ranties centuries ago to tackle the common law's inflexibility. At the time, no contract-related writ permitted a plaintiff to sue the other side if it had not performed its obligations under the contract. The ever-inventive common law lawyers solved the problem by transforming nonperformance of a contract into a tort—an action of deceit that required reliance. Over time, a suit for breach of warranty became an action of *assumpsit,* a contract action.[11] Nonetheless, through the centuries the contours of the cause of action remained uncertain and controversial. Warranty's birth as a tort haunted it.

American scholars extensively debated and analyzed warranties concerning the sale of goods during much of the twentieth century.[12] Codification of the law of warranty concerning the sale of goods in the Uniform Sales Act, and subsequently in the Uniform Commercial Code, did little to quell the debate about whether reliance was a required element of a cause of action for breach of warranty.[13] Outside the context of the sale of goods, academic writing about warranties appears nonexistent, despite the use of warranties in all kinds of commercial agreements (e.g., leases, licenses, and acquisition, credit, settlement, and entertainment agreements).[14]

The evolution of warranties outside the U.C.C. context pivots on the 1990 case of *CBS Inc. v. Ziff-Davis Publishing Company*. In that case, New York's highest court held unequivocally that a warranty was contractual, and that reliance was not an element in a cause of action for its breach.[15] (The Second Circuit has qualified the *CBS* decision by holding that a party waives its cause of action for breach of warranty if the party knows of a warranty's falsity and does not explicitly preserve its rights.[16] Nonetheless, the breadth of the *CBS* decision leaves open whether New York's Court of Appeals would concur with the Second Circuit.[17])

11. *See generally* James B. Ames, *History of Assumpsit,* 2 Harv. L. Rev. 1 (1888).

12. *See e.g.* James J. White, *Freeing the Tortious Soul of Express Warranty Law,* 72 Tul. L. Rev. 2089 (June 1998); George Gleason Bogert, *Express Warranties in Sale of Goods,* 33 Yale L. J. 14 (1923); Samuel Williston, *What Constitutes an Express Warranty in the Law of Sales?,* 21 Harv. L. Rev. 555 (1908); *see also* Thomas Williams Saunders, *Warranties and Representations: Fraudulent Representations on the Sale of Personal Chattels,* 10 W. Jurist 586 (1876) (discussing then contemporary English cases).

13. *See generally* White, *supra* n. 12, at 2094-2098; Sidney Kwestel, *Freedom from Reliance: A Contract Approach to Express Warranty,* 20 Suffolk U. L. Rev. 959 (Winter 1992).

14. The author found no mid- to late-20th century scholarly writing on warranties outside the U.C.C. context before the *CBS* decision. But proving the negative is, of course, problematic. After *CBS*, scholarly and practitioner writing on reliance's role as an element in a cause of action for breach of warranty outside the U.C.C. context blossomed. *See e.g.* Bill Payne, *Representations, Reliance & Remedies: The Legacy of Hendricks v. Callahan*, 62 Bench & Bar Minn. 30 (Sept. 2005); Robert J. Johannes & Thomas A. Simonis, *Buyer's Pre-Closing Knowledge of Seller's Breach of Warranty,* 75 Wis. Law. 18 (July 2002); Sidney Kwestel, *Express Warranty as Contractual—The Need for a Clear Approach,* 53 Mercer L. Rev. 557 (Winter 2002); Matthew J. Duchemin, *Whether Reliance on the Warranty is Required in a Common Law Action for Breach of an Express Warranty?,* 82 Marq. L. Rev. 689 (Spring 1999); Frank J. Wozniak, *Purchaser's Disbelief in, or Nonreliance upon, Express Warranties Made by Seller in Contract for Sale of Business as Precluding Action for Breach of Express Warranties,* 7 A.L.R.5th 841 (1992).

15. *CBS Inc. v. Ziff-Davis Publg. Co.*, *supra* n. 8.

16. *See Galli v. Metz*, 973 F.2d 145, 151 (2d Cir. 1992) (holding that where a buyer closes with full knowledge that the facts disclosed by the seller are not as warranted, the buyer may not sue on the breach of warranty, unless it expressly preserves the right to do so); *Rogath v. Siebenmann*, 129 F.3d 261, 264-265 (2d Cir. 1997) (requiring the express preservation of rights when the seller is the source of knowledge of the warranties' falsity).

17. *CBS Inc. v. Ziff-Davis Publg. Co.*, *supra* n. 8, at 454, *505-506, **1002 ("We see no reason why Ziff-Davis should be absolved from its warranty obligations under these circumstances. A holding that it should because CBS questioned the truth of the facts warranted would have the effect of depriving the express warranties of their only value to CBS—i.e., as continuing promises by Ziff-Davis to indemnify CBS if the facts warranted proved to be untrue (*see Metropolitan Coal Co. v. Howard*, *supra,* at 784). . . . Ironically, if Ziff-Davis's position were adopted, it would have succeeded in pressing CBS to close despite CBS's misgivings and, at the same time, would have succeeded in *defeating* CBS's breach of warranties action because CBS harbored these *identical misgivings*.") (emphasis in the original).

Since the seminal *CBS* decision, the majority of courts addressing the issue of reliance have agreed with the *CBS* court and held that reliance is not an element of a cause of action for breach of warranty.[18] In addition, courts have roundly criticized the small number of decisions holding to the contrary.[19] Thus the modern view is that warranty has shed its tort origins[20] and is a promise like any other in a contract.[21] This book goes forth on that basis. (Because state Law governs this issue, be sure you know the law in the state whose law governs the transaction.) Chapter 9 discusses the consequences of this now bright-line distinction between representations and warranties.

With this context, let's return to our house purchase hypothetical. As stated previously, Bob would not have a cause of action for misrepresentation with respect to the roof's age because his contractor had told him that it was older than Sally represented. Nonetheless, because Sally also warranted the roof's age, Bob would be able to sue for a breach of warranty post-closing—so long as he told Sally when they were closing that he was reserving his right to make a claim.[22]

Deal lawyers almost always negotiate for both representations and warranties.[23] For example, in the house purchase agreement between Sally and Bob, the representations and warranties article would be introduced with the following language:

> **The Seller *represents and warrants* to the Buyer as follows:**

By virtue of this one line, every statement in the sections that followed would be both a representation and a warranty.

In the purchase agreement between Sally and Bob, Sally's representations and warranties would resemble the following:

18. *See Grupo Condumex, S.A. v. SPX Corp.*, 2008 WL 4372678 at *4 (No. 3:99CV7316, N.D. Ohio, Sept. 19, 2008) ("Declining to impose an obligation on a party claiming damages for breach of warranty to prove reliance on the warranty conforms to the current views of a majority of other jurisdictions. *Mowbray v. Waste Mgmt. Holdings, Inc.*, 189 F.R.D. 194, 200 (D. Mass.); *see Power Soak Sys. v. EMCO Holdings, Inc.*, 482 F. Supp. 2d 1125, 1134 (W.D. Mo. 2007) ('The modern trend is that a buyer need not rely on a seller's express warranty in order to recover for the seller's subsequent breach of the express warranty.'); *Southern Broadcast Group, LLC v. GEM Broadcasting, Inc.*, 145 F. Supp. 2d 1316, 1321-1324 (M.D. Fla. 2001) (citing cases applying Illinois, Pennsylvania, Connecticut, Montana, New York, New Mexico, Indiana, and Massachusetts law); *Norcold Inc. v. Gateway Supply Co.*, 154 Ohio App. 3d 594, 601, 798 N.E.2d 618 (2003) (also recognizing that a 'decisive majority of courts' have held that reliance is not an element for claim of breach of warranty).")

19. Cases holding to the contrary: *Hendricks v. Callahan*, 972 F.2d 190 (8th Cir. 1992) (applying Minnesota law); *Land v. Roper Corp.*, 531 F.2d 445 (10th Cir. 1976) (applying Kansas law); *Middleby Corp. v. Hussman*, 1992 WL 220922 (N.D. Ill. 1992) (applying Delaware law); *Kazerouni v. De Satnick*, 228 Cal. App. 3d 871 (2d Dist. 1991).

Cases criticizing *Hendricks* and *Land*: *Giuffrida v. Am. Family Brands, Inc.*, 1998 WL 196402 at *4 (E.D. Pa. Apr. 23, 1998); *S. Broad. Group, LLC v. GEM Broad., Inc.*, 145 F. Supp. 2d 1316, 1321 (M.D. Fla. 2001); *Mowbray v. Waste Mgt. Holdings, Inc.*, 189 F.R.D. 194, 200 (D. Mass. 1999).

Case criticizing *Middleby*: *Vigertone AG Prods., Inc. v. AG Prods. Inc.*, 316 F.3d 641, 649 (7th Cir. 2002) (Judge Posner).

Case distinguishing *Kazerouni*: *Telephia v. Cuppy*, 411 F. Supp. 2d 1178 (N.D. Cal. 2006).

20. *CBS Inc. v. Ziff-Davis Publg. Co.*, *supra* n. 8, at 453, 503, 1001 ("This view of 'reliance'—i.e., as requiring no more than reliance on the express warranty as being a part of the bargain between the parties—reflects the prevailing perception of an action for breach of express warranty as one that is no longer grounded in tort, but essentially in contract."); *see also Ainger v. Mich. Gen. Corp.*, 476 F. Supp. 1209, 1224-1225 (S.D.N.Y. 1979), *aff'd,* 632 F.2d 1025 (2d Cir. 1980) ("Transporting tort principles into contract law seems analytically unsound.").

21. *Glacier Gen. Assur. Co. v. Cas. Indem. Exch.*, 435 F. Supp. 855, 860 (D. Mont. 1977) ("The warranty is as much a part of the contract as any other part, and the right to damages on the breach depends on nothing more than the breach of warranty.").

22. *See supra* nn. 16 and 17 and accompanying text.

23. Chapter 9 discusses situations when it might be appropriate to ask for just warranties.

A condition is not a condition to the making of a covenant. Instead, a condition is a state of facts that must exist before a party must perform the obligation that flows from a covenant.

Although many lawyers refer to a condition as a condition precedent, the *Restatement (Second) of Contracts* has eliminated the use of that term.[3] Previously, a condition was labeled either a **condition precedent** or a **condition subsequent**. While a **condition precedent** was defined as a state of facts that had to exist before there was an obligation to perform, a **condition subsequent** was a state of facts that took away a preexisting obligation.[4] As a lawyer could draft most provisions as either a condition precedent or a condition subsequent, distinguishing between the conditions was problematic. The difference, however, remained important because the type of condition determined which party had the evidentiary burden of proving the condition. The *Restatement* has recharacterized the condition subsequent as the discharge of an obligation.[5] So now, conditions precedent are referred to simply as conditions.[6]

In the contract between Bob and Sally, the condition to the obligation and the obligation to perform might look something like the following:

> If the Buyer obtains a mortgage, then the Buyer shall buy [is obligated to buy] the House.

Obtaining the mortgage triggers Bob's obligation to purchase.

The condition to an obligation and the obligation need not be in the same sentence. They can be in different sections of the contract. But for every condition to an obligation, the contract must include an obligation. They are a matched pair.

To decide whether a condition is the appropriate contract concept, determine if a relationship exists between two events and whether one must precede the other temporally. Try to fit the fact pattern into an *if/then* formulation. *If* this happens, *then* and only then is a party obligated to perform. If you can do that, draft a condition.

When creating an if/then statement, the *then* clause should state who has the obligation to perform.

Correct

> **Mortgage**. If the Buyer obtains a mortgage, the Buyer shall [is obligated to] purchase the House on the Closing Date.

Do not craft the sentence so that it states what happens if the condition is not satisfied.

Wrong

> **Mortgage**. If the Buyer does not obtain a mortgage, the Buyer is not obligated to purchase the House on the Closing Date.

3. *Restatement (Second) of Contracts* § 224, Reporter's Note.
4. *Restatement of Contracts* § 250 (1932).
5. *Restatement (Second) of Contracts* § 224, Reporter's Note.
6. That said, many practitioners continue to use the argot they have always used: *condition precedent.*

This formulation states the common law consequences of the failure to satisfy a condition, not the condition to an obligation and the obligation to be performed if the condition is satisfied. When you find a condition drafted in the negative, restructure it so that the *then* clause states that a party has an obligation to perform. The revised formulation clarifies who has an obligation and under what circumstances it is triggered. It will also facilitate the proper drafting of the contract provision.

Because a right is the flip side of a covenant,[7] parties can provide for a condition to the exercise of a right. Here is the same business term drafted first as a condition to an obligation, along with the obligation, and then as a condition to a right, along with the right.

Version 1

> **Painting of Bedroom**. If the Seller paints the bedroom, the Buyer shall pay an additional $1,000 in purchase price.

Version 2

> **Painting of Bedroom**. If the Seller paints the bedroom, the Seller is entitled to an increase in purchase price of $1,000.

Whether the language in the first version or the second is used, the result remains the same: no additional payment unless the bedroom is painted. Better drafting is to state the condition to the obligation. If the provision containing the right were challenged, a brief would need an extra section to clarify the relationship between covenants and rights. (First, how an entitlement (a right) is the flip side of a covenant and, second, why the contract provision does not even mention the party who has the obligation to perform.)

4.2.2 ONGOING CONDITIONS AND WALK-AWAY CONDITIONS

Conditions can be divided into two subcategories, **walk-away conditions** and **ongoing conditions.** A condition's category depends on the type of obligation that must be performed if the condition is satisfied. This book uses the terms **ongoing conditions** and **walk-away conditions** as a pedagogical aid; they are not technical contract law terms.

- A **walk-away condition** is a condition that must be satisfied before a party is obligated to perform its subject matter performance obligation.
- An **ongoing condition** is a condition that must be satisfied before a party is obligated to perform an obligation that *is not* a subject matter performance obligation.

As Sections 5.4 and 8.2 explain in more depth, the subject matter performance provisions, generally speaking, are the covenants in which the parties promise to perform the main subject matter of the contract. Therefore, for example, in an acquisition agreement, where the main subject matter of the contract is the purchase and sale of the business, the subject matter performance provisions are the parties' reciprocal promises to buy and sell that business. Similarly, in a lease where the main subject matter of the contract is the rental of specific premises, the subject matter perfor-

7. See § 3.4.

ment in Document 2, Chapter 32. It is organized almost wholly by subject matter. Only the parties' representations and warranties are set out by contract concept and they are towards the end of that agreement, reflecting their relative lack of importance.

5.7 ENDGAME PROVISIONS

The **endgame provisions** are additional substantive business provisions, but are sufficiently important to warrant a brief discussion devoted just to them. These provisions generally are the next-to-last provisions of a contract. They state the business terms that govern the end of the parties' contractual relationship. They require a drafter to determine the different ways that a contract can end and how the contract will deal with each of the scenarios.

Contracts can end either happily or unhappily. The joint venture can be successfully concluded, or the borrower can fail to pay principal when due. In either event, the contract must deal with the consequences of the end of the contract. If a contract ends happily, the endgame provisions will set out any final payments that need to be made or state any covenants that survive the termination of the relationship. For example, an employment agreement might include a confidentiality covenant that continues past the end of the term of the contract. If a contract ends unhappily, the endgame provisions will state what constitutes a default and the agreed-on remedies. As these provisions invariably involve money, they are often hotly negotiated.

Endgame provisions are often drafted as conditions to an obligation to perform and the statement of the obligation, or conditions to discretionary authority and the statement of the discretionary authority. Occasionally, they are drafted as conditions to a right and a statement of the right.

Example 1

Release of Collateral. After the Borrower has paid all of the outstanding principal and accrued interest, the Bank shall sign any documents necessary to release the Collateral. *(Condition to an obligation and the obligation.)*

Example 2

Late Submission of Manuscript. If the Author does not submit his manuscript before November 1, 20XX, the publisher may refuse to publish the Book. *(Condition to discretionary authority and the discretionary authority.)*

Example 3

Return of Deposit. If the Tenant does not return the Premises in broom-clean condition, the Landlord is entitled to retain the amount of the Deposit equal to the cost of appropriately cleaning the Premises.[5] *(Condition to a right and the right.)*

5. See Chapter 10, Guideline 3 and § 12.1.2, pp. 176-178, for explanations of why a *right* is appropriate here rather than *discretionary authority*.

5.8 GENERAL PROVISIONS

The final provisions of an agreement are the **general provisions**, often referred to as the **boilerplate provisions**. These provisions tell the parties how to govern their relationship and administer the contract. Classic general provisions include notice, governing law, forum selection, anti-assignment, merger, waiver of the right to a jury trial, and severability provisions.

The phrase *boilerplate provisions* sometimes misleads drafters because the phrase suggests that the provisions are standardized and in no need of tailoring. Treating these provisions this way courts disaster. Each of these provisions raises important business and legal issues that you must address.

Some general provisions are covenants, while others are declarations.

Example 1

Assignment and Delegation. The Tenant shall not assign its rights or delegate its performance under this Lease to any person. *(A covenant.)*

Example 2

Successors and Assigns. This Agreement binds and benefits the parties and their respective permitted successors and assigns. *(A declaration.)*

5.9 SIGNATURE LINES

A contract concludes, of course, with the parties' **signatures**. (Although signatures are not required to create a contract, they are good to have.) While generally both parties sign a contract because both make promises, in some contracts, such as a guaranty, only one party makes promises. In that case, only that party signs.

5.10 SCHEDULES AND EXHIBITS

5.10.1 INTRODUCTION

Schedules and exhibits are additional materials not within the body of a contract but are nonetheless part of a contract. Although some drafters use the terms *schedules* and *exhibits* interchangeably, they have different purposes.

Schedules and exhibits generally gain their status as part of an agreement by being referred to in the agreement or in the interpretive section of the definition article. Under the common law, if the reference is specific enough, then an explicit incorporation by reference is unnecessary.[6] That said, including them within the defi-

6. *See United Cal. Bank v. Prudential Ins. Co. of Am.*, 681 P.2d 390, 420 (Ariz. App.1983) ("While it is not necessary that a contract state specifically that another writing is 'incorporated by this reference herein,' the context in which the reference is made must make clear that the writing is part of the contract."); *see also New Park Assoc., LLC v. Blardo*, 906 A.2d 720, 725 (Conn. App. 2006) (stating that "the language of the contract clearly and unambiguously refers to A205 as part of the contract."); *see CJS Contracts* § 402, Separate writings—Incorporation by reference (Westlaw, database updated June 2013) ("A reference to another document must be clear and unequivocal, and the terms of the incorporated document must be known or easily available to the parties. . . . [A] mere reference to another document is not sufficient to incorporate that other document into a contract; the writing to which reference is made must be described

Although some drafters precede the first party's name with *by and between*, the words *by and* are superfluous, and you should omit them.

Some lawyers use *between* if a contract has two parties and *among* if it has three or more. This is wrong. *Between* is correct whenever two or more parties are in a direct, reciprocal relationship with each other. In contrast, *among* should be used to express a less direct relationship with a group.[7]

Consider the example of a stockholders' agreement whose parties are the seven stockholders and the corporation. In this instance, an agreement exists between each stockholder and each of the other stockholders and between each stockholder and the corporation. Accordingly, *between* is the correct preposition to use in the preamble. Distinguish this example from the following: *The Clean Air Act is among the environmental laws that have been enacted.* Here, the laws do not have a direct, reciprocal relationship with each other. Instead, they are members of a group. Thus, *among* is correct.

If you intend to use *between* in all instances in a preamble, beware. You may have an uphill battle convincing your colleagues that you are right. The improper use of *among* in this context is deeply ingrained. But, keep in mind that using *between* or *among* in the preamble does not affect a contract's substance.[8] Therefore, do not waste negotiating capital on this point.

6.2.3.1 Identifying the Parties

When drafting the preamble, take the time to be sure that you properly identify the parties. Using the wrong name may, at a minimum, start a litigation to determine who the correct party to the contract is. To ascertain an entity's name, check its organizational document—for example, its certificate of incorporation. That will give you the entity's legal name, including such details as whether a comma precedes *Inc.* If the party is an individual, confirm that you have that person's full legal name, rather than a nickname or professional name.[9] Some drafters put the parties' names in all capital letters, but this is unnecessary; it is stylistic.

> *Drafting tip:* Draft the preamble and signature lines at the same time, so you focus in both these critical places on the parties' names.

After an entity's name, state what type of entity it is, along with its jurisdiction of organization (together, its **organizational identity**). Some drafters omit this information, believing it to be inappropriate in a preamble. That may be correct in the

7. *The Oxford English Dictionary* 154-155 (2d ed., Clarendon Press Oxford 1989); *see also* H. W. Fowler, *A Dictionary of Modern English Usage* 57 (Sir Ernest Gowers ed., 2d ed., Oxford U. Press 1965).

In New York City, lawyers used to circulate a Cleary Gottlieb newsletter from 1981. (The author is voluntarily dating herself and expects readers to be kind.) In it, one of the firm's lawyers argues fervently in favor of the use of *between* in all instances in a preamble, regardless of the number of parties. *See* Andrew Kull, *Between You, Me and the Gatepost* in *Cleargolaw News* vol. XXIII, No. 4 (Mar. 19, 1981) (copy on file with the author). Serendipitously, 30 years later, Andrew Kull was Professor Kull, my colleague at Boston University School of Law.

8. The choice between these terms can matter in a contract's substantive provisions, so make sure you understand when each should be used.

9. Some women use their given surname for professional purposes, but their married name for legal purposes, such as passports and drivers' licenses.

context of consumer agreements being drafted in plain English. However, in the context of sophisticated parties entering into a complex commercial agreement, other concerns take priority.

Specifically, the jurisdiction of organization may be necessary to identify an entity and to prevent confusion as to which entity is a party to the contract. Although no two entities organized in the same state may have the same name, entities organized in different states may have the same name. Indeed, some holding companies intentionally give their subsidiaries the same name so that they have the same public persona.

For example, ABC Inc., a holding company incorporated in Delaware, may have 49 subsidiaries, each of which is named ABC Inc., and each of which is incorporated in a different state. If the preamble lists ABC Inc. as a party, but omits its state of incorporation, a nonparty might not know which ABC Inc. is the party to the agreement. Including an entity's organizational identity clarifies any ambiguity. Here are two examples of an entity's name followed by its organizational identity.

Example 1

Internet Inc., a Delaware corporation,

Example 2

Colossal Construction LP, a New York limited partnership,

Note that a comma precedes and follows the organizational identity. Grammar dictates this punctuation because the organizational identity is an **appositive**: a word or phrase following a noun that further describes the noun. Note also that neither *corporation* nor *limited partnership* is capitalized. Capitalize these terms only if they are part of an entity's name.

Wrong

Hong Corporation, a California Corporation,

Correct

Hong Corporation, a California corporation,

In addition, avoid the old-fashioned, elongated version of an entity's organizational identity.

Wrong

Internet Inc., a corporation organized under the laws of the State of Delaware,

Instead, truncate the appositive as in the previous examples.

Correct

Internet Inc., a Delaware corporation,

defined terms with the same definitions, the parties use an appendix, whose defined terms are incorporated into each agreement.

So, what do you do if you are a junior lawyer and the designated drafter? The real world answer is that you follow the precedent you are given or the style of the person for whom you are working. You should be a chameleon until you are in charge. Then, you can decide.

On balance, this author believes that, in most instances, definitions should be placed in a separate section at the beginning of the contract—where they are easy to find and hard not to trip over (making it ever so much more likely that readers will give them the attention they deserve). Readers who wish to begin with the action sections, or any other section, may easily do so by obtaining the appropriate page number from the contract's table of contents.

There are some exceptions to this general rule. In the appropriate transaction, defining the terms in an appendix or other stand-alone document is a viable option. In addition, it may make sense to define all the terms in context if an agreement is short, informal, or includes only a few definitions.

Even if a contract includes a definitions section, it is appropriate to define a particular term in context in three instances.

- First, when the words of a provision cannot be easily reordered to turn them into an independent definition and defined term.
- Second, when a defined term is used multiple times, but in only one section.[11]
- Third, when you use a defined term in the monetary provisions and the defined term and its definition can be placed in a subsection by themselves.[12] By isolating the definition, the risk of ambiguity is reduced. In addition, it facilitates the reading of some of the agreement's more sophisticated provisions.

7.5 GUIDELINES FOR DRAFTING DEFINITIONS AND DEFINED TERMS

7.5.1 GENERAL GUIDELINES

No hard-and-fast rules govern when definitions should be drafted. If you use a precedent to draft the agreement, you will begin your draft with some definitions that probably work perfectly well—that is one of the benefits of using a precedent. (Of course, you can only be sure that no change is required by reviewing each instance in which the defined term is used.) Other definitions in the precedent will need to be tailored to the specific transaction. For example, in a contract for the sale of real property, the definition of *Premises* will need to be changed (obviously) so that it refers to the property being sold in that transaction. Finally, you will be able to craft some definitions only in the middle of the drafting process when you discover that you have a new concept (the definition) for which you need a new defined term.

Before finalizing a defined term and its definition, check every use of it. Sometimes a definition that works perfectly in three provisions does not work in the fourth. The computer is a terrific tool for this task. Most word-processing applications can search a document for specific words. This automates the task, making it much easier to complete. If you subsequently decide to change a definition, repeat the search to make sure that each provision still makes sense with the new definition.

11. See § 7.5.3, Guideline 1.
12. See Chapter 32, Document 4, The Action Sections of an Asset Purchase Agreement, § 2.2(a)(ii).

7.5.2 SPECIFIC GUIDELINES: DEFINING TERMS IN THE DEFINITIONS SECTION OR ARTICLE

Here are guidelines for drafting definitions and defined terms in a definitions section or article.

1. *Introduce the definitions and their defined terms with words to the following effect:*

> **Definitions and Defined Terms.** Each term defined in the preamble and the recitals of this Agreement has its assigned meaning, and each of the following terms has the meaning assigned to it:

If no terms are defined in the recitals, do not refer to the recitals in this introductory language. Many drafters continue to use the term recitals although the information is contained in the *Background or an untitled paragraph.* The better practice is to use the term/title that preceded the recitals, if any. If there was no title, you can refer to the *preceding introductory paragraph.*

2. *Do not create a defined term unless you will use it more than once, and once you create it, use it each time the definition is appropriate.* Despite the preceding sentence, you may use a defined term only once if its use will enhance a provision's readability. Specifically, sometimes a concept is so complicated that putting it in the middle of a provision makes the provision difficult to understand. If the defined term sufficiently encapsulates the concept, using it in the provision may permit a reader to understand better an otherwise thorny provision. If you do this, break the provision down into two subsections. Put the defined term and its definition in the first subsection and the substantive provision in the second.[13] Drafters sometimes take this approach in credit agreements when stating complex accounting concepts.[14]

3. *Create only one defined term for each definition, and use it exclusively.*

4. *List the defined terms alphabetically.* Including subsection referents, such as (a), (b), or (c), is unnecessary but not wrong. Getting your word-processing program to stop its automatic lettering is not worth the trouble.

5. *Include all terms defined in the agreement in the list of defined terms, other than terms defined in the preamble or the recitals.* These latter terms are already incorporated by reference in the language Guideline 1 suggests. If you define a term in context,[15] the alphabetical listing should cross-reference the definition's location.

> **"Rent"** has the meaning assigned to it in Section 2.2.
>
> *or*
>
> **"Rent"** is defined in Section 2.2.

6. *When defining a term, capitalize the first letter of each word. Put the entire defined term in bold and surround it with quotation marks:*

> **"Mechanical Failure"**

13. See § 7.5.3, Guideline 1, for an example.
14. For an example, see § 22.3.3, text accompanying n. 10.
15. See § 7.5.3.

Consider also whether any payment should be accelerated or delayed. Loan agreements often require mandatory prepayments of principal if the borrower sells equity securities, borrows more money, or sells substantially all of its assets.

8. *State **how** a party is to pay money: personal check, company check, cashier's check, certified check, or immediately available funds.*

> **Rent**. With respect to each month of the Term, the Tenant shall pay the Rent to the Landlord *by certified check* no later than the fifth day of that month.

The form of payment determines when a recipient has access to the money and reflects an allocation of risk between the parties. Some forms of payment are more risky for a recipient than others. The most risky are personal checks and company checks. When a party pays by check, the recipient does not have immediate access to the funds. It must first deposit the check at its bank, and that bank must (technically) receive payment from the paying party's bank. The delay that this process entails creates a credit risk: The paying party might not have money in its account at the time payment is required. Thus, even if the recipient has performed, it might not get paid. Despite this risk, many recipients are willing to accept a personal or company check. For example, Internet service providers, telephone companies, and electric utilities all accept their customer's personal checks—although most would prefer an online payment.

Less risky for a payee are cashier's checks (also known as bank checks) and certified checks. A **cashier's check** is a check that a bank issues from its own account. It is the bank's promise to pay the recipient.[8] (The paying party applies to its bank for a cashier's check, at which time the bank takes the money from that party's account and issues its own check payable to the order of the recipient.) Therefore, when a recipient accepts a cashier's check as payment, it no longer takes a risk as to the paying party's creditworthiness. Instead, its credit risk is the bank's creditworthiness. Although the recipient's credit risk is significantly reduced, it still does not have access to the funds until the business day after the banking day on which the cashier's check was deposited.[9] In addition, the check is subject to final clearing and reversal if it is dishonored because of fraud or some other issue.

A **certified check** is a check as to which a bank has set aside sufficient funds from the paying party's account to ensure full payment of the check. The bank *certifies* the check by having an authorized employee sign the check.[10] Again, while the recipient has reduced its credit risk, the funds are not available until the business day after the banking day on which the certified check was deposited.[11] In addition, the bank can take back its payment if it discovers that the check was fraudulently issued.

Parties often use cashier's checks or certified checks when the parties know the payment amount several days before the transaction, the amount is relatively large, and the recipient wants to reduce its credit risk. Car dealers often insist on one of these forms of payment.

In complex, sophisticated transactions with significant sums at risk, many recipients refuse to take any risk of nonpayment and, in addition, want immediate access

8. 12 C.F.R. § 229.2(i) (2006).
9. 12 C.F.R. § 229.10(c)(v) (2003).
10. 12 C.F.R. § 229.2(j) (2006).
11. 12 C.F.R. § 229.10(c)(v) (2003).

to the money for investment or other purposes. In these transactions, the paying party can **wire transfer** immediately available funds from its bank account to the recipient's.[12] The recipient need not make a deposit because the wire transfer accomplishes that, and the funds do not need to clear because the funds transferred were immediately available funds. Although wire transfers can be made through different systems,[13] generally the parties use a system that the Federal Reserve System maintains.[14] Parties speak colloquially of a **Fed funds** transfer.

If a wire transfer involves multinational parties or parties located in different cities, determine where the funds are to be sent and the currency for payment. Are funds being transferred to an account in New York City, Detroit, or Tokyo? Funds immediately available in New York City are not immediately available in Tokyo because of the difference in time zones. An obligation to pay by a Fed funds wire transfer is generally along the following lines:

> **Payment of Purchase Price**. The Buyer shall pay the Seller the Purchase Price by wire transfer of [immediately available funds] [funds immediately available in Chicago] [immediately available funds in pound sterling]. The Seller shall notify the Buyer of the bank account into which the funds are to be transferred no later than two business days before the Closing Date.

Some drafters provide that a paying party must pay the consideration in *cash*. Do not do this. **Cash** is currency (bills and coins), and it is most unlikely that the parties intend the paying party to arrive with bushels of dollar bills. Although some courts have interpreted *cash* to mean immediately available funds,[15] other courts have held that *cash* means currency.[16] While using the word *cash* is unlikely to cause a problem, when drafting, say what you mean.

9. *If money is payable for more than one reason, the terms for each payment should conform to this section's guidelines.* For example, if a company is obligated to pay an executive both a salary and a bonus, create separate payment sections for each payment, and then in each section, state the appropriate amount, when the payment is due, etc. Treating the two types of payments separately will help you analyze the possibly different business issues associated with each of the payments (e.g.: Under what circumstances is the bonus paid? Is it paid if the company terminates the executive for cause?).

10. *If payment is based on a formula, state the formula accurately.* While a formula may appear simple at first, it often requires sophisticated drafting, especially if tax or accounting issues are implicated.[17]

12. 12 C.F.R. § 229.2(ll) (WL current through June 7, 2012) ("Wire transfer means an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary on receipt or on a day stated in the order, that is transmitted by electronic or other means through Fedwire, the Clearing House Interbank Payments System, other similar network, between banks, or on the books of a bank.").
13. *Id.*
14. *See generally Fedwire Funds Servs.*, http://www.federalreserve.gov/paymentsystems/fedfunds_about.htm (accessed June 16, 2013).
15. *Upchurch v. Chaney*, 635 S.E.2d 124, 125 (Ga. 2006) (holding that in context of a judicial sale cash meant immediately available funds).
16. *Nance v. Schoonover*, 521 P.2d 896, 897 (Utah 1974) (holding that parties intended cash to mean currency).
17. See Chapters 22 and 25, specifically § 25.2.6.

notify [*what*] the Manufacturer [*who*] of its decision by telephone [*how*] no later than three business days after the date of its receipt of the Item [*when*] for approval.

Example 2

Delivery of Disputed Amount. No later than five days after its receipt of the Release Notice [*when—Should it be later or sooner?*], the Escrow Agent [*who*] shall deliver [*to whom?*] a certified check [*how—Would a wire transfer be better?*] in an amount equal to the Disputed Amount [*how much?*], payable to the order of the party set forth in the Release Notice.

Example 3

Condition of Premises at End of Term. The Tenant [*who*] shall leave the Premises broom clean [*what—Is this the proper standard if representing the Landlord?*] when it vacates the Premises at the end of the Term [*when and why—What if the Tenant leaves earlier?*].

When analyzing the substance of a covenant, be wary if it asks your client to promise something that your client cannot control. This is a high-risk covenant because an outside event or third party controls whether your client breaches it. For example, imagine that Herald Stadium Productions asks your client, Preston Presentations Inc., to sign a contract that includes the following provision:

McCrary Concert. Preston Presentations Inc. shall present a concert on July 4, 20XX at Herald Stadium at which Sir Paul McCrary is the lead act.

This covenant presents no problem if your client has already arranged that Sir Paul will perform. If it has not, your client is in serious risk of breaching this covenant. Sir Paul could just say "No."

As noted in Chapter 3, covenants include promises both to do and not to do something. Some drafters refer to these promises as affirmative and negative covenants. This nomenclature is generally not useful, except in the context of a loan agreement where covenants are classified for convenient reference.[2] There, affirmative covenants generally require a borrower "to maintain prudent business practices,"[3] including payment of taxes, maintenance of equipment, maintenance of existence, compliance with laws, and the keeping of proper business and financial records. Other affirmative covenants require the borrower to provide the bank with current financial information. In contrast, negative covenants typically prohibit actions that the borrower might take if the loan agreement were not in effect and that would significantly change the borrower's structure or business operations.[4] For example, negative covenants prohibit

2. *See* Richard Wight, Warren Cooke & Richard Gray, *The LSTA's Complete Credit Agreement Guide* §7.1 (1st ed., McGraw-Hill 2009) ("Covenants can be divided into three categories: financial covenants, affirmative covenants, and negative covenants. . . . There is no substantive effect to these classifications; they are purely a matter of convenience of reference.").

3. Michael A. Leichtling, Barry A. Dubin & Jeffrey J. Wong (1943-2001), *Commercial Loan Documentation Guide* vol. 1, § 11.01 (Matthew Bender 2012).

4. Sandra Schnitzer Stern, *Structuring and Drafting Commercial Loan Agreements* vol. 1, ¶¶ 5.01[1], 6.01[1] (A.S. Pratt & Sons 2012).

mergers, debt, and the granting of security interests. Breaches of these covenants generally require that the borrower intended to perform the act that violated the covenant. Banks generally grant a borrower a grace period to cure a breach of an affirmative covenant as it may be inadvertent.[5] Breaches of negative covenants generally result in an immediate event of default.[6] Once a company has merged, for instance, the merger can rarely be undone.

10.2 DRAFTING GUIDELINES

Adhere to the following guidelines when drafting covenants:

1. *To obligate a party to perform, use* ***shall****.*

Regular Exercise. The Athlete *shall* exercise regularly in order to maintain himself in top physical condition.

Most commentators agree that sophisticated commercial contracts should use *shall* to signal a covenant.[7] Nonetheless, some commentators ardently advocate banning *shall* from the legal lexicon.[8] They believe that lawyers have used it improperly so many times and in so many ways, it can no longer do its job. For example, courts have interpreted *shall* to mean *will*,[9] *may*, and a *condition*. The proposed alternatives are *will* and *must*. However, neither of those alternatives is a panacea. The suggested solutions replace one set of problems with another.

Assume that drafters banish *shall* from their contracts. In that event, a drafter would need to use either *will* or *must* to signal a covenant. But as *will* is already reserved for the future,[10] it would then need to do double duty, creating again the possibility of ambiguity. The use of *must* creates the same problem because drafters use it to signal a condition. The issue of whether *shall* signals the future or discretionary authority will not go away if *will* is used instead of *shall*. It will merely be transformed. Instead, courts will need to construe *will*.[11] Imagine the irony of a court using as precedent the cases analyzing whether *shall* was intended to signal a covenant, the future, or discretionary authority. Analogous issues would arise if *must* were to replace *shall*. To cure the problematic use of *shall*, drafters must reform and reserve the use of *shall* for duties.

The following example demonstrates a proper use of *will*. It appears in a covenant, but does not signal the obligation. Instead, it describes what the nonparty limited

5. Stern, *supra* n. 4, at ¶ 8.01[2]; Leichtling et al., *supra* n. 3, at § 11.01.

6. Stern, *supra* n. 4, at ¶ 8.05[2].

7. *See* Kenneth A. Adams, *A Manual of Style for Contract Drafting* 43-44 (3d ed., ABA 2013); Scott J. Burnham, *Drafting and Analyzing Contracts* §§ 16.2 and 17.6.1 (3d ed., Matthew Bender 2003); Robert C. Dick, *Legal Drafting in Plain Language* 93 (3d ed., Carswell 1995) (Canada); F. Reed Dickerson, *The Fundamentals of Legal Drafting* 214 (2d ed., Little, Brown & Co. 1986); Lenné Espenschied, *Contract Drafting, Powerful Prose in Transactional Practice* 139 (ABA 2010).

8. *See* Bryan A. Garner, *A Dictionary of Modern Legal Usage* 940 (2d ed., Oxford U. Press 1995); Joseph Kimble, *The Many Misuses of "Shall,"* 3 Scribes J. Leg. Writing 61, 69-71 (1992).

9. *E.g. Cunningham v. Long*, 135 A. 198, 201 (Me. 1926) (stating that when looked at in the context of the other contract provisions, "shall" plainly had an element of futurity).

10. See Chapter 13, which discusses in detail when to use *will*. It also provides a set of nongrammatical rules to ensure the proper use of *shall*.

11. *See Doe v. Wal-Mart Stores, Inc.*, 572 F.3d 677, 681-682 (9th Cir. 2009) (issue whether the phrase "will undertake" created a covenant or discretionary authority).

Nonselling Stockholder Purchases. On receipt of a Sales Notice, each Nonselling Stockholder may purchase from the Selling Stockholder the number of Shares equal to [insert formula] by delivering a Purchase Notice to the Selling Stockholder.

This provision gives a Nonselling Stockholder permission (discretionary authority) to purchase Shares, which permission it may or may not exercise. If it does exercise its discretionary authority (as to some or all of the Shares), the Selling Stockholder is then obligated to sell the number of Shares that the Nonselling Stockholder wants to purchase. The key here is that one party having discretionary authority is not the same as the other party having an obligation to perform. The contract must include a specific covenant obligating the other party to perform.

Drafters should know that a provision granting discretionary authority to do something does not prohibit a party from doing anything else. For example, here is language that resulted in litigation.

Assignment and Delegation. The Bank may assign all or any part of its rights in the Loan to any Qualified Bank Transferee.[5]

The court interpreted this as explicit permission to assign to Qualified Bank Transferees, but not to the exclusion of other transferees. The grant of permission to assign did not imply a prohibition on other assignments.

This provision could have been fixed in two ways.

Version 1

Assignment and Delegation. The Bank may assign all or any part of its rights in the Loan *but only* to a Qualified Bank Transferee.

Version 2

Assignment and Delegation. The Bank shall not assign all or any part of its rights in the Loan to any Person, except to a Qualified Bank Transferee.

Version 2 is preferable because it creates a duty for the Bank not to assign. Therefore, any assignment in contravention of the provision would be a breach entitling the borrower to damages.

Lawyers sometimes negotiate whether an equitable remedy can or should be drafted as a right rather than discretionary authority.[6]

Version 1

Equitable Relief. If the Executive breaches her duty of confidentiality, the Company *may* seek equitable relief.

5. Tina L. Stark, *Assignment and Delegation,* in *Negotiating and Drafting Contract Boilerplate* ch.3, 71-72 (Stark et al. eds., ALM Publg. 2003); *see Pravin Banker Assocs., Ltd. v. Banco Popular Del Peru*, 109 F.3d 850, 856 (2d Cir. 1997). The provision is from the case. It could be more concisely drafted.

6. See §12.1.2.

Here *may* is being used in the sense of permission. Restating the provision: *The Company has the Executive's permission to seek equitable relief*. Many parties in the Company's position would be quite unhappy with this provision in that it states no more than a Truism: the Company can go into court to seek a temporary injunction or it cannot seek one. From a business perspective, the Company wants more from this endgame provision. It wants an acknowledgement that if it goes into court, the Executive agrees that the court should award equitable relief. In essence, the Company wants a liquidated damages provision that's about equitable relief rather than money. To provide the Company with this remedy, the drafter should change the provision from one of discretionary authority/permission to one of right. In that case, the Company would have the right to equitable relief and the Executive the obligation not to interfere with that right.

Version 2

Equitable Relief. If the Executive breaches her duty of confidentiality, the Company *has the right* to equitable relief.

The enforceability of the equitable relief provision is questionable. As a general matter, parties cannot change the standard for equitable relief by an agreement: damages must be inadequate.[7] In accordance with this rule, many courts have held that a contractual provision for equitable relief does not bind a court. Nonetheless, some cases suggest that such a provision may influence a court's decision. If the parties include a right to equitable relief, stating facts in the agreement that justify this relief may be helpful.[8]

This issue also arises in endgame provisions outside the context of equitable relief.

Version 1

Deposit. The Landlord *may* keep the entire Deposit if the Tenant remains in possession after the Term.

Technically, the provision could be read as a condition to discretionary authority and the related discretionary authority. Under the stated circumstances, the Landlord has the Tenant's permission to keep the Deposit, but the discretionary authority to return it. But both parties would probably agree that the previous sentence inaccurately memorializes their intent and agreement. Somewhat reasonably, the Landlord would argue that, in reality, there is no choice involved in this remedy because no reasonable business person would give away money. Therefore, the proper way to describe the Landlord's legal relationship with the Deposit is that the Landlord has a right to the Deposit that cannot be abrogated. That is, the Tenant would have the flip-side obligation not to seek the return of the Deposit. Some lawyers might disagree with this drafting decision. This author's bottom line is that discretionary authority mischaracterizes the intent of this business deal and that we as drafters must respond to our clients' needs. This provision should be drafted as a right.

7. *Restatement (Second) of Contracts* §359 cmt. a (1981).

8. For an excellent discussion of this issue and case citations, *see* Edward Yorio, *Contract Enforcement: Specific Performance and Injunctions* §§19.2-19.3 (Aspen Law & Business 1989).