

DyKEMA COX SMITH

Precision Contracts:

Advanced Principles for Drafters

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Precision Contracting



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Plain English Please, and Cut the Fat

LEGALESE	ENGLISH (AND COMMENTS)
A period of seven (7) days	Seven days (no “a period of,” and no need to repeat numbers)
After its receipt of (books and records of the Company)	After it receives (Company’s books and records)
Annexed hereto; attached hereto, and made a part hereof as if set forth verbatim	(These phrases typically accompany references to exhibits to documents. They add nothing. Delete.)
As hereinafter defined	(Say once at the beginning that the document may use terms before defining them, or trust the reader to find the definition—it’s either above or below so they have only two places to look.)
At the same time	When, or Concurrently
For the avoidance of doubt	(Cut. Rewrite it in a way that eliminates any doubt.)
Here- There – and Where- (such as “heretofore,” “thereunder”, and “wherein”)	(Use ordinary English words that do the job, and also leave no doubt about the antecedent.)

Plain English Please, and Cut the Fat (Cont.)

LEGALESE	ENGLISH (AND COMMENTS)
In the event that	If
IN WITNESS WHEREOF	(This is weird and archaic. The phrase “WITNESSETH” before recitals is the same.)
Include without limitation	Include (and maybe say once, somewhere appropriate, that it means “without limitation”)
Shall	(Often superfluous or confusing. For example: “If the house shall burn down.” An ordinary person would say “If the house burns down.”)
Shall be binding upon and inure to the benefit of	Shall bind and benefit
Shall mean	Means (for defined terms)
Shall not receive any	Shall receive no

Who else loves the Oxford (Serial) Comma?

Dairy drivers argued that they deserved overtime pay for certain tasks. The company disagreed.

This is what the law says about activities that do NOT merit overtime pay. Pay attention to the first sentence:

The canning, processing, preserving, freezing, drying, marketing, storing, packing for shipment or distribution of:

- (1) Agricultural produce;*
- (2) Meat and fish products; and*
- (3) Perishable foods.*

Is packing for shipment its own activity, or does it only apply to the rest of that clause?

EVIN O'CONNOR; CHRISTOPHER O'CONNOR; JAMES ADAM COX; MICHAEL FRASER; ROBERT MCNALLY v. OAKHURST DAIRY; DAIRY FARMERS OF AMERICA, INC., *No. 16-1901 (1st Cir. 2017)*.

Who else loves the Oxford (Serial) Comma? (Cont.)

Inadvertent Apposition

I'd like to dedicate this presentation to my parents, Justice Ruth Bader Ginsburg[,] and God.

I'd like to dedicate this presentation to the love of my life, Amber Clark[,] and God.

Efforts Standards

- The Function and Utility of Efforts Standards
- Accomplishing Goals Outside of a Party's Control
- Examples:
 - Obtainment of Third Party Consents
 - Promotion of Products
 - Satisfying Closing Conditions

Drafting Efforts Standards

- Things to consider:
 - What is the difference between the different language that is used to express efforts standards?
 - How do we express the appropriate efforts standard in a clear manner?
 - How do we draft such standards to better ensure enforceability under Texas law?

Efforts Standards - Examples

- Best Efforts
- Reasonable Efforts
- Commercially Reasonable Efforts
- Commercially Reasonable Best Efforts
- Good Faith Reasonable Efforts

The Efforts Hierarchy

- Best Efforts as the highest standard?
- Conventional Wisdom: **Best Efforts** requires that party to do everything possible to accomplish the goal, including the use of extraordinary measures.
- Conventional Wisdom: **Reasonable Efforts** is a less onerous standard that allows for the application of some level of rationality to the promisor's obligation. What would a reasonable promisor have done under the circumstances?
- Practical Example

U.S. Caselaw

- U.S. Courts have not required that parties with a duty to use **best efforts** use extraordinary measures to accomplish a goal irrespective of any detrimental consequences.
- *Triple-A Baseball Club Associates v. Northeastern Baseball, Inc.*, 832 F.2d 214, 228 (1st Cir. 1987) – “We have found no cases . . . holding that “best efforts” means every conceivable effort.”
- *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609, 614 (2d. Cir. 1979) – “The requirement that a party use its best efforts necessarily does not prevent the party from giving reasonable consideration to its own interests.”

Other Cases

- *Corporate Lodging Consultants, Inc. v. Bombardier Aerospace Corp.*, No. 03-1467-WEB, 2005 WL 1153606 (D. Kan. May 11, 2005) - “Best efforts does not mean perfection and expectations are only justifiable if they are reasonable.”
- *Coady Corp. v. Toyota Motor Distributors, Inc.*, 361 F.3d 50, 59 (1st Cir. 2004) – “‘Best efforts’ . . . Cannot mean everything possible under the sun. ‘Best efforts’ is implicitly qualified by a reasonableness test.”
- *Scott-Macon Securities, Inc. v. Zoltek Cos.*, No. 04CIV.2124MBM, 2005 WL 1138476, at 14 (S.D.N.Y. May 12, 2005) – “New York courts use the term “reasonable efforts” interchangeably with “best efforts”.

Enforceability of “Efforts Provisions” (Texas Law)

- Courts in most U.S. jurisdictions have held that efforts provisions are enforceable. Texas has specific caselaw on the subject.
- *Kevin M. Ehringer Enterprises, Inc. v. McData Services Corp.*, 646 F.3d 321 (5th Cir. 2011) (applying Texas law) – held that McData’s promise to use “best efforts” to promote, market and sell products wasn’t an enforceable promise because “a best efforts contract must set some kind of goal or guideline against which best efforts may be measured.”

Additional Application of Texas Law (Herrmann Holdings)

- *Herrmann Holdings, Ltd. v. Lucent Technologies Inc.*, 302 F.3d 552 (5th Cir. 2002) involved “best efforts provisions” requiring the defendant to file a registration statement and cause it to become effective “as promptly as practicable” and “in the most expeditious manner practicable”. The court held that these phrases helped establish an *objective goal*, thereby rendering the efforts provision enforceable.

Additional Application of Texas Law (Med. Components)

- *Med. Components, Inc. v. Osiris Med., Inc.*, No. EP-15-CV-305-PRM, 2016 U.S. Dist. LEXIS 183370 (W.D. Tex. 2016):
- “Pursuant to Texas law, a “best efforts” provision . . . is enforceable if it provides an objective and specific goal against which a party’s efforts can be measured.
- The court held that the best efforts provision in the subject contract was enforceable because it provided an objective goal by which the promisor's efforts could be measured—namely, the specific number of units that were to be manufactured and marketed under the contract in each of the three contract years. (225,000 units in the first contract year; 262,500 units in second contract year, etc.)

Suggestions on Efforts

- Default to the use of “reasonable efforts”. The use of “best efforts” risks confusion.
- If the parties desire a more onerous standard than “reasonable efforts”, then add specific tasks and timing requirements.
- Add specific standards for measuring performance to better ensure that your efforts provisions will be enforced.
- Define “Reasonable Efforts” in your important agreements.

“Reasonable Efforts” Examples

- **“Reasonable Efforts”** means, with respect to a given obligation, the efforts that a reasonable person in the promisor’s position would use to comply with the obligation as promptly as possible.
- **“Reasonable Efforts”** means the reasonable efforts that a prudent Person desirous of achieving a result would use in similar circumstances to ensure that such result is achieved as expeditiously as possible; provided, that “Reasonable Efforts” does not require the promisor to take any of the following actions: (a) initiating litigation; (b) incurring Indebtedness; (c) disposing of any significant assets. . . .

Materiality and Ambiguity

- Used to “qualify” or narrow an otherwise broad provision
- E.g., “ABC Company is not a party to any *material* litigation,” or “Distributor may only sell products that are *materially* different from the Products.”

Materiality and Ambiguity (Cont.)

- Ambiguity in the definition:
 - “...of such a nature that knowledge of the item would affect a person’s decision-making.”
 - Typical in securities, M&A, and suppression of evidence in criminal cases, and others
 - E.g., refers to information that would have caused the purchaser to not enter into or consummate the transaction (deal breaker)

Materiality and Ambiguity (Cont.)

- Ambiguity in the definition part ii:
 - “significant,” or “important enough to merit attention”
 - More general applications
 - e.g., refers to something that is simply more than insignificant

How is Materiality Used?

- Courts embrace “affects of a decision”
- Practitioners often use “important enough to merit attention”
- Examples:
 - There is no material litigation pending against the Company.
 - Lender must deliver [x] unless doing so would cause the Lender any additional material legal or regulatory burdens, any additional material out-of-pocket costs not identified in this Agreement, or be otherwise materially disadvantageous to Lender.
 - The Seller is not in breach of any material contract to which it is a party.

Defining Material or Materially

- Use “material” and “significant”
- Define it, both in scope and perspective, BUT IN CONTEXT:
 - “Material” and “Materially” refer to a level of significance that would have affected any decision of a reasonable person in the Purchaser’s position regarding whether to (i) enter into this Agreement or (ii) consummate the transaction contemplated by this Agreement.
 - Condition to close versus indemnity claim

Defining Significant

- Some precedent: “Significant deficiency” means a deficiency “that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the registrant’s financial reporting.” See SEC Release No. 33-8829
- Precision is better:
 - “Significant” means important enough, from the perspective of a reasonable person in the Purchaser’s position, to merit attention, and it includes a lesser level of significance than does the defined term “Material.”
 - “Insignificant” means not important enough, from the perspective of a reasonable person in the Purchaser’s position, to merit attention.

Bright-line Alternatives

- Instead of: ...breach of any Significant agreement to which the Seller is a party....
- Consider: Schedule [x] contains..., and...breach of an any agreement that is listed on Schedule [x]
- Instead of:...no pending Significant litigation...
- Consider:...no pending litigation a party to which is seeking injunctive relief or has alleged damages in excess of \$[x]

Bright-line Alternatives (Cont.)

- Baskets – True (Dollar One), or Tipping
- Bring-down and Double Materiality

Material Conclusions

- If you prefer mainstream, always assume “affects of decision”
- Use a bright-line for items of lesser significance
- Where it makes sense, dispense with the qualification (e.g., notice of an amendment to an agreement)

Material Adverse Change/Material Adverse Effect

- Most commonly used in representations and warranties and closing conditions
- Absolute MAC:
 - Since December 31, 2017 no MAC has occurred.
 - Since December 31, 2017 no events or circumstances have occurred that constitute, individually or in the aggregate, a MAC.
- Modifying MAC:
 - Seller's financial statements contain no inaccuracies except for those inaccuracies that would not reasonably be expected to result in a MAC.
 - Seller is not party to any litigation that would reasonably be expected to result in a MAC.

MAC/MAE (Cont.)

- MAC/MAE verbs
 - Seller’s financial statements contain no inaccuracies except for inaccuracies that [will] [could] [would] not [reasonably] be expected to result in a MAC.
- MAC better than MAE in “absolute”
- Sometimes both?
- Baseline dates – Audited, Signing, Formation

Defining MAC

- Basic – “Material Adverse Change” means any Material adverse change in the business, results of operations, assets, liabilities, or financial condition of the Seller.

MAC Reasoning

- Reasons for Basic definition
 - MAC in something; or
 - An event or circumstance that would reasonably be expected to result in a MAC; or
 - Both.
- Careful of redundancy.
- If “Material” is not used or used for both parties, make sure to add perspective.

Quantitative MAC Clauses?

- Probably not a good idea:
 - One threshold for all rarely works.
 - Creating multiple thresholds creates confusion.
 - Illustrations versus exclusive risk unenforceability.
 - “Unknown purpose” versus “quantifiable.”

MAC Field of Change

- **M&A** – results of operations, assets, liabilities, or financial condition
- **Merger** – ability to consummate the transaction
- **Credit** – on the rights of the agent or any lender under any of the loan documents or the ability of the borrower to perform its obligations under the loan documents
- **New line of business** – as currently conducted currently proposed to be conducted

MAC Mixed Case Law

- Make sure to include specific industry-wide or general developments if you want them covered!

MAC Prospects

- “Prospects” means, at any time, results of future operations that are reasonably foreseeable based on facts and circumstances in existence at the time.
- Would [would not] reasonably be expected to result in a MAC (“back door prospects”)
- Better off creating a representation, warranty or condition

MAC Carve-outs

- Any change affecting the economic or financial conditions generally (global, national, or regional, as applicable)
- Any change affecting the party's industry as a whole (it can be specified that this carve-out does not apply if those conditions disproportionately affect the party in question)
- Any change caused by announcement of the transaction or any related transaction (this carve-out can be general or limited to changes related to specific aspects of the party's operations, such as loss of customer orders or employee attrition; note that this carve-out could increase the buyer's risk as to whether it would successfully invoke a MAC provision, because it might be unclear whether a particular

MAC Carve-outs (Cont.)

- adverse effect was caused by announcement of the transaction)
- Any change in a party's stock price or trading volume (in most contexts a carve-out for changes in stock price would probably be unnecessary, since it isn't clear that a drop in stock price would fall within the scope of a field of change that doesn't include capitalization but the cautious drafter might want to avoid any possibility of confusion on the subject by including this carve-out)
- Any failure to meet analysts' or internal earnings estimates

MAC Carve-outs

- Any action contemplated by the agreement or taken at the buyer's request
- Any action required by law

Knowledge

- When a party is making a statement of fact it is sometimes appropriate to qualify that statement with respect to “knowledge”.
- In example, when a party is making a representation in an acquisition agreement.
- A party will want to include such a qualification in any statement where that party is not in a position to verify the truth or accuracy of that statement. In example, “To the Knowledge of Seller, no third party has breached any of the Assumed Contracts.”

Knowledge - Use of a Defined Term

- Consider using Knowledge as a defined term, which allows you to directly address two issues that would be otherwise ambiguous:
 - Whose knowledge is relevant?
 - Must such persons have actual knowledge? or do those persons have a duty to investigate?
 - In the latest ABA private deal study, 82% of reported deals included a **constructive** knowledge standard

Whose Knowledge is Relevant? (Examples)

- The following persons: Jane Bockus, Jeff Gifford, and Nick Monaghan. [Naming each person with implicated knowledge is the clearest approach.]
- The Company's executive officers (as defined in rule 405 of the Securities Act). [This approach only makes sense for public companies.]
- The Company's directors, officers, and any other persons having supervisory or management responsibilities with respect to the Company's operations.

Actual or Constructive Knowledge (Examples)

- The actual knowledge of _____, without any requirement to investigate.
- The actual knowledge of _____, after inquiry of the Company's employees.
- The actual knowledge of _____, after reasonable investigation.
- The actual knowledge of _____, after due inquiry.
- The actual knowledge of _____, and the knowledge that each such person would reasonably be expected to obtain in the course of diligently performing his or her duties for the Company.

Termination for Convenience

- “Termination for convenience” is a phrase used in different types of agreements to allow a party to terminate an agreement without cause prior to the end of its term.
- The phrase originated in government contracts, providing the governmental authority the ability to terminate a contract without breaching such contract. “Termination for convenience” is now referred to more generally.

Termination for Convenience (Considerations)

- Termination for convenience provisions are generally enforceable under Texas law.
- Texas courts have not articulated strict rules of interpretation or applied particularized canons of construction to termination for convenience clauses. Accordingly, when the termination for convenience provision is worded so that it can be given a definite legal meaning and it is not ambiguous, the court will construe it as a matter of law.
- Courts analyze both the ***title*** (section heading) of the provision and the ***language*** of the provision itself.

Examples of Termination for Convenience

- **“Termination for Convenience.** Acme may terminate this Agreement for convenience by providing at least 30 days’ prior written notice to Service Provider.”
- **“Termination without Cause.** Acme may terminate this Agreement at any time, without cause, by providing at least 30 days’ prior written notice to Service Provider.”
- (You also may want to address any liquidated damages or expressly state that there would be no penalty upon such termination).

Relationship Laws (Termination for Convenience)

- Also consider any jurisdiction-specific “relationship laws” that might impact your ability to terminate for convenience (or provide supplemental terms pertaining to such a termination) regardless of the language in your contract.
- Industry/Relationship Examples:
 - Franchise Laws
 - Motor Vehicle Dealers
 - Wine & Spirits
 - Farm and Heavy Equipment
 - Motor Fuel
 - Sales Representatives

Insurance

- *TIG Ins. Co. v. James*, 276 F.3d 754 (5th Cir. 2002)
- *Via Net v. TIG Ins. Co.*, 211 S.W.3d 310 (Tex. Sup. Ct. 2006)
 - Contracting party sought to be named as additional insured
 - COI provided listing “holder is added as additional insured re “General Liability”
 - COI disclaimer
- Upshot: Don’t rely on COI language! You need a declaration page, or some other evidence directly from the insurer, showing you’re insured.

Credits and Bibliography

- Adams, Kenneth A., *A Manual of Style for Contract Drafting 4th Edition* (American Bar Association 2017).