

Unraveling the Mystery of The Business Contract and Marital Bliss

What does a contract have in common with courtship and marriage? Absolutely everything. While a contract may appear to be a complicated document full of suspect language, the entire procedure involved in the planning, negotiating, drafting and execution of a contract is extremely similar to the age-old tradition of "tying the knot." In this article, I hope to demystify the contracting process and the aura of contract language. Through my references and comparisons, it will become clear that getting into and out of a contract is not so different from the build-up and break-up of life's most personal relationship.

Seeking to Contract (Dating) The music is loud, the energy intense and the choices boundless. Craig is single, can cut a rug with the best of them and is in the hottest nightclub in town. He leaves in the early morning hours with "call me" ringing in his ears and a pocketful of telephone numbers in his wallet. The next day Craig makes the calls and lines up the dates. He tolerates drinks, dinners, movies, and even craft fairs hoping to click with that special gal. TimCo is up for sale. It has put the word out on the street soliciting offers from interested persons. As part of this marketing process, Cassandra E. O'Brien (CEO) is asked to answer questions and provide information about TimCo to potential suitors, and to provide tours so suitors can kick the tires. Whether what you want is personal (to meet your soul mate) or business (to sell or buy a product or service), you are searching for the person or thing that best meets your objectives. In the personal world, that search takes the form of dating; in the business world, that search entails embarking upon negotiation.

Letters of Intent / Memorandum of Understanding (Going Steady) Craig's dating reaps rewards. He is spending most of his free time with Marion. Craig and Marion are learning more about each other and sharing more personal facets of their lives. What may have been an inappropriate topic on a first date becomes a subject to be discussed at length:

Marion: Have you ever been married? Craig: Yes. Marion: Only once? Craig: Yes. Marion: Any children? Craig: One. Marion: You said you were a lawyer? Craig: Yes. My parents try not to dwell on that disappointment. Craig: Have you ever been married? Marion: No. Craig: You are a doctor? Marion: Yes. My parents try not to dwell on the fact I am dating a lawyer.

The ideal of confidentiality has now entered the picture, and the relationship has become exclusive. True, Craig and Marion may trust each other, see only each other, acquire things together and make future plans and commitments, but the only thing binding them together is their mutual interest in each other. A number of suitors are interested in TimCo. CEO provides the answers to a number of general questions including the following:

Suitor 1: Are TimCo's tax returns true, correct and complete? TimCo: Yes. Suitor 2: Do its financial statements accurately and fairly present the results of business operations? TimCo: Yes. Suitor 3: Does the spreadsheet list all of the real and personal property TimCo owns? TimCo: Yes. Suitor 1: Is TimCo involved in any litigation? TimCo: No.

CEO reviews all the proposals from all of the suitors. She concludes that one suitor, MoneyCorp, made the best proposal and that its corporate culture most accurately reflects TimCo's values. CEO communicates this to P. Rupy Eric Simon (PRES), her counterpart at MoneyCorp. MoneyCorp sends a letter of intent (LOI) requesting TimCo's signature by a certain date.

***Note* MoneyCorp could have proposed a memorandum of understanding (MOU), an agreement signed by it and TimCo at the same time. Because, substantively speaking, there is no difference between the LOI and MOU, they will be called the "LOI" for our purposes.**

An LOI spells out what the parties see as the driving points to the deal, such as the price, payment method (cash, installments, non-cash consideration or a combination), and deal structure (asset sale,

equity sale, merger). While there may be a meeting of the minds on price and structure, the LOI will explicitly state that this agreement is non-binding and subject to negotiation of the definitive contract containing the driving points and legal language typical for this type of transaction. Two common exceptions to the non-binding nature of the LOI are confidentiality and exclusivity. The parties are not ready to make public their commitment; yet it is a "given" that all discussions and exchanges of information remain confidential and that the seller negotiate only with the potential buyer in question. At this point, TimCo and MoneyCorp each recognize the beauty of the LOI. Confidentiality and exclusivity are established, thereby protecting delicate information and ensuring MoneyCorp that it is not being used by TimCo to leverage a better deal. Much like what is happening between Craig and Marion, TimCo and MoneyCorp have expressed serious, but not finite, interest in each other.

Contract Negotiating and Signing (Moving to and Getting Engaged) Craig and Marion meet each other's family, vacation together, and may even move in with one another as their lives intertwine to a stronger degree. They learn more and more about each other and what it will take to stay together:

Marion: Why did your first marriage end? Craig: It was like, you know, a teenage marriage. I think we were too young. Marion: What exactly happened? Craig: I rushed into something I wasn't ready for.... We weren't as compatible as we had thought&in fact, we fought more than we got along. Marion: Would you want more children? Craig: To be honest, no (I really don't think so....). What about you? Marion: Actually, I am very committed to my career, and I am hoping that the person I marry will respect that. It doesn't leave a lot of time for raising children. Craig: So being a doctor is of utmost importance to you? Marion: Very much so. It is no less important than your practicing law. Craig: Touché! Marion: You know, if we ever get engaged, we'd have to get permission from my parole officer before getting married. Craig: Your PO? Marion: Yes. I cannot make any long-term commitments without his approval. Craig: When do we see him? Marion: Come with me next month. Prove to him you are right for me!

It becomes obvious that what each is disclosing, no matter how positive or how negative, and no matter the obstacle, only serves to bring Craig and Marion closer, because it is the truth about each of them. So, Craig pops the question. They get engaged. They tell their families and friends. At this point, while an engagement is no more legally binding than going steady, the moral obligations have increased. Craig and Marion and the "World" perceive Craig and Marion as "a couple." There is a difference in referring to someone as your fiancé versus your boyfriend. The message now conveyed produces an expectation of permanence even if there is a compromise to be made or a condition standing in the way of that permanence. TimCo and MoneyCorp now are negotiating the definitive contract. The price, payment and structure (\$10,000,000; all cash; stock purchase) reflect the LOI. The parties are into the legalese. For example, since this is a stock deal and CEO is actually the seller, the contract asks TimCo and CEO to provide, and represent and warrant as to, detailed, proprietary information about TimCo and for the parties to agree to certain action items and conditions to closing, such as the following:

MoneyCorp: Do you owe any back income taxes? TimCo and CEO: No. MoneyCorp: Are any of the accounts receivable shown on the financial statements over 90 days past due or not collectable? TimCo and CEO: Only the accounts receivable from Oui Mean Business are more than 90 days old. Besides that, all are collectible. MoneyCorp: Are there any liens on the real or personal property? TimCo and CEO: None, except for the BigBank mortgage that is placed against the land and building constituting our plant. MoneyCorp: Are you in breach or default of any of your contracts? TimCo and CEO: No. MoneyCorp; Are CEO's 100 shares the only TimCo stock outstanding? TimCo and CEO: Yes. Why? MoneyCorp: It is absolutely imperative that we own 100% of TimCo after closing. If anyone else owns stock, we want to talk to that shareholder. TimCo and CEO: CEO is the only TimCo shareholder. MoneyCorp; Do we need the consent of the Department of Justice? TimCo and CEO: Yes. DOJ must rule that our deal does not have any anti-competitive impact. MoneyCorp; We will contact DOJ together seeking its approval. TimCo and CEO: Lead the way, hard-charger.

Representations and warranties are the contract's question and answer section, fact-finding exercise between the LOI and contract signing.

***Note* The word "certifies" and the phrase "represents and warrants" indicate answering party's responses to asking party's questions. The following is such an example: "TIMCO AND CEO EACH HEREBY REPRESENT AND WARRANT TO MONEYCORP AS FOLLOWS: (A) TIMCO HAS PAID ALL TAXES THAT HAVE OR MAY BECOME DUE PURSUANT TO THE TAX RETURN, (B)**

EXCEPT FOR THE NEED FOR DOJ CONSENT, TIMCO AND CEO EACH HAVE THE POWER AND UNRESTRICTED RIGHT TO PERFORM ITS OBLIGATIONS UNDER THIS AGREEMENT; (C) ALL TIMCO ASSETS ARE FREE AND CLEAR OF ANY LIENS EXCEPT FOR THE MORTGAGE TO BIGBANK; (D) EXCEPT FOR THE ACCOUNTS RECEIVABLE FROM OUI MEAN BUSINESS, EACH ACCOUNT RECEIVABLE LISTED ON EXHIBIT 1 HAS BEEN OR WILL BE COLLECTED WITHIN 90 DAYS OF THE DAY IT FIRST BECOMES DUE; (E) TIMCO IS NOT IN BREACH OR DEFAULT, IN ANY MATERIAL RESPECT, OF ANY CONTRACT TO WHICH IT IS A PARTY, AND (F) CEO IS TIMCO'S SOLE SHAREHOLDER."

Asking party wants unqualified answers. Unqualified answers give asking party a sense of comfort knowing that it can hold answering party accountable if the truth does not match the answer. Answering party prefers to qualify its responses.

***Note* Words or phrases like "knowledge," "material" and "except for" are some qualifiers. Qualified answers are, in effect, risk shifting devices, because they give answering party the ability to avoid liability by claiming it did not know of the inaccuracy or saying it highlighted the inaccuracy and asking party went ahead with the deal anyway. Perhaps most importantly, if during this due diligence period answering party's responses are so qualified as to be meaningless or disclose facts too troublesome to asking party, the latter can terminate negotiations and walk away from the deal.**

Covenants are the contract's action item sections. The parties identify what needs to be done to consummate the deal and assign the responsibility. Affirmative covenants describe what a party must do to close; negative covenants set forth what a party cannot do.

***Note* Words and phrases such as "shall do," "shall not do," "will do," "will not do," "shall cause to be done," and "will undertake" followed by a positive or negative action item description are examples of covenant indicators. The following is such an example: "FROM THE EXECUTION DATE TO THE CLOSING DATE, CEO, TIMCO AND MONEYCORP WILL COOPERATE WITH EACH OTHER IN ALL APPLICATIONS OR FILINGS WITH THE DOJ IN CONNECTION WITH THIS TRANSACTION."**

Conditions are the contract's gate-keeping provisions. They reflect the convergence of representations, warranties and covenants. While the convergence is not absolute, it is good practice to cross-check all conditions with a representation and warranty, or covenant.

***Note* The following is an example of a condition: "THE CONSENT OF THE DOJ MUST HAVE BEEN OBTAINED AND MUST BE IN FULL FORCE AND EFFECT BEFORE CEO, TIMCO AND MONEYCORP CAN CONSUMMATE THE TRANSACTIONS CALLED FOR BY THIS AGREEMENT."**

TimCo and MoneyCorp have negotiated a definitive agreement containing, among other things, the questions and answers described above in the form of representations, warranties, covenants and conditions. The only action item is the affirmative mutual obligation to approach DOJ. The only condition is DOJ approval. TimCo and MoneyCorp have spent significant time and money to achieve an agreement both can sign. Execution signifies a greater degree of commitment, because the contract creates legal obligation, as contrasted to an engagement. However, much like an engagement, the relationship is not yet final. The parties may march forward together after contract signing, but TimCo and MoneyCorp know very well that there are things each must do and conditions that must be satisfied before their relationship will become permanent.

Pitfalls in Getting to Closing (Breaking the Engagement) Several months into the engagement, Marion and Craig have a discussion in the Parole Officer's presence that leads to "trouble in paradise."

Marion: It was nice having your daughter with us over the weekend. Craig: I'm glad you enjoyed her visit. Someday when we have a child together, you'll see how wonderful it is to be a parent. Marion: Excuse me? Craig: Well, I was just thinking that you would make a great mother. Marion: I have a career, and I'm not willing to give it up to raise a child. You know, we had this discussion months ago. You said that you weren't interested in having more children. Craig: Well, I don't think we should rule it out altogether. Marion: Are you going to stay home with our child so that I can go to work? Craig: Well, no, but..... PO: Craig, you got no rap sheet. I am hesitant to let Marion marry someone without a record. Couples need

shared experiences. Craig: Give me all your money, or I will beat you up! PO: I like you. You're a problem solver. You've given me a reason to arrest you. You have my blessing to marry Marion.

Marion now has learned something about Craig that is different from what he told her before they became engaged. If Craig and Marion cannot agree on the issue of having or not having children, this most likely will lead to canceling their wedding plans even though they sought and obtained PO's consent. In some respects calling off the engagement will be embarrassing and somewhat awkward for both individuals because the decision stems from a real or perceived lack of honesty. Still, the most important thing is that Craig and Marion will both feel incredible relief that they recognized their incompatibility on this important issue before exchanging their vows and making their union legal.

***Note* The breach of promise to marry action was adopted into the common law during the 17th century first as a tort claim, then as a contract action. The action derives from 15th Century English ecclesiastical courts, which viewed a promise to marry as the equivalent of a legal marriage. As such, actions for breaches of promises to marry were commonplace during this time.**

MoneyCorp just got word that DOJ approved the transaction with TimCo. PRES invites CEO to lunch to break the news. Right before the wine arrives at their table&

MoneyCorp: You just got a bill from the IRS seeking \$1,000,000 in payment of income taxes that should have been paid three years ago? TimCo: Yes. MoneyCorp: Did you know about this before we signed the contract? TimCo: Yes. We expected this bill after consenting to the audit adjustment. MoneyCorp: But you said TimCo did not owe any back taxes! TimCo: We don't owe anything until we get a bill. We don't pay anything without an invoice. That was Late Shareholder's rule. MoneyCorp: Who is Late Shareholder? TimCo: The only other TimCo shareholder. He owned 25%. When he died TimCo took back all his stock. MoneyCorp: By the way, DOJ granted its consent. TimCo: When do we close? MoneyCorp: We need to resolve the tax mess first.

Representations and warranties continue to serve a purpose after contract signing. For example, they protect asking party by giving it a second opportunity to walk away from the deal if it turns out that the facts do not fit the truth, even though there is a signed contract. This protection can be found in a properly drafted contract where the continued truth and accuracy of the representations and warranties are expressed closing conditions.

***Note* The following is such an example: "THE OBLIGATION OF TIMCO AND CEO TO CONSUMMATE THE TRANSACTION IS SUBJECT TO THE CONDITION THAT THE REPRESENTATIONS AND WARRANTIES MADE BY MONEYCORP IN THIS AGREEMENT SHALL BE TRUE AND CORRECT IN ALL MATERIAL RESPECTS THROUGH THE CLOSING."**

Separate and distinct from asking party's remedy, given asking party's representations and warranties, answering party also can terminate the agreement if asking party fails to perform any of its obligations. This closing condition shows up in a properly drafted contract as the fulfillment of or compliance with all covenants.

***Note* The following is such an example: The obligation of MoneyCorp to consummate the transaction is subject to the condition that TimCo and CEO shall have performed and complied with all of their respective covenants in this Agreement in all material respects through the Closing.**

Whether TimCo revealed the liability or MoneyCorp discovered it through further due diligence, MoneyCorp now knows that TimCo's tax representation and warranty was inaccurate. This inaccuracy constitutes a failure of a condition. MoneyCorp has an opportunity to terminate the transaction, much like Marion had the chance to break the engagement when she learned the truth about Craig's interest in having more children.

Closing (the Marriage) Craig and Marion are now standing at the altar. Actually, the altar is the open door of a plane from which they will parachute with an Elvis impersonator performing the ceremony. They have gotten to this point because everything that they needed to do has been done, and everything they needed to learn about each other has been learned. Even the issue of having children no longer stands in the way, because Craig has given in to Marion's desire to consume herself with her career. Ten thousand feet from the ground, they say "I do." MoneyCorp and TimCo resolved TimCo's breach of its tax

representation and warranty. TimCo will pay the \$1,000,000 liability and accept a corresponding reduction to the purchase price.

***Note* It is possible that in spite of TimCo's breach, MoneyCorp, for business reasons, may wish to close the deal without the tax liability issue first being resolved. Although MoneyCorp's lawyer will counsel against waiving the unresolved breach and failure of condition, it is ultimately MoneyCorp's decision.**

Following TimCo's payment, there are no other inaccurate representations and warranties or unfulfilled covenants or conditions preventing the closing. They close the deal.

***Note* As a practical matter, consumer deals typically do not present a lag time between contract signing and closing. When you buy a car, the purchase and financing documents are done after you and the dealer agree on the price and trade-in value. If you are financing, you certify (that is, represent and warrant) to your financial status in the loan application. The deal will fall through if your loan is not approved (failure of condition). Once your financing is approved, you sign the purchase and loan documents all at once, and then drive away in your new car. By contrast, in typical loan documents, if it turns out that your financial picture is not as you certified, you could be found in breach.**

Termination (Separation and Divorce) Craig and Marion's feet have hardly hit the ground when....

Craig: You are making a big mistake by not having children, and you'll be very sorry one day. Marion: I cannot believe we are having this discussion again. This issue nearly stopped our wedding, and now, after promising me that you did not want children, you are bringing it up again. Craig: Well, I was wrong to make such a stupid promise. I want a son, and everybody knows you can afford to spend the early years with him. It's not like I bring home chicken feed. Marion: Are you suggesting that I have a child and give up my career to raise him? Craig: That's exactly what I'm suggesting. How selfish can you be? Marion: I'm stunned. I should have known the first time we had this discussion that it would resurface. You are NOT the person I fell in love with. Craig: Look who's talking? I never thought you could be so cold and selfish. Marion: It's over, Craig. Craig: What's over? Marion: This discussion, as well as this marriage. No, the third time is not a charm. Craig twice told Marion he did not want children. She believed him and based on his representations to her that he did not want children, she agreed to marry him. Marion does not care whether Craig purposefully misled her or had a good faith change of mind. What Marion and Craig both know is that not having children is, to Marion, fundamental to their relationship, and his demand to have them cannot be reconciled with her not wanting to be a mom. They separate and divide their possessions 50/50. The day the divorce is final, Craig makes his way back to the hottest nightclub in town. The music is loud, the energy intense.... The last time she had lunch with PRES, CEO ended up taking a \$1,000,000 haircut because of the tax issue. So, after not seeing or hearing from PRES since the closing until an hour ago when he called to say he wanted to meet her at her home, CEO is holding onto her purse.

MoneyCorp: We got a letter from a lawyer representing 10 people claiming to be heirs of Late Shareholder. They claim to own 25% of TimCo. CEO: Your problem, you own TimCo. MoneyCorp: No. It is your problem! Our deal was to acquire 100% of TimCo. You told us you were the only owner, and we bought everything you had. Now, we find out you owned only 75%. CEO: (to herself) Oops....

Representations and warranties continue to protect asking party, even if the truth is learned after the closing. Asking party can seek to restore the parties to the same positions they occupied before the closing and/or seek money damages. Unwinding of the transaction is asking party's third opportunity to walk, but unlike the other two chances, it will likely require court action to implement now that closing has taken place since it is a most drastic post-closing remedy. The breakup could be accompanied by payment from answering party. We will discuss a monetary remedy in lieu of unwinding in the next section. Clearly, CEO and TimCo have breached the stock ownership representation and warranty. It is a given that MoneyCorp never would have gone to closing had it known it was not purchasing 100% of TimCo. MoneyCorp takes steps to unwind. CEO gives back her \$9,000,000 and gets back her TimCo stock.

***Note* As drastic as the step of unwinding may be, it does not preclude the possibility that MoneyCorp also may seek money damages from TimCo to make it whole.**

Indemnity (Property Settlement) Now, assume MoneyCorp did not seek to unwind, and instead the telephone rings a month after CEO met PRES at her home.

MoneyCorp: We purchased the other 25% of TimCo from the heirs. CEO: Great. Take care! MoneyCorp: Not so fast. Remember, it was your problem. You breached the representation and warranty about ownership. It cost MoneyCorp \$2,500,000 plus legal fees. We are sending you an invoice. We expect payment in 30 days CEO: How do you feel about installment payments?

Indemnification is the contract section dealing with remedies after the deal closes. Indemnification imposes a financial obligation on the breaching party for financial harm that the breach causes to the non-breaching party. The breach can be of a representation and warranty or any other matter the parties negotiate as being appropriate for indemnity. In a properly drafted contract, the representations and warranties and "post closing matters" survive closing for a specified period of time. Thus, if the breach occurs during that time period, the asking party has a remedy. MoneyCorp may have chosen indemnity over unwinding as the appropriate remedy for any number of reasons, not the least of which might be that the synergies and benefits of the MoneyCorp-TimCo entity far outweigh the \$2.5 million recoverable outlay. Perhaps MoneyCorp escrowed part of the purchase price to ensure that the funds would be there if TimCo breached.

Contracts of Adhesion (Shotgun Wedding) Somewhere in a parallel universe occurs the classic relationship example. Craig is awakened in the middle of the night by a disgruntled farmer and his sons. They haul him off to the local justice of the peace where Marion, the farmer's daughter, and her mother are waiting. Craig and Marion, surrounded by her dad, her mom, her brothers, and her dad's weapons, stand before the justice to exchange vows. Firepower, not the fire in his heart, makes Marion an honest woman and Craig say "I do". A typical, current business example: The now "happily" married couple is about to close on their house. At closing, each sees for the first time the mortgage and promissory note they are being asked to sign. Marion starts reading, asking questions about and requesting changes to the documents. The lender asks if the couple wants the home or the changes. If they want the home, the documents cannot be changed; if they want the changes, there is no home. Craig and Marion sign the mortgage and note as presented. An Adhesion Contract is defined as follows: A standard-form contract prepared by one party, to be signed by the party in a weaker position, usually a consumer, who has little choice about the terms. (BLACK'S LAW DICTIONARY 318 (7th ed. 1999) As ominous as this lack of choice may appear, an adhesion contract is more like a club than a loaded shotgun. A court can refuse to enforce any provision or the entire contract if it finds the clause or contract fits the above definition These protections essentially replace a shotgun's live shells with blanks. You can still be clubbed over the head, but you have a better chance to fight back.

Conclusion You do not need a lawyer to tell you when to befriend someone, go on a date or decide to marry. Similarly, you do not have to be a lawyer to understand a contract. Although this sounds like a declaration against the author's interest, it is not. A client that is familiar with the structure and purposes of a contract and its clauses is not afraid to use counsel to advise it on the legal ramifications. This familiarity helps the client better understand the role of counsel, more effectively communicate what it wants from counsel, more easily distinguish the risks between or among alternatives and more confidently make fully-informed decisions and express them to counsel. In the end, the client will find itself making efficient and cost effective use of counsel without sacrificing protection.