Making Offers No One Can Refuse: Effective Contract Drafting—Part 2

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Making Offers No One Can Refuse: Effective Contract Drafting — Part 2

In the last issue, the Legal Writer introduced this five-part series on effective contract drafting. The Legal Writer discussed the planning and negotiating process in drafting a contract. In this issue, we discuss the different parts of a contract.

Parts of a Contract
Many contracts have the same basic provisions regardless of the subject matter or complexity. This column describes the provisions you’ll most commonly find in a contract. We discuss how some provisions create liability for the parties and offer tips on how to spot and draft contract language to reduce liability and minimize risk.

The primary parts of an agreement are the cover page and table of contents; titles and headings; introduction/preamble; recitals; and words of agreement, definitions, and action sections.

Cover Page and Table of Contents
Lengthy contracts normally include a cover page and table of contents. The cover page is a separate page that states the title of the contract, the name of the contracting parties, and the date of the agreement. The table of contents lists the headings, subheadings, schedules, and exhibits, together with their corresponding page numbers, to help the reader find the contract’s provisions.

Titles and Headings
The title of the contract expresses the contract’s subject. Put the title on the cover page. Or, to save paper, center the title at the top of the contract’s first page. The first letters of each word in the title are usually capitalized to make them conspicuous and the contract easy to identify. Include a few words to express what the contract is about. The title shouldn’t be too generic. Help the reader understand what the contract is about. Examples: “Lease Agreement for Commercial Space at 689 Main Street, Yonkers, New York”; “Real-Estate Contract for Sale of 295 Elmwood Lane, Ithaca, New York”; and “Rental Agreement for Apartment 2G, Located at 3015 Plandome Road, Manhasset, New York.”

It’s also important to include headings. Headings help structure the contract and ease readability. Don’t be over- or under-inclusive. Headings should be clear and concise. They should reflect the information in the related sections. If the headings don’t reflect that information, there might be an issue interpreting the underlying section.

Introduction/Preamble
The main function of the introduction, also known as the preamble, is to identify concisely the names of the parties and the legal action they’re taking. Avoid “Know All Men By These Presents” or “This Agreement is entered into. . . .” Not only are they archaic, passive-voice expressions, but they force the reader to plow through several words to find out who the parties are.

The date in the introduction shouldn’t be a future date. If you intend to make the provisions effective on a future date, use the signing date in the introduction and list an effective-date provision in the body of the contract. The contract will be in force on the signing date, but the provisions will be effective only on the effective date.

When identifying the parties involved in the transaction, use their full legal names as well as their proper short forms. There’s no benefit or purpose to enumerating the parties. To make party names easily identifiable, type them out in all-capital letters. The short forms usually capitalize the first letter of each word and identify the parties’ roles, such as “Buyer” or “Seller.” Once you introduce these short forms, use them throughout the contract. If you use short forms for the parties, continue using the same identification throughout the agreement. Don’t use two short forms for one party, such as “‘Goldilocks Co.’ or the ‘Company.’” Just be consistent and pick a short-form reference that won’t confuse a reader.

Be careful when choosing similarly spelled generic names for the parties. For instance, the difference between “licensor” and “licensee” is a matter of the “or” and “ee” on the endings. If both these names were used to identify the parties to a contract, it would be easy to overlook a typographical error that results in “licensor” instead of “licensee.” Some drafters use “between” in the introductory statement when referring to the contracting parties’ relationship, even when

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Using the correct prepositions with regard to time will ensure a clear contract.

Practitioners usually introduce recitals with the word “whereas.” But “whereas” is legalese; it adds no meaning to recitals. Instead of using “whereas,” number each recital and introduce them with a word such as “Background” or “Premises.”

Example: “This Asset Purchase Agreement (this ‘Agreement’), dated August 10, 2013, is made between Goldilocks Corporation, a Delaware corporation (the ‘Buyer’), and Three Bears, LLC, a New York limited liability company (the ‘Seller’ and, collectively with the Buyer, the ‘Parties’).” Pay attention to punctuation, or its absence, when naming the parties, especially in the case of entities. If a limited-liability company’s articles of organization state that the company’s name is “Apex Property, LLC,” write it in the same way, comma for comma. Don’t rewrite it as “Apex Property L.L.C.”

Recitals

Contract drafters often begin with a statement regarding background, known as “Recitals.” Recitals give context. They describe the contract’s background and explain why the parties are entering into it. To avoid ambiguities, the parties’ reasons for entering into the contract should be clear and consistent with the contract’s language. The recitals are meant as general evidence of the parties’ intent for entering into the contract. They don’t include specific information about what the parties agree to. Don’t include substantive provisions, such as those addressing the parties’ rights or obligations. Recitals don’t provide rights or remedies, so they’re not enforceable. Save substantive provisions for the body of the contract. Although recitals aren’t necessary to create an enforceable contract, they can help if a dispute arises about the contract’s purpose.

Definitions

Defined terms are used when words or lengthy phrases are either ascribed a special meaning or repeatedly referred to in the contract. There’s no need to define a term that’ll be used only once in the document, unless it would make the provision significantly easier to understand. Defined terms may be presented in two ways: (a) through a separate section for definitions or (b) embedded in the text of a contract provision, otherwise known as on-site. The convention when initially defining a term is to capitalize the first letter of each word and to put the letters in quotation marks. Many drafters also underline or put the term in bold so that it can be located easily. To signify that you’re using a previously defined term, capitalize the first letters of each word.

The term can be defined on-site if the contract is short, informal, or has few defined terms. Example: “Landlord shall lease to Tenant the building located in Four West 4th St., Syracuse, New York (the ‘Premises’).” If you’re defining on-site, make sure which text a definition relates to. Proper placement is important for on-site definitions.

Sophisticated commercial transactions, on the other hand, will likely use a separate definitions section. A definitions section will “achieve clarity without repetition.” When using a definitions section, list the defined terms in alphabetical order for the reader’s convenience.

It’s also common for contracts to use a mixed approach, defining some terms on-site and some terms in a definition section. In this case, it might
be easier to have an index of defined terms at the end of the contract to help readers find their way. Defined terms should provide relevant legal definitions for any term not obvious to the reader. It’ll reduce the risk of referring to the same thing in a different way. It’ll also make the contract clear about what the parties intended. For instance, a contract might provide that “the parties shall use reasonable efforts to perform this agreement timely.” When a later provision provides that “the seller shall use best efforts,” this inconsistency suggests that the intended meaning of reasonable efforts is different from best efforts. This implies that best efforts is a higher standard than reasonable efforts. Be consistent and precise in using a defined term.

Use your word processor’s “find” or “search” functions to test whether you’ve used a definition consistently and whether the defined term is capitalized wherever it appears in the document. Definitions should be a word or phrase that’s both informative and concise. Don’t simply use the words “includes” and “shall” to define a term. Also, don’t define a defined term in another term’s definition. An example of what not to do: “‘Payment Period’ means each calendar year in the five-year term that begins on January 1, 2013 and ends on December 31, 2018 (the ‘Term’).” But it’s acceptable to use other already defined terms within a definition. It’s also acceptable to use the lowercase term as part of a definition.

On the other hand, it’s unnecessary to define a term that has a settled definition when you’re using it for its standard meaning. But don’t assume that the term is standardized. Terms can be defined to include concepts that aren’t customarily included in a given word or phrase.

**Action Sections**
The action sections state the parties’ main obligations and provide the following: (1) the parties’ agreement to perform the main subject matter of the contract; (2) the duty to pay financial consideration, if any; (3) the term of the contract, if any; (4) the closing date, if any; and (5) the list of closing deliveries, if any.

- **Subject-Matter Performance**
  A subject-matter-performance provision provides for the contract parties’ covenants that each will perform the contract’s main subject matter. They’re usually reciprocal, executory covenants given in exchange for the other’s covenant and establish the agreement’s primary consideration.
  
  **Example:** Term. Unless terminated earlier in accordance with the terms of this Agreement, this Agreement shall commence on April 1, 2010, and shall continue until and including May 31, 2013. Additionally, include a time-of-day reference and be conscious of time zones. A strong time reference might read: “This shall be performed by 5:00 p.m. Buffalo, New York time.” This way, there’s no confusion on what “EST” might mean or whether “5:00” means the morning or the afternoon.

- **Consideration**
The payment provision provides for the contract’s financial consideration. The financial consideration can be cash, royalty, any monetary equivalent, or other fees. When drafting this provision, state who is paying what to whom, when, why, and how. Calculate the amounts that can be calculated instead of including a mathematical formula.

- **Term**
  Term provisions note when contracts begin and end. A term provision applies when a period of time will govern the parties’ relationship, such as in lease, licensing, and supply agreements. Some contracts, such as acquisitions, are one-time deals with no term and which terminate when the transaction is consummated.

  References to time are important contractual aspects that are often points of contention in litigation. References to time can be used to reference the date of something, to specify the beginning or end of a time period, or to apportion a quantity per unit of time. To avoid confusion, be clear about the time, and don’t use the word “within” when referenced to a time period. “Within” creates ambiguity. “Within” makes it unclear whether the referenced date is included or excluded. Use the word “including” to clarify whether the date referenced counts. Using the correct prepositions with regard to time will ensure a clear contract. To signify the beginning of a term, use “from,” “after,” “starting,” or “commencing,” followed by the date. When identifying the end of a term, use “until,” “to,” or “through” followed by the date and the time.

- **Closing-Related Provisions**
  Not all contracts have closing conditions. They’re generally seen in acquisitions and financings when there’s a time gap between the signing date and closing date. Thus, “[when a transaction has a closing, the agreement will include a closing date provision and closing deliveries provisions.” The closing-date provision will state the date, time, and place of closing. Although some contracts provide for a specific closing date, a “rolling closing dates” provision allows the parties jointly to postpone the closing date to a later date. This gives the parties flexibility if the documentation isn’t ready by the closing date.

  A closing-deliveries provision will specify conditions that must be fulfilled or waived before a party must close on the transaction. It’ll also specify each party’s covenants about how it’ll deliver its performance at closing. For instance, the seller promises to execute and deliver the conveyed documents, while the buyer promises to deliver the purchase price. Both are examples of closing-related provisions.

- **Covenants Not-to-Compete (in an Employment Context)**
  In the covenants not-to-compete field, myriad state statutes are straightforward...
ward in telling you what you can and can’t do in writing a covenant not-to-compete clause into your contract.82 These statutes differ from state to state.83 In California, for example, covenants not-to-compete are strictly prohibited; they are void ab initio. In other words, any contract that restrains “anyone” (businesses included) “from engaging in a lawful profession, trade, or business of any kind is to that extent void.”84 To get around this rule, the drafter should focus on drafting anti-solicitation and confidentiality provisions into the contract. By contrast, there’s no specific statutory law in New York on covenants not-to-compete.85 If your client wants to put a covenant not-to-compete clause into the contract in New York, the best way to ensure that you’re following the proper jurisdictional standards is to do a thorough search of the case law.86

In the next issue of the Journal, the Legal Writer continues with representations and warranties, covenants and rights, conditions, discretionary authority, and declarations.

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ATTORNEY PROFESSIONALISM FORUM CONTINUED FROM PAGE 57

Is my adversary’s conduct a violation of the Rules of Professional Conduct? What about the Standards of Civility? Are there ethical considerations that have to be addressed? Does opposing counsel’s conduct warrant or require a report to the Disciplinary Committee?

Sincerely,
A.M. Civil