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I. **INTRODUCTION – THE DIFFICULTY AND IMPORTANCE OF CONSIDERING A LITIGATOR’S PERSPECTIVE**

The purchase and sale agreement (PSA) – or stock or asset acquisition agreement – typically is negotiated over an extended period of time by transaction lawyers who specialize in a certain area of law and / or industry. Months or years later, their work is picked over by others without this perspective – litigators, who must present it to judges and juries.

The PSA is the bridge between the PSA drafters, and the litigators and their audience. It is the primary means that the drafters – and the parties who hired them – have to communicate with this audience.

This communication breaks down too often. Where the drafters aspire to draft a clear and unambiguous agreement that memorializes their clients’ intentions and allows their business relationship to move forward, too often the that aspiration is not achieved. Instead, the intent of the parties and the drafters is thwarted by future parties, litigators, and judges who do not read the agreement as the parties and drafters intended.

Why does this occur? It often is not because of any defect on the part of the individual drafters (though that can occur), nor the bad faith of any party entering into the agreement (though that can occur too). Instead, it often is because the drafters and parties seeking to communicate to the future litigators and judges do not share the litigators’ and judges’ perspective.
In an ideal world, everyone would be experienced and conversant in every practice and substantive area of law. We do not live in an ideal world, so some communication breakdowns arising from different perspectives are inevitable. However, a solution – or at least improvement – is possible, because the transaction attorneys who draft a PSA can adopt at least some of the litigators’ perspective, even amidst the stress and time pressure of negotiating and drafting an agreement; in doing so, we believe, they can learn to consider that perspective as a routine part of their practice, and avoid (at least some) of the issues that often cause carefully drafted PSA’s to fall into litigation.

Doing so requires you, as a drafter to think about six topics when negotiating and drafting a PSA, including:

1. Your (future) audience;
2. The context or “story”;
3. Avoiding a lawsuit;
4. Who will pay if a lawsuit occurs;
5. Background law, rules, and precedent;
6. Whether and how to use “standard” clauses and definitions.

Each of these topics is addressed in turn below.
II. SIX TOPICS TO THINK ABOUT WHEN NEGOTIATING AND DRAFTING AN AGREEMENT

1. YOUR (FUTURE) AUDIENCE

“The first step to winning a lawsuit is convincing the judge to want to rule in your favor; every step thereafter – the gathering of the facts and evidence to support your position – is just giving him the vehicle to do so.”¹

In a transaction, the audience of the PSA is the parties and lawyers, who must be convinced the document memorializes the agreement they intend to make.

In litigation, the audience of the PSA is primarily a judge and his clerks.

The differences between these two audiences are immense and revolve around three issues – objectivity, experience, and motivation.

Objectivity – the parties who agree to and lawyers who draft an agreement are all familiar with it; they approach it from a perspective of subjectivity. Their subjectivity includes their knowledge of the background of the transaction, their respective motivations and expectations entering into it, their and their counterparty’s respective conduct during negotiations, and the intent and purpose of the clauses that deviate from the form clauses normally found in agreements of that type.

A judge has none of this perspective; he and his clerks will approach

¹ This paraphrases a lesson of John McCollam, one of the founders of Gordon, Arata, McCollam, Duplantis & Eagan.
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it from a perspective of objectivity. This perspective is captured in the primary method the court will employ in interpreting the contract – the objective method of interpretation, which seeks to interpret the language of a contract according to its plain and ordinary meaning.

Parties and drafters often do not realize the extent to which their subjectivity colors their interpretation of an agreement. This can be mitigated in various ways, including by having an objective attorney from one’s own firm review the main terms of an agreement for ambiguity, and, as discussed below, carefully defining the dates and terms one employs, as well as providing narrative and context in individual sections and clauses, as well as the recitals.

Experience – most judges – to say nothing of their clerks – are not civil transactional attorneys, nor are they oil and gas attorneys.

For some perspective, in the federal system most judges spend more time trying criminal matters than civil ones, and try as many or more criminal cases each year as civil cases; it is not uncommon for a judge to go a year or longer without trying a civil case. Of their civil cases, a majority typically are habeas, civil rights, or discrimination. Their other civil cases are divided among the many areas of law over which a federal court has jurisdiction, including various types of fraud, securities, and antitrust.

Consequently, a federal judge will only handle a handful of cases a
year that are typical of the civil cases firms like ours (and yours) regularly try. This means that, even if a practice area is dominant in a certain jurisdiction – like oil and gas in Louisiana or Texas – a federal judge may only handle a handful of cases in that area each decade.\(^2\)

The lack of experience of his clerks – most of whom are either fresh from law school or were criminal lawyers previously, hired to handle the voluminous and procedurally demanding cases in that area – goes without saying. Yours may be the first PSA the clerk ever reads.

Similarly comprehensive statistics are not available for state court judges, but it is safe to presume they do not handle disputes arising from major transactions everyday.

The consequence of this is that the audience of your PSA in litigation may be entirely unfamiliar with it.

Transaction lawyers often (though not always) are aware of this with regard to the substantive matters they specialize in, and they usually will take the care to define their technical terms.

They often are not aware of this with regard to the structure of the PSA itself, and the norms of negotiating and closing a large transaction.

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The clerk tasked with interpreting an agreement in the first instance may never have heard of “reps & warranties”, much less understand what their role in the PSA is supposed to be. At least one state supreme court confused itself when trying to understand how a PSA could provide for a “closing date”, and then an adjustment of price after the “closing date”; the court there found the contract ambiguous, leading to protracted litigation and ultimately the contract’s unenforceability, though other factors also were at play in this decision.³

This lack of familiarity presents opportunities to parties who wish to breach an agreement, as it allows them to advance interpretations of a PSA that no transactional practitioner experienced in an area would accept. However, it also means that those who wish to secure their counterparties to an agreement must draft them for that objective and unexperienced audience, as discussed below, through the use of tools such as a single page of definitions, exclusive and consistent use of defined terms, and exposition of intent and explanations of context in specific sections as well as the recitals.

**Motivation** – finally, the judge will approach the agreement with a different motivation than the parties and the drafters. The nominal goal of a judge interpreting a PSA is to discern the intent of the parties. However, as

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discussed below, any lawsuit arising out of a PSA will not arise in a vacuum; instead, it will arise within a narrative of events preceding the PSA and occurring after it.

This means the judge will not only be trying to discern the intent of the parties when interpreting to the PSA. He also will interpret the PSA so that it makes sense of these surrounding events, and achieves some measure of justice in light of them.

Concretely, a drafter should accommodate this motivation with two measures. First, he should avoid making the PSA (seem) unfair or one-sided. It is tempting to do so when one has the opportunity. However, in the event litigation arises – and such behavior can very well make litigation more likely to begin with – it merely will make the judge push back against the perceived unfairness; in other words, it can cause your client to lose the first step in the litigation by causing the judge to want to rule against him.

Second, and similarly, unenforceable clauses should not be included in the agreement. At best it makes the drafter seem ignorant; at worst it makes the party seem like an overreaching bully. Neither is an image one wants to begin a trial with.

2. **THE CONTEXT OR “STORY”**

As discussed above, neither the transaction, nor the lawsuit arising from it, take place in a vacuum. The context of the transaction is part of the
subjective perspective of the parties and drafters which color their interpretation of the agreement, and to which their objective audience is not privy. Likewise, the PSA will be interpreted in light of – both to be consistent with, and to achieve justice considering – the events that occur after it that result in a dispute and litigation.

This narrative or story, of the transaction and the events leading up to the lawsuit, will be the context and subject matter of the lawsuit, and how the judge perceives it typically will determine who prevails.

This is important for the drafters because they have an invaluable tool at their disposal to frame this context in their favor – the PSA itself. In a lawsuit arising from a transaction, the single document the fact-finder is guaranteed to study is the PSA. The PSA also holds a privileged place in the canons of construction the court uses to determine the parties’ intent.

Drafters can harness this tool in two ways. First, they can include the context of the transaction in the recitals. This is sometimes done, but it often is perfunctory or filled with legalese, more concerned with disclaiming any liability or responsibility for prior acts than explaining what preceded the PSA. These recitals can be the first item a judge reads about your case, and a privileged item the other side essentially cannot deny – take advantage of them to tell your side of the story in an objective and mutually agreed to context, before a dispute arises.
Second, exposition and explanations can be included throughout the agreement itself, in specific sections and clauses. For instance, a provision may deviate from the standard provision and seem unfair to one party, who also seems to have gotten the short end of the stick in other parts of the agreement. As discussed above, this perception is damaging in the event litigation arises; preemptively mitigate it by explaining (assuming there is an acceptable explanation…) the reason for the deviation, and the advantages the other party is obtaining from the agreement – or events surrounding it – that may not be apparent.

Likewise, if a particular provision is important and painstakingly drafted – such as in the description of a sequence of payments or promissory notes that occur on different dates pursuant to various conditions – the parties’ intent can be captured not only by making it longer and more detailed, but by explaining the parties’ intent in plain English, and instructing the court, in the event the scheme described is found to be ambiguous, to interpret the clause to achieve that intent.

Lawsuits are won and lost on stories and context. The PSA is a tool to present your story in an objective and mutually agreed to form, before any dispute arises; use it.

3. **AVOIDING A LAWSUIT**

Transactional lawyers often consider – and are skilled at negotiating
and drafting – provisions to allow their clients to escape liability and exposure in the event of a lawsuit. This is the focus of most indemnity and ADR clauses, for instance.

Transaction lawyers generally are less likely to consider – or are less likely to successfully draft – provisions to incentivize or discourage parties from filing a lawsuit in the first place. The exception to this statement almost proves the rule – the mandatory mediation clauses included in many PSA’s are notably ineffective, in our experience, except to make a broader arbitration provision seem less harsh for a court asked to compel arbitration.

Instead, there are at least three measures a drafter can take that may actually avoid a lawsuit.⁴

First, as discussed above, avoid motivating someone to want to sue you by avoiding substantive provisions that are grossly unfair to one party, or that operate to one party’s (dis-)advantage when an objective reader of the clause would expect the opposite result.

For instance, stock or asset purchase agreements where one company is acquiring the other company, including its management, often contain earnout provisions. In these earnout provisions, payment of a portion of the purchase price is delayed and paid over the subsequent three to five years, contingent on the acquired company achieving certain

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⁴ A fourth obvious one – eliminating ambiguity – is addressed in Section 6 below.
financial benchmarks, as a means to incentivize the acquired management to continue to perform.

Earnout provisions can be supremely useful. However, the financial benchmarks often are based on yearly EBITDA and set at levels the acquired company would meet if it continued to operate on its own; the acquiring company then also retains the right – often not explicitly stated, but pursuant to its implicit right as the new owner of the company – to allocate its corporate overhead against the EBITDA of the acquired company, causing the acquired company to miss its benchmark. If this outcome is not evident from the text of the PSA, and especially if it is not disclosed to the acquired company as part of negotiations, then the acquiring company is essentially purchasing a lawsuit as part of its acquisition.

Second, and likewise, a PSA can help to avoid a lawsuit by giving an aggrieved party an “out” in case events do not proceed as planned or a dispute unexpectedly arises. For instance, an earnout can provide it is forfeited only in part if one member of a management team leaves, but the other members stay and fulfill their obligations; this gives a disgruntled manager an incentive not to try to poison the well if things should not work out and he should leave. Similar creative structures can be designed to allow a partial exit from a pure asset acquisition that does not perform as
expected, for instance, by allowing the refund or re-allocating of accounts receivable or production proceeds held in suspense.

Finally, a PSA can help to avoid a lawsuit by providing parties tangible incentives not to litigate. For instance, in the earnout scenario described above, a PSA, and the accompanying employment agreement, typically will provide the earnout payments are forfeited if a manager is terminated for cause. This only provides – in the eyes of a court – a financial incentive for the employer potentially to misrepresent the employee’s performance; it also means an employee terminated under it will face not only the humiliation of being terminated for cause, but a type of financial ruin as well. We have not performed a statistical analysis of the topic, but in our experience, we believe it is safe to presume that such an employee with nothing to lose is much more likely to file a lawsuit.

This situation can be solved by providing that, even in the event of termination with cause, the employee will receive a severance pack – for instance, of $20,000 per month for one year – which shall be automatically forfeited should the employee file suit to challenge the termination. This makes the employee’s financial situation less perilous and gives him a concrete incentive not to proceed with a lawsuit out of spite or embarrassment.

Similarly, an asset acquisition agreement can provide for a partial
refund under certain conditions – for instance, should a neutral arbitrator determine certain objective criteria are not met – but that the right to the refund is forfeited if the arbitrator’s decision is challenged, or the agreement otherwise challenged.

By not needlessly antagonizing, and giving the aggrieved an “out” and a financial incentive not to pursue a lawsuit, the PSA can not only shield a party from liability should a lawsuit occur, but help to prevent a lawsuit from occurring in the first place.

4. **WHO WILL PAY IF A LAWSUIT OCCURS**

With the exception of trying to make indemnity provisions as comprehensive as possible, transactional lawyers often do not consider who actually will pay should a lawsuit arise and the indemnity provisions be invoked – the client’s insurer. In our experience, lawyers negotiating and drafting a PSA often (with notable exceptions!) have essentially no knowledge of their client’s commercial general liability (CGL) coverage, and rarely undertake a detailed coverage analysis when negotiating indemnity clauses. This can be pernicious for two reasons.

First, the transactional lawyer can be too successful – an indemnity provision can be so strong that there is essentially no method one party can use to attack the other party without pleading fraud or intentional misconduct; fraud and intentional misconduct generally are not covered by
CGL policy, while negligence, gross negligence, and even recklessness often are. This is congruent with the advice above about giving an aggrieved party an “out” – if the only way an aggrieved party has to sue your client is by claiming fraud, there is a much higher chance your client will be accused of fraud than if other (still difficult to prove) causes of action are left available.

Second, pursuant to the contractual liability exclusion – or modifications to it, such as the Contractual Liability Limitation endorsement – a client’s CGL insurance may not cover liability assumed by the indemnities in a PSA, particularly where these liabilities can originate through a string of contracts, rather than the counterparty’s own negligence.⁵

A denial of coverage for liability assumed in a PSA can have a particularly negative impact on a company acquired through an asset acquisition sale, where the acquired company left essentially a corporate shell with some capital and CGL coverage to defend any claims not transferred to the acquiring company. Then, a denial of coverage can force the acquired company to pay defense costs it is unequipped to meet, and to face the unwelcome calculus of whether it should not fight a suit because its

lack of capital makes the defense costs not worthwhile, but at the risk the
suing party will attempt to execute the resulting judgment by piercing the
corporate veil.

For these reasons, when negotiating and drafting indemnity and
similar provisions, we encourage drafters not merely to seek the most
comprehensive indemnification possible, but to think about the means by
which an aggrieved party will bring a suit should it feel compelled to do so,
and, in the event such a suit is brought, the coverage that will pay for it.

5. BACKGROUND LAW, RULES, AND PRECEDENT

When faced with the challenges and considerations discussed above,
and when trying to make a PSA clearer to objective and uninformed future
litigators and judges, it seems to us a transaction attorney’s natural instinct
is to make the PSA ever longer and more detailed.

This is an understandable, and sometimes appropriate, reaction.

However, it has the unfortunate effect that, the longer and more
detailed an agreement, the higher the risk that one part of the agreement will
contradict another part.

The negative consequence of this risk is difficult to overstate.

If a lawsuit arises, then it need not be too expensive or distracting if
it can be resolved on summary judgment, based on the language of the
agreement. However, due to the rules of parol evidence and what a court
may and may not determine as a matter of law versus what a jury must determine as a matter of fact, summary judgment generally only is granted, based on the language of the agreement, where an agreement is judged to be unambiguous.

A finding that one part of the agreement contradicts the other, in any way material to a dispute, essentially mandates that the agreement be judged to be ambiguous. Then, parol evidence may be offered to resolve the ambiguity, and the parties may conduct discovery on the issue. In the best case, expensive discovery occurs and the court ultimately determines it is able to determine the contract’s interpretation; in the worst case, the court determines there is an issue of fact requiring a jury determination.

Either scenario is expensive and essentially a failure of the PSA. Accordingly, any “solution” that increases the risk of internal contradiction, and thus ambiguity, is best avoided.

An alternative to making a PSA longer and more detailed is to rely more on background law and rules, and precedent.

A court may not be familiar with the structure of a PSA. However, a court is capable of reading case. Where a controlling decision exists determining the meaning even of a seemingly convoluted provision, a court will use that decision to determine the meaning of the provision as a matter of law, and grant summary judgment.
This approach also has the advantage that, frankly, the default or background law and rules can be preferable to that devised by the negotiating and drafting attorneys, who may not accurately foresee the events they contract for.

This is commonly seen in ADR provisions, where a PSA includes a complex timeline and sequence of events pursuant to which arbitration must be sought. Even where an arbitrator is given discretion to adjust the timeline, unless both parties consent to the adjustment, where the timeline is explicitly agreed to in the PSA most arbitrators will decline to do so. The timeline can be intended to ensure efficient arbitration occurs. However, in practice, the filing or discovery periods are often ill-suited – in either direction – to a specific case.

In that instance, simply providing that arbitration shall occur pursuant to the commercial rules of the American Arbitration Association often yields a preferable outcome than the painstakingly drafted arbitration provision.

In addition, as noted above, utilizing such a default provision allows a party, when litigating the issue, to rely on the ample precedent that often exists surrounding commonly litigated provisions. A longer and more detailed provision will often be distinguishable from the standard provision in a way that allows a party to escape the force of this precedent, at least to
secure a finding the provision is ambiguous and discovery, and possibly fact-finding by a jury, must occur.

At the least, when provisions are lengthened and detailed, as noted above, a party would be wise (i) to explain the reason for the deviation from the standard provision, and (ii) to provide a catch-all clause, agreeing and instructing the court, in the event of a finding of ambiguity, to construe the clause itself to achieve the parties’ stated intent.

Even then some courts will find the lure of ambiguity irresistible. However, if there is some precedent addressing a provision previously, a court is almost infinitely more likely to rule on its meaning as a matter of law than if it confronts the provision in the first instance.

6. STANDARD CLAUSES AND DEFINITIONS

Finally, one reason a drafter can find it difficult to adopt a litigator’s perspective is that the clause(s) that gives rise to litigation may not be the focus of the parties’ negotiations, and thus the drafter’s attention. As a result, whole sections of the PSA may be assigned to a less experienced attorney and reviewed with varying degrees of rigor; more certainly, many provisions of the agreement will be composed of “standard” clauses found in essentially every PSA, and taken from a form or past agreement on the firm’s file system.

Consistent with the advice immediately above, if “standard”
provisions are to be included, it certainly is preferred they be in a form previously used – and, hopefully, previously reviewed by a court – than drafted anew for each agreement. However, we find that often the “standard” set of clauses is not needed, and in fact can have the direct opposite effect of that which the particular transaction requires.

We find this occurs particularly frequently with “time is of the essence” and “merger” clauses. A “time is of the essence” clause essentially makes every deadline in the contract a strict deadline. In many states, it also makes any modification of a deadline a substantive change to the contract governed by the statute of frauds, including that statute’s requirements for contractual modifications.

In our experience, this clause is sometimes included by attorneys who consider themselves scrupulous about deadlines, but who do not consider the possibility that, for instance, the transaction may not close, or the post-closing accounting may not be completed, by the deadlines provided in the agreement. In that instance, a court may find the “time is of the essence” clause renders unenforceable the parties’ informal agreements to extend the closing deadline, and causes the contract to terminate by its terms.6 Similarly, a court may find the time is of the essence clause makes a parties’ essentially innocent and common failure to complete timely the

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post-closing accounting a material breach of the contract, entitling the counterparty to rescission and/or significant damages, or at least making the contract ambiguous and the issue a question of fact not susceptible to summary judgment resolution.

From the point of view of litigation, technicalities that can derail an agreement or singularly support a lawsuit should be avoided where they are not important to a client’s position; we find that blanket “time is of the essence” clauses rarely are sufficiently important to warrant inclusion. Instead, the contract’s deadlines should be analyzed individually, and where time is of the essence for your client, a clause should be included where that particular deadline is defined.7

Similarly, almost every PSA today includes a merger clause. However, once litigation commences, parties often—and in good faith—complain that other agreements, and side agreements modifying the PSA itself, were and are crucial to it.

We find that when parties include “merger” clauses, what they really intend are clauses (i) excluding parol evidence, and (ii) disclaiming reliance on representations made in negotiations or otherwise not in the agreement.8

7 For a skillful selective inclusion of a “time is of the essence” clause, see 115-117 Nassau St., LLC v. Nassau Beekman, LLC, 74 A.D. 3d 537 (N.Y.A.D. 1 Dept. 2010).
The typical merger clause is much broader than this; where those other clauses are intended, they should be used in its place.

The consequence of essentially inadvertently including a merger clause can be severe. For instance, where two agreements are concluded, at least one party often understands them to be essentially part of the same transaction, as when an employment agreement accompanies a stock of asset acquisition agreement, or assets are sold in a series of assignments, agreements, and settlements. When one agreement is materially breached, that party will seek to stop performing under the other agreement(s), or even have those agreements rescinded.

Needless to say, where a merger clause is present, a court is much less likely to find the agreements related and such cessation of performance or rescission warranted. At the least the merger clause will inject an element of uncertainty into the issue, and require a court to find a more explicit link between the agreements – such as one’s incorporation into the other – than would prevail absent the merger clause.\(^9\)

This advice is part and parcel of the advice given at the beginning of this piece, to think about the story and context of one’s transaction, including what led up to it and what will follow it. If other agreements or representations constitute part of your client’s motivation for entering into a

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\(^9\) See *In re C-Span Entertainment, Inc.*, 162 S.W.3d 422 (Tex.App.—Dallas 2005) (finding multiple agreement linked despite merger clause, because one incorporated the other by reference in a schedule).
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transaction, then attempt to insist on their inclusion by reference in the agreement – at least in the recitals – and / or that the merger clause be excluded or modified to acknowledge their existence.

Finally, in terms of clauses not paid attention to, the point is obvious, but please think about your definitions, and adhere to their consistent use throughout the agreement. We consider this point to require no further elaboration, as we hope essentially every lawyer is aware of it; we mention it only because it so often is forgotten.

A corollary to this point that, in our experience, some lawyers may not be aware of is the wisdom of including all of a contract’s dates in the definitions, then only referring to them later by their defined terms. This has the obvious advantage of making modification of the agreement simpler, as dates can be adjusted by modifying the single definition, rather than conducting a find-and-replace – subject to the whims of typos – for the entire agreement.

It also has the advantage of placing all of the deadlines in one place – so the timing of the events mandated by the contract can be considered together – allowing ambiguities to be avoided. Ambiguities often are found where two events are mandated to occur before specific deadlines, but the sequence of their dates is logically impossible given the sequence in which they must occur, for instance, where accounting must be completed by one
date, which is after a date by which payment must be made. As discussed above, such ambiguities wreak havoc on an agreement, at best preventing summary judgment and requiring expensive discovery and litigation to resolve, and at worst making the agreement itself unenforceable, or causing a different interpretation than that intended to prevail. For these reasons, we strongly advise that all of the contract’s deadlines be collected and defined together, rather than be dispersed throughout the contract.

III. CONCLUSION

We all are busy, and none of us can have the omniscience of every other practitioner’s perspective. Nonetheless, some mistakes in the PSA that routinely lead to litigation can be avoided by thinking about the six topics listed above, and using them to adopt a litigator’s perspective on the PSA.
The PSA is a means to communicate with future litigators and judges about the parties’ intent.
The negative results of not considering the litigator’s perspective

- Agreement does not function as intended
- Disputes develop

- Lengthy & expensive litigation –
- Complaints about “ignorant” judges & juries and “obviously” wrong decisions

- Issues often foreseeable from litigator’s perspective
- Anticipation is the first step to avoidance
Solution – 6 topics to think about

You can see litigator’s perspective by thinking about...

1. ...your (future) audience – (i) judges and clerks, and (ii) people,
2. ...the “story” – PSA unique tool: use to define context of what led to the transaction & what parties intended to occur after it;
3. ...avoiding a lawsuit – not just through indemnities, but measures to keep the parties from resorting to litigation
4. ...who will pay if a lawsuit occurs – structuring insurance and indemnities to ensure all liability is covered
5. ...background law, rules, and precedent – using them to avoid overly detailed agreements & provisions
6. ...“standard” clauses – whether they really are needed or appropriate
Think about…

1. ...your (future) audience – (i) judges and clerks, and (ii) people

2. ...the “story” – PSA unique tool: use to define context of what led to the transaction & what parties intended to occur after it;

3. ...avoiding a lawsuit – (i) treating counterparties fairly, (ii) giving aggrieved an “out”, and (iii) a financial incentive not to sue

4. ...who will pay if a lawsuit occurs – structuring insurance and indemnities to ensure all liability is covered

5. ...background law, rules, and precedent – using them to avoid overly detailed agreements & provisions

6. ...“standard” clauses and definitions – consider whether and how to use them
How to win lawsuits

• First step in litigation – convince the judge to want to rule for you
• Rest is just giving him the vehicle to do so
The PSA is read and drafted by two different audiences, which are different in three ways

**Transaction audience**
- Parties
- Their Lawyers

**Litigation audience**
- The litigation team
- Judges / juries

**Three Difference**
1. Objectivity
2. Experience
3. Motivation
Those who draft an agreement may not realize their subjectivity colors their interpretation of it.

1. Objectivity
   - Knowledge of background of transaction
   - Parties’ motivations and subjective expectations
   - Conduct during negotiations, leading to agreement

2. Experience
   - Knowing nothing about the transaction or parties
   - Will interpret PSA according to the plain and ordinary meaning of its terms

3. Motivation

Mitigate?
- have objective litigator review agreement
- confirm it says what you think
## 2. Experience – those who interpret your agreement are not civil transactional or oil & gas lawyers

**Not civil transactional lawyers**

- In federal court:
  - judges spend more time on criminal trials than civil
  - Of civil cases, majority habeas, civil rights, or employment discrimination
- State court - no comprehensive statistics, at least do not see complex PSA’s regularly

**Not oil & gas lawyers**

- Judges diverse, often political backgrounds
  - Few worked in oil & gas
  - Few see oil & gas regularly
- Particular issue in areas of new discoveries
- Clerks
  - Your PSA --> their first
Consequence – you cannot count on future audience having a priori knowledge

<table>
<thead>
<tr>
<th>Of the PSA</th>
<th>Of your subject matter</th>
</tr>
</thead>
</table>
| • PSA’s have a structure  
  – Your audience may not be aware of it  
  – Clerk – may not know what “reps & warranties” are…  
  • “Everyone” knows the purpose of certain clauses  
  – Your audience not | • Obvious issues for specialized industries - IP, oil & gas, etc.)  
• Also for common transaction structures – e.g., courts have become confused:  
  – a deal “closed”, yet  
  – post-closing adjustments to the closing price were required... |
## Solutions – communicate clearly & use what they know

<table>
<thead>
<tr>
<th>Communicate Clarity</th>
<th>Description</th>
<th>How you can use</th>
</tr>
</thead>
</table>
| • Impart background knowledge in the PSA  
   ‒ Of industry, and  
   ‒ the transaction | • Defined terms – use extensively and exclusively  
• Context – provide narrative:  
   ‒ Of transaction – in recitals  
   ‒ Of choices – in clauses |
| Background law and legal reasoning | • They know how to read cases and apply canons of construction  
• Will rule based on controlling cases | • Use clauses courts in your jurisdiction have ruled on previously  
• If different, reference the ruled-on clause & explain the difference |
3. Motivation – Judge will interpret PSA (i) in light of surrounding events and (ii) to be fair – need to explain

Avoid

• Obvious unfairness
• Unexplained unfairness – if unavoidable, explain it
• Unenforceable clauses

Provide

• Narrative, story explaining:
  – context and choices
  – what counterparty received for bitter pills
• Statements of purpose or intent
  – seems fairer
  – Judges do not want to thwart clear and express will of parties
Think about…

1. …your (future) audience – (i) judges and clerks, and (ii) people

2. …the “story” – PSA unique tool: use to define context of what led to the transaction & what parties intended to occur after it;

3. …avoiding a lawsuit – (i) treating counterparts fairly, (ii) giving aggrieved an “out”, and (iii) a financial incentive not to sue

4. …who will pay if a lawsuit occurs – structuring insurance and indemnities to ensure all liability is covered

5. …background law, rules, and precedent – using them to avoid overly detailed agreements & provisions

6. …“standard” clauses and definitions – consider whether and how to use them
The PSA is litigated as part of a broader narrative or story – use the PSA to define that narrative

- Case “about” one clause
- But, part of litigation will be events that
  — led to PSA, and
  — to disagreement
  — and then lawsuit
- Judge / jury’s perception of narrative determinative

Use the PSA to define that narrative
- Only document guaranteed to be studied in litigation
- Opportunity to define your story:
  — Objective
  — Mutually agreed to
  — Preceded dispute
## Provide narrative recitals and specific provisions

<table>
<thead>
<tr>
<th>Description</th>
<th>Concretely, describe:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Recitals</strong></td>
<td>• Client’s motivation for entering into PSA</td>
</tr>
<tr>
<td>• Impart background knowledge in the PSA</td>
<td>• Provisions material to that decision (court <em>must</em> enforce)</td>
</tr>
<tr>
<td>– of the industry, and</td>
<td>• Concessions client made – why deal fair</td>
</tr>
<tr>
<td>– of the transaction</td>
<td>• Deviations from standard clauses</td>
</tr>
<tr>
<td><strong>Specific provisions / clauses</strong></td>
<td>• Intent of parties with complex clauses – e.g., payment schedules</td>
</tr>
<tr>
<td>• Why specific choices were made</td>
<td></td>
</tr>
<tr>
<td>• How certain (complex) clauses are supposed to function</td>
<td></td>
</tr>
</tbody>
</table>
Think about...

1. ...your (future) audience – (i) judges and clerks, and (ii) people

2. ...the “story” – PSA unique tool: use to define context of what led to the transaction & what parties intended to occur after it;

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6. ...“standard” clauses and definitions – consider whether and how to use them
The problem

• Ever lengthier agreements and
• more detailed provisions

• Inconsistencies and
• internal contradictions

• Ambiguity, and
• Denials of summary judgment

• Outcomes:
  – At best – lengthy and expensive discovery and litigation before suit resolved
  – At worst – agreement (mis-)interpreted, contrary to intent of the parties

• Litigation lengthy, expensive, and distracting regardless
3 measures to consider when negotiating and drafting the PSA to avoid a lawsuit

**Don’t motivate someone to want to sue**

- Avoid provisions:
  - grossly unfair
  - yield opposite result one would expect

**Give an aggrieved an “out”...**

- Party with “nothing to lose” -> scorched earth lawsuit

**...and financial incentives**

- Tangible financial incentive:
  - penalty if litigation,
  - reward if not

**Example / notes**

- EBITDA based earnouts:
  - where hit,
  - but for acquirer’s overhead

- Earnout partially forfeited if rest of team stays on

- Re-allocate receivables / production proceeds

- “For cause” severance package, forfeited if suit filed
Think about...

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Transacting for lawsuits – two problems often arise from issues transacting attorneys may not consider

Transactional lawyers often consider

- Indemnities – maximize
- ADR – keep out of court

Transactional lawyers often fail to consider

- Who will pay if a lawsuit arises – a party angry enough will get around indemnities...
- Client’s CGL coverage

Two issues

- Indemnity too successful – only claims remaining fraud, intentional misconduct
- Contractually assumed liability exclusion – PSA not “assumed contract”
## Some solutions to avoid these two problems

### Solution(s)

<table>
<thead>
<tr>
<th>Too successful – only possible claims not covered</th>
<th>Contractual liability – excluded despite CGL coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Leave other (difficult to prove) but covered claims</td>
<td>• Purchase / request rider</td>
</tr>
<tr>
<td>• Provide for attorneys’ fee award if suit not successful, to discourage “Hail Mary” suit</td>
<td>• Add PSA to “insured contract” policy schedule</td>
</tr>
<tr>
<td></td>
<td>• Conduct coverage analysis when negotiating indemnities</td>
</tr>
</tbody>
</table>

---

Think about...

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5. ...background law, rules, and precedent – using them to avoid overly detailed agreements & provisions

6. ...“standard” clauses and definitions – consider whether and how to use them
The problem (again)

• Ever lengthier agreements and
• more detailed provisions

• Inconsistencies and internal contradictions
• Newly drafted, complex clauses:
  – distinguishable from standard provision
  – no controlling precedent

• Ambiguity, and
• Denials of summary judgment

• Outcomes:
  – At best – lengthy and expensive discovery and litigation
  – At worst – agreement (mis-)interpreted
• Litigation lengthy, expensive, and distracting regardless
Three alternatives to more length and detail

<table>
<thead>
<tr>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Background law / precedent</strong></td>
</tr>
<tr>
<td>• Courts don’t know O&amp;G</td>
</tr>
<tr>
<td>• Can read cases</td>
</tr>
</tbody>
</table>

| **Standard provisions** |
| • Tendency is to rewrite provision; don’t |
| • Start from standard, and explain deviations |

| **Default rules** |
| • Use default rules |
| • E.g., ADR – AAA rules |
| • Delivery – standard risk allocations |

• More likely to be litigated previously—precedent
• Fewer inconsistencies—been tested
• Often superior—Prognosticating hard
• Default rules developed for a reason
Think about...

1. ...your (future) audience – (i) judges and clerks, and (ii) people
2. ...the “story” – PSA unique tool: use to define context of what led to the transaction & what parties intended to occur after it;
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Standard forms – the issue

• We all use standard forms from our firm’s systems
• The issue – “standard” now includes clauses not needed or inappropriate for a transaction
Two clauses often needlessly (and harmfully) included

<table>
<thead>
<tr>
<th>Issue(s)</th>
<th>Alternatives / solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Time is of the Essence” – all deadlines firm</td>
<td>• Analyze deadlines individually</td>
</tr>
<tr>
<td>• All deadline changes material modifications</td>
<td>• Make “of the essence” only as needed in that clause</td>
</tr>
<tr>
<td>• No informal extensions</td>
<td>• Can always add to extension if first deadline not met</td>
</tr>
<tr>
<td>• If deadline not met – ambiguity, unenforceability</td>
<td>• Use clauses intended:</td>
</tr>
<tr>
<td></td>
<td>– no parol evidence, and</td>
</tr>
<tr>
<td></td>
<td>– no reliance on oral or pre-K representations</td>
</tr>
<tr>
<td>Merger – this agreement is only agreement</td>
<td>• Insist to include references to other agreements</td>
</tr>
<tr>
<td>• Often are other agreements – parties blocked from invoking other if one breached</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Side agreements, e.g., extending closing date, made inadmissible</td>
</tr>
</tbody>
</table>
## Deadlines and dates – problems result from defining them in different places throughout the PSA

<table>
<thead>
<tr>
<th>Issue(s)</th>
<th>Situation(s)</th>
<th>Resulting problem</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Multiple deadlines and dates</td>
<td>“Of the essence” clause – one deadline not met</td>
<td>material breach</td>
</tr>
<tr>
<td>• Defined throughout PSA</td>
<td>inconsistencies between dates</td>
<td>• Ambiguity, meaning</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– no summary judgment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>– Likelihood of misinterpretation</td>
</tr>
</tbody>
</table>
Solution – define all dates and deadlines together

Solution
• Gather and define together at once
  – then use defined terms throughout agreement
  – Same as technical definitions

Advantages
• Easy modification – change once in definition
• Forces consideration of dates together:
  – More likely to be correctly provided for, and in logical sequence
  – Avoid inconsistencies
Questions?