

# Anatomy of a Contract

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The Pillsbury logo, featuring the word "pillsbury" in a lowercase, red, sans-serif font.

# Overview

- Tour the timeline of a contracting process
- Review some types and functions of contract provisions
- Give examples of how lawyers choose contract provision types to solve problems

# Selling a Business: A Timeline

## SELLING A BUSINESS

### PLANNING

#### Why would you sell?

- › Strategy? Or opportunity?
- › Key is moving assets to their most highly valued use

#### How would you sell?

- › An entire company (merger or equity sale), or just parts? (assets, or a "subsidiary" company)
- › Get tax advice!

#### What happens if you sell?

- › Impact on the rest of your business, and on shareholders, employees, customers and suppliers ("stakeholders")
- › Impact on the community, the marketplace, the government and the environment

#### Are there good buyers out there?

Look at comparable sales, hire advisers to describe and promote

#### What do you own?

- › Surprisingly, many owners don't know!
- › Seller "due diligence" review to define and disclose assets and obligations, whether owned or leased, what is needed to transfer them

### OFFERING

#### Prepare an offer package

- › Invitation to bid, data room, form of agreement

#### What does the seller own?

- › This time, it's the bidders who make "due diligence" reviews!
- › Access data room and confidential information memorandum

#### Bidders make their offers

- › Take seller's offer "as is," or make counter-offer or non-binding indication of interest
- › Line up financing from banks

The seller and the preferred bidder may negotiate

### AGREEING

#### Define what assets and obligations are being transferred

#### Spell out the purchase price

- › Cash from the buyer, money from banks, buyer assumes seller obligations
- › Earnouts and other adjustments can bring a seller and a buyer together

#### "I'll buy the business if A and B happen, unless X or Y happens"—conditions to closing

- › Government and other approvals
- › What if there's an earthquake?
- › Seller keeps the business running
- › Buyer gets financing

#### "Representations and warranties"

Lawyer talk for "seller promises about the business on which the buyer can rely"

#### How will employees be treated?

- › Address pensions, health plans, visas, labor union and other worker concerns
- › Incentivize key employees to remain with the business

### SIGNING

- › Get final management or shareholder approvals
- › Give public notice to stakeholders and others, comply with preclosing covenants

### CLOSING

- › Work with stakeholders to address concerns and promote the deal
- › Get consents from governments and others
- › Complete the buyer's financing, to buy the business and keep it running



Congratulations—  
You've sold the business!



### POST-CLOSING

#### Wait, there's more! What happens after the end!

- › Make earnouts and other price adjustments
- › Sort out claims that come in after the closing
- › Seller and buyer cooperate and perform their promises



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# General Types of Provisions

- Preliminaries (parties, dates, recitals and definitions)
- Covenants
- Representations and warranties
- Conditions precedent and closing provisions
- Indemnities
- Remedies

# Parties and Dates

- Who are the parties, and how do you know?
  - Full legal name, jurisdiction and type of entity
  - Registration number and address in some legal systems
  - “DBAs”
  - Agency, trust and instrumentality relations
- Effective (“as of”) dates and actual dates
- The syntax of the traditional contract (or “what the heck does “W I T N E S S E T H” mean?”) and the contemporary contract

# Traditional Style

## PURCHASE AND SALE AGREEMENT

**THIS PURCHASE AND SALE AGREEMENT** (this "Agreement"), entered into as of June 4, 2012 (the "Execution Date"), by and among **CHEVRON U.S.A. INC.**, a Pennsylvania corporation ("CUSA"), **CHEVRON PIPE LINE COMPANY**, a Delaware corporation ("CPL"), and **PLAINS RESOURCES INC.**, a Delaware corporation ("Buyer"),

### W I T N E S S E T H:

WHEREAS CUSA and CPL (collectively "Sellers") are the owners of interests in crude oil and natural gas production properties located offshore California and wells, platforms, pipelines, processing facilities, terminals, storage facilities, real property interests, equipment, inventories and other property related thereto defined below; and

WHEREAS Sellers desire to sell such interests to Buyer, and Buyer desires to purchase such interests from Sellers, on the terms and subject to the conditions set forth in this Agreement:

NOW, THEREFORE, in consideration of the mutual promises set forth in this Agreement, Sellers and Buyer hereby agree as follows:

# Contemporary Style

## PURCHASE AND SALE AGREEMENT

**THIS PURCHASE AND SALE AGREEMENT** (this "Agreement") is entered into as of June 4, 2012 (the "Execution Date"), by and among **CHEVRON U.S.A. INC.**, a Pennsylvania corporation ("CUSA"), **CHEVRON PIPE LINE COMPANY**, a Delaware corporation ("CPL"), and **PLAINS RESOURCES INC.**, a Delaware corporation ("Buyer").

This Agreement is entered into with regard to the following recitals:

- A. CUSA and CPL (collectively "Sellers") are the owners of interests in crude oil and natural gas production properties located offshore California and wells, platforms, pipelines, processing facilities, terminals, storage facilities, real property interests, equipment, inventories and other property related thereto defined below.
- B. Sellers desire to sell such interests to Buyer, and Buyer desires to purchase such interests from Sellers, on the terms and subject to the conditions set forth in this Agreement.

In consideration of the mutual promises set forth in this Agreement, Sellers and Buyer hereby agree as follows:

# Recitals and Definitions

- Why recite anything?
- Who is saying “Whereas,” and what happens if he or she is wrong? California Evidence Code § 622
- *Recitals of fact*, including the relevant history of prior relations and occurrences
- *Recitals of intention*, declaring each party’s inducements and consideration for entering into this transaction
- Definitions: be consistent, and avoid surprises



# Drafting Tips

- Use divisions like Articles, Sections, Subsections, Exhibits and Schedules
- Decimals (1.1.1) are preferred to letters and “romanettes” ((a)(v)(A)(1)(xiv))
- Watch how one provision or document relates to others, and the “ripple effects” of changes
- Use ordinary language like “above,” “below,” “this Agreement”; be careful with “herein,” “and” and “or”

# When Clauses Collide

- “X; *provided, however, that Y.*” *Y trumps X*
- “Subject to Y [another sentence or section], X.”  
*Y trumps X*
- “Notwithstanding Y, X.” *X trumps Y*
- “Without prejudice to Y, X.”  
*X and Y supposedly live together in peace and harmony*

# Covenants

- Covenants are promises by a contract party to take (or refrain from taking) specified actions
- Be wary of a party's covenanting to produce a result not within its control
- Covenants generally apply over a time period: generally, between signing and closing or effective on closing
- Operative or “deal” covenants go up front, general covenants or “boilerplate” in back

# Covenants

- Always know, and usually say:
  - Who benefits and who is burdened by the covenant?
    - So a contract between  $A$  and  $B$  should not have a sentence beginning “ $C$  shall...”
  - At, or between what, points in time must the covenant be performed?
    - Assume the other party is “Holmes’s bad man”—it doesn’t want to perform
    - At what exact time and under what exact circumstances will it be in default?
  - Is a separate contract being used to implement or supplement the covenant?
- Know the legal system that lurks in the background of your covenants
  - For example, UCC, real property law, credit regulation, suretyship...

# General Covenants

- *Respect your boilerplate!*
- Assignability of contract (including preemptive rights (e.g., right of first refusal)); no third-party beneficiaries
- Entire agreement, modifications, severability
- Counterparts (not available in all legal systems!)
- Exclusivity, confidentiality, no illegal export of technology
- Costs, books and records, audits
- Notices, further assurances

# Representations and Warranties

- What's the difference, if any? (And while we're at it, what about “guaranty” and “guarantee”?)
- Representations are provisions that impose liability on a party for statements, made to induce promises and performance by others, that are not correct at the moment when made or the moment when repeated (“brought down to date”)

# Representations and Warranties

- Representations about *the parties and this contract*: organization, power, authority, consents, enforceability, brokers or finders
- Representations about *the business line, property or project*: definition, history, ownership, value, taxes, environmental matters, liens, compliance with laws and contracts, claims (**know your specialists!**)
- Representation that buyer does not intend to “distribute” equity interests

# Conditions Precedent

- A condition precedent provides that, if an event has not occurred or if a statement of facts is not correct at a stated time, one party's further obligations are discharged
- An unsatisfied condition may still be excused ("removed") if the party entitled to it waives it or prevents its occurrence
- But *by itself*, failure of a condition does not mean that either party incurs a liability



# Conditions Precedent

- Third-party actions (regulatory approvals, payoff letters, contract consents)
- Side documents (counsel opinions, engineer reports)
- Absence of material adverse changes (the “no-MAC” condition)

# Conditions Precedent

- Certificate by other party
  - it performed its covenants;
  - its conditions have been satisfied or waived; and
  - its representations, made on signing date, are accurate on the closing date *“as though made on such date”*
  - Exceptions must be accepted
- Simultaneous performance of other party's closing obligations (seller delivers transfer documents, buyer or lender delivers funds)

# Closing Provisions

- Fix the target and outside closing date
  - Specify place and time of closing
  - Fix early date for removing certain conditions
- Describe roles of escrow agents, trustees, underwriters
- Extensions to a “walkaway” date when one (or either) party may terminate
- Possible breakup fee

# Indemnities

- An indemnity is a provision that imposes liability on a party (indemnitor) to protect others (indemnitees) from adverse consequences of a stated contingency
- Used for consequences that are **uncertain to occur**, and that are outside the protected party's total control
- Allocated risks can be business risks, or risks created by transaction itself

# Indemnities

- Elements of the indemnity
  - “Indemnitor indemnifies and defends
  - the Indemnitees
  - against liabilities, losses, damages, expenses or claims
  - arising out of or relating to
  - [the indemnified events or occurrences].”
- Does indemnity cover matters caused by Indemnitees’ own conduct? To what extent?
- Procedures for making claims
- Impact of insurance coverage—especially R&W insurance
- Security backing up the indemnities

# Indemnity Limitations

- Survival
- Deductibles, baskets and caps
- Consequential damage waivers
- Waivers of statutory or regulatory rights
- Sandbagging (and anti-sandbagging!)

# Remedies

- Default Definitions
  - “Potential Default,” “Event of Default”
  - Failure to pay payment covenant (generally, no notice or cure opportunity)
  - Failure to perform other covenants
  - Breach of representations
  - Sale of collateral, impairment of business
  - Insolvency or dissolution events or actions

# Remedies

- Remedy Provisions
  - Generally, both *elective* and *cumulative*
  - Retention of deposit or escrow amount, sometimes as “sole remedy”
  - Acceleration of repayment of existing debt, no new debt
  - Foreclosure on or private sale of collateral
  - Pursuit of “deficiency”
  - Call on guaranties and indemnities
  - Default interest rates, late charges, liquidated damages



# Remedies

- Limitations of liability
  - Consequential damages waivers
  - Waivers of statutory or regulatory rights
  - Survival and limitations clauses
- Governing law
- Dispute resolution
  - Award of attorney's fees to prevailing party
  - Choice of forum and consent to jurisdiction
  - Alternative dispute resolution (ADR)
  - Waiver of jury trial, punitive damages and discovery; consent to specific performance

# The Case of the Lurking Landfill

Issue: Buyer is concerned that there might be an undisclosed and unknown environmental liability associated with the property or business

- **Representation and warranty** as to absence of such conditions
- **Condition to closing** that no such condition is identified
- **Indemnity** against damage or claims resulting from such a condition
- **Covenant** to perform remediation
- What about the seller? Potential **termination right** of its own
- Special **remedy and dispute resolution** provisions

# Solving Contract Problems

*Recap of general rules for contract provisions*

- **Covenants** impose liability for non-performance over time of duties within a party's control
- **Representations** impose liability for incorrect statements made at a moment in time
- **Conditions** provide excuses (without liability *per se*) if events do not occur at or by a moment in time for some reason
- **Indemnities** impose liability to protect others from future contingencies, within or beyond parties' control
- **Remedies** trigger or define rights upon breach, provided for by law or in the contract

# Summary

- Contract provisions create legal relations and allocate business and transactional risk
- Covenants, representations, conditions precedent and indemnities are *tools* that can be employed in *different ways* to achieve *different results*
- To add value on transactions, lawyers need to understand how these tools work and how and when to use each of them

# Thanks!

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