

# HOW TO READ A CONTRACT

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## I. INTRODUCTION

People are reluctant to read contracts—and for good reason. A contract often appears to be a formidable foe. The aspiring reader contemplates the ranks of terms and conditions lined up in neat rows, considers an assault, and quickly decides to retreat. Whether the document is found on the computer screen or the printed page, the reader would prefer to click or sign, taking a chance on the terms of surrender, rather than read it. Familiarity with the terrain seems to make little difference. Even attorneys and sophisticated business persons are reluctant to attempt to scale these walls.

This phenomenon should not surprise us, for most people do not know how to read a contract. They know how to read as such, but research into the

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Over the years I have developed an expertise in drafting contracts, as exemplified by my student book *Drafting Contracts* and its practitioner version, *The Contract Drafting Guidebook*. I was stimulated to think about reading contracts by an invitation to speak at the AALS Workshop on Reading Critically, January 1999. The preliminary thoughts I presented at that workshop can be found in *Critical Reading of Contracts*, 23 LEGAL STUD. F. 391 (1999). The work was further developed for a faculty colloquium I presented while a visitor at the University of Hawaii William S. Richardson School of Law in the spring of 2002. I am grateful for the support and hospitality of the faculty, students and staff of that school. I am also grateful to Dale Latham of the Bonneville Power Administration in Portland, Oregon, for the opportunity to employ these techniques by conducting training workshops for contracts specialists.

process of reading informs us that there is reading and there is *reading*. That is, the protocols—the procedures and skills—the reader employs to read a novel are not the same as those employed to read a poem, a statute, or a contract. Although we must know the protocols in order to read each kind of text, we are rarely taught them expressly. We are simply told, for example, to “read the contract” and left to our own devices. Because those who do know how to read contracts are generally unconscious of the protocols they employ, their value as teachers is limited. They can do it, but they cannot tell you how they do it. This Article makes explicit the implicit protocols employed by an experienced reader of contracts and attempts to convey those protocols to the novice.

Contract law tells us that a contract is formed by “objective manifestation of assent.” Once you have manifested assent to a contract, whether by signing, clicking, or some other means, you are bound by its terms whether or not you have read them or understood them. The audience for a primer on contract reading must therefore be the general reader of contracts, whether attorney or not, for everyone is expected to read and understand contracts. The pronoun “you” will be used throughout to stand for the contract reader, whatever his or her background.

This Article mentions certain rules of contract law for the sake of illustrating the contract-reading skills that are the primary focus of the Article. In order to avoid distracting the reader from the Article’s central purpose, and because these principles are basic to contract law, this Article does not explain the meaning of many of the legal terms used, and does not use footnotes to identify authority for the specific rules mentioned. The author refers the reader to any general contracts treatise, such as E. Allan Farnsworth’s *Contracts*, for explanation of the rules mentioned.

You read contracts under many different circumstances but the protocols remain essentially the same in all circumstances. You may, for example, read contracts at different times in the life of a transaction. Sometimes you read a contract after the fact, that is, after you have agreed to its terms. For example, an insured might pull out the insurance contract to find out whether he or she has a claim after a loss has occurred, or a client might point out certain contract language to an attorney to find out whether the other party is in breach of the agreed-upon terms. At other times, you read the contract before the fact. For example, an attorney may read it in order to advise a client on what terms might be negotiated; the client might read it to decide whether to sign it. When reading after the fact, you are likely to start with the particular term in issue and work back to put that specific term in the general context of the agreement. When reading before the fact, you are likely to do the opposite, starting with the general theme of the contract in order to put the particular terms in context.

You may also have different goals to achieve through contract reading at different times. For example, if you are reading an on-line contract, you have no opportunity to negotiate its terms. Your goal may be to determine your rights and duties under the proposed contract in order to decide whether you should enter into the transaction, or, if you have decided to enter the transaction in any event, to at least understand what you have gotten into. If you are an attorney reading a contract proposed to a client, your goal may be to negotiate terms that protect your

client's interests. But no matter when you are reading it or what your goals are, the protocols require you to take both the narrow view and the long view: the narrow view to examine the particular language in careful detail, and the long view to see that detail in the context of the transaction and the law of contracts.

These different contract-reading scenarios indicate some of the important differences between reading contracts and reading many other texts. Contract reading is nonlinear, imaginative, nonliteral, transformative, and iterative. Contract reading is *nonlinear* because you do not begin at the beginning and end at the end. You must move around from place to place as you gather information and perceive relationships between the parts of the contract. It is an *imaginative* process because, even though contracts are written in the present, they govern the future. You must use your imagination to consider what that future might bring in order to determine whether the contract provides for it. Contract reading is *nonliteral* because you must supply text that does not appear on the page. The rules of contract law, applicable regulations, and custom and usage all provide additional text that you must consider. Contract reading is *transformative* because the text is not always static. You may have the opportunity to change the text through redrafting or negotiation.

Most importantly, contract reading is *iterative*. Because a contract is such a complex text, you will not be able to grasp the significance of every term in one reading. Whether you are reading the contract before or after the fact and no matter what your goal, reading the contract involves exploring the text many times for different purposes. I have divided contract-reading into five different explorations of the text. I call each of the explorations a "pass," in the sense of a sweep over a target. The name of each of the five passes describes the principal purpose of that pass. The boundaries between passes are, of course, somewhat artificial, and there is considerable overlap between them. For example, during your first four passes you will be gathering information that you will evaluate during the fifth pass. Nevertheless, if you are a novice reader, you will find it helpful to work through each pass before moving on to the next. As you gain expertise, you will find that you are able to compress the process and will achieve more of your goals in fewer passes. The following is a brief description of what you are expected to accomplish with each pass.

#### ***A. First Pass: Orientation***

In the Orientation pass, you will discover the general theme of the contract and the legal relationship of the parties. You will also begin to see the structure around which the contract is built. You will then pause to consider the goals of the parties and how those goals might be reflected in the contract.

#### ***B. Second Pass: Explication***

In the Explication pass, you will identify the boilerplate declarations and focus on the rights and duties of each party. You will also detect when those rights and duties are expressly conditional on the happening of some event.

### *C. Third Pass: Implication*

In the Implication pass, you will read into the contract terms and conditions that are not expressly stated in the contract. You will continue to explore the relationships between the contract terms, particularly those relationships that are not expressly stated.

#### **D. Fourth Pass: Remediation**

In the Remediation pass, you will ascertain the consequences of nonperformance of the parties' duties. Some of these consequences are expressly found in the agreement, but others must be implied.

### ***E. Fifth Pass: Evaluation***

In the Evaluation pass, you will make normative judgments about the terms of the agreement. You might find weaknesses in language, terms that are too harsh, terms that are missing, or terms that may be negotiated.

## II. THE PASSES OUTLINED

This Article proceeds with an Outline of the various steps that comprise each of the five passes. The remainder of the Article describes the steps in detail, demonstrating how they can be applied to read a contract.

As you make your passes over the contract, you should take notes about what you find. To take notes, use both the contract itself and the Outline.

*The contract itself.* Get in the habit of “talking back” to the text of the contract. Ask what a term means and put a big question mark next to it if you do not understand it. Underline terms that strike you as important. Draw lines between related terms. Question whether language might be changed to make it clearer or simpler. You will learn to see the contract not as a completed text, but as a work in progress that is open to change.

*The Outline.* The Outline of the five passes provided in this Article is more than a table of contents. You can use it to organize the information you gather and your thoughts about the contract as you work through the passes. For example, if terms you envisioned are not included in the contract, note them on the Outline and later determine whether you wish to include them. Note any inquiry you may wish to make about the default rules of contract law or applicable regulation.

### *A. Introduction*

Contract reading is:

- Nonlinear Do not begin at the beginning and end at the end.
- Imaginative Consider what the future might bring and how the text might provide for it.

- Nonliteral Supply text that does not appear on the page.
- Transformative Look for opportunities to change the text.
- Iterative Explore the text many times for different purposes.

***B. First Pass: Orientation***

In the Orientation pass, you will discover the general theme of the contract and the legal relationship of the parties. You will also begin to see the structure around which the contract is built. You will then pause to consider the goals of the parties and how those goals might be reflected in the contract.

- A. Ascertain the general theme of the contract. Look to:
  1. The description of the instrument
  2. The caption
  3. Recitals
  4. The primary exchange of promises
- B. Detect the structure of the contract:
  1. Foundation or cathedral?
  2. Stepping stone or final agreement?
  3. What are the parts of the contract?
    - Description of the instrument
    - Caption
    - Language of transition
    - Recitals
    - Definitions
    - Operative language
    - Boilerplate terms
    - Closing
- C. See the transaction against a larger background
  1. What are the goals of the parties?
  2. What are the applicable rules of contract law?
  3. Is there applicable regulation?

*C. Second Pass: Explication*

In the Explication pass, you will identify the boilerplate declarations and focus on the rights and duties of each party. You will also detect when those rights and duties are expressly conditional on the happening of some event.

- A. Identify the boilerplate terms. Boilerplate provisions frequently include:
  - 1. Merger
  - 2. Modification
  - 3. Assignment and delegation
  - 4. Force majeure
  - 5. Severability
  - 6. Headings
  - 7. Dispute resolution. Dispute resolution terms frequently include:
    - a. Arbitration
    - b. Choice of law
    - c. Choice of forum
    - d. Attorney's fees
- B. Ascertain the rights and duties of each party:
  - 1. Identify promises
  - 2. Watch for promises that are beyond customary norms
  - 3. Determine the duration of the contract
  - 4. Identify conditions. Who controls the happening of the event?
    - a. Neither party
    - b. The party whose performance is conditional on the event
    - c. The other party
- C. Consider creating a graphic

*D. Third Pass: Implication*

In the Implication pass, you will read into the contract terms and conditions that are not expressly stated in the contract. You will continue to explore the relationships between the contract terms, particularly those relationships that are not expressly stated.

- A. Read in the default rules

- B. Read in the implied conditions
  - 1. Is one party's entire performance a condition of the entire performance of the other party?
  - 2. Who performs first?
  - 3. Did the party who performed first protect itself?
- C. Read in trade usage, course of dealing, and course of performance

#### ***E. Fourth Pass: Remediation***

**In the Remediation pass, you will ascertain the consequences of nonperformance of the parties' duties. Some of these consequences are expressly found in the agreement, but others must be implied.**

- A. Is a party's nonperformance breach? Nonperformance might be excused by:
  - 1. Changed circumstances
  - 2. Modification or waiver
  - 3. Nonoccurrence of a condition
  - 4. Trade usage
- B. If nonperformance is not excused, what happens?
  - 1. The nonbreaching party may recover damages. To determine damages:
    - a. Ask what the nonbreaching party would have had if the contract had been performed
    - b. Look for express terms relating to damages
  - 2. The nonbreaching party's counterperformance may not be due. Whether counterperformance is due may depend on whether:
    - a. The entire performance was not given
    - b. A part of the performance was given
    - c. The performance was not timely given
  - 3. Create a visual representation
- C. Look for terms that address remedies. These may include:
  - 1. Specific performance
  - 2. Liquidated damages
  - 3. Limitation of remedies
  - 4. Dispute resolution

*F. Fifth Pass: Evaluation*

In the Evaluation pass, you will make normative judgments about the terms of the agreement. You might find weaknesses in language, terms that are too harsh, terms that are missing, or terms that may be negotiated.

- A. Assemble your concerns:
  - 1. Should you expressly state omitted terms?
  - 2. Do you understand and agree with all the stated terms?
  - 3. Do you understand and agree with the consequences of breach?
  - 4. Do you wish to alter any boilerplate terms?
  - 5. Are there terms you wish to negotiate?
- B. Check the document for completeness
- C. Detect weaknesses with language:
  - 1. Plain English
  - 2. Ambiguity
  - 3. Definitions
- D. Explore opportunities to gain greater expertise:
  - 1. Find an up-to-date form
  - 2. Find a book or expert on the subject

### III. FIRST PASS: ORIENTATION

In the Orientation pass, you will discover the general theme of the contract and the legal relationship of the parties. You will also begin to see the structure around which the contract is built. You will then pause to consider the goals of the parties and how those goals might be reflected in the contract.

In this pass you will:

- Ascertain the general theme of the contract
- Detect the structure of the contract
- See the transaction against a larger background

#### *A. Ascertain the General Theme*

The general theme of the contract is the nature of the transaction and the legal relationship of the parties. For example, it may be an agreement between a landlord and tenant for the rental of an apartment, or an agreement for the sale of goods between a commercial seller and a consumer buyer. Most of us do not read contracts for pleasure, so you probably have an interest in the transaction. Note which party is you or your client. Useful questions to ask to ascertain the general theme include:

- What is this transaction about?
- Who are the parties? Which one am I?
- What is the relationship between the parties?

To answer these questions, look to the following sources:

- The description of the instrument
- The caption
- Recitals
- The primary exchange of promises

### *1. The Description of the Instrument*

The description of the instrument is the shorthand heading that frequently appears in bold letters at the top of the contract. Like the title of a book, it might give you some idea of the contents of the document. If it says *Residential Lease*, *Contract for the Sale of Goods*, or *Consumer Loan*, it has given you some help in discovering the general theme. If it says *Agreement*, it is not particularly helpful.

### *2. The Caption*

The caption, usually found directly below the description of the instrument, contains the names of the parties, sometimes contains shorthand terms by which the parties are described in the agreement (usually in a parenthetical following each name), and sometimes describes the legal relationship between the parties. The names may tell you what kinds of legal entities are involved in the transaction. For example, the caption may tell you whether the agreement is between two corporations, between a corporation and an individual, or between two individuals. The shorthand terms may also tell you something about the nature of the transaction and the legal relationship between the parties.

For example, the caption:

Agreement dated January 1, 2001 between First Bank of New York ("Lender") and John C. Smith ("Borrower")

provides you with much information. The names (First Bank of New York and John C. Smith) tell you that the parties are a bank and an individual. The shorthand terms ("Lender" and "Borrower") tell you the nature of the transaction and the legal relationship between the parties: this is a loan agreement in which the Bank is lending money to Smith.

This caption:

John Doe, hereinafter described as Landlord, and Richard Roe, hereafter described as Tenant, agree to a residential lease on the following terms

tells you that the parties are both individuals, that the nature of the transaction is a residential lease, and that the legal relationship between the parties is that Doe is leasing the property to Roe.

On the other hand, a caption that states:

Agreement entered into this 1st day of January, 2001 between Owens Chemical, Inc. ("Company") and John Bartos ("Contractor")

provides virtually no clues to the general theme of the contract, so you will have to look elsewhere.

In the previous examples there are only two parties to the agreement, which makes it easier for you to keep the relationships straight. If there are more than two parties, then you need to ascertain the legal relationships among all the parties. For example, this caption:

Agreement dated January 1, 2001 between First Bank of New York ("Secured Party"), Jones Corp. ("Debtor"), and Mary Jones ("Guarantor")

indicates that the nature of the transaction is a security agreement. The Bank is the secured party, Jones Corp., a corporation, is the debtor, and Mary Jones individually is a guarantor. As you continue your passes, you will have to determine what the legal relationships between the various parties are and which of these legal relationships is affected by each term of the agreement.

### *3. Recitals*

Recitals are statements of background, often containing "whereas" clauses, that sometimes appear at the beginning of a contract. If the agreement contains recitals, your job has been made easier, for the purpose of recitals is to provide the reader with the background necessary to see the agreement in context. If the drafter has done the job well, then the nature of the transaction should be clear to you from the recitals. For example, if the recitals state:

Background: On March 15, 1999, Seller promised to deliver 100 widgets to Buyer. Buyer alleges that 40 of the widgets were defective. Buyer and Seller desire to enter into an accord to resolve the dispute between them.

then you have been handed the general theme of the contract on a platter. You will not always be so lucky.

### *4. The Primary Exchange of Promises*

The substantive provisions of the agreement provide the remainder of the clues to help you discover the general theme. Because a contract is an exchange of promises, you will always find promises made by each party. Among them, usually toward the beginning of the contract, there is often a primary exchange of promises that contains the essence of the transaction. Because the parties do not typically use the word *promise*, look for language of commitment such as *shall*, *will*, *must*, or *agrees to*.

Consider the following example:

1. Description of Work. Contractor shall devote full time and use best efforts to make sales of chemical products to Company's customers.

...

3. Commission. Company shall pay to Contractor a commission of six percent (6%) of gross sales. Payment shall be made on the 15th of each month for sales made during the previous month.

In this contract, Contractor has agreed to sell Company's products and Company has promised to pay Contractor a commission.

#### ***B. Detect the Structure of the Contract***

In order to explore the contract, you will find it helpful to study its architecture. One reason contracts are intimidating is that they appear monolithic—a giant wall that does not admit of easy entrance. But when you get to know the document, you may see that it has a structure, a pattern that allows you to make distinctions. The ability to recognize a contract's structure is a trait that separates the novice contract reader from the expert contract reader. The expert, perceiving the pattern, unconsciously places the terms of the contract into various categories. When you begin to perceive these patterns, you are on your way to becoming an expert who can penetrate any contract. There are a couple of patterns that you can identify early on in the contract-reading process:

- Whether the contract is a foundation or a cathedral
- Whether the contract is a stepping stone or a final agreement

In addition, identifying the parts of the contract will help you discern its structure.

##### ***1. Foundation or Cathedral?***

Experts know that documents are structured differently for different purposes, perhaps following the adage that "form follows function." For example, a contract may provide just the foundation for the agreement, the primary exchange of promises. This is frequently the European and Japanese model. As contingencies occur, the parties must add the details that were not constructed in advance. Alternatively, the contract may have the intricacy of a Gothic cathedral if it attempts to predict and provide for every contingency and provide for it. Many American drafters strive for this construction. Having recognized these different structures, you must be prepared to work out the details in the first structure and find them in the second.

##### ***2. Stepping Stone or Final Agreement?***

Sometimes the agreement is a stepping stone to a later agreement. Parties negotiating a complex agreement may build their agreement in stages, like a structure that is initially built small but with the capacity for later growth. The parties may, for example, call their initial agreement a "Memorandum of Understanding" or "Letter of Intent," often specifically providing that they do not

consider themselves bound by the agreement unless and until they reach a later stage of agreement. In real estate transactions, parties may sign a “buy-sell agreement” or “escrow agreement” that does bind them, but contemplates a later contract that contains additional terms. Alternatively, the parties may make clear that their initial agreement, however skeletal, is the final agreement.

### 3. What Are the Parts of the Contract?

Within these different structures, you will often see a pattern that allows you to break the contract down into smaller pieces. A common structure frequently includes the following parts, in this order:

- Description of the instrument
- Caption
- Language of transition
- Recitals
- Definitions
- Operative language
- Boilerplate terms
- Closing

During this pass, when you ascertained the general theme, you saw that the structure usually includes a *description of the instrument*, a *caption*, and a *closing* that contains signature lines (or the equivalent, such as a button that says “I agree”). *Language of transition* often appears after the caption or before the closing, providing a transition from the caption to other text or from other text to the closing. For example:

In consideration of the mutual covenants set forth below, the parties hereby agree as follows:

In witness whereof, the parties have executed this agreement on the day and year first above written.

This transition language generally serves no purpose and can be disregarded.

Some contracts may contain *recitals* or *definitions*. The recitals provide background information that enables you to put the transaction in a context. If the contract contains recitals, you look at them in order to determine the general theme. When you encounter definitions, you should set them aside, reading them only when an operative term uses the defined term. We will return to definitions in that context.

The remaining portion of the contract is the *boilerplate terms* and the *operative language*. The boilerplate terms do not contain rights and duties of the parties but declare the ground rules the parties have agreed to follow in certain circumstances. They are the housekeeping details that appear in virtually every contract. The boilerplate may be set off with a heading such as “Miscellaneous” (but never “Boilerplate”) at the end of the document. More likely, these terms are

mingled with the other terms, usually toward the end of the document. For now, just identify the boilerplate terms and set them aside; you will scrutinize the boilerplate in the next pass. The operative language is the heart of the contract, containing the promised performances of the parties and the events that must occur before those performances are due. Sometimes the operative language is broken down into sections that reveal the structure of the contract. For example, a homeowner's insurance policy may be organized around sections called "What we will cover" and "What we will not cover," while a residential lease may be broken down into "Landlord's Obligations" and "Tenant's Obligations."

More frequently, however, the document itself does not expressly reveal its detailed structure. Nevertheless, as you read it, you will see patterns, terms that may be grouped together around a common theme. A sales contract, for example, may contain Delivery Terms (Seller's obligations to deliver), Payment Terms (Buyer's obligations to pay), and Warranty Terms (Seller's obligations after delivery). Look for those organizing principles as you continue your passes.

### *C. See the Transaction Against a Larger Background*

After you have ascertained the general theme and the structure of the contract, you will find it helpful to pause in your reading. Take a few moments to reflect on the transaction. You should see the transaction against the background of:

- The goals of the parties
- The rules of contract law
- Regulation

#### *1. What Are the Goals of the Parties?*

Ask what each party wants to get out of the transaction, that is, what their goals are. The answers to this question are not always found in the contract, but your imaginative search will pay dividends. You can better understand the transaction when you see that certain provisions are inserted to further the goals of the parties in that particular transaction.

I call this use of the imagination "what-iffing" the contract. It is what makes contracts such interesting reading, for every contract is an adventure in time travel! Even though the contract is written in the present, it describes events that are going to arise in the future. But the future is unpredictable. Because the events may not occur, the parties are taking risks. A prudent party may try to predict those future risks and seek protection from them in the contract. The "Three P's" of contract drafting are *Predict, Provide and Protect*:

- Predict what may happen in the future,
- Provide for that contingency in the contract, and
- Protect the party with a remedy.

Because much of the law of the contract involves risk-shifting, your imagination and your close reading will lead you to observe provisions where one party shifted a risk to the other party or where there is an opportunity for risk-shifting.

For example, in a transaction involving the sale of goods, what are the goals of the seller and the buyer? One goal of the seller is to avoid claims by the buyer. In predicting the future, the seller may foresee a claim by the buyer that the goods are defective. The seller may therefore provide terms that shift the risk that the goods are defective to the buyer. Because the buyer's goals include getting defect-free goods, the buyer can be expected to shift this risk to the seller.

### *2. What Are the Applicable Rules of Contract Law?*

The technique of identifying goals will also alert you to terms that the parties did *not* include in the contract. You will need a knowledge of contract law to determine the consequences if an issue arises that is not addressed in the contract. The rules supplied by contract law are often called the "default rules." Just like the default settings on your word processor, they are the rules that apply unless you change them—which you are generally free to do. But if the contract is silent on a rule, contract law will generally read in the rule that reasonable parties would have written in if they had thought about the omission.

For example, another goal of the seller of goods is to get paid. The contract may state, "Seller shall deliver the goods on July 1 and Buyer shall pay Seller \$1000 on August 1." The reader must "what-if" the contract by time traveling ahead to August 1 and asking, "What happens if Buyer does not pay?" If the contract does not provide for this contingency, the reader must use contract law to determine the consequences. The default rule where the seller has delivered the goods is that the seller's remedy is to recover the money from the buyer, ultimately through a lawsuit. Knowing this rule after the fact, the seller can determine his or her options. Knowing the rule before the fact, he or she may negotiate for cash on delivery or negotiate for terms that protect her when extending credit, such as a down payment or a security interest.

### *3. Is There Applicable Regulation?*

An important exception to the parties' freedom of contract arises when state or federal law regulates the transaction. The parties' freedom of contract may be limited in that they may not include certain terms or they must include certain terms. In some jurisdictions, the form of the contract may be regulated. Often the contract makes no reference to this body of law that provides additional rules. You must research the law and detect whether the contract terms are in violation of those rules. For example, residential leases are regulated in most jurisdictions. The regulations may provide how a landlord must proceed when evicting a tenant. Because these are not default rules but regulations, they must be followed despite what the contract may say.

To find the terms that are expressly stated in the contract, we turn to the Second Pass: Explication.

#### IV. SECOND PASS: EXPLICATION

In the Explication pass, you will identify the boilerplate declarations and focus on the rights and duties of each party. You will also detect when those rights and duties are expressly conditional on the happening of some event.

In the previous pass, you examined the structure of the contract and separated out everything but the boilerplate terms and the rights and duties of the parties. In this pass, you will:

- Identify the boilerplate terms
- Ascertain the rights and duties of each party

##### *A. Identify the Boilerplate Terms*

Before we turn to the terms that govern the legal relationship between the parties in a particular transaction, it will be helpful to first weed out the boilerplate provisions. The boilerplate terms do not contain rights and duties of the parties but declare the ground rules the parties have agreed to follow in certain circumstances. They are the housekeeping details that appear in virtually every contract.

If you are familiar with contract law, you will carefully ascertain the function of each boilerplate term as you set it aside. The boilerplate terms cannot be disregarded just because they appear in every contract. Take a second look to determine whether the boilerplate provision is in fact the same term found in most contracts or whether it has been altered or tailored to fit this transaction. For example, a *force majeure* clause answers the question, "What if performance becomes impracticable because of an event beyond the control of the party who promised it?" The provision usually reflects the default rule that unanticipated events that are beyond the control of the parties excuse nonperformance. However, it might enumerate specific events that could occur in this transaction. On occasion, it might change the default rule to provide that no event excuses nonperformance. Because they do not always state standard terms, you cannot gloss over these boilerplate provisions, no matter how dull they appear.

Boilerplate provisions frequently include the following:

- Merger
- Modification
- Assignment and delegation
- Force majeure
- Severability
- Headings
- Dispute resolution

### *1. Merger*

This declaration answers the question, "Where is our agreement found and will provisions not included in the written agreement be enforceable?" It generally states that promises not found in the writing are not part of the agreement. For example:

This agreement signed by both parties constitutes a final written expression of all the terms of this agreement and is a complete and exclusive statement of those terms.

This innocent-sounding provision can cause a lot of problems when a party later claims that an oral promise was made. For example, you are buying a used car and during the sales pitch, the seller says that he or she will fix anything that goes wrong with the car in the next two weeks. The written contract states that the purchase is "AS IS," which means the seller has no obligation to fix the car. If the contract has a merger clause, the writing will probably govern over the spoken statement. The lesson here is clear—if anyone made promises or representations to you that are not found in the written contract, ask for them to be included before you sign.

### *2. Modification*

This declaration answers the question, "If we later decide to change our agreement, is the original agreement or the modified agreement effective?" For example:

*All Modifications to be in Writing.* This contract may be modified or rescinded only by a writing signed by both of the parties.

This provision can cause hardship because, in spite of the boilerplate agreement, people frequently make changes to their contracts after they have been signed and do not write them down. For example, you have an auto loan that is payable on the first of the month and the bank can repossess your car if you do not pay on time. You call the bank and ask if you can pay on the tenth this month. The bank tells you that will not be a problem. On the seventh, they repossess your car. When you point out that the agreement was modified to allow payment on the tenth this month, the bank will say that the oral modification does not count because of the boilerplate that requires all modifications to be in writing! While you may ultimately prevail, you can save yourself a lot of hassle by doing what the boilerplate says and getting the modification in writing.

### *3. Assignment and Delegation*

This declaration answers the question, "Can the rights and duties under this agreement be delegated or assigned?" For example:

Either Seller or Buyer may delegate its duties under this contract in whole or in part. If any delegation is made, the delegating party must give notice to the non-delegating party at least 5 days prior to the delegation. The delegating party remains fully liable for performance of the delegated duties.

The operation of this provision can also take you by surprise, because it allows the parties to have someone else perform the work they promised to do. For example, you shop around and learn that ABC Pools, Inc. has a good reputation for constructing swimming pools, so you hire them to install your pool. You look out the window and there is Sleazy Pool Co. building your pool. You call ABC and they say, "The boilerplate provision in our contract says we can freely delegate our duties. That is what we did." If you want performance by the party you contracted with, you had better put in the contract that duties are *not* delegable.

#### *4. Force Majeure*

This declaration answers the question, "What if performance becomes impracticable because of an event beyond the control of the party who promised it?" For example:

*Force majeure.* Neither party shall be held responsible if the fulfillment of any terms or provisions of this contract are delayed or prevented by revolutions or other disorders, wars, acts of enemies, fires, floods, acts of God, or without limiting the foregoing, by any other cause not within the control of the party whose performance is interfered with, and which by the exercise of reasonable diligence, the party is unable to prevent, whether of the class of causes hereinbefore enumerated or not.

#### *5. Severability*

This declaration answers the question, "If a court refuses to enforce part of our agreement, will it give effect to the remainder?" The provision may not be meaningful when a drafter is concerned that a term in the agreement may be unconscionable, for a court will generally determine whether the offensive provision goes to the essence of the agreement. The language might look like this:

The invalidity, in whole or in part, of any term of this agreement does not affect the validity of the remainder of the agreement.

#### *6. Headings*

A declaration used by overly-careful drafters provides that headings in a contract have no substantive significance. For example:

The headings and subheadings of clauses contained in this agreement are used for convenience and ease of reference and do not limit the scope or intent of the clause.

#### *7. Dispute Resolution*

Terms relating to dispute resolution are important boilerplate terms. Dispute resolution terms might include:

- Arbitration
- Choice of law

- Choice of forum
- Attorney's fees

#### a. Arbitration

The default rule is that parties have the right to take their dispute to court. Therefore, if the parties want to require a party to take a future dispute to arbitration, they must include an arbitration clause in the agreement. An arbitration clause might look like this:

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

#### b. Choice of Law

This declaration answers the question, "If we have a dispute, what law will apply?" The choice of law clause provides for the body of law that will be applied to resolution of the dispute, but does not limit the place where the trial will be held. The parties are generally free to specify the applicable law, subject to relevance and to the public policy of the jurisdiction asked to apply it. For example:

This agreement is governed by the law of the State of Kansas.

#### c. Choice of Forum

While a choice of law clause identifies the applicable law, it does not identify the location where the parties must bring their dispute. A choice of forum clause does that by specifying the jurisdiction in which the plaintiff must bring the claim. For example:

Any claim arising from this transaction must be filed in Dade County, Florida.

#### d. Attorney's Fees

The default rule on attorney's fees is that each side pays its own attorney's fees, win or lose. The parties are free to change that rule by providing that the loser must pay the winner's attorney's fees. A provision such as this changes the default rule:

The prevailing party in any lawsuit arising under this Agreement or as a result of its cancellation may recover reasonable attorney's fees from the loser.

***B. Ascertain the Rights and Duties of Each Party***

You should now ascertain the rights and duties of each party and the relationships between one party's rights and duties and the other party's rights and duties. To accomplish this task:

- Identify promises
- Watch for promises that are beyond customary norms
- Determine the duration of the contract
- Identify conditions

***1. Identify Promises***

The contract's expression of the parties' promises may take various forms. The contract language rarely uses the word *promise*, but conveys a commitment or obligation to do or not to do something. Look for language such as *shall*, *will*, *must*, or *agrees to*. Your goal is to determine for each party:

- What do we have a duty to do or not to do?
- When do we have to do it?
- What do we have a right to receive?
- When do we receive it?

For example, a residential lease may provide:

- Lessee agrees to pay Lessor \$1000 per month on the first of each month.
- Lessee shall take good care of the premises and the fixtures, and commit and suffer no waste of any kind.
- Lessee must use the premises only as a family dwelling.
- Lessee will neither change locks nor install additional locks on any doors.
- Lessee's use of nails, tacks, brads, screws, stick-on picture hangers or tape on the woodwork, floors or ceilings of the premises is strictly prohibited.

These provisions all contain duties of the tenant. The Lessee has the duty to pay rent on the first and to care for the premises in the specified ways during the term of the tenancy. The terms might all be found in one part of the contract called something like "Duties of Tenant," but if they are not, you can nevertheless detect this relationship among the promises. Note that every duty creates a corresponding right in the other party. In our example, Lessor has the right to receive rent on the first of the month and has the right to expect Lessee to care for the premises. Notice the duties may be stated as negative duty—a party may have a duty *not* to do certain things.

Sometimes you have to use inferences—reading between the words—to determine what the promises are. For example, a franchise agreement provides:

Franchisee shall have the exclusive right to distribute Franchisor's products in Musselshell County.

What are the promises here? First, you may need to refresh your memory of who the parties are. Going back to the caption, you determine that Franchisor is the corporation that owns the franchise name and that Franchisee is the person who is buying the rights to this particular franchise, probably you. The contract states that you have the "right" to distribute the products. You know that every right has a corresponding duty, so this also means that you have the duty to distribute the products. How much of a duty do you owe? If the contract does not say, the default rule is that you promise to make "reasonable efforts" to distribute the products. You have detected two promises by you: a promise to distribute the products in Musselshell County and a promise to make reasonable efforts to do so. You would also infer a promise not to distribute the products anywhere else.

What did Franchisor promise? Franchisor is granting you a right, but most importantly it is an *exclusive* right. That is, there is a negative duty by Franchisor not to give the same right to anyone else. If Franchisor did not give you the exclusive right, it would not be a breach of Franchisor's promise if Franchisor granted the same right to others.

Sometimes operative language appears as declarations rather than as promises. In that case, ask why the parties would make such a declaration. This process may help you determine what the rights and duties are. For example, a contract drafted by a company that engages a sales person declares:

4. *Relationship of Parties.* The parties intend that an independent contractor relationship will be created by this contract. The Company is interested only in the results to be achieved and the conduct and control of the work will lie solely with the Contractor.

What was the company's purpose in making this declaration? The term states that the sales person's status is that of independent contractor, presumably to distinguish his or her status from that of an employee. There are advantages to the company in having the sales person be an independent contractor rather than an employee. For example, if the sales person is an independent contractor, the company is not liable for the sales person's negligence and the sales person is not entitled to certain statutory employment benefits. Therefore, you may read the declaration as a promise by the sales person not to assert employee status even though it may be in his or her interest to do so.

## 2. *Watch for Promises That Are Beyond Customary Norms*

A term that is illegal is not enforceable. Some terms, while not illegal, are so oppressive or "unconscionable" that they may shock the conscience of the court, and the court may decline to enforce them. Knowing the substantive area of law can help you identify promises that push the envelope of customary practices. Identifying these provisions can be useful for negotiation. If they cannot be altered, as in an internet transaction, identifying them can at least help you decide whether to enter into the transaction. For example, an employment contract provides:

In the event either party terminates this contract, Employee agrees not to work in a similar field of employment in this state or any adjacent state for a period of three years.

You may have identified this term as a restrictive covenant. Note that it applies even if the employee is fired and that its scope is broad. The employee may wish to determine whether it is enforceable and whether it is customarily found in all such contracts in the industry. This information will aid in negotiating the final contract. For example, if case law in your state indicates that the provision is enforceable and every employer in your field includes it, you may have little power to change it.

One reason we do not generally read form contracts, such as car rental contracts or insurance contracts, is that we have an expectation of what we will find in them and we do not expect surprises. The drafters of these form contracts know that if they slip an unusual term into such a contract, a court may refuse to enforce the term because it is beyond your reasonable expectations. The drafters also know that their chances of having these unusual provisions enforced are better if they make the term conspicuous. If you see bold print, a term that must be separately clicked on or signed, or some other device calling your attention to the provision, you should be alerted that the provision may be onerous. Make sure you understand its significance.

For example, the Federal Trade Commission (FTC) became concerned that used car dealers were misleading buyers by not clearly disclosing when the buyer was not getting any warranty. Now, the FTC requires that the used car dealer place a sticker on the window informing the buyer whether the seller is providing a warranty or not. If the seller has checked the box next to the bold print statement "AS IS—NO WARRANTY," the buyer has been alerted that the risk of defects in the car has been shifted to the buyer. Instead of warranting that the car is merchantable, the dealer is promising nothing about its condition. The buyer is assuming the risk of all defects in the automobile.

As another example, before you order goods online, the seller asks you to agree to the terms and conditions. At the top of the terms and conditions, you see this notice:

**THIS AGREEMENT CONTAINS A DISPUTE RESOLUTION CLAUSE. PLEASE SEE SECTION 8 BELOW.**

The fact that this language appears in capital letters and bold print alerts you to its importance. You scroll down to Section 8, which also contains bold print:

#### **8. Dispute Resolution**

...

**You understand that, in the absence of this provision, You would have had a right to litigate disputes through a court, including the right to litigate claims on a classwide or class-action basis, and that You have expressly and knowingly waived those rights and agreed to resolve any Disputes through binding arbitration in accordance with the provisions of this paragraph.**

If you later attempt to take the seller to court to resolve a dispute, the seller will claim that a reasonable person should have been aware that this contract contained an arbitration clause. You may well be stuck.

### *3. Determine the Duration of the Contract*

Once you have identified the duties of the parties, determine when in time they must be performed. Often a contract has a date in the caption or in the signature lines, but those dates are not always meaningful. For example, on February 7, the parties sign a one-year lease that begins on March 1. The significant dates to identify are the start date, here March 1, and the end date, here one year from March 1. The February 7 date is not significant. If another term provides that rent is due on the first day of each month, that is a significant date as well, because it identifies when a performance is due. If the contract term is renewable, note when the notice of renewal must be given. For example, if an agreement says:

This lease is automatically renewed for an additional term of one year unless either party gives notice to the other at least 30 days before the renewal date

then note the date thirty days before the end of the first year as the date by which notice must be given. Enter the significant dates on a time line or tickler file.

Sometimes a contract contains no date for the performance of a duty. For example, a contract for the sale of goods may provide that "Seller shall sell a type X widget to Buyer for \$100,000." The default rule for time of performance in the absence of a time stated by the parties is a reasonable time. Seller has a reasonable time to tender the widget to Buyer. Sometimes a performance is not due on a particular date, but after another performance is given. This observation brings us to conditions.

### *4. Identify Conditions*

A party's duties are not always immediately performable. Often some event must occur before a party has to perform a duty. Such an event is called a condition. Confusingly, drafters frequently call the provisions of a contract the "terms and conditions" without intending the designation "condition" to have any legal effect. They usually just mean *terms*. You will have to identify those provisions that really have the legal effect of conditions. Ask if some event has to occur before a party has a duty to perform. If the answer is yes, that event is a condition.

Conditions can be either express or implied. We will first look at express conditions. To find express conditions, look for language such as *if, in the event that, provided, or subject to*. For example:

The Purchaser shall not be obligated to purchase the property if the purchase price exceeds the reasonable value of the property established by the Veteran's Administration.

In the event this note is prepaid in full or refinanced, the Borrower shall receive a refund of the unearned portion of the prepaid finance charge.

After you have identified the condition, the event that must occur before a performance is due, it is helpful to ask two questions:

- Who controls the happening of the event?
- Did a party promise to bring it about?

The answer to the first question, “Who controls the happening of the event?” may be that the event is within the control of:

- Neither party
- The party whose performance is conditional on the event
- The other party

**a. The Event Is Within the Control of Neither Party**

Some conditions are pure conditions, that is, they are not within the control of either party to bring about. For example, assume Buyer and Seller agree:

If the U.S. government lifts export restrictions to China, Seller agrees to sell Buyer 1000 Type Y widgets for \$100,000.

You identify the promises—Seller has a duty to sell the widgets and Buyer has a duty to pay for them. But you also note that those promises are not immediately performable. They are conditional on the occurrence of an event—the U.S. government lifting export restrictions to China. If this event does not occur, the parties have no duties. If the event does occur, the duties are immediately performable. When you ask, “Who controls the happening of the event?” The answer is neither party. When you ask, “Did a party promise to bring it about?” The answer is no. Because neither party promised to bring it about, neither party is in breach if it does not occur.

**b. The Event Is Within the Control of the Party Whose Performance Is Conditional on the Event**

It may not seem logical to allow a party to control whether or not it performs. Nevertheless, there are circumstances in which a party can condition its own performance. For example, a contract for the sale of real estate frequently provides that the buyer’s duty to purchase is “subject to the buyer obtaining mortgage financing.” This condition is an event that is within the control of the buyer. Now you ask if the buyer has a duty to obtain financing. The answer is *not exactly*. It would not make sense to require the buyer to *obtain* financing, since the reason for the condition is to protect the buyer in case the buyer cannot obtain financing, but it does make sense to require the buyer to *look* for financing. Even though the term is stated as a condition, you would read in a promise by the buyer to make good faith efforts to bring about the event.

Sometimes the party's control seems to provide the party with a way to avoid the party's contractual duties. "Satisfaction" clauses are a notorious example. In a satisfaction clause, the promisor conditions his or her performance on his or her satisfaction with something. For example, a contract commissioning a work of art might provide:

Owner shall pay Artist the sum of \$5000 if Owner is satisfied with the work.

Performance of Owner's promise to pay for the work is conditional on the occurrence of the event—satisfaction with the work. It would appear that Owner has an easy out from the duty to pay—Owner can say "I'm not satisfied," and then not pay. Not surprisingly, it is not quite that easy. Now you ask if the party has a duty to bring about the event. The answer is that Owner has no duty to bring about his or her satisfaction, but he or she does have a duty to act honestly or reasonably. When the satisfaction is based on subjective factors, such as artistic judgment, courts have found an implied promise by the party to exercise his or her satisfaction in good faith. When the satisfaction is based on objective factors, such as operative fitness, courts have found an implied promise by the party to act like a reasonable person in exercising his or her satisfaction.

### c. The Event Is Within the Control of the Other Party

Often one party has to do something before the other party has to perform its duty. For example, a life insurance contract provides:

If insured does not submit proof of death within 90 days of death, this policy is void and the company is released from all liability.

This condition provides that the insurance company does not have to perform its promise to pay the death benefit unless a certain event occurs, submission of proof of death. This event is within the control of the insured. Did the insured promise to bring it about? No. In fact, the insurance company would be happy if the insured did not do it! So this is a condition without a promise.

More often, a party has promised some performance and that performance is the event that has to occur before performance by the other party is due. In that case, the promise is also a condition. Sometimes the event that conditions performance is stated in the contract. If so, it is called an express condition. For example:

Seller shall deliver the horse Dirty Contract Breaker in good health to Buyer at Buyer's place of business by June 1. If the horse is delivered as promised, Seller shall pay Buyer \$100,000.

Here, Buyer's duty to pay is expressly made conditional on performance of Seller's promises. More frequently, however, the condition is not expressed but must be implied. For example, if the buyer's duty in a contract for the sale of goods is to "pay net 30 days from delivery," you must read in that the buyer's duty to pay is not performable until the goods have been delivered, and even then the buyer has thirty days to pay.

*C. Consider Creating a Graphic*

Because the terms of the contract are related, a graphic can help you visualize those relationships. Sometimes a time line or a flow chart will help you visualize who has to do what, when they have to do it, and what events condition the performances. For example, a contract between the Seller of real property and a Broker provides in part:

The Seller agrees:

- a. To refer all inquiries and offers for the purchase of said property to the Broker;
- b. To cooperate with the Broker in every reasonable way;
- c. To pay the Broker a fee for professional services of \_\_\_\_\_ percent (      %) if:

(1) A Buyer is procured ready, willing, and able to buy said property, or any part thereof, in accordance with the price, terms, and conditions of this Agreement, or such other price, terms, and conditions as shall be acceptable to the Seller, whether or not the transaction proceeds; or

(2) The said property, or any part thereof, is sold through the efforts of anyone including the Seller; or

(3) The said property, or any part thereof, is sold within \_\_\_\_\_ months after the term of this Agreement to anyone who was introduced to the said property through the efforts of the Broker or the Broker's agents prior to the expiration of said term. However, no fee will be payable under this clause if the said property is sold after said term with the participation of a licensed broker to whom the Seller is obligated to pay a fee under the terms of a subsequent written exclusive listing agreement.

The conditions in subsection (c) can be recast as IF-THEN statements to make clear the events that must occur before payment is due:

IF

- A buyer is procured who is ready willing, and able to buy the property; or
- The property is sold by anyone including the Seller; or
- The property is sold within X months after the term of the agreement to anyone introduced to the property by the Broker during the term of the agreement, unless the Seller must pay a fee to another licensed broker

THEN

- The Seller shall pay the Broker a fee of x %

We will read in implied conditions along with other implied terms in the Third Pass: Implication.

## V. THIRD PASS: IMPLICATION

In the Implication pass, you will read into the contract terms and conditions that are not expressly stated in the contract. You will continue to explore the relationships between the contract terms, particularly those relationships that are not expressly stated.

The process of ascertaining the parties' duties is more easily accomplished when the terms are expressly stated in the contract, but one of the difficulties of reading contracts is that the terms do not always appear in the contract! Why do parties leave terms out of written contracts? They might have been hasty or careless. More likely, they did not want to take the trouble to hammer out all the details or they may not have foreseen all the possibilities. Sometimes, they may have foreseen them but they do not wish to raise them for fear of jeopardizing the deal.

It is not reasonable or desirable to plan for everything that may happen. As you continue to reflect on the goals of the parties and "what-if" the contract, you may determine that certain terms should have been included. In this pass, you will read in three kinds of terms that do not appear in the contract:

- Default rules
- Implied conditions
- Trade usage

### *A. Read in the Default Rules*

When the parties omit a term, contract law will generally supply the "default" rule. The process of determining the default rules is easier if you are familiar with the substantive area of law. If you are not familiar with the transaction, you may have to do some research to determine what the default rules are. You can then more easily determine whether the contract term:

- Is omitted, so the default rule must be read in;
- States the default rule; or
- Changes the default rule.

For example, a contract between a widget dealer and a buyer states:

Seller shall deliver 100 widgets to Buyer on June 1.

The contract does not state what quality of widgets Seller must deliver. The default rule, found in Uniform Commercial Code § 2-314, is that a merchant seller gives the buyer an implied warranty of merchantability. This warranty is a promise that the widgets are fit for the ordinary purposes for which widgets are used. Even though it is omitted from the contract, you must read in the default rule that the seller is promising that the widgets are merchantable.

Alternatively, the contract might state:

Seller shall deliver 100 widgets to Buyer on June 1. Seller promises that the widgets are merchantable.

Thanks for nothing, you might say, because that provision merely states the default rule. As we saw above, you would read the rule in even if it was not stated in the agreement. On the other hand, if the contract provides:

Seller shall deliver 100 widgets to Buyer on June 1. All goods are sold AS IS

then you may conclude that Seller has shifted the risk that the widgets are defective to Buyer, for the phrase "AS IS" effectively disclaims the implied warranties. The parties have used their freedom of contract to change the default rule. As the buyer, you might note this change as a negotiating point.

#### ***B. Read in the Implied Conditions***

In the last pass, you identified the promises. In this step, you must determine whether the relationship between the promises is a condition. Recall that a condition is an event that must occur before some performance is due. In the last pass, you identified the express conditions. You will now identify implied conditions. You will ask:

- Is one party's entire performance a condition of the entire performance of the other party?
- Who performs first?
- Did the party who performed first protect itself?

##### *1. Is One Party's Entire Performance a Condition of the Entire Performance of the Other Party?*

One goal of a party is to get the other party to perform. One way to achieve that goal is for the party to make its promised performance conditional on performance by the other party. For example, the contract states that the seller promises to deliver a widget to the buyer, and the buyer promises to pay \$10,000 for it on delivery. No express conditions are stated. You now time travel and ask what happens if, at the time of delivery, the buyer refuses to pay for the widget. Does the seller have to deliver it? The answer is no, because the default rules will supply an implied condition—in the absence of an agreement to the contrary, the performance of one party's promise is a condition of the performance of the other party's promise. The buyer invoked that rule to give the seller an incentive to perform and to protect the buyer when the seller did not perform.

##### *2. Who Performs First?*

The technique of making your performance conditional on the other party's performance only works if the performances are simultaneous. If one party performs first, that party has lost the ability to condition its performance on performance by the other party. In that situation, the party who performed first has become a creditor and may use other devices to reduce the risk that the other party will not perform. For example, if the contract states that the seller promises to deliver a widget to the buyer, and the buyer promises to pay \$10,000 for it 30 days

later, then the buyer's performance is not an event that had to occur before the seller had to perform. By extending credit, the seller has made its duty to deliver independent of the buyer's duty to pay. As another example, if the builder promises to build a house for the owner for \$300,000, the default rule is that the builder must go first because the builder's performance will take time. The builder must take the risk that the owner will not pay on completion.

### *3. Did the Party Who Performed First Protect Itself?*

You must first determine whether a party has made its performance conditional on performance by the other party, either expressly or impliedly. If a party has not, look for provisions that protect the party who has performed. In our example where the seller has promised to deliver before receiving payment, the seller takes a risk of not receiving the buyer's performance—payment. The seller has become a creditor, for the seller is unable to make her performance conditional on receiving payment. In this situation, look for other steps the seller has taken to protect herself. The seller might, for example, have required the buyer to grant the seller a security interest, giving the seller the right to repossess the goods if the buyer does not pay for them. Or the seller might have insisted that a third party guarantor promises to pay for the goods if the buyer does not. In the Builder-Owner contract, the builder will insist that the owner perform first. But the owner will complain that his or her completion of performance will give the builder no incentive to perform. The result will be a compromise—the owner will agree to make "progress payments" when the builder's performance has reached certain stages.

### *C. Read in Trade Usage, Course of Dealing, and Course of Performance*

Parties frequently omit terms, sometimes intentionally and sometimes unconsciously, because they are so familiar with the usages in their business that they assume those practices are part of the contract. Often trade practices come from the parties' trade or business, but they can also be established by the parties' course of dealing over a series of transactions or their course of performance over a single contract. These assumptions can be dangerous when a party is not familiar with the practices or when the parties wish to change the practice.

As an example of trade practice, assume the seller is selling the buyer 100,000 bushels of wheat. Parties in the wheat business know that because of the inexactness of measurement and the moisture content, they cannot expect exactly the quantity specified, but only a quantity plus or minus a certain percentage. To avoid disputes, particularly with someone who is not familiar with the practice, it might be best to state expressly in the contract that the quantity promised is "100,000 bushels plus or minus 5%."

As an example of course of performance, assume that a contract for the sale of an automobile states that the price includes the seller's duty to change the oil "at reasonable intervals" for the next two years at the seller's expense. During the first year, the seller changes the oil every 5000 miles. Now the buyer demands that the seller change it every 3000 miles. The parties' course of performance over

the first year has probably established that the meaning of “reasonable intervals” is 5000 miles. If the buyer wanted more frequent oil changes, the buyer could have expressly stated it in the contract or not acquiesced in the course of performance.

In the Fourth Pass: Remediation, we will look for the consequences of a party’s nonperformance of its duties.

## VI. FOURTH PASS: REMEDIATION

In the Remediation pass, you will ascertain the consequences of nonperformance of the parties’ duties. Some of these consequences are expressly found in the agreement, but others must be implied.

In the First Pass: Orientation, you saw the importance of “what-ifffing” the contract in order to predict the future. This process is particularly important in the area of remediation, because you must always ask what happens if a party does not do what it promised to do. In this pass, you will see that sometimes nonperformance is not breach. But if it is breach, remedies supplied by the rules of contract law and by the terms of the contract will come into play.

### *A. Is a Party’s Nonperformance Breach?*

Breach of contract generally occurs when a party does not do what it promised to do. However, nonperformance is not always breach of contract because the nonperformance might be excused. Nonperformance might be excused by:

- Changed circumstances
- Modification or waiver
- Nonoccurrence of a condition
- Trade usage

#### *1. Changed Circumstances*

An unexpected event, such as an Act of God, might excuse nonperformance. Check the boilerplate *force majeure* clause or the default rule for the events that excuse nonperformance.

#### *2. Modification or Waiver*

The parties might have modified the terms of the contract so that there was nonperformance under the original terms but not under the terms as modified, or vice-versa. Resolution of the issue will often turn on whether the modification was effective. Waiver may arise when the parties have not made a formal modification, but one party’s conduct has lulled the other into a reasonable belief that nonperformance is not breach. For example, a loan agreement provides that the borrower will pay on the first of the month, that time is of the essence, and that the lender may repossess the borrower’s car if the borrower does not timely pay. The borrower establishes a course of conduct of paying late and the lender takes

no action. The lender has probably waived its right to treat nonperformance of borrower's promise to pay on the first of the month as a breach that would entitle lender to repossess the car.

### *3. Nonoccurrence of a Condition*

Nonperformance is not breach if performance was conditional on an event and that event did not occur. Sometimes the condition is an express condition, such as a time for performance that has not arisen. At other times it may be an implied condition. For example, if Party A's performance was impliedly conditional on Party B's performance and Party B has materially breached, then Party A's nonperformance is excused because the event that had to occur before A's performance was due has not occurred.

### *4. Trade Usage*

As you have seen, trade usage may excuse nonperformance. For example, if a seller promises 2000 Grade A sheets of plywood and 100 of them are not up to the Grade A standard, the seller has not done what the seller promised to do. However, the seller may not be in breach if a 5% deviation from the specified grade is acceptable in the trade.

## ***B. If Nonperformance Is Not Excused, What Happens?***

If the nonperformance has not been excused, then the nonperformance is probably breach of contract. If the nonperformance is breach, what are the remedies? The promises and conditions in the contract are inextricably bound up with the remedies available to a party for nonperformance by the other party. After you have identified the promise that has not been performed, ask, "What happens if a party does not do what it promised to do?" The answer may be:

- Damages; or
- Counterperformance is not due.

Creating a visual representation may help you figure out what happens in the event of breach.

### *1. The Nonbreaching Party May Recover Damages*

In general, the nonbreaching party can recover money damages for the breach of promise. To determine damages:

- Ask what the nonbreaching party would have had if the contract had been performed
- Look for express terms relating to damages

a. Ask What the Nonbreaching Party Would Have Had If the Contract Had Been Performed

The default rule is that the injured party may recover the expectancy—the amount which will put him or her where he or she would have been if the contract had been performed on both sides. For example, a contractor enters a contract with an owner to build a house for \$200,000, of which \$180,000 represents the cost of labor and materials and \$20,000 represents profit. The owner immediately breaches. The contractor is entitled to the \$20,000 profit that the contractor would have received if the contract had been performed. If the owner breaches after the contractor has spent \$30,000 on labor and materials, then \$50,000 represents the contractor's expectancy. Alternatively, assume that after the contractor has spent \$30,000 on labor and materials for which the owner has paid the contractor, the contractor breaches by walking off the job. The owner has the house finished by another contractor at a cost of \$190,000. The owner's damages are \$20,000, for if the owner pays the first contractor \$10,000 and the second contractor \$190,000, the owner will have what he or she expected—the promised house for \$200,000.

b. Look for Express Terms Relating to Damages

You may find provisions relating to damages expressly stated in the contract. For example, in a lease, the tenant promises to pay rent on the first of the month. What if he or she does not do what he or she promised to do? The contract may provide that he or she promises to pay a \$10 late fee for rent paid after the fifth of the month. What if he or she does not do that? Another provision may provide that the landlord may evict the tenant for nonpayment. The landlord will probably not be permitted to evict the tenant when he or she first breaches his or her promise. The contract will contain a number of promises and conditions related to this remedy, including, for example, any required notices. You must find all of these provisions, which may be scattered throughout the contract, and must figure out the relationships between them. Sometimes in a regulated area such as residential landlord and tenant law, the procedure is found not only in the contract but in statutes.

*2. The Nonbreaching Party's Counterperformance May Not Be Due*

You saw in Pass Three: Implication that one party's performance of its promise can be an implied condition, an event that has to occur before the other party's performance is due. In addition to recovering damages, often when one party does not perform, the other party does not have to perform. This consequence is usually not expressly stated but must be implied. However, whether the counterperformance is excused may depend on whether:

- The entire performance was not given;
- A part of the performance was given; or
- The performance was not timely given.

#### a. The Entire Performance Was Not Given

Generally, when the performances are due simultaneously but one party does not perform entirely, the other party's performance is excused. For example, assume the contract states:

Seller shall deliver 100 widgets to Buyer by July 17. Buyer shall pay Seller \$100,000 on delivery.

Assume Seller delivers no widgets. Because Seller did not give its entire performance, Buyer does not have to perform by paying. That term is not stated in the contract, but Seller's entire performance is an implied condition, an event that has to occur before Buyer has to perform.

#### b. A Part of the Performance Was Given

It is hard to determine when less than the entire performance by one party relieves the other party of its duty to perform. Assume Seller delivers 75 of 100 widgets on July 17. Seller has clearly breached its promise, so Buyer is entitled to damages. But since Seller gave partial performance, is Buyer entitled to reject the widgets and consider its contract duties discharged? This is one of the abiding problems of contract law. The courts usually resolve the problem by determining whether a breach is "material." If the breach is material, Buyer may consider its duties discharged, but if the breach is immaterial, its remedy is limited to damages. The reader should know that the courts do not favor a conclusion that a breach is material. Look for a provision that would change this default rule. For example, the parties are free to state that failure to deliver any quantity less than 100 is a material breach.

As another example, assume you are having a contractor build a swimming pool to a depth of nine feet. What happens if the contractor does not build it to that depth? If the breach is held to be immaterial, you may be entitled to damages, but you will not have the pool you wanted. If the term is important to you, spell it out in the contract. You might want to provide that this term is material and that you have no obligation to pay in the event of nonperformance. Put this provision in bold letters to emphasize its importance or use some other means to call it to the attention of the contractor.

#### c. The Performance Was Not Timely Given

Performances that are not timely given pose a problem similar to that posed by partial performance. Assume Seller delivers all 100 widgets, but delivers them on July 20. Seller has breached a promise, so Buyer is entitled to damages. But is Buyer entitled to reject the widgets and consider its contract duties discharged? The default rule is that a breach with respect to time is generally immaterial. Therefore, Buyer still has to perform and its remedy is limited to deducting damages. Suppose, however, the contract states:

Seller shall deliver 100 widgets to Buyer by July 17. Buyer shall pay Seller \$100,000 on delivery. Time is of the essence of this agreement.

By adding the provision, “time is of the essence of this agreement,” the parties intend to make a breach with respect to time material. If Seller delivers on July 20, Buyer may be justified in saying, “I do not have to accept or pay for the goods.” In other words, the language attempts to make Seller’s performance a condition, an event that has to occur before Buyer has to perform. However, courts do not always give weight to boilerplate language like “time is of the essence.” If the contract expressly stated, “If Seller delivers after July 17, Buyer does not have to accept the goods,” the courts would be more likely to enforce the remedy.

### *3. Create a Visual Representation*

Making a diagram or flow-chart of the consequences of nonperformance can help you visualize them. For example, in a loan agreement, a debtor promises to pay a debt of \$3000 at a rate of \$300 per month and grants the creditor a security interest in his or her automobile to secure payment. In the event of debtor’s nonpayment, the remedies may look something like this:

IF the debtor does not timely pay

THEN the creditor may:

- Sue for the missed payment, plus late fees and attorney fees; or
- Accelerate the debt, and
  - Sue for the entire amount plus attorney fees, or
  - Repossess the car and sue for any deficiency after sale.

## *C. Look for Terms that Address Remedies*

Provisions in the contract that address remedies may include:

- Specific performance
- Liquidated damages
- Limitation of remedies
- Dispute resolution

### *1. Specific Performance*

Often a party does not want the money damages for nonperformance but wants the actual performance. Such a demand is called specific performance. The general rule, which the parties cannot contract around, is that specific performance can generally not be obtained for personal services and can only be obtained when the breaching party did not deliver something that is unique. For example, because real estate is considered unique, the purchaser or the seller can generally request specific performance. The contract may provide:

The Purchaser agrees that this contract does authorize the Seller to enforce the remedy of specific performance. The Seller agrees that

this contract does authorize the Purchaser to enforce the remedy of specific performance.

### *2. Liquidated Damages*

Because the amount of damages can be difficult to ascertain, contracts sometimes contain a liquidated damages clause in which the parties agree on the damages in advance. For example:

For each and every day work contemplated in this contract remains uncompleted beyond the time set for its completion, Contractor shall pay to the Owner the sum of \$500, as liquidated damages and not as a penalty. This sum may be deducted from money due or to become due to Contractor as compensation under this contract.

Courts look carefully at liquidated damages provisions. An ironclad rule is that the goal of contract damages is to compensate the nonbreaching party, not to punish the breaching party. Therefore, a court will scrutinize a liquidated damages provision to make sure it is not punitive.

### *3. Limitation of Remedies*

While they may not provide for damages that overcompensate, parties are nevertheless generally free to limit the remedies for breach. For example, you saw earlier that a warranty is a promise relating to the quality of the goods. The default rule is that a merchant seller gives an implied warranty that the goods are merchantable. If the seller breaches that warranty, the default rule is that the buyer recovers all resulting damages. You have seen that the seller may change the default rule by shifting the risk of defects to the buyer by giving no warranty. More frequently, however, the seller gives the buyer a warranty in one term of the contract and in another limits the remedy for breach of that warranty. For example, a seller promises:

Seller warrants that these goods to be free from defects in material and workmanship for a period of one year from date of purchase

and also provides:

*Consequential Damages.* In the event of a breach or repudiation of this contract by Seller, Buyer shall not be entitled to any consequential damages in excess of \$1000. This limitation shall not apply, however, to damages for injury to the person if the goods are consumer goods.

### *4. Dispute Resolution*

In addition to these limitations on the monetary amount of damages, recall from the Second Pass: Explication that contracts frequently contain boilerplate terms governing dispute resolution. Examine these terms to determine whether there are terms that may affect the procedure for obtaining remedies, such as provisions governing arbitration, choice of law, choice of forum, or attorney's fees.

Having finished our information-gathering passes, we now turn to the Fifth Pass: Evaluation.

## VII. FIFTH PASS: EVALUATION

In the Evaluation pass, you will make normative judgments about the terms of the agreement. You might find weaknesses in language, terms that are too harsh, terms that are missing, or terms that may be negotiated.

Up to this point, you have largely been an investigator, seeking information about the contract, but where you found problems you have put aside your judgments. In this pass, you will:

- Assemble your concerns
- Check the contract for completeness
- Detect weaknesses with language
- Explore opportunities to correct the weaknesses

### *A. Assemble Your Concerns*

In the previous passes, you may have detected some concerns that you want the contract to address. You have practiced preventive law, “what-iffing” the contract, trying to determine what might happen, and determining whether the contract addresses the alternatives. For example, you may have noted either on the Outline or on the contract:

- Omitted terms
- Terms that were stated
- The consequences of breach
- Boilerplate terms

#### *1. Should You Expressly State Omitted Terms?*

You may have noted that some terms you expected to find were omitted. If they were not included because the default rule is clear, you may not wish to express them. But if you have some concern about what the default rule would be, you might want to express them. Other terms that were omitted may include implied promises and implied conditions. Do you want to state some of them expressly in the agreement?

#### *2. Do You Understand and Agree with All the Stated Terms?*

With regard to the terms that were stated in the contract, were risks shifted to you? Were there terms that seemed onerous or conditions that gave a party an out? If you noted that you are not sure of the significance of a provision, ask how it fits in with the parties’ goals: Why would a party want this term in the contract?

### *3. Do You Understand and Agree with the Consequences of Breach?*

The consequences of breach may not have been spelled out in the contract. Do you want to make these consequences clear? For example, in the process of “what-if” the contract, did you detect a term that you want to be material in the event of breach, or one that you do not want to be material, or do you want to set a standard for what is material?

### *4. Do You Wish to Alter Any Boilerplate Terms?*

Recall the boilerplate provisions that you set aside. Do you want to adapt any of them for the particular needs of this transaction? For example, a *force majeure* clause may excuse the seller’s nonperformance in the event of “revolutions or other disorders, wars, acts of enemies, fires, floods, acts of God” or other events not within the seller’s control. As the seller, you “what-if” the provision and determine that you are concerned about a strike at your plant. Rather than argue later about whether that is an excusing event, you might specify that strike is an excusing event.

### *5. Are There Terms You Wish to Negotiate?*

You may have noted on the contract or on the Outline terms that you are unhappy with. These terms may be subject to negotiation. If you are dealing with a contract that cannot be negotiated, determine whether you want to enter the transaction. If risks have been shifted to you, are they worth taking?

## ***B. Check the Document for Completeness***

Are all blanks and details filled in? Is the contract otherwise complete? Watch out for language that is “incorporated by reference.” This means you must find the referenced language and read it in just as if it were expressly stated in the contract. There may also be references to parties who are not parties to the contract. Unless they have signed the contract, they are not bound by its terms. For example, a buyer and seller of real property may provide that a third party escrow will perform certain duties. If the escrow is not a party to the contract, there must be another contract in which the escrow promises to perform those duties. If the contract is only one part of a transaction, you may need to coordinate it with other documents.

## ***C. Detect Weaknesses with Language***

Does the contract have to be written in its present style? Contracts are often handed down from transaction to transaction, frequently accreting language that is not clear. Language problems include:

- Plain English
- Ambiguity
- Definitions

*1. Plain English*

If you run a contract through a grammar-checking program, you will usually discover four general problems: long sentences, words of many syllables, the passive voice, and gender-specific language. If you cure those problems, you will find that the contract is now in plain English and is much easier to read. Contracts are rarely written in plain English, although many states require consumer contracts to be written in plain English. Sometimes a contract can be so badly written that translating it into plain English may be necessary to unlock its meaning before you can complete your second pass. Here is an example:

I agree to pay you \_\_\_\_\_ percent (\_\_\_\_%) of the selling price as and for your compensation hereunder in the event that you or any broker cooperating with you shall find a buyer ready and willing to enter into a contract for said price and terms, or at such other price and terms as I accept, for the sale or exchange of said real property by you or any other, including myself, while this contract is in force.

This probably means:

I agree to pay you \_\_\_\_\_ percent of the selling price (your "commission") if, during the term of this contract, you find a buyer ready and willing to purchase or to enter a contract to purchase the property for the above price and terms. I will pay you the commission if, during the term of this contract, I agree to a sale at any other price or terms, or any other person, including myself, finds a buyer.

You could, of course, let the matter slide. But a preventive approach to problems of language may help avoid conflicts down the road.

*2. Ambiguity*

The preventive approach to contract drafting is particularly helpful when the problem may result in an ambiguity, a word or phrase that can be interpreted more than one way. In "what-iffing" the contract, try to detect whether the meaning of the provision is unclear. Problems with meaning frequently arise because English grammar and usage causes ambiguities. As a reader, you should not feel stupid for puzzling over meaning. In fact, you may prevent a problem from arising later on. For example, assume you are itemizing the subsidiary promises in the agreement and you come across this one:

Seller shall replace the vehicle if there is a problem with its use and value or safety.

Seller has made a promise here that is subject to a condition. But what is the condition? Is it that there is a problem with

(use) and (value or safety)

or

(use and value) or (safety)

This ambiguity needs to be resolved.

The passive voice may cause ambiguities. For example, in determining the duties of the parties to a residential lease, you find that the contract states:

The premises shall be kept in good repair.

Does this mean that the landlord shall keep them in good repair or the tenant shall keep them in good repair? By resolving the problem now, you may be preventing a later dispute.

### *3. Definitions*

When you need to know the meaning of a word or phrase that appears in the contract, first check to see if there is a definition section of the contract that defines contract terms. If there is, you must use the term as defined in the contract rather than a common sense or dictionary definition. Do not read the definition section until the term appears in a provision of the contract. For example, you are a shareholder and find this provision in your shareholder agreement:

Shareholders may not transfer any or all of the shares of the Corporation. Exception: Shareholders may transfer any or all of the shares if they comply with the following provisions.

You want to know if you can give a bank a security interest in your shares. It depends on the meaning of the word *transfer*. You find this definition in the definition section of the contract:

As used in this agreement, *transfer* means to sell, transfer, assign, pledge, encumber or otherwise dispose of or convey (by operation of law or otherwise).

You now replace the defined term in the contract provision with the definition in order to determine the meaning of the provision:

Shareholders may not sell, transfer, assign, pledge, encumber or otherwise dispose of or convey (by operation of law or otherwise) any or all of the shares of the Corporation.

It is clear that, as defined, a transfer would include granting a security interest.

### ***D. Explore Opportunities to Gain Greater Expertise***

You will find it easier to read a contract if you have expertise in the substance of the transaction. How can you gain that expertise? You might look to:

- An up-to-date form
- A book or expert on the subject

#### *1. Find an Up-to-date Form*

Now that you are an experienced reader of contracts, a good source to improve your knowledge is other contracts used in the area. As you read them, be alert for provisions that address issues that are missing from your contract.

For example, a book publishing contract may contain no term dealing with the publication of an electronic version of the book. Would you know that it would be prudent to address this term? If you did, would you know how to word it? If you have familiarity with modern publishing, the process of "what-ifffing" the contract might lead you to ask, "What if the publisher wishes to bring out an electronic version?" You might bring the contract to an expert in the field for review. Or you might contrast your contract with a more up-to-date form and detect that the newer contract contains such a provision.

#### *2. Find a Book or Expert on the Subject*

You may wish to consult with a book or someone in the business who can identify issues that you missed when "what-ifffing" the contract. One reason you read a contract before the fact is to determine what the negotiable terms are. Some are obvious, such as a blank price term that must be filled in by the parties. Other negotiable terms may be found during the course of the analysis you engaged in while reading the contract. For example, you detected risks that were shifted to you, default rules that were changed that disadvantaged you, performances you promised that might have the harsh effect of a condition if not performed, or terms that were omitted. In negotiating, you might identify these areas and negotiate to not take the risk, to return to default rules, to avoid the harsh effect of nonperformance, or to add missing terms.

One thing you may not know as a novice is that there may be certain terms that are customarily negotiable while others are virtually unchangeable. You might consult an expert or a book on the subject to discover the distinction. For example, if you are a first author negotiating a book publishing contract, it is unlikely that you can negotiate the royalty term. You might, however, be able to negotiate such terms as the amount of an advance, the number of complimentary copies, or what happens if the book goes out of print.

### **VIII. CONCLUSION**

As with any "how to" manual, this one will not help you acquire the skill unless you put its teaching into practice. There is undoubtedly a contract in your life that you promised yourself you would read some rainy day. It might be your insurance contract, a lease or mortgage, the warranty you got with your new computer, or the contract you clicked on in order to access an internet service. Now that you have read this Article through, try reading the contract by following the steps in the Outline. As with any new skill, the learning curve may initially be steep, but soon you will be an expert contract reader. Achieving a satisfaction similar to solving a difficult puzzle, you will wonder why you have missed the pleasure of contract-reading for so long.

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