

Carefully negotiating a complicated set of provisions may be a long, laborious process. Often the negotiation of one agreement is taking place as a part of a larger transaction in which the client is being pulled in many different directions. Occasionally, a client will take the view that as long as he gets the deal closed, he can worry about the rest of the "legal mumbo-jumbo" later. Unfortunately, the legal mumbo-jumbo is likely to contain provisions that, if ignored, could create significant problems for the client and its business later.

In other words, it is the lawyer's job in the contract formation process to make the client understand and care about many things that the client may prefer to ignore. It is a task requiring not only technical knowledge of the issues but the necessary interpersonal skills to engage the client in this process. In order to perform this task well, the lawyer must also develop the skill to explain complicated concepts and issues in a clear and understandable way. A significant element of this is gauging the client's knowledge and interest level and tailoring the explanation accordingly.

§ 3:4 The Drafting Process

§ 3:4.1 Getting Started

At the outset, the lawyer responsible for drafting the contract will get some indication from his client as to what the terms of the transaction are to be. It may be a phone call of the type described above, it may be something in writing such as a letter between the parties, or it may be a term sheet. In any case, the lawyer will probably seek additional information from the client that will help him produce a credible first draft. At this stage the lawyer should explore whether the client has any documents that may be relevant. The client is unlikely to know what is relevant, so pointed questions must be asked. Are there any letters or other written communications between the parties relating to the transaction? Are there any written materials relating to the subject matter of the transaction? If the transaction is an acquisi-

tion, is there an offering book with respect to the target? Are there any relevant financial statements or reports? Are there any expert reports relating to the subject matter of the transaction, such as reports of accountants, appraisers or environmental experts? Such materials may or may not be helpful to the lawyer's task, but the lawyer must ensure that he has an opportunity to make that determination himself.

Then the lawyer prepares the first draft of the contract. During the drafting process additional issues and factual questions will arise. Some may be so important or wide-ranging that an answer must be obtained from the client before the drafting process continues any further. These may include fundamental structuring points that will broadly affect how the contract is to be drafted, or issues that may affect the viability of the deal. This type of concern will warrant immediate communication with the client.

Other issues will be of less importance. In the interests of efficiency (and not exhausting the client's patience and goodwill) a method of raising these issues other than repeated phone calls to the client should be employed. There are three approaches:

- Put the issues or question in the draft itself, bracketed and made bold to ensure that they are seen by the reader and to make them easier to find and delete as the contract is revised.
- Prepare a separate list of issues and questions to be delivered to the client with the first draft of the contract.
- Raise all of the issues and questions when the draft is first discussed with the client.

Under most circumstances, the best approach is to combine either the first or second method with the third. Have the client read the draft and the lawyer's written questions and issues (whether embedded in the document itself or in a separate list) together. Then, when it is time to go through the draft together, the lawyer should elicit discussion and response from the client as to each of these points.

The above process should also be followed in the situation where a junior lawyer is preparing a draft for a senior lawyer. By doing this, the junior lawyer will develop important issue-spotting skills, and she will demonstrate to the senior lawyer that she is actively thinking about the assignment rather than just going through the motions. Many of these will be valid points that ultimately will be addressed in the draft or raised with the client.

§ 3:4.2 Drafting the Contract

Which lawyer drafts the contract is often dictated by custom: financing agreements are drafted by lenders' counsel; acquisition agreements are drafted by purchaser's counsel; underwriting agreements are drafted by underwriter's counsel; employment contracts are drafted by employers' counsel; security agreements are drafted by secured party's counsel. The underlying principle is that the party with the most leverage or with the most to lose from an inadequately drafted contract will do the drafting.

What is the importance of being the draftsperson? The draftsperson can ensure that the issues he wants to be addressed are not only covered, but covered in the manner that best serves his client's purposes. The party that is reacting to the draft presented by the other side is functionally in a defensive posture: it is reacting to the other side's proposals rather than proactively asserting its own agenda.

The difference between these two positions can be illustrated in an example. What if, contrary to tradition, a purchaser of a business allows the seller's lawyer to prepare the purchase agreement? The seller's lawyer will prepare a very slim draft, omitting as many of the provisions that protect the purchaser as he feels he can get away with. (The seller's goal is to receive its consideration with as few strings attached as possible, whereas a purchaser wants representations regarding the purchased assets and indemnities for the breach of the representations, among other things.) The purchaser and its counsel will react by providing an extensive barrage of comments intended to turn the draft into a more middle-of-the road document. However, the purchaser in this case is in the posture of requesting numerous changes, rather than imposing its terms on the other side. From a purely mechanical standpoint, no changes to a draft document are made without the approval and cooperation of the party that has the draft on its or its lawyers' word processing system.

Another benefit of having drafting responsibility is being able to control the pace of the transaction. The ability to control when a draft agreement is delivered to the other participants in a deal can be an important strategic device, particularly for a party anxious to have the deal progress quickly.

§ 3:4.3 Use of Precedent

In contract drafting, plagiarism is a virtue. A lawyer drafting a contract should always try to start with a form designed for the kind of transaction involved, or from a contract previously used in a similar transaction. There are numerous reasons for not wanting to "reinvent the wheel": starting a contract from scratch is more time-consuming than marking up a good form; precedents contain provisions that address issues in ways that are generally accepted in the legal and business communities; and boilerplate provisions that have been used and accepted in previous transactions are less likely to require careful review and negotiation.

It is crucial to find a precedent that closely matches the transaction at hand. Ideally, you will have several good precedents. The closer the match is, the less redrafting and engineering will be required of the draftsperson. A lawyer using a stock purchase agreement as a precedent for an asset purchase, for example, will have to add all the provisions that identify the assets to be transferred and the mechanics of such transfer, since these provisions will not be in a stock purchase precedent. Another example is the use of a single-lender credit agreement precedent for a credit facility involving a syndicate of lenders. The draftsperson will be required to make some significant changes (*e.g.*, adding all of the agency and voting provisions that are needed in syndicated credit agreements) as well as numerous clean-up changes (*e.g.*, changing each reference in the agreement to "lender" to the appropriate plural reference). The extra effort and time expended in finding the most closely applicable precedent at the beginning of the drafting process will be well-rewarded.

If instead of a model form, the precedent is an agreement from a previous transaction, particular care must be taken to distinguish between standard provisions and the provisions that were specifically negotiated. Of course, to the extent these negotiated provisions are favorable to the draftsperson's position, it will not be harmful to include them in the first draft. But it can be very damaging to unknowingly give something up in the first draft by including a concession made in a previous transaction. The inexperienced lawyer may have a difficult time distinguishing between boilerplate and negotiated provisions. One way to address this concern is to obtain the first draft of the precedent (by getting the first word processing version or searching the files) and comparing it to the final version. This will not only

prevent the unintended use of negotiated provisions but will also give the junior lawyer a road map of some issues that may come up (and their possible solutions).

If the reader of the first draft (whether it is a senior lawyer, the client or the other side) is familiar with the precedent used to create the draft, it may be useful to provide a copy that shows what changes have been made.[1] This will enable the reader to review the draft more efficiently by focusing on the changes to the precedent.

The effective use of precedents goes beyond finding the right agreement to start from. It also comes into play when the draftsperson needs to add provisions that don't appear in the precedent he is using. For example, a party to the transaction may be a quasi-governmental entity and the lawyer may want to add a waiver of sovereign immunity. He has two choices: draft from scratch or find a good precedent for this provision. If good language is found, it is an easy process adding it to the draft, although the draftsperson must make sure that all defined terms used in the inserted provision match those in the agreement, and that otherwise the style and format of the insert blend into the agreement.

On the other hand, in many cases it may be easier to draft from scratch (particularly as the draftsperson gains experience). Some lawyers seem to think there is magic to using precedent—that for every new concept or provision that must be inserted in a contract, there is precedent that works exactly right. This is often not the case, and a skillful draftsperson may be able to draft a better provision in less time than one found in a precedent after a lengthy search. This is particularly true where the concept to be written is not a frequently recurring one. It bears repeating that the purposes for the use of precedents are to streamline the drafting process and to rely on time-tested language covering recurring facts or circumstances.

For the junior lawyer who has not yet developed a feel for what is normally included in a particular type of agreement, it is a good practice to refer to one or two other precedents as the first draft is being prepared. This will provide guidance as to which provisions are customary and which are deal-specific.

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1. This is a function of most word processing programs; it is generically referred to as "blacklining" or "redlining."

§ 3:4.4 Marking up a Precedent

This section addresses a mundane, mechanical matter: how best to mark up changes to a draft for word processing. A draftsperson who revises a contract by word-processing the revisions herself will not need any of the techniques discussed in this section. But those who do it the old-fashioned way—that is, by marking up a precedent by hand for input by a secretary or word processor—should heed the following guidelines. And in any event, the points that follow are important when the lawyer is called upon to provide comments to an agreement someone else has drafted by preparing a markup. See section 3:4.6.

All of these guidelines are presented with one goal in mind: efficiency. It is always more efficient to prepare a clear markup that is easily understood by the word processor the first time, rather than needing to make multiple revisions. Avoiding multiple revisions yields saved time for the lawyer.

The following pages show comparisons between difficult-to-read markups and easy-to-read markups. **Example A** shows the right and wrong way to make insertions. Note that it is much easier to see the insertions and where they are supposed to go in the second example. Drawing the insertion lines in between the lines of the text can force the reader to follow the lines as if trying to find her way out of a maze. **Example B** illustrates how best to reflect a number of small changes in close proximity. Sometimes crossing out the phrase or sentence and rewriting it is much cleaner, as is demonstrated here. **Example C** illustrates a very important point: for inserts of any significant length, it is far easier (both for the person doing the markup and the word processor) to do so by inserting a rider. This is particularly true if the draftsperson expands or modifies the inserted language as she goes along. There is a potential tactical advantage to sending word processed riders: in many cases, the drafting lawyer will insert your language in its entirety, because it is so easy to do so.

Example A

Wrong way

On the Effective Date there shall be no actions, suits, proceedings or investigations pending or threatened (a) with respect to the Transaction, this Agreement or any other Document or (b) which the Agent or the Required Banks shall determine could reasonably be expected to (i) have a Material Adverse Effect or (ii) have a material adverse effect on the rights or remedies of the Banks, the Letter of Credit Issuer or the Agent hereunder or under any other Credit Document or on the ability of any Credit Party to perform its obligations hereunder or under any other Credit Document.

Right way

On the Effective Date there shall be no actions, suits, proceedings or investigations pending or threatened (a) with respect to the Transaction, this Agreement or any other Document or (b) which the Agent or the Required Banks shall determine could reasonably be expected to (i) have a Material Adverse Effect or (ii) have a material adverse effect on the rights or remedies of the Banks, the Letter of Credit Issuer or the Agent hereunder or under any other Credit Document or on the ability of any Credit Party to perform its obligations hereunder or under any other Credit Document.

Example B

Wrong way

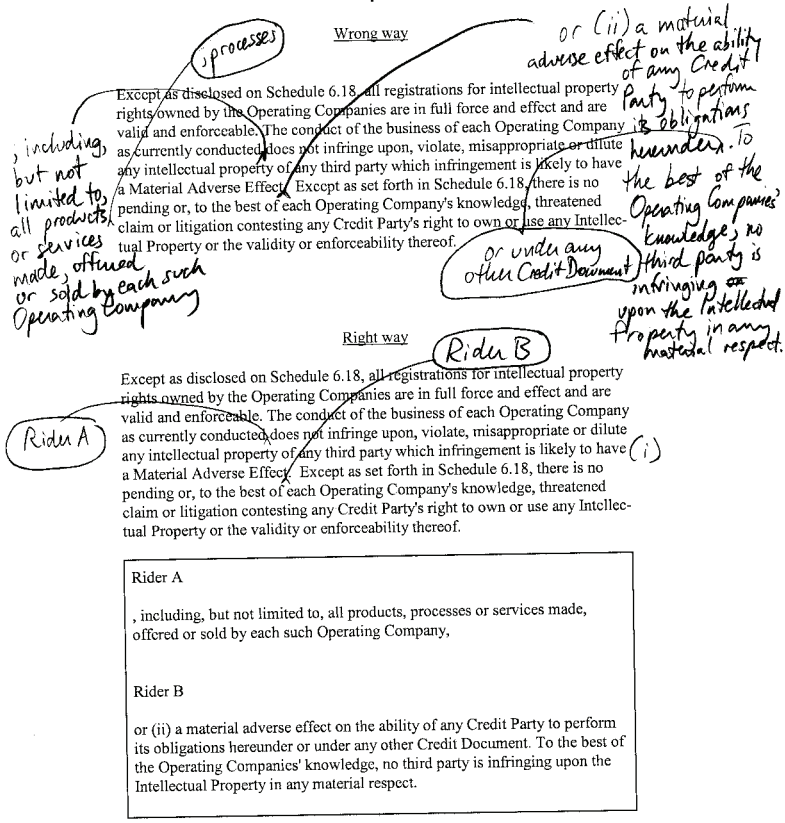
"Qualified Preferred Equity" shall mean preferred Capital Stock of Holdings which contains no covenants and requires no redemptions, repayments, sinking fund payments or other returns of capital thereunder at any time any Obligations remain outstanding.

Right way

"Qualified Preferred Equity" shall mean preferred Capital Stock of Holdings which contains no ~~covenants and requires no redemptions, repayments~~, sinking fund payments or other returns of capital thereunder at any time any Obligations remain outstanding.

material covenants (other than covenants restricting the incurrence of debt), provides for no cash payments of interest and (except as required by the Shareholders' Agreement) requires no redemptions prior to August 30, 2003, repayments other than payments in kind

Example C



Rider A , including, but not limited to, all products, processes or services made, offered or sold by each such Operating Company, Rider B or (ii) a material adverse effect on the ability of any Credit Party to perform its obligations hereunder or under any other Credit Document. To the best of the Operating Companies' knowledge, no third party is infringing upon the Intellectual Property in any material respect.

§ 3:4.5 Final Steps in Producing a First Draft

When a first draft is completed, it will usually be sent to the client for its review and comments. At this point, the draft will be cleansed of any internal commentary that was meant only for the eyes of the lawyers, and any questions or issues for the client will be incorporated into the document or on an attached list, as discussed above.

When the lawyer and the client go through this first draft together, the lawyer will want to ensure that the client's expectations as to how long this process will take are realistic—often a client will underestimate how long this session will last, particularly in the case of a long

or complicated contract. In addition to the questions and issues directed to the client in the contract or in a separate list, the lawyer may want to focus the client's attention on particular issues that the lawyer considers likely to be of interest or importance to the client. The extent the lawyer will want to do this will be a function of the experience level of the individual client. A client who is a novice may need more of a guided tour of the contract. Even if such a client has carefully read the draft, she may need help recognizing the significance of certain provisions or the way certain provisions in the contract interact with each other.

The lawyer will then revise the draft to incorporate the input obtained from the client. Ordinarily, these changes should be made in a new version and blacklined so the next review by the client can be limited to the language which has changed. If time permits and the client wishes, the process of review, comment and revision can be repeated. Sometimes, the lawyers may be instructed to send the draft to the opposing party and counsel prior to the client's review and input. If the lawyer believes this approach may be disadvantageous to the client (because, for example, the draft opens some doors that the client may not want to open), she should discuss this concern with her client prior to circulating the draft. Eventually, the draft is ready to be sent to the other side. Under normal circumstances it will be sent to the business people on the other side of the transaction and their lawyers at the same time.

In multiparty transactions, strategic issues come into play in deciding who gets to see the contract and when. Often there is a desire for two parties to be able to agree to a contract and then present it as a *fait accompli* to other interested parties. This is based on the concern that sharing multiple drafts of a contract while it is being negotiated will be perceived by other parties as an invitation to comment. For example, a syndicated credit agreement is usually fully negotiated by the borrower, the agent and their respective counsel before it is sent to the other banks in the syndicate. To mention another example, the lender in an acquisition financing will have an interest in seeing the acquisition agreement but will usually not be given the opportunity until late in the process. In this situation, a bank and its counsel presented with a final (even signed) acquisition agreement will be reluctant to raise anything but the most important substantive points.

When the first draft is sent out to the other side, unless the drafting

lawyer's client has given final approval of the draft, it is usually sent under a cover memo stating that the draft "is subject to the client's continuing review and comment." This is absolutely essential in the case described above where the lawyer is instructed to circulate the draft without any client review. Failure to provide this warning does not stop the client from making additional comments, but makes it far less awkward for the client or its counsel to do so.

If the agreement was based on a precedent familiar to opposing counsel, it is usually appropriate to offer a blacklined version as well as a clean copy. If there is such a precedent and counsel wants to compare it to the new draft, your failure to volunteer a blackline just makes the process more difficult for your counterpart. Such tactics are not conducive to a constructive negotiating process.

§ 3:4.6 The Role of the Non-Drafting Lawyer

So you and your client have just received an agreement to review and comment on. What to do?

First, you and your client must read it. Some people start reading a contract on page one and continue to the end. Others jump around, perhaps starting with the operative provisions, then the covenants, then the representations, and so on. A particularly helpful technique is to remove the definitions section and staple it separately, referring to it as necessary. This is usually much more helpful than slogging through the definitions, which are often the first section of the agreement, without any context.

This initial read leads to a discussion of the draft with the client. More often than not, that discussion involves a page-turning session in which both lawyers and clients raise and discuss their respective points. Occasionally, the client will want a markup of her lawyer's preliminary comments before this discussion takes place. If that is the case, the lawyer will prepare a formal markup of the document with her own questions or comments. This markup should be either word processed and blacklined or prepared following the same principles as for a word processing markup. (All riders should be typed, however.) This markup can be used to raise questions or issues with the client. One advantage of getting this markup in the client's hands in advance of the page-turning meeting is that it enables the client to better understand the context of her lawyer's comments.

After the client and the lawyer go over their comments, the next step is to pass those comments along to the other side. There are two approaches to this. There can be a meeting of all parties and their lawyers (or only lawyers), where all the comments can be raised and discussed. Alternatively, a markup can be prepared and sent to the other side in anticipation of such a meeting. The second approach is almost always preferable. At a meeting where comments are being raised for the first time, resolution of the issues is less likely because the other side will not want to concede on any single point without understanding the complete package of requested changes. Delivering a markup first gives the other side an opportunity to review, consider and discuss the comments prior to a meeting. As a result, the meeting is likely to be more constructive.

If the initial meeting included clients, the lawyers will want to follow up with another session that covers the so-called legal or drafting points: the typos, the grammatical and stylistic points, the substantive points that are truly legal in nature, and points that the lawyers should be able to resolve without the clients' input. A discussion of these points with clients in the room or on the phone often results in grumpy clients.

The markup that is sent out in advance of a meeting will be prepared by the lawyer and reflect both the lawyer's and the client's comments. The same principles discussed with respect to a word processing markup apply: once again, the theme should be user-friendliness. It should be easy to follow—the other side may have problems with the *substance* of your points, but causing them to struggle to *understand* them will certainly not help. Some thoughts in this regard:

(1) Whenever possible, provide suggested language rather than just a general comment. This is particularly true where the issue is a complex one or involves any degree of subtlety. It goes back to the basic premise that the act of drafting allows the draftsperson to direct the resolution of the provision in a particular way. Of course, there is no assurance that your counterpart will accept your language, but in many cases she will either use it verbatim or use it as a basis for the change. In any event, you avoid the confusion as to the change you are requesting that which can be created if only a general comment is provided. In addition, by preparing language you will be forced to think through additional issues that

would have gone unnoticed if a more general comment had been made. Even on uncontroversial points, by providing your own language you improve the chances that the change won't be drafted in some unfavorable (or incorrect) way. Further, this engenders cooperative spirit—the draftsperson won't feel that everyone is sitting back while he does all the work.

(2) The use of typed riders is extremely important here for several reasons. First, they are *always* easier to read than handwritten inserts. Second, you can revise and edit a rider much more easily than a handwritten insert. Last, providing riders makes it very convenient for the other lawyer to adopt your language in the revision process.

(3) Be neat when doing a handwritten markup. Do it in pencil, so that any changes to the markup itself can be made neatly. Don't write insertions too close to the margin, otherwise words will get cut off in the copying or faxing process. Make sure that the copies of the markup are legible and that all riders are attached.

(4) Don't hesitate to use your markup to *explain* a point as well as to convey it. For example, if you strike out a sentence because it covers a point already made elsewhere in the agreement, *say* that in the margin or in brackets. Or, if you've provided a rider to address an issue that may not be readily apparent from the language itself, add a bracketed note at the end of the rider explaining the purpose for the language. The more you help the other side to understand your comments, the less time will be wasted *explaining* them, so that more time can be spent *discussing* them.

Most contracts are not finalized after one revision. The steps described above will be repeated each time a new draft is produced.

§ 3:5 The Lawyer as Facilitator

Under normal circumstances, it is the lawyer's job not only to draft and help his client negotiate the contract, but also to facilitate and coordinate the various requirements that must be satisfied for the con-

tract to be effective. In many cases, these are primarily responsibilities of the junior lawyer.The qualities that are necessary for a lawyer to handle these matters successfully are organization, foresight, diligence and an attention to detail.

§ 3:5.1 Representations and Warranties

It is the ultimate responsibility of the client to ensure that the representations made about it and its business are correct. However, the lawyer is often closely involved in the process of getting the representations right.

[A] Legal Issues

Certain representations and warranties are essentially statements of legal conclusions. Among these are the following representations,[2] with a description of the actions the lawyer may be asked to take to ensure their accuracy:

Representation	Action
The Company is validly existing and in good standing.	Order and review a certified certificate of incorporation and a good standing certificate for the client from the state of the Company's organization.
The Company has the corporate power and authority to execute, deliver and perform the agreement.	Order a certified certificate of incorporation from the state of the Company's organization and re view it and the Company's by-laws.
The Company has taken all neces sary corporate action to authorize its execution, delivery and perfor mance of the agreement.	Review the applicable board of directors' minutes or resolutions.

2. See section 9:2 for a more detailed discussion of these representations.

The execution, delivery and performance by the Company of the agreement doesn't conflict with its certificate of incorporation, by-laws, material agreements, laws, rules, orders, judgments or decrees.	Review the certificate of incorporation and by-laws. Review the material contracts, if feasible. (This will depend on the circumstances. Sometimes the client will have inside counsel who can provide the proper level of comfort on this. In other cases, the client may not want to incur the expense of a full-scale review.) Obtain copies of and review any available orders, decrees or judgments that may be applicable. Consider and research legal impediments to the agreement that may exist. Consult (with the client's authorization) local counsel or legal specialists if the law of other jurisdictions or some special area of the law may be relevant.

[B] Ensuring Proper Review by the Client

Even in the case of representations that don't relate to legal issues, the lawyer should think carefully about any potential issues. In the process of working generally for the client or working on the particular transaction, the lawyer may have obtained knowledge of a fact or circumstance that may need to be disclosed under a representation.

By the time that the contract is ready to be signed, the client should have carefully read and considered the representations. In the first instance, this means that the right individuals at the client have done so—that is, those people that are most likely to know what the relevant facts are. (In many cases, this will be the in-house general counsel, if there is one.) If the lawyer has any doubt that the client has properly focused on these provisions, the lawyer should sit down with the right person and walk through the representations with her.

[C] Preparing Disclosure Schedules

Many representations need to be qualified by exceptions. For example, a representation that a company is in good standing in every

state in which it does business will not be true if there is a state where the company is *not* in good standing because, for example, there is unpaid franchise tax that is being disputed. As discussed above, the lawyer can help his client uncover these exceptions. In most cases, it is also the lawyer's function to organize these exceptions and incorporate them into disclosure schedules.

Why use schedules instead of just putting the exceptions directly into the text of the representation? The latter method works fine if there are only one or two exceptions, but beyond that it's mechanically easier to use a schedule. Further, in most agreements with extensive representations, the parties expect the exceptions to be in the schedules. It is almost always best to put things where the reader will expect to see them.

Another reason for putting factual disclosures in schedules is that more often than not it is the non-drafting party who is responsible for the schedules (for example, the borrower under a credit agreement or the seller under an acquisition agreement). So the schedules are normally prepared as a separate document on the non-drafting party's (or its lawyer's) word processing system, to be attached to the agreement at the closing.

The facts that need to be incorporated into the schedules almost always have to come from the client. The lawyer, however, has several important roles in connection with the schedules:

- *Help the client understand the scope of the required disclosure. The representation that gives rise to the disclosure will be written in language that the client may need assistance to understand. For example, the scope of a representation that there is no litigation "that could reasonably be expected to have a material adverse effect" may not be immediately clear to a person who is not well versed in contract language and who therefore might be inclined to disclose more or less than is actually necessary.*

- *Act as a filter for the raw data provided by the client. The client may provide information that is more or less detailed than it needs to be or that requires some massaging before it is appropriate to disclose. For example, what if in response to a representation requiring disclosure of all capitalized leases the client produces a printout showing all of its leases, both capitalized leases and operating leases, and indicating the monthly required payments on each? It may not result in a*

false representation to attach this list as the schedule, but it would be better to pare it down to be responsive only to what the representation requires. If all the extraneous information is included, the other party may be able to argue that the representation is breached if the information regarding operating leases or monthly payments is incorrect, even if those items were not required. In any event, it is almost always a bad idea to disclose more than is necessary. A lawyer should not automatically accept information provided to him for inclusion in schedules; he should review it and convert the raw data into appropriate disclosure.

▶ *Be the keeper and processor of the schedules. The task of organizing and processing the schedules is a detail-oriented and time-consuming one. The lawyer should always volunteer to take on this assignment. When the client wants to maintain control of this process, the lawyer should keep a close eye on the schedules as they are produced, to ensure that they are in the proper format, that they are responsive to the applicable contract provisions and that they don't give rise to significant substantive points that need to be addressed in some other fashion.*[3]

It is best for all of the schedules to be prepared as a single word processing file. Any other approach makes it difficult to distribute revised drafts of the schedules. Even where parts of the relevant factual information are on another participant's word processing system, it is ultimately more efficient to consolidate all such information in one place.

Delivery of the first draft of schedules late in the process often leads to significant angst and delay, particularly when items being disclosed identify risks or issues that the parties must then address. Remember that one of the primary purposes of representations (and therefore of disclosure schedules) is to smoke out relevant facts. Once these facts come to light, they may give rise to substantive negotiations, which may in turn require that contract provisions be added or modified. It is easy to see how this process may become much more difficult if it

3. An example of the latter would be disclosure showing that all of the assets to be sold in an asset sale transaction are subject to liens securing the seller's bank borrowings. This is not a mere disclosure item; the seller will have to arrange to have the liens released at closing.

occurs at the last minute due to a late delivery of schedules. To avoid this problem, it is often helpful to start circulating drafts of the schedules even before they are finalized. This way, the parties can review what is available at an earlier time, with additional information being included in subsequent drafts.

§ 3:5.2 Covenants

A lawyer will assist her client in understanding and getting comfortable with the covenants in the contract. This is often more challenging with covenants than it is with representations. The task of getting a representation to work (except as to bringdowns) is a purely forensic one, involving the determination and disclosure of the true state of facts at the time the representation is made. Getting covenants to work involves getting your client to look into the future in order to build in necessary flexibility.

The first step in this process is to be sure that the client understands what the covenant will or won't permit it to do. Do not assume that the client understands the scope of a covenant: it is not unusual for a business person to make incorrect assumptions regarding the covenant that could result in some necessary issue not being addressed. The best approach is to engage in a dialogue with the client when reviewing the agreement together. As the lawyer comes upon covenants that are likely to produce issues, he should point them out to the client and suggest some possible points that may need to be addressed. Such a dialogue might unfold like this:

Lawyer: This is a covenant that restricts the joint venture from incurring indebtedness . . .

Client: That's okay because there won't be any bank debt at the joint venture.

Lawyer: Well, let's look at the definition of "indebtedness"—it's very broad. For example, it includes letters of credit . . .

Client: Well, we will need room to have letters of credit issued, to back up some of the joint venture's insurance obligations.

Lawyer: How much room do you need for that?

Client: Looking at our current needs, I would say about $1 million at any one time.

Lawyer: But if the Atlanta project we were talking about earlier gets off the ground, won't your insurance needs increase and require more letter of credit support?

Client: You're right, we'd better ask for $2 million.

The lawyer has helped the client understand the true nature of the restriction by getting him to focus on the defined term instead of relying on his general sense of what "indebtedness" means. The lawyer has also brought his understanding of the client's business to bear in helping to identify a future item that needed to be addressed.

Of course, while there will be many covenants that require a fair degree of focus on the part of both the lawyer and the client, there will also be many that require little attention. A skill that a good contract lawyer must develop is to be able to home in on the covenants that are likely to cause his client problems.

§ 3:5.3 Closing Conditions

The lawyer has two primary functions relating to conditions precedent: negotiating them and making sure that they are satisfied. In many cases, the clients will feel that the signing of an agreement concludes the deal, whereas in many cases there is still a mountain of paper to be produced and finalized before the transaction is closed. A key element of the negotiation of the conditions precedent is avoidance of conditions that will be difficult to satisfy. A requested condition may also be objected to on the basis that it is onerous, or expensive, or not customary, but the cardinal sin is to have the contract require something that can't be delivered; this results in the other party being given an option to close or not.

[A] Subjective Closing Conditions

A risk of non-closure arises each time that a condition is drafted to permit the other party to make a subjective determination as to whether a condition is satisfied. Examples of these are:

> Seller shall deliver a bill of sale, in form and substance satisfactory to Purchaser.
>
> Purchaser and Seller shall enter into a mutually satisfactory services agreement.
>
> No material adverse change shall have occurred with respect to Lessee's financial condition, as determined by Lessor in its sole discretion.
>
> Shareholder shall have completed its due diligence review of the business, assets, contracts and financial condition of Company, and shall be satisfied in all respects with the results thereof.

Let's examine how each of these could be reworked in order to make them more certain.

> Seller shall deliver a bill of sale, in form and substance reasonably satisfactory to Purchaser.

By the inclusion of a reasonableness standard, purchaser cannot avoid closing merely by objecting to the bill of sale; it must have a *reasonable* objection. Of course, the parties could disagree on whether a particular objection is reasonable, but as a practical matter, with a simple document such as a bill of sale, there are unlikely to be many controversial issues.

Another approach to the same problem is imposing a standard which is more objective:

> Seller shall deliver a bill of sale, in form and substance customary for transactions of this type.
>
> Seller shall deliver a bill of sale substantially in the form used by Seller in transactions of this type.

These approaches attempt to moderate the subjectivity of the condition by referring to market practice or to a party's own prior practice. Here the goal is to employ an external standard instead of a party's discretion in determining whether a condition has been satisfied.

A redraft of the second example:

> Purchaser and Seller shall enter into a services agreement substantially in the form attached as Exhibit 2.

As in the bill of sale example, this condition as originally written allowed purchaser to walk away if the services agreement was not to its liking. On the other hand, it gave the same right to seller, but for the purposes of this analysis we will assume seller's goal is to lock purchaser in as much as possible, not to have an escape hatch itself. The change above achieves that objective for seller by having the parties agree in advance to the form of services agreement. Once the form of agreement is negotiated and attached as an exhibit, purchaser may not later take the position that the terms of the agreement are not acceptable to it. Of course, the circumstances sometimes make this approach impractical, particularly when an agreement must be entered into quickly before there is time to negotiate all of the ancillary documents. In such a case, one of the approaches described above must be relied on in order to avoid a completely subjective condition.

The third example above, with two alternative redrafts:

> No material adverse change shall have occurred with respect to Lessee's financial condition, as determined by Lessor in its sole discretion.
>
> No material adverse change shall have occurred with respect to Lessee's financial condition, as determined by Lessor in its reasonable discretion.
>
> No material adverse change shall have occurred with respect to Lessee's financial condition.

The first of these gives lessor the greatest leeway, allowing it to unilaterally determine if a material adverse change has occurred. If lessor fails to close on this basis and is sued for breach by lessee on the grounds that no material adverse change existed, the judge would conclude that the agreement gave lessor complete discretion.[4]

In the second example, lessor must be reasonable in its determination. If lessor asserted that a material adverse change occurred because lessee's annual sales had declined .05%, that would be unreasonable. A decline of 15% would be a much more difficult call. A

4. All contracts are subject to an implied covenant of good faith. It is possible that a judge might find this implied covenant breached if the lessor asserted a material adverse change if indeed there were no adverse change at all.

judge presented with the issue of whether lessor's assertion that a 15% drop constituted a material adverse change would have to determine whether it was reasonable for lessor to reach this conclusion. The judge would need to examine whether a reasonable lessor would consider this fact significant in deciding whether to enter into a similar lease transaction.

In the third example, whether a material adverse change has occurred is not determined by the parties at all. It is a completely objective standard. (Unfortunately it still contains a large amount of wiggle room, because material adverse change is a flexible concept.) If the parties found themselves in court because lessor failed to close, the question for the judge would not be whether a reasonable lessor would consider it material, but whether it was *in fact* material.

The above focuses on how to make conditions less subjective. However, for the party whose satisfaction is required, the more subjective the conditions are, the better. But where both parties' performance is subject to conditions, it is difficult for a lawyer to argue that the conditions to the other party's performance should be airtight, while those required for his client's performance should be riddled with subjective escape hatches.

[B] Due Diligence Conditions

Let's take another look at the last of the initial four examples above:

> Shareholder shall have completed its due diligence review of the business, assets, contracts and financial condition of Company, and shall be satisfied in all respects with the results thereof.

The issue here is obvious: shareholder can assert that anything it finds in its review is unsatisfactory, and walk away from the transaction. A due diligence condition is by its nature subjective. A party that hasn't finished its review of necessary facts and issues by the time the contract is signed will often insist on a due diligence out. On the other hand, an open-ended due diligence condition creates an option: the party can close the deal, or not, as it chooses.

One way of handling this is the insertion of a reasonableness standard, in the same manner as discussed above. In other words, the determination that some information discovered in the due diligence process is unsatisfactory has to be made on a reasonable basis. This is

certainly helpful, although the approach is often resisted by a party who doesn't want to find itself in a dispute over what is reasonable.

Another approach is to wait to sign the agreement until the due diligence process has been satisfactorily completed. Unfortunately, this issue usually comes up where the party objecting to the due diligence condition has some business need to have the contract signed quickly. A common example is a bidder for an acquisition that must deliver a financing commitment with its bid. Often the lender providing the commitment letter will insist on a full due diligence out because it has not had time to do the level of homework that would support a sound credit decision.

There are cases, however, where the due diligence process is partly completed at the time an agreement is signed. In these cases, the due diligence condition can be modified to reflect that certain areas of diligence have been completed on a satisfactory basis:

> Shareholder shall have completed its due diligence review of the business, assets, contracts and financial condition of Company, and shall be satisfied in all respects with the results thereof, provided, however, that Shareholder has reviewed and is satisfied with all of Company's public debt indentures, employee benefit plans and employment agreements existing on the date hereof.

What if, after signing the agreement that contains the above condition, shareholder discovers that one of the debt indentures had been amended in an adverse manner in an amendment that had not been reviewed, or that there are other employee benefit plans or employment agreements that had not been available to it at the time of signing? This is the reason that a limited due diligence condition of the type above is usually accompanied by the following additional condition:

> Nothing shall have come to the attention of Shareholder in its continuing review of the business, assets, contracts and financial condition of the Company that is material and adverse to the Company and that is additional to, or different from, the information available to Shareholder on the date hereof.

[C] Third Party Deliveries

Another category of conditions precedent that may create a significant risk of non-closure are those that require a delivery or an action by a person other than the parties to the contract. Some examples of this type of condition (in increasing order of difficulty) are:

> Borrower shall have delivered certificates of insurance issued by its insurance company or insurance broker setting forth a summary of casualty insurance on its property.
>
> Mortgagor shall have received an appraisal from B&B Appraisal Company stating that the fair market value of the Property is not less than $10,000,000.
>
> Employee shall have received consent from her current employer to the termination of her existing employment agreement.

The first example is a relatively benign requirement because certificates of this type are routinely given by insurance companies and insurance brokers. All that is required here is that the certificate is delivered, not that the insurance coverage levels have to meet any particular standards. As a result, the lawyer's primary task here is to see to it that the condition is actually satisfied by the time of closing. The lawyer needs to coordinate with the client to make sure that the insurance company or broker is contacted sufficiently early so that this delivery is not a last-minute crisis.

The second condition is more troublesome. There are two issues: what if B&B Appraisal Company goes out of business or for any other reason does not deliver the appraisal? What if the appraisal comes in at less than $10,000,000? As to the first of these issues, the appropriate fix is to refer to "B&B Appraisal Company or such other appraiser as the parties reasonably agree to." The second issue is less easily resolved. Perhaps the mortgagor may be willing to accept a lower appraised value if other elements of the deal are adjusted. For example, the appraisal requirement could be reduced to $7,500,000, but the interest rate on the mortgage loan would increase in the event the appraisal comes in at less than $10,000,000. On the other hand, if a $10,000,000 valuation is an absolute necessity to the mortgagee's willingness to do the deal, the only alternatives are to sign the agreement and accept the risk of non-closure due to a low appraisal, or to delay the signing until the appraisal is completed.

The last condition is an example of a third party consent requirement. This type of condition presents the greatest risk to the party that must satisfy it. Why would the prospective employee's existing employer consent to the employee's jumping ship? The natural reaction of the employer in such a circumstance would be to say no, or to ask "what's in it for me?" Of course, there may be mitigating factors. The employer may be happy to get rid of this person, or there may be a strong personal relationship with management of the existing employer that will smooth the way.

The best way to ensure that a condition involving a third party action or consent can be satisfied is to rewrite it using one of the following standards:

> Employee shall have used its [reasonable] [best] efforts to obtain consent from her current employer to the termination of her existing employment agreement.

With this approach, the condition does not require the existing employer's consent to be delivered, it merely requires that the employee make some level of effort to obtain the consent. Regardless of which standard is employed, the condition will be satisfied so long as the employee makes the required effort, whether or not it is successful. (See section 5:2.4.)

[D] Legal Opinions

The requirement of legal opinions at closing is a topic that bears special mention. A legal opinion is a written statement of legal conclusions relating to the agreement, delivered by one party's lawyer to the other party. At first blush, a condition precedent that a legal opinion be delivered seems different from a requirement that a third party consent be delivered. After all, the lawyer whose opinion is required to be delivered is involved in the deal and has an incentive to see the transaction close. This is true, but sometimes an individual lawyer cannot be certain that the opinion required by opposing counsel will be an opinion that she, or her firm, will be willing or able to deliver.

Most law firms have a review process that must be completed before opinions bearing the firm's name may be delivered. Sometimes the opposing lawyers may disagree on the appropriate scope of the opinion. In other cases, a requested opinion can't be given because

the necessary legal conclusion can't be reached. For these reasons, a closing condition requiring the delivery of an opinion "in form and substance satisfactory" to the other party and its counsel may be incapable of being fulfilled. Therefore, whenever possible, it is advisable for the form of necessary opinion to be negotiated in advance and attached as an exhibit. In addition, completing all of the necessary due diligence prior to the time that the agreement is signed and the form of opinion is attached as an exhibit will help avoid last-minute problems. If, for example, a review of the client's contracts shows the need for a consent that may be difficult or impossible to obtain, the lawyer required to give an opinion on this issue will be embarrassed if that important fact is uncovered at the closing, rather than prior to the signing of the agreement.

One of the worst places for a lawyer to find himself is at a closing where the very last issue, the one that stands between the clients and the consummation of their business deal, relates to a legal opinion. The clients will not understand the opinion issue, will not want to understand it, and will not understand why the lawyers can't just work it out among themselves like rational business people. In order to avoid this very awkward situation, it is preferable that the lawyers attend to the negotiation of the legal opinions at an early stage of the transaction.

[E] Satisfying the Closing Conditions

After the closing conditions are negotiated, it is each lawyer's job to ensure the completion of the conditions that must be satisfied in order for his client to be entitled to performance from the other party, and also to confirm that the other party's conditions are satisfied. The mindset of some clients is that once the agreement is signed, the deal is done and the closing is just a legal technicality. A lawyer will be appreciated best by his clients at this stage of the transaction by organizing a closing that is smooth and uninteresting. This is achieved by foresight, organization and attention to detail. The first step in this process should be the creation of a "closing checklist," a document that lists all of the transaction documents and closing conditions, who is responsible for them and their current status. This checklist creates a roadmap to the closing and is typically shared by all of the lawyers working on the deal. The process of assigning responsibility

for each closing item is extremely important; without this, participants in the transaction may each assume that another is taking care of something, with the result that that item falls through the cracks.

The lawyers on both sides of the transaction should confer regularly about the status of the closing conditions, using the closing checklist as a guide. At the closing the checklist is an invaluable tool. It serves as a guide to literally "check off" each closing document as it is finalized.

Certain closing conditions are very standard. In many transactions involving entities as opposed to natural persons, documents relating to the entity's existence and power are required. For example, agreements to which a corporation is a party may require the following closing documents:

- Certificate of incorporation, certified by the secretary of state of the jurisdiction where the corporation is incorporated.
- By-laws, certified as accurate by the corporate secretary.
- Good standing certificate issued by the secretary of state of the state of incorporation, and certificates from other states indicating that the corporation is qualified to do business in such states.
- Resolutions of the corporation's board of directors authorizing the transaction, certified by the corporate secretary.
- Certificate of the corporate secretary certifying the signatures and titles of the officers who are signing the transaction documents.

It is almost always the responsibility of the lawyer (usually the junior lawyer) to prepare and/or gather these and similar documents. Although a review of these items doesn't often yield surprises, it can happen, and any issues are best dealt with early. For example, what if a company's certificate of incorporation requires a special shareholder vote for the company to enter into the particular transaction? Or, what if the by-laws require the signatures of specified officers to enter into certain contracts? Such issues may be easy to address if discovered early enough.

As discussed above, subjective conditions and conditions that require the participation of third parties are two potential closing con-

dition pitfalls. The lawyer should make it a priority to get these conditions satisfied as early as possible prior to the closing. For example, if there is a condition that the other party has to receive a satisfactory environmental report, the lawyer should make sure that the report is being prepared, that once it is prepared it is looked at promptly, and that the party reviewing the report is satisfied with it. Never passively wait until the scheduled closing date to learn that a process like this hasn't been completed.

[F] Closing Certificates

A certificate is a document signed by an individual, either in his individual capacity or as an officer of one of the parties to the contract, in which statements of fact are made.

A certificate that is often required as a closing condition is a certificate executed by a senior officer of one of the parties that states that all of the representations made by the party in the contract are true and correct. What is the benefit of receiving this certificate? After all, if a representation is untrue, there will be remedies available under the contract anyway, so what additional protection does delivery of the certificate add? The rationale is that requiring an individual (even in his capacity as an officer of an entity) to sign a formal-looking document will result in that individual making a more diligent inquiry into the truth of the matters certified to, than he would in the context of signing a larger document solely on behalf of the entity.