

Black Holes and Boilerplate in M&A Practice

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Serious academic studies of M&A deal documents are focusing attention on the quality and cost-effectiveness of the work of M&A lawyers. The studies seek to evaluate the quality and efficiency of the work by empirical analysis of business agreements, including so-called ‘boilerplate’, that is, standard contract clauses. Some of the studies point out that less-than-optimum lawyering can not only be inefficient but also result in a standardised boilerplate clause becoming devoid of meaning, to such an extent that the clause becomes a ‘black hole’, unintelligible to the parties and to the courts. These studies focus on United States legal practice but the commentary and implications drawn could apply to practice in Europe and more widely.

Review of these empirical studies is useful for deal lawyers, because they furnish a welcome new viewpoint for evaluating the extent to which drafting, negotiating and redrafting deal documents really adds value for a client and for the M&A process.

Some of the criticisms and prescriptions for reform set out in these recent studies seem inapplicable to M&A deal practice, notably because they focus on lawyers’ services as a commodity, and take insufficient account of factors such as the complexity of an M&A deal and of the typical M&A agreement; the hands-on involvement of clients and the high chance that key language in the agreement will be tested within a short timeframe; and the potential for a lawyer to add value by thoughtful review, reflection and judgement. But some of the criticisms should be taken to heart.

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This article explores these issues in the context of the process of drafting and negotiating a share purchase agreement (SPA) for acquisition of a private target, in Europe and the US. It discusses:

- the spirited academic debate about ‘boilerplate’, contractual ‘black holes’ and standardisation;
- the typical organisation and complexity of an SPA, including some examples relating to representations and warranties, which makes standardisation difficult;
- the context in which SPAs are drafted and negotiated, which leaves little room for inattention or complacency on the part of deal lawyers; and
- some issues relating to SPAs on which the debate about black holes and performance of lawyers is quite relevant.

The debate about boilerplate and black holes

Among the major contributions to this debate are the following recent papers by eminent US law school professors:

- ‘The Black Hole Problem in Commercial Boilerplate’¹ by Stephen Choi, Mitu Gulati and Robert E Scott, who write about problems arising from interpretation of a commercial boilerplate clause (the *pari passu* clause) in sovereign debt bond indentures;
- ‘Engineering Greater Efficiency in Mergers and Acquisitions’² and ‘Boiling Down Boilerplate’³ by Robert Anderson and Jeffrey Manns, who evaluate ‘efficiency’ in M&A agreements including ‘boilerplate’ provisions thereof, based on computer-aided textual analyses of a very large sample of US merger agreements over the 20-year period 1994–2014;
- ‘Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals’⁴ by John C Coates IV, who also analyses a large sample of higher-value US merger agreements, over the same 20-year period; and

1 Stephen J Choi, Mitu Gulati and Robert E Scott, ‘The Black Hole Problem in Commercial Boilerplate’ (2017) 67 Duke LJ 1 (hereafter ‘The Black Hole Problem’).

2 Robert Anderson and Jeffrey Manns, ‘Engineering Greater Efficiency in Mergers and Acquisitions’ (2017) 72 The Business Lawyer 657 (hereafter ‘Engineering Greater Efficiency’).

3 Robert Anderson and Jeffrey Manns, ‘Boiling Down Boilerplate in M&A Agreements’, paper presented 7–8 April 2017, Duke Law School Conference on Contractual Black Holes, www.law.nyu.edu/sites/default/files/Boiling%20Down%20Boilerplate_Robert%20Anderson%20and%20Jeffrey%20Manns.pdf accessed 11 March 2018 (hereafter ‘Boiling Down Boilerplate’).

4 John C Coates IV, ‘Why Have M&A Contracts Grown? Evidence from Twenty Years of Deals’, European Corporate Governance Institute, Working Paper no 333, 8 November 2016 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2862019 accessed 11 March 2018 (hereafter ‘Why Have M&A Contracts Grown?’).

- ‘The Architecture of Contract Innovation’⁵ and ‘Asymmetric Standardization in M&A Agreements’,⁶ by Matthew Jennejohn, who applies sophisticated ‘network analysis’ techniques to analyse US M&A agreements from 2012 to 2014 involving three New York firms, focusing on interrelationships among specific provisions in those agreements and among the lawyers who worked on them.

The first two sets of articles are quite critical of deal lawyers, whereas the last two provide a more positive assessment.

Here are some key take-aways from these papers.

‘The Black Hole Problem’

In this much-remarked article, Choi, Gulati and Scott draw conclusions from their long-standing studies of *pari passu* clauses in sovereign bond indentures.

The authors point out that a standardised term in ‘boilerplate contracts’ that is ‘reused for decades and without reflection merely because it is part of a standard form package of terms, and is thereby emptied of any recoverable meaning, can create a contractual black hole’.⁷ They add that, more commonly, terms that have lost much (but not necessarily all) meaning may still provoke litigation over ‘essentially meaningless variations in the boilerplate language’, creating ‘contractual grey holes’. They conclude that collectively such black holes and grey holes create an ‘interpretation conundrum’, which they refer to as the ‘black hole problem’.⁸

They also point out that although ‘boilerplate terms’ offer ‘the efficiency advantages of standardisation’, their repetitive use can have two negative consequences. One is ‘rote usage’, by which the original shared meaning is lost, and the term becomes ‘ritualized legal incantation’ (perhaps with the addition of redundant terms, described as ‘a species of contractual overkill’).⁹ A second is ‘encrustation’, that is, the addition of legal jargon that ‘weakens the communicative properties of boilerplate terms’.¹⁰ They write that these problems are exacerbated because ‘lawyers working with standard form

5 Matthew Jennejohn, ‘The Architecture of Contract Innovation’ (2018) 59 Boston College Law Review 71 (hereafter ‘The Architecture of Contract Innovation’).

6 Matthew Jennejohn, ‘Asymmetric Standardization in M&A Agreements’ (25 March 2017), paper delivered at the Conference on Contractual Black Holes (7–8 April 2017, Duke Law School), labelled ‘Draft’, www.law.nyu.edu/sites/default/files/Jennejohn%2C%20Asymmetric%20Standardization%20of%20M%26A%20Agreements%20%2824%20March%202017%29.pdf accessed 11 March 2018 ((hereafter ‘Asymmetric Standardization’)).

7 ‘The Black Hole Problem’, 2.

8 *Ibid.*

9 *Ibid.*, 6.

10 *Ibid.* 3, 6–7.

language that has been repeated for many years by rote ... are unlikely to have much, if any, understanding of the purposes served by those terms', but may use the language because they think that earlier authors could have had a good reason for their choice.¹¹

In respect of the example they use, the *pari passu* clause in sovereign bond indentures, important court decisions in 2000,¹² 2011¹³ and 2012¹⁴ interpreted this standard contract language in a way that had very significant consequences, unintended by the parties to those contracts or by the lawyers who drafted them. This particular black hole problem was not just an embarrassing oversight; it had an important but unexpected economic impact on the sovereign bond market. However, even when that became apparent, market practice was slow to change the standard *pari passu* boilerplate clause.

'Engineering Greater Efficiency'/'Boiling Down Boilerplate'

In these two papers, as well as another one published in 2017,¹⁵ Anderson and Manns draw conclusions from a computer-aided analysis of 12,047 merger agreements and reorganisations filed by public companies in the Securities and Exchange Commission (SEC) EDGAR Database from 1994 to 2014.¹⁶ This sample was subjected to computer analysis, including a word-for-word comparison to determine similarity among the agreements, measured by 'edit distance' (the number of characters that are different from one document to the next). Documents in the sample also reviewed using anti-plagiarism software to identify one or more source documents used for drafting the agreement.

The paper 'Engineering Greater Efficiency' concludes that there was less similarity among the agreements than the authors expected: only 4.3 per cent of the general sample of agreements were more than 25 per cent similar and in most cases about 50 per cent of the text of a given precedent document was rewritten from one deal to the next.¹⁷ They also found, unsurprisingly,

11 *Ibid* 7–8.

12 Cour d'Appel de Bruxelles, 8ème ch, 26 September 2000, no 2000 QR92.

13 *NML Capital v Republic of Argentina*, Case No 08CU6978; 08 Civ 1702 (SDNY 7 December 2011).

14 *NML Capital Ltd v Republic of Argentina*, 699 F 3d 246 (2nd Cir 2012), cert denied 134 S Ct 2819 (2014).

15 'The Inefficient Evolution of Merger Agreements' (2017) 85 *George Washington Law Review* 101.

16 'Engineering Greater Efficiency', 671; see n 15 above 112. The sample excluded other kinds of acquisition agreements including SPAs and asset acquisitions. The merger agreements in the samples included acquisition of public and private targets.

17 'Engineering Greater Efficiency', 661, 678; 'Boiling Down Boilerplate', 113–114.

that when selecting precedents (or ‘templates’) for drafting a new agreement, the most likely choices were precedents from the drafter’s own law firm and from the same industry as in the new deal, with a preference for more recent rather than older deals.¹⁸ Further, during the period studied the average length of agreements in the sample increased by 88 per cent (from 21,014 words to 39,403 words).¹⁹

From these findings the authors draw conclusions that are sharply critical of deal lawyers, including the following:

- ‘[L]awyers appear to use precedents they are familiar with rather than those... that may be more readily adapted to the transaction at hand.’²⁰
 - This results in editorial ‘churning’, that is, ‘too many edits being made to routine provisions and a potential decrease in the reliability of documents based on vetted language’.²¹
 - ‘Although innovation may occur, such “churning” does not appear to be justified based on deal-specific information or any pretence of innovation.’²²
- Further analysis presented in the paper ‘Boiling Down Boilerplate’ explores the impact of ‘churning’ on so-called standard boilerplate in M&A agreements, ‘standardised provisions which we would expect to change rarely, if ever, from one deal to the next’.²³ This additional computer-based analysis of the authors’ large deal sample²⁴ found a ‘drift of lineages over time’ from prior precedents and also evidence of ‘speciation’,²⁵ meaning that given texts based on the same template may develop so that they bear little resemblance to one another.²⁶ The authors attribute this process to ‘unreflective copying of precedent provisions combined with ad hoc edits to individual clauses, which erode the textual integrity and meaning of boilerplate provisions’.²⁷ They conclude that, in the M&A context represented in their sample, just as in the sovereign debt context discussed above, there is a risk that ‘rote usage, combined with encrustation and abrasion of terms[,] may distort the degree of standardisation and meaning of boilerplate over even a short number of generations’.²⁸

18 ‘Engineering Greater Efficiency’, 673–678.

19 *Ibid* 680.

20 *Ibid* 661.

21 *Ibid* 662, 670.

22 *Ibid* 662.

23 ‘Boiling Down Boilerplate’, 105.

24 The authors describe this analysis as follows: ‘[W]e use the eigenvalues derived from a multidimensional scaling of the distance matrices for sets of related paragraphs (those derived from a common ancestor).’ ‘Boiling Down Boilerplate’, 124 (footnote omitted).

25 *Ibid*, 125.

26 *Ibid*.

27 *Ibid*, 101.

28 *Ibid*, 129.

The essence of these criticisms is that at least some lawyers, in their ‘unreflective’ approach, not only waste time and money by ‘churning’ but also that clauses in M&A agreements, because they are distorted, are defective, compared with ‘standardised’ boilerplate.

‘Why Have M&A Contracts Grown?’

Professor Coates in this article examines a sample of 564 M&A contracts from the years 1994–2014 for all-cash acquisitions of US public targets with a deal value exceeding \$100m.²⁹ He finds that during that period the contracts more than doubled in average length (a total increase of 163 per cent, from 16,999 words on average to 44,730 words) and used increasingly complex language (as measured by sentence length and syllable count in words used). He tests three hypotheses for why lawyers drafting these agreements may have contributed to these phenomena: ‘grandstanding’, meaning lawyers ‘add words to prior contract models, with little or no marginal semantic, legal or economic context’; ‘reactive growth’, whereby language is added to prior contract models ‘in reaction to external shocks – new case law, new statutes, or new financial risks’; and ‘innovative growth’, involving language adding ‘new ways to achieve the goals of contract parties, or to improve the speed or efficacy of doing so’.³⁰

He concludes that although some ‘grandstanding’ may exist, contract growth was a combination of ‘reactive’ and ‘innovative’. He adds that ‘clear evidence can be found of rational responses by contract lawyers to external events, the emergence over time of “best practices” (as opposed to meaningless variations in verbiage) and substantially new contract clauses’.³¹

‘The Architecture of Contract Innovation’/‘Asymmetric Standardization’

In the first of these papers Professor Jennejohn presents the results of analysis of 30 merger agreements for US public companies during the years 2012–2014 involving three New York law firms³² and the senior lawyers who worked on those deals (as described in press releases from those firms). A type of network analysis featuring ‘design structure matrices’ was used to analyse provisions in the agreements for cross-references (either explicitly or via defined terms) to other provisions in the agreement and participation

29 ‘Why Have M&A Contracts Grown?’, 12–13.

30 ‘Why Have M&A Contracts Grown?’, 2.

31 *Ibid.*, 2.

32 The firms are Cravath, Swaine & Moore, Davis Polk & Wardwell and Shearman & Sterling. ‘The Architecture of Contract Innovation’ 102.

by senior lawyers in the relevant deals.³³ The author concludes that both the agreements studied and the teams working on them are not ‘purely modular’, but rather fit a model of ‘flexible specialisation’, whereby ‘thick connections between subsystems are maintained and the costs of changing those interlocking components are monitored by fostering organisational routines that allow transaction designers to quickly coordinate adjustments, across the integrated system’.³⁴ In particular, ‘deal teams repeatedly recombine in unique configurations from deal to deal, promoting the dissemination of design-relevant information throughout the firm and, in turn, the tacit routines that foster rapid learning among transactional lawyers’.³⁵

To illustrate his conclusions regarding M&A agreements, Jennejohn very helpfully quotes the following plain-language explanation from the 1975 treatise *Anatomy of a Merger*: ‘A properly drafted acquisition agreement is a rather delicate mechanism. There is a structure and symmetry among its principal articles that must be understood and constantly reviewed in order to conclude successful negotiations. [The provisions of the agreement] function together as a unit, serving different but complementary purposes.’³⁶ The paper ‘Asymmetric Standardization’ analyses a different sample, M&A agreements (asset purchases, merger agreements and SPAs) published on the SEC’s EDGAR portal during the period 1996 to 2001 in which a given firm participated (as either buyer’s or seller’s counsel)³⁷. The study used a computer-assisted ‘vector-space’ method to analyse sets of deal terms (including selected reps, covenants, closing conditions and financial provisions, among others) as a function of deal type, choice of law, business sector of the parties and whether the seller’s ownership was concentrated or dispersed.³⁸ The study found – unsurprisingly – that some terms, such as the due authorisation rep, the covenant as to operation of the business from signature to closing and language on severability, were more ‘standardised’ than others, such as those on deal consideration, mechanics of transfer of ownership and the definition of a ‘material adverse effect’.³⁹ The analysis also found that deal type played a role; for example, the intellectual-property rep and the material-adverse-effect clause were least standardised in asset deals, whereas language on indemnification was least standardised in SPAs.⁴⁰

33 *Ibid* 105.

34 *Ibid*, 77, 78, 93.

35 *Ibid* 78.

36 James C Freund, *Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions* (1975) 153.

37 ‘Asymmetric Standardization’. The firm was Brobeck, Pfeleger & Harrison.

38 *Ibid*, 7–10.

39 *Ibid* 11–15.

40 *Ibid* 11–15.

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In the first two sets of articles described above, the condemnation of deal lawyers is severe: ‘ritualized legal incantation’ is perpetuated by lawyers ‘unlikely to have much, if any, understanding of the purposes served by the language they use’⁴¹ who may engage in ‘unreflective copying of precedent provisions combined with ad hoc edits to individual clauses, which erode the textual integrity and meaning of boilerplate provisions’.⁴²

The other papers cited above provide a more positive assessment of deal lawyers: the contract language they draft includes ‘rational responses... to external events’ and over time features “‘best practices” (as opposed to meaningless variations in verbiage) and substantially new contract clauses’,⁴³ developed through a process involving ‘flexible specialisation’, which promotes ‘the dissemination of design-relevant information throughout the firm and, in turn, the tacit routines that foster rapid learning among transactional lawyers’.⁴⁴

For a deal lawyer, some of these positive comments seem intuitively correct, and even obvious, in that they confirm that running an M&A deal may be a complex process not always susceptible to standardised, much less commoditised, solutions. However, it would be a mistake to give perfunctory dismissal to the less-than-laudatory comments contained in some of these papers.

The organisation and complexity of SPAs

An SPA for a private M&A deal generally includes the following components:⁴⁵

- an introduction or preamble listing the parties and the target;
- a list of defined terms, including definitions or cross-references to the place in the SPA where the terms are defined (this list might be set out in a schedule);

41 ‘The Black Hole Problem’, 3, 7.

42 ‘Boiling Down Boilerplate’, 101.

43 ‘Why Have M&A Contracts Grown?’, 2.

44 ‘The Architecture of Contract Innovation’, 78.

45 See Reid Feldman, ‘Recent Trends in European SPAs and Companies with US Practice’ (2016) 17 *Business Law International* 217–231 at 219 (hereafter ‘Recent Trends’); John C Coates IV, ‘M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice’ (11 April 2015). ECGI – Law Working Paper No 292/2015 <https://ssrn.com/abstract=2593866> accessed 11 March 2018.

- a statement of the parties' agreement for the sale and purchase of shares and relevant closing conditions (or, if there is no deferred closing, a statement of the sale and purchase);
- a definition of the price (including provisions for calculating any component not yet determined) and how it is to be paid;
- a description of the closing procedure;
- representations and warranties (R&Ws or reps)⁴⁶ of the seller (and the buyer, normally much more limited than those of the seller), which are generally qualified by a disclosure schedule or exhibits (and sometimes by reference to information found in a data room);
- covenants of the parties, including steps relating to satisfaction of closing conditions and other steps to be carried out or obligations applicable between signing and closing and subsequent to closing;
- indemnification obligations; and
- other (often called 'miscellaneous') provisions including such matters as choice of law, dispute resolution, integration of prior agreements and assignment of the parties' rights and obligations.

Although the list of issues addressed in the typical SPA is standardised, there may be several possible choices for how each issue is treated. For example, price terms may or may not include a post-closing financial adjustment for all or part of the price, or a 'locked box' component; R&Ws may vary not only in subject matter but also with respect to choice and qualification of the applicable criteria and exceptions thereto; conditions to closing may include

46 Traditionally in the system of common law, the remedy for the seller making an untrue representation might be rescission but an untrue warranty could result only in damages. See n 62. However, merely affixing the label 'representation' or 'warranty' to a statement in a contract is not necessarily dispositive of how the statement will be characterised by a court. Indeed, in US practice, and elsewhere (eg, in civil laws countries, where the distinction is not present in local law) it is common to use the terms together, labelling the relevant statements of fact as 'representations and warranties' without intending that there be any difference between the two terms (even if some courts in the US may see a difference, see, eg, *Pivotal Payments Direct v Planet Payment*, No. N15C-02-059 EMD CCLD (Del Super Ct 29 December 2015). It has been suggested that, for clarity of drafting, statements of fact in M&A agreements be labelled 'representations' or 'warranties' but rather 'indemnifiable matters' or 'statements of fact' (see 'That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined 'Fraud Carve-Outs' in Acquisition Agreements', 69 *Business Lawyer* 1051, 1065-1067, 1069-1072 (2014) at n 47 and sources cited; Kenneth A Adams, 'The Phrase "Represents and Warrants" in Pointless and Confusing', *Business Law Today* (October 2015), www.americanbar.org/publications/blt/2015/10/05_adams.html accessed 11 March 2018; "Representations," "Warranties," and the Delaware Superior Court', www.adamsdrafting.com/representations-warranties-and-the-delaware-superior-court accessed 11 March 2018. In UK practice, the distinction between the two terms is given much greater weight, although sometimes they are used in the same breath, see *Philip v Cook* [2017] EWHC 3023 (QB).

deal-specific items; and indemnification clauses can vary in respect of scope, duration, calculation components, limitation in amount and other factors.

An illustration of the variables presented in drafting an SPA, and the interplay among one set of variables with another, can be explored by looking at R&Ws. Subjects addressed in R&Ws include:⁴⁷

- basic issues relating to the sale of shares being acquired, in particular: the seller's authority to consummate the transaction; due organisation and capitalisation of the target and the seller's ownership of its shares; absence of any broker's or finder's fee; absence of conflicts between the transaction and legal provisions or other contracts;
- classic reps relating to the situation (including financial) of the target, including its financial statements (which tend to be somewhat more stringent in smaller deals than in larger ones), whether full disclosure has been made to the buyer (a so-called 'catch-all' rep, which becomes somewhat less prevalent as deal size increases), the target's compliance with law and title to and sufficiency of the target's assets; and
- sectoral matters, such as tax, litigation, material contracts, employment-related issues, environmental issues, regulatory issues, intellectual property and real property.

The effect of reps can be limited by qualifications, including as to materiality, knowledge (whether actual or constructive, and whether limited to the knowledge of a defined group of individuals, known as a 'knowledge group'), scope and to the period of time covered by the rep.

One purpose of reps and warranties is to describe certain features of the target and its business, in some cases supplemented by lists of these features and/or exceptions to the rep, set out in an exhibit or a disclosure letter.

Here is a simple example:

Since ___ [specified date], to the Knowledge [defined as the actual knowledge of Ms X, Mr Y and Ms Z] of the Seller, there has been no [material] _____, except as set forth in Schedule ___.

When reps are made without a knowledge qualifier but the seller (or knowledge group) in fact does not know whether or not the rep is true, they can serve the function of allocating risk as between the parties.

R&Ws set out a baseline for exercise of the buyer's rights in case of inaccuracy or breach thereof, including the right to walk away from the transaction (ie, not to close) and the right to indemnification.

Those rights may result from provisions in the SPA itself on closing conditions and indemnification. For example, the buyer's obligation to close can be subject to the reps being accurate at closing 'in all respects'

⁴⁷ See 'Recent Trends', 219.

or ‘in all material respects’ (perhaps with a ‘materiality scrape’, that is, excluding materiality qualifications in individual reps); such materiality conditions can also be attached to indemnification obligations (or some of them). The importance of the R&Ws will likewise be highly dependent on the indemnification language, which will define and potentially limit the remedies (in addition to a decision not to close) resulting from an inaccuracy or breach of the reps.

The buyer’s rights arising from inaccuracy of a rep can also result from generally applicable law, which can serve as the basis for a contract claim or an extra-contractual claim such as for fraud or misrepresentation. To the extent that the SPA’s closing and indemnification provisions clearly set out rules governing all consequences of rep/warranty inaccuracies, and state that the seller makes no extracontractual representations and that the buyer relies on none, there may be no need or indeed any room for application of suppletive rules provided by generally applicable law (except in cases of fraud, as discussed below). However, by oversight or design an SPA may not deal with all these consequences completely or clearly.

These variables, in the content of M&A agreements that are nevertheless generally organised based on a standardised outline, have in recent years been the subject of numerous so-called ‘deal points’ studies,⁴⁸ which examine how often some of these variables are chosen in final deal documents. Typically, the studies cover scores of variables (or deal points): for example, 2017 ABA Strategic Buyer/Public Target M&A Deal Points reported on 59 variables, including four relating to R&Ws, seven on closing conditions, 13 on deal protection provisions; the 2017 ABA Private Target M&A Deal Points Study reported on 45 variables, including eight relating to R&Ws, five on closing conditions and 13 relating to indemnification; and the 2015 ABA European Private Target M&A Deal Points Study reported on 31 variables, including six relating to R&Ws, six relating to closing conditions and 12 relating to indemnification.⁴⁹

These deal point studies furnish powerful empirical evidence supporting the conclusions that an M&A agreement is complex and that there is much interplay among its various component parts, which makes complete standardisation an inappropriate goal.

48 See American Bar Association Market Trends Subcommittee, Deal Points Studies, covering M&A agreements for private and public targets in the US, Europe and Canada, beginning in 2006, <http://apps.americanbar.org/dch/committee.cfm?com=CL560003>; see also 2017 SRS Acquiom M&A Deal Terms Study (22 June 2017), available at www.srsacquiom.com/resources/2017-srs-acquiom-ma-deal-terms-study accessed 11 March 2018.

49 *Ibid.*

The context in which SPAs are drafted and negotiated

The context of drafting and negotiating an SPA or other negotiated M&A agreement is quite different from the context described in some of the black-hole literature.

In the sovereign-debt market (as convincingly described by Choi, Gulati and Scott), there was no bargaining among the parties (sovereign issuers and investors) or their financial advisers, much less among their lawyers, over the boilerplate clauses in the indenture contract (the *pari passu* clause or any other non-financial clause), but only a desire to conform to the ‘market standard’; in general clients did not pay attention to the consequences of a particular drafting choice, in many cases because the likelihood of the clauses being implemented, seemed too remote.⁵⁰

M&A deals for private targets are drafted and negotiated in a different context. Clients generally do read the ‘fine print’ of an M&A agreement and are well aware that the language in the SPA will set the rule-book for possible post-acquisition claims, which are not rare.⁵¹ Many clients have personal experience with the available drafting options and in some cases have lived through post-closing disputes. The consequences of one choice or another are potentially immediate. Clients expect their lawyers to explain the available drafting options (taking account of due diligence results, relevant negotiating tactics and other considerations) and to advise on the impact thereof on the clients’ rights and obligations, in the specific context of the deal being negotiated. And it is unusual that there is no give and take between buyer and seller in reaching a final text (even in the context of so-called controlled auctions).

Of course it matters what terms are the ‘current market standard’, meaning what equilibrium between buyer and seller has been reached by other parties in other deals, which can be important in a negotiation. But the equilibrium reached by others may not be the best result for a given party, and generally does not prevent seeking another outcome.

50 ‘The Black Hole Problem’, 45; see *ibid* 48 (reporting on the explanation from sovereign-bond market participants that ‘no one paid attention to anything but whether the bond had the “standard documentation”; that is, not until the very end, when everyone scrambled to find a good lawyer to tell them what their documents mean’).

51 One recent study of deals with escrow arrangements closing in 2010 found that 60 per cent of deals had at least one escrow claim, most frequently for post-closing purchase-price adjustments (48 per cent of deals), tax matters (18 per cent), fees of costs (14 per cent), intellectual property (11 per cent), undisclosed liabilities (eight per cent) and employee-related matters (eight per cent) (see 2015 SRS Acquiom M&A Claims, <https://www.srsacquiom.com/resources/2015-srs-acquiom-ma-claims-study-sample> accessed 27 March 2018).

Another factor militating against standardisation relates to concern with costs. In the sovereign debt market as in some other contexts, (eg, in the derivatives market) the parties, their financial advisers and their counsel all have an incentive to minimise up-front costs, so as to make deal documentation comply with a market standard with little or no deviation. By contrast, in the M&A market, because clients are fully conscious of immediate risks raised by inappropriate drafting, they may consider that up-front attention by their counsel, even if costly, is a worthwhile investment.

The argument for standardisation rests on a dual premise that is of doubtful application to the private target M&A practice: that a standardised boilerplate text will be adequate to serve the needs of all parties in an M&A deal; and that standardisation is good because it reduces the number of unnecessary edits, thus saving significant time and money for clients.

But at least in the private M&A market, this analysis is flawed. There is no standardised model agreement that fits all needs. The deal lawyer's role is not to fit the agreement into a given mould, but instead to protect his/her client's interests through choices made in the agreement. Pushed to the extreme (which is surely not the intent of the scholars writing about the black hole problem), treating standardisation as a goal reflects a vision of lawyering as an unthinking commodity, an accumulation of keystrokes.

Further, the economic analysis, as applied to the private M&A market, is not convincing. Legal fees are not based to any significant extent on the number of edits to a document. Instead, fees generally represent many other factors including evaluation of the basic legal and economic framework of the deal, due diligence, thoughtful analysis and the application of good judgment and psychology. Unthinking copying of the last set of deal documents can be dangerous. When careful rereading of familiar language is accompanied by superficial textual changes, the latter may be inconsequential, in terms of both cost and context; the important function of the deal lawyer is to make sure that the document is drafted, evaluated, negotiated and finalised in a manner that maximises the client's interests, which will include minimising risk.

The black hole problem in the context of SPAs

It seems inaccurate to make a wholesale condemnation of M&A deal lawyers for 'churning', engaging in 'ritualised legal incantation' by using language they do not fully understand and not optimising contract terms to maximise their clients' interests.⁵² However, there are lessons to be learned from the black hole/boilerplate debate.

⁵² See text at nn 18–22.

The profession of deal lawyers, like most professions, includes some members who perform less than optimally. For example, grandstanding certainly does take place; drafting is sometimes imperfect;⁵³ and not every law firm succeeds in ensuring that staffing is always appropriate or that junior lawyers are properly supervised and do not spend excessive time on their assigned tasks.

And of course there is room for improvement in drafting, in both style and substance. Some examples are given below.

Wordiness

In drafting and negotiating an SPA, clarity and completeness are important, but more is not necessarily better. Adding words that do not have real added value – even if they do not constitute black holes – can be counterproductive.

It is clear that the length of SPAs has grown both in the US and Europe⁵⁴ (although an SPA in Europe, particularly in continental Europe, is likely to be more concise than an analogous US SPA).⁵⁵ Samples described above of deals involving US public companies during the period 1994–2014 increased in length considerably.⁵⁶ Some of the increase is no doubt attributable to additions dealing with newly arisen legal issues,⁵⁷ but this does not seem to account for all of the added words.

Length sometimes hinders comprehension, and can lead to text not being completely thought through, for example, when two clauses (relating to indemnification limits) in different places in the SPA were each stated to be applicable ‘notwithstanding anything’ to the contrary.⁵⁸ Word processing software and widespread availability of easily copied precedents increase the risk of adding unnecessary or perhaps insufficiently analysed text.

Note that reducing the length of a contract does not equate to reducing the time required to produce it (or the legal fees charged); a concise document may take more work to produce than a longer one. Shortening

53 See *EMSI Acquisition, Inc v Contrarian Funds, LLC*, CA No 12648 VCS, 2017 WL 1732369 (Del Ch 3 May 2017) at 30 (‘[I]nelegant drafting’ has left the Court unable definitively to construe the indemnification provisions of the SPA in a manner that would enable final adjudication of this dispute at the pleading stage’, footnote omitted); *Wood v Capita Insurance Services Limited* [2017] UKSC 24 [16, 26] (although the SPA was ‘professionally drafted’, a key clause ‘has not been drafted with precision and its meaning is avoidably opaque’).

54 See n 45 above.

55 ‘Recent Trends’ (see n 46 above) 220.

56 See n 19 and n 30 above.

57 *Ibid* 2.

58 *EMSI Acquisition, Inc v Contrarian Funds*.

a document while dealing completely with complex variables can impose clarity and help to avoid potential black holes.

Some potential black holes

M&A literature, including the numerous deal points studies,⁵⁹ provide many examples of key deal terms designed to protect the interests of one party or another on many specific points, and seem to have helped make best practices widely available. But drafting problems identified in these publications seem nevertheless to persist, as shown by the deal points studies themselves.

Four examples are given below, relating to the ubiquitous ‘fraud carve-out’, post-closing attorney-client privilege and conflict issues; and the impact of statutes of limitations on duration of indemnification obligations.

THE UBIQUITOUS ‘FRAUD CARVE-OUT’

It is not uncommon for key clauses in an M&A agreement, such as exclusive-remedy clauses, indemnification caps and non-reliance clauses, among others,⁶⁰ to feature a so-called ‘fraud carve-out’, stating that the relevant clause applies ‘except in cases of fraud’. One reason the fraud carve-out is ubiquitous is that it can be an easy win for buyer’s counsel, since at the negotiating table no seller wants to intimate that it is engaging in fraudulent conduct. But a powerful argument has been made that in some jurisdictions in the US the word ‘fraud’ can refer to conduct that does not include an actual intent to deceive and need not require actual reliance by the buyer on a false statement.⁶¹ For that reason, an

⁵⁹ See n 49 above.

⁶⁰ Other places where carve-outs for fraud (or intentional misrepresentation) are sometimes found include in clauses dealing with survival of reps and indemnification baskets (see ABA 2017 Private Target Deal Points Study n 44 slides 76, 84 and 92; ABA 2015 European Private Target Deal Points Study n 44 slides 66 and 80).

⁶¹ See *That Pesky Little Thing Called Fraud* (n 47) 1065–1067, 1069–1072. The traditional common-law definition of fraud, which constitutes the tort of deceit, requires a representation made with knowledge of its falsity or recklessly as to whether it was true or false, with the intent that another party rely on it, and which was in fact relied on by that other party to its detriment (see, among many examples, *True Blue v Leeds Equity Partners IV*, 2015 WL 5968726 (Del Super, Ct 25 September 2015) 15, *Khatshouri v Jimenez* [2017] EWHC 3391 (QB) [17]). Nevertheless, even in English law a carve-out ‘in the case of fraud’ may extend beyond the tort of deceit, see *Cavell USA, Inc v Seaton Insurance Co*, [2009] EWCA Civ 1363 [29] (holding that the carve-out ‘extends to at least in some cases of dishonest abuse of fiduciary position’).

increasing number of US private M&A agreements that feature fraud carve-outs also include a definition of what the carve-out covers. For example, one series of studies shows that during the period 2006 to 2017, when an overwhelming majority of deals included a fraud carve-out to the exclusive-remedy clause, the percentage of those deals that included a definition of ‘fraud’ carve-out increased from eight per cent to 36 per cent.⁶² In the remaining 64 per cent of such deals, the presence of a fraud carve-out without a definition of ‘fraud’ might be a potential drafting black hole.⁶³

Potentially most problematic is the presence of a fraud carve-out in a non-reliance clause, whereby the buyer affirmatively states that it is not relying on any representation not stated in the agreement itself (and/or that no extra-contractual representations have been made). Whereas it may be impossible for a seller to obtain an effective waiver from the buyer of the latter’s right to bring an action for fraud (if that waiver is itself obtained by fraud it may be void), if the buyer disclaims reliance on extra-contractual representations then the scope of a possible fraud claim may be limited to the representations, if any, in the agreement. Consequently, such a non-reliance clause might be an effective way to preclude a claim of fraud or misrepresentation based on extra-contractual representations in many jurisdictions, for example in the US, the UK and

62 See ABA Private Target M&A Deal Point Study 2017 (see n 48 above) slide 99 (of deals during the years 2006 to 2017 with exclusive-remedy clauses, between 69 per cent and 88 per cent included a fraud carve-out and of those deals the percentage in which fraud was defined increased from eight per cent to 36 per cent); cf 2017 SRS Acquiom Deal Points Study (see n 48 above) slide 78 (of deals with exclusive-remedy clauses, carve-outs for ‘equitable remedies’ were found in 88 per cent of deals, for fraud in 86 per cent of deals and for ‘intentional misrepresentation’ in 40 per cent of deals); 2015 ABA European Private Target M&A Deal Points Study (see n 48 above) slide 82 (of deals with exclusive-remedy clauses, there were carve-outs for fraud in 57 per cent of deals, up from 26 per cent in the 2013 study and 30 per cent in the 2010 study, and for ‘intentional misrepresentation’ in 21 per cent of deals, up from nine per cent in the 2013 study and 11 per cent in the 2010 study).

63 Arguably such a definition is less important in jurisdictions in which fraud is defined by statute law, eg, in France (see Code civil Art 1137, which provides that fraud (*dol*) consists of obtaining consent of a contracting party by ‘manoeuvres’, ‘lies’ or intentionally not revealing information which a party knows is ‘determinative’ for the other party; note, however, the new requirement in French law that a party in negotiation must inform the other of any information whose importance is ‘determinative for the other’s decision as to whether or not to conclude the contract’, Code civil Art 1112-1).

France.⁶⁴ But deal points studies show that a sizeable minority of deals for private targets (45 per cent in the US and 41 per cent in Europe) do not contain such a clause.⁶⁵ Moreover, even when the agreement contains such a clause, it can be vitiated if it includes the carve-out ‘except in cases of fraud’. This is because such a carve-out might allow the buyer to claim for damages or rescission for any representations made outside the contract if made fraudulently – however that may be defined in the particular context (perhaps requiring only that the representation have been made intentionally). Yet recent deal points studies indicate that a non-reliance clause with a fraud carve-out was found in nine per cent of US M&A deals for private targets and six per cent of such deals for public targets:⁶⁶ a not-insignificant stockpile of potential black holes.

64 See *Representaciones e Investigaciones Medicas v Abdala*, 655112/2016, 2017 WL 3283470 (NY Sup Ct 31 July 2017) (an explicit non-reliance/no extra-contractual remedies clause was held sufficient to preclude buyer’s fraud claim); *Prairie Capital III LP v Double E Holding Corp* (Del Ch 25 November 2015) (holding that a no-extra-contractual-representations clause was sufficient to define ‘the universe of information’ on which the buyer relied and was sufficient to preclude buyer’s fraud claim, even in the absence of an express no-reliance clause); but see *True Blue* (see n 62 above (holding that a fraud claim was not precluded by an entire-agreement clause which did not specifically disclaim reliance on extra-contractual representations); see also the recent English cases that have held that contractual clauses labeled as ‘warranties’ will not be considered also to be representations, inaccuracy of which would support a claim of misrepresentation: *Sycamore Bidco Limited v Breslin* [2012] EXHC 3443 (Ch) [204] ff (holding that although the SPA stated that the buyer did not rely ‘on any representation other than those set out in the Transaction Documents’, there were no representations therein, and warranties labelled as such would not be considered to be representations); *Idemitsu Kosan Co, Ltd v Sumitoma Corporation* [2016] EWHC 1909 [24] ff, (holding that the communication of the warranties to the buyer prior to contract signature did not constitute representations as to the accuracy thereof and that statement in the SPA that the buyer did not rely on ‘any representations, warranties or undertakings of any kind other than the Warranties’ did not result in the warranties being representations); Cour de cassation, ch civ 3, 21 March 2001 no 99-14399 (holding that an investor’s statement of non-reliance on tax considerations precluded a claim for fraud based on extra-contractual representations on tax matters).

65 ABA Private Target M&A Deal Point Study 2017 see n 48 above slide 69 and ABA European Private Target M&A Deal Point Study 2015 see n 48 above slide 60.

66 See ABA Private Target M&A Deal Point Study 2017 see n 48 above slide 69 (indicating that, of the deals studied for 2016 and 2017, 55 per cent included an express non-reliance clause but of those 17 per cent included a fraud carve-out); ABA Strategic Buyer/Public Target M&A Deal Point Study 2017 see n 48 above slide 109 (indicating of the deals studied that during the years 2014–2016, 50 per cent included a non-reliance clause but of these 11 per cent included a fraud carve-out).

POST-CLOSING ATTORNEY-CLIENT PRIVILEGE AND CONFLICT ISSUES

After the sale the target, and its rights vis-à-vis its counsel, are controlled by the buyer. These rights include the possible assertion by the buyer (via the target) of a conflict of interest, if after closing the sellers wish the same counsel to represent them, as well as buyer's access (via the target) to privileged pre-closing communications between those counsel and the target. Since these issues were raised by a Delaware court case in 2013, *Great Hill Equity Partners IV, LP v SIG Growth Equity Fund I, LLLP*,⁶⁷ and earlier cases before New York courts,⁶⁸ US M&A agreements for private targets have increasingly included provisions waiving potential conflicts, thus allowing selling shareholders to retain the target's counsel post-closing (such clauses were present in 69 per cent of 2016/2017 deals studied, up from only 14 per cent of 2014 deals studied) and stating that the seller, and not the target, controls the attorney-client privilege attaching to deal counsel's pre-closing communications (63 per cent of 2016/2017 deals studied, up from 46 per cent of 2014 deals studied).

The manner in which this issue arose, and the subsequent change in market practice, is in some ways reminiscent of the saga of the *pari passu* clause in sovereign debt indentures: a kind of warning sounded in 1996, when the New York Court of Appeals ruled that the counsel for the target company in a merger was disqualified, on conflict-of-interest grounds, from representing the seller's shareholders in an arbitration with the surviving company in the merger (on an indemnification claim for breach of an environmental rep),⁶⁹ but that such surviving company was precluded, on grounds of attorney-client privilege, from obtaining access to communications between that counsel and the target during deal negotiations.⁷⁰ A second warning flashed in 2008, when a Delaware Court of Chancery upheld language in an asset purchase agreement that provided for attorney-client privilege applicable to negotiations for the deal remained with the seller.⁷¹ The 2013 *Great Hill* court pointed out that in the aftermath of these decisions several published articles recommended that practitioners include language in M&A agreements on these points – and that the issue had also been raised even earlier, in a 1985

67 *Great Hill Equity Partners IV, LP v SIG Growth Equity Fund I, LLLP* CA No 7906 (Del Ch 15 November 2013).

68 *Tekni-Plex, Inc v Meyner & Landis*, 89 NY2d 123, 674 NE 2d 663 (NY 1996); *Postorivo v AG Paintball Holdings, Inc*, 2008 WL 343856 (Del Ch 7 February 2008).

69 *Tekni-Plex* (n 69) 136.

70 *Ibid* 138.

71 *Postorivo v AG Paintball Holdings, Inc* (see n 68 above).

US Supreme Court decision,⁷² so deal counsel were on notice that these issues could (and perhaps should) be addressed in the M&A agreement. In the aftermath of these cases, the percentage of deals in which this point is addressed might increase even further from the percentages mentioned above. However, these issues surely ought to be considered more widely, in the US and elsewhere.

IMPACT OF STATUTES OF LIMITATIONS ON DURATION OF INDEMNIFICATION OBLIGATIONS

The duration (or ‘survival’) of the seller’s indemnification obligations is one of the most heavily negotiated provisions of an M&A agreement. It is common that a general limitation on indemnification be set in an M&A agreement at a relatively short period (a period within the range of 12 to 24 months, covering one complete audit cycle, being often chosen), with carve-outs for various issues including ‘fundamental’ reps such as ownership of shares or capitalisation, tax matters, sectoral reps such as those relating to environmental or employment matters.⁷³

However, such duration clauses should be checked against statutes of limitation under applicable law, which may either shorten or lengthen the time within which the buyer can make claims, notwithstanding what is set out in the SPA. In some jurisdictions (eg, Delaware and France⁷⁴) contractual shortening or lengthening of the limitations period is acceptable, but this is not true universally, and if the point is not verified it may cause unexpected problems post-closing. US case law provides some examples. A 2011 Delaware case⁷⁵ upheld a one-year survival period for reps (and suggested that claims under a clause providing for survival ‘indefinitely’ would be read as allowing claims up to expiration of the applicable statute of limitations). In another Delaware case, decided in 2015,⁷⁶ the court held that, notwithstanding

72 *Commodity Futures Trading Commission v Weintraub*, 471 US 343, 349 (1985) (stating the parties’ agreement that ‘when control of a corporation passes to new management, the authority to assert and waive the corporation’s attorney-client privilege passes as well’).

73 Deal-points studies indicate that in recent private target deals the general survival periods were longer than 12 months but less than 24 months, in 57 per cent of US deals and in 48 per cent of European deals. ABA Points Target M&A Deal Points Study 2017 see n 49 above slide 74 and ABA European Points Target M&A Deal Points Study see n 49 above slide 67.

74 Delaware law on this point was amended in 2014 to allow parties to a contract involving at least \$100,000 to extend the statutes of limitations up to 20 years (previously this apparently required a contract under seal). In France, Code civil Art 2254, as modified in 2008, allows parties by contract to shorten the statute of limitations (to not less than one year) or to lengthen it (to not more than ten years).

75 *GRT v Marathon GTF Technology CA No 5571-CS* (Del Ch 11 July 2011).

76 *Bear Stearns Mortgage Funding Trust 2006-SL1 v EMC Mortgage LLC*, CA No 7701-VCL (Del Ch 12 January 2015).

contractual survival periods, the relevant statute of limitations would determine the maximum period during which a claim could be brought (in that case, for failure of securitised mortgage loans to comply with reps), but then decided that under Delaware law the applicable statute of limitations was the six-year limit set out in New York law, with the result that the claim was deemed timely. These cases suggest that any contractual survival periods may have to comply with any statute of limitations, and statutory restrictions on modifications thereof, that the relevant court will apply in case of dispute.

* * *

The literature on the ‘black hole problem’ provides a welcome fresh look at M&A practice. Analyses of shortfalls in lawyering, and the spectre of unnecessary or even counterproductive tinkering with contract language, should serve as a wake-up call to deal lawyers, reminding them that self-evaluation is appropriate and complacency is dangerous.