Never Really Thought About It: Understanding "Miscellaneous" Provisions and Other Background Text in Agreements

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Ms. Nadile is active with the American Bar Association, where she serves as Vice Chair of the Secured Transactions Subcommittee of the Uniform Commercial Code Committee of the Business Law Section and is a member of the Joint Task Force for Deposit Account Control Agreements. She is also active with The Association of the Bar of the City of New York, currently serving as Secretary to the Commercial Law and Uniform State Laws Committee, and The Association of Commercial Finance Attorneys, where she is a member of the Board of Directors and a past Education Chair for the Continuing Legal Education Weekend.

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Modification

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I. Overview. A modification is a contract, so in theory a modification requires offer, acceptance, and consideration. Like most contracts, a modification does not need to be evidenced by a writing unless the agreement is within the statute of frauds.

Conflict arises, however, because parties often change these rules, either expressly or implicitly. They frequently draft a provision requiring modifications to be in writing – and then make them orally. Or they agree to a modification that lacks consideration and expect it to be enforceable anyway. Or they agree that one party may unilaterally modify terms without acceptance by the other.

When drafting modification provisions, it is therefore necessary to "time travel" to the future to see what conflicts might arise and how they are likely to be resolved.

II. Consideration.

Here is a case that arose in Montana. A bank entered into a standard auto loan agreement with a consumer. The terms provided that the consumer would make payments on the first of the month, and if a payment was not timely made, the bank had the right to accelerate the debt and repossess the car. One day the consumer called the bank and explained that she had a temporary cash flow problem. Would it be all right, asked the consumer, if she paid that month on the 20th rather than on the 1st? No problem, responded the bank. The agreement was not properly communicated to all departments, however, and when the consumer had not paid by the 15th, the bank accelerated the debt and repossessed the car. But you agreed to give me until the 15th, cried the consumer. Ha Ha, responded the bank, There was no consideration for that promise. We gave you until the 15th to pay, but what did you do for us?

Is there any court that would find in favor of the bank in that situation? But what tools does the court have to supply consideration or a consideration substitute? Here are some possibilities from common law:

A. A bargained-for consideration.
B. Something new on the part of each party – "a horse, a hawk, a robe."
C. Rescission of the old agreement and formation of a new agreement.
D. Reliance as a consideration substitute.

Many courts have been willing to enforce modifications even when there is technically no consideration. Restatement § 89 provides that the modification is enforceable if it is "fair and equitable in view of circumstances not anticipated" when the contract was made. Article 2 simply disposes of the consideration requirement with respect to the sale of goods. UCC 2-209(1) provides that "[a]n agreement modifying a contract within this Article needs no consideration to be binding." Of course, this is not a blanket invitation to extract modifications. The process is subject to the good faith requirement of Article 1.

III. Oral modifications.

In our hypothetical, even if the court finds that the consideration requirement is satisfied or dispensed with, the bank has another line of defense. Buried in the boilerplate there is a provision that states, "No modification of this agreement is enforceable unless it is found in a writing signed by both parties." The bank now says, Ha Ha, that modification is not enforceable because it is not found in a signed writing. Will a court be able to get around that requirement?

It might be noted here that UCC 2-209(2) expressly honors this practice: "(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded ...." States that have adopted the Field Code, such as California, have a similar provision by statute.

Courts frequently enforce oral modifications in the face of a no-oral-modification (NOM) clause on a theory of waiver or estoppel. The parties today agreed to the NOM clause, but there is no reason that they cannot agree tomorrow to suspend the NOM clause and enter into an oral modification. A party could have insisted on the right to a signed agreement, but instead waived that right. This view is supported by UCC 2-209(4): "(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) ... it can operate as a waiver." Similarly, the court may estop a party from enforcing the NOM clause since that party engaged in the conduct that led to the oral modification. Restatement § 89 may be applied in this context as well.

Drafters may attempt to block these parries by inserting a non-waiver provision on top of the NOM provisions; e.g., something like "No provision of this agreement may be waived by the parties unless the waiver is found in a writing signed by both parties." Not surprisingly, most courts use the same techniques to find that the parties agreed by their conduct to orally waive the non-waiver provision and then agreed to make an oral modification in spite of the NOM provision.

Note that the chief distinction between modification and waiver is that a modification is an express contract, arising by agreement, while a waiver arises impliedly by conduct. This distinction has a number of implications. For one, a waiver does not remain in place and can be retracted on notice. Courts have generally found that a party may retract a waiver before it has been acted upon. This view is supported by UCC 2-209(5): "(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver."

IV. Offer and Acceptance.
This issue of whether there has been acceptance of an offer of modification has been litigated frequently in recent years. The classic case arises when a bank sends a notice to a customer stating that it has changed the terms of the agreement; e.g., changing the interest rate or providing that all disputes will be resolved by arbitration. A dispute arises and the customer goes to court. The bank moves to compel arbitration. The customer claims that it never accepted the offered arbitration clause.

Classical contract law provides that there is no such thing as acceptance by silence, and here the bank clearly did not secure the express acceptance of the customer to the new terms. The bank may have attempted to remedy this situation by providing in the initial terms that the terms may be modified by the bank on notice to the customer and that the customer gives its consent to these new terms. While this may seem a sensible provision, parties generally have the freedom of contract to make the terms of their agreement, but they do not have the freedom to change the rules of contract formation; that is, they can't agree that a contract may be entered into without offer, acceptance, and consideration.

On the other hand, parties who enter into long-term contracts know that the future is unknowable. Knowing that circumstances may change in the future, prudent parties will provide for those possibilities in their contract. Thus, for example, a buyer of goods might consent to the right of the seller to adjust the price if the cost of various inputs goes up or down. Thus, an agreement allowing certain modifications seems both sensible and necessary.

Courts addressing this problem have, not surprisingly, come up with a spectrum of solutions. Let us examine one of those cases that explores the spectrum.

In *Stone v. Golden Wexler & Sarnese, P.C.*, 341 F. Supp. 2d 189 (E.D.N.Y. 2004), the bank mailed the customer notice that in future all disputes would be resolved by arbitration. The court noted that absent any prior agreement with respect to modifications, such a modification would not be enforceable under contract law. The bank did not dispute this conclusion, but instead argued that the parties had agreed to such modifications in this provision of the original credit card agreement:

> Changes in Terms. We may amend or change any part of your Agreement, including the periodic rates and other charges, or add or remove requirements at any time. If we do so, we will give you notice if required by law of such amendment or change. Changes to the annual percentage rate(s) will apply to your account balance from the effective date of the change, whether or not the account balance included items billed to the account before the change date and whether or not you continue to use the account. Changes to fees and other charges will apply to your account from the effective date of the change.

The bank cited as precedent *Bank One, N.A. v. Coates,* 125 F. Supp. 2d 819 (S.D. Miss. 2001), aff'd without opinion, 34 Fed. Appx. 964, 2002 WL 663804 (5th Cir. 2002), a case in which

Ohio law was applied. The *Stone* court stated in analyzing this case:

> The court concluded that Coates was bound by the arbitration clause because the original agreement, which Coates had signed, authorized the bank to make amendments without limitation and the bank complied with its change-in-terms provision. Although the *Coates* court noted that there is an Ohio statute authorizing unilateral change to credit card agreements, the court did not rely on that statute to reach its conclusion.

Other courts, however, have gone the other way. In *Badie v. Bank of America,* 67 Cal. App. 4th 779, 79 Cal. Rptr. 2d 273, 284 (1998), the California court stated:

> the Bank reserved to itself the unilateral and nonnegotiable right to vary every aspect of the performance required by the parties to the account agreements. The Bank's interpretation of how broadly it may exercise that right, with no limitation on the substantive nature of the changes it may make as long as it complies with the *de minimis* procedural requirement of 'notice,' virtually eliminates the good faith and fair dealing requirement from the Bank's relationship with its credit account customers ...

The *Stone* court took a middle position, using rules of interpretation to limit the power of the bank to make modifications. The agreement states, “We may amend or change any part of your Agreement,” which would seem to authorize all amendments. But it then uses language which the court concluded was language of limitation rather than language of example: “including the periodic rates and other charges, or add or remove requirements at any time.” The court therefore concluded that the court had the right to change the rates and charges in the original agreement, but could not add terms that were never in the original agreement.

Does this mean that if the drafter had expressly stated that the bank reserved the right to make any modifications, without limitation, then the court would have enforced the clause as written? I don’t think so. At that point, it would become a matter of policy rather than a matter of drafting.

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SECURITY AGREEMENT BOILERPLATE

A "security agreement" is an agreement that creates or provides for an interest in personal property that secures payment or performance of an obligation.[1]

I. RECITALS

A. Overview:

Recitals explain the transaction, including naming parties thereto, their status and why they are entering into the security agreement. For attachment of a security interest to occur, (i) secured party must give value, (ii) debtor must have an interest in or the power to transfer an interest in the collateral to the secured party, and (iii) debtor must authenticate a security agreement that describes the collateral.[2] "Secured party" is defined as the person in whose favor the security interest is granted.[3]

B. Example:

"SECURITY AGREEMENT, dated as of ___________, between [name of Debtor], a [State] [type of registered organization] and [name of Secured Party] ("Secured Party");

WHEREAS, Debtor has entered into a Credit Agreement dated the date hereof (as amended from time to time, the "Credit Agreement"), with the Secured Party, pursuant to which the Secured Party, subject to the terms and conditions contained therein is to make loans to the Debtor;

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[1] Uniform Commercial Code § 9-102(a)(73); § 1-201(37). All section references used herein are to the Uniform Commercial Code, as in effect on the date hereof.
[2] § 9-203(b)(1); § 9-23(b)(3)(A); § 9-203(b)(2). Note there are exceptions to (iii); for example, if the collateral is a deposit account, and the secured party has control under Section 9-104 pursuant to a security agreement.
[3] § 9-102(a)(72)(A).

WHEREAS, it is a condition precedent to the Secured Party's making any loans to Debtor under the Credit Agreement that the Debtor execute and deliver a Security Agreement in substantially the form hereof;

NOW THEREFORE,"

II. DEFINITIONS

A. Overview:

(i) A security agreement is frequently one of many "loan documents" executed in conjunction with a loan. To the extent possible, it is best to keep the definitions in all the loan documents consistent.

(ii) In addition, the parties must choose which state's UCC governs, and to the extent terms are defined differently in various Articles of the UCC, which Article of the UCC governs. For example, "instrument" under Article 9 includes non-negotiable and negotiable instruments, while "instrument" under Article 3 includes only negotiable instruments.[4]

(iii) Also, it is important to note that sometimes using the Article 9 definition may not be beneficial. For example the UCC definition of commercial tort claims is "any claim", thus making it difficult for a debtor to know when it has a claim and difficult for a secured party to enforce a debtor default for failure to report the existence of such a claim. Thus, both parties benefit from inserting a clear standard into the UCC definition of commercial tort claim.

Similarly, the UCC definition of deposit accounts includes all deposit accounts including payroll accounts. For reputational and liability reasons, a secured party generally does not want to exercise control over a payroll account and therefore is usually willing to exclude payroll accounts from the UCC definition of deposit accounts, or alternatively, to exclude payroll accounts from the perfection requirement.

(iv) It may make sense to exclude certain personal property from collateral thereby creating a need for a definition of "Excluded Collateral". For example, a secured party may not want to spend time reading all of debtors contracts and therefore usually will include an exclusion for contracts that have an enforceable anti-assignment provision. Secured parties do not want their debtors to incur taxable phantom income and therefore will generally exclude from a US loan voting stock of foreign subsidiaries in excess of 65%[5]. Similarly, it may not be worth the borrower's effort and expense to perfect a security interest in certain assets, including goods subject to a certificate of title if such personalty constitutes a minimal amount of the

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[4] § 9-102(a)(47); § 3-102(1)(e); § 3-104(b).

[5] If a foreign subsidiary provides credit support of any type beyond a 2/3 pledge of its stock, the foreign subsidiary is deemed to have paid a dividend to the US parent equal to the principal amount of the loan to the extent of the foreign subsidiaries earnings and profits. Thus, any such credit support beyond the 2/3 pledge can result in "phantom income" (i.e., taxable income without corresponding cash) to the US parent. See Section 956 of the US Federal Income Tax Code.

debtor's assets. A debtor does not want to lose the benefit of its bargain in the credit agreement and therefor will want to exclude capital leases, purchase money financings and cash to secure letter-of-credit rights, if they are permitted under the credit agreement.

(v) Some states adopted non-uniform provisions of the UCC, so be cognizant of which state's UCC is chosen to govern. For example, a question sometimes arises as to whether an annuity is a contract of insurance which is excluded from the scope of Article 9 by Section 9-109(d)(8), or whether it is a general intangible. New York concluded that an annuity contract is a contract of insurance, and is therefore excluded from the scope of Article 9. A secured party lending to a debtor that holds valuable annuity contracts may wish to designate law other than the New York UCC to govern. Also, some states (for example, New York) did not adopt the Article 9 override of statutory anti-assignment clauses. Thus, another non-uniform provision to be aware of is whether the state's UCC is applicable to government debtors. Typically, the UCC of the state chosen will be the same state whose law governs the security agreement as a matter of contract between the debtor and the secured party.

(vi) Moreover, certain terms must be defined. For there to be a security interest, the interest must secure "payment or performance of an obligation." For drafting simplicity and clarity, consider defining a term to refer collectively to the secured obligations. "Secured Obligations" can include future advances only if the security agreement so states. Beware of dragnet clauses because courts may not give effect to these provisions (e.g., limit obligation to obligations arising out of the Loan documents).

(vii) While remedies under Article 9 can only be enforced upon default, Article 9 does not define default. Thus, the security agreement must define "Default" and/or "Event of Default." Without such definition, it is unclear when remedies can be exercised.

B. Negotiable Provisions:

(i) The definitions in a security agreement are negotiable. The parties may negotiate, for example, whether "Obligations" will cover existing obligations and hereafter arising obligations, or obligations arising under the loan documents or at any time owing to the secured party. As noted, use these dragnet clauses with caution, as courts may not enforce such provisions.

(ii) The parties may also negotiate, for example, (a) whether "Excluded Deposit Accounts" will be "Excluded Collateral" or "Unperfected Collateral"; (b) whether "Commercial Tort Claims" must meet value thresholds or must be asserted in a judicial proceeding; or (c) whether "Commercially reasonable efforts" require making of payments or concessions.

C. Example:

All capitalized terms used herein without definition shall have the respective meanings provided therefor in the Credit Agreement.

All terms defined in the UCC of [the State] and used herein shall have the same definitions herein as specified therein. However, if a term is defined in Article 9 of the UCC of the State differently than in another Article of the UCC of the State, the term has the meaning specified in Article 9.

"Commercially Reasonable Efforts" means efforts that are commercially reasonable but in no event require the making of payments or material concessions.

"Commercial Tort Claim" has the meaning provided in the UCC except it shall refer only to such claims that have been asserted in judicial proceedings.

"Deposit Accounts" has the meaning provided in the UCC except it shall not include Excluded Deposit Accounts.

"Excluded Collateral" means (1) any property in which the Debtor now or hereafter has rights, to the extent in each case, a security interest may not be granted by the Debtor in such property as a matter of applicable law, or under the effective terms of the governing document applicable thereto, without the consent of one or more parties thereto other than any Loan Party, but only for so long as such consent has not been obtained; (2) assets subject to capital leases, purchase money financing and cash to secure letter-of-credit reimbursement obligations to the extent such capital leases, purchase money financing or letters of credit are permitted under the Credit Agreement; (3) assets sold to a person who is not a Loan Party in compliance with the Credit Agreement; (4) assets owned by a Guarantor after the release of the guaranty of such Guarantor pursuant to Section ___ of the Credit Agreement; (5) vehicles and other goods subject to a certificate of title; (6) any collateral as to which the Collateral Agent has determined in its sole discretion that the collateral value is insufficient to justify the difficulty, time and/or expense of obtaining a perfected security interest therein; (7) any application for registration of a Trademark filed with the United States Patent and Trademark Office ("PTO") on an intent-to-use basis until such time (if any) as a statement of use or amendment to allege use is accepted by the PTO, at which time such Trademark shall automatically become part of the Collateral and subject to the security interest pledged; (8) any property to the extent that such grant of a security interest is prohibited by a Governmental Authority, or requires a consent not obtained of any Governmental Authority; (9) the issued and outstanding voting capital stock of any first tier Foreign Subsidiary in excess of 65% thereof, *[(10) any property to the extent that such grant of a security interest would contravene the Agreed Security Principles, and (11) any subsidiary to the extent that Rule 3-10 or Rule 3-16 of Regulation S-X under the Securities Act requires separate financial statements of such subsidiary to be filed with the SEC (or any other governmental agency).]* Notwithstanding the foregoing any and all proceeds of Excluded Collateral to the extent that the proceeds are not themselves Excluded Collateral shall be Collateral.

"Excluded Deposit Accounts" means (1) any deposit accounts specially and exclusively used for payroll, payroll taxes and other employee wage and benefit payments to or for the benefit of the Debtor's salaried employees, (2) escrow arrangements (e.g., environmental indemnity accounts), and (3) deposit accounts not otherwise subject to the provisions of this paragraph the aggregate average daily balance of which for all Loan Parties do not exceed $_______ at any time.

"Secured Obligations" means all of the indebtedness, obligations and liabilities of the Debtor to the Secured Party, individually or collectively, whether direct or indirect, joint or several, absolute or contingent, due or to become due, *now existing or hereafter arising* (and whether arising before or *after the filing of a petition in bankruptcy and including all interest accrued after the petition date) under or in respect of the Credit Agreement, any promissory notes or other instruments or agreements executed and delivered pursuant thereto or in connection therewith, or this Agreement.*

"Unperfected Collateral" means Excluded Deposit Accounts, goods subject to certificate of title laws, and letter-of-credit rights, individually or in the aggregate not in excess of $_____.

III. GRANTING LANGUAGE

A. Overview:

(i) No special language is required to create a security interest. The phrase "grant a security interest" is sufficient. "Grant" and "pledge" can be used synonymously,[6] but are frequently used together. It is preferable not to use "assign" because such term can connote an outright transfer of ownership when applied to certain intellectual property.

(ii) The security agreement must "provide a description of the collateral,"[7] and that description of collateral is sufficient if it "reasonably identifies" the collateral.[8] "Supergeneric" descriptions such as "all the debtor's assets" and "all the debtor's personal property" are not permitted. Usually, the security agreement will simply use the categories of collateral established by the UCC.

(iii) An all asset lien can be described by naming each Article 9 category of collateral[9] and then adding "and all other personal property whether governed by Article 9 or other law." Nonetheless, one should be cognizant of certain exceptions and limitations on language used to describe collateral, including:

(a) "Commercial tort claims" must be described specifically (for example, plaintiff's and defendant's name and a description of the claim) in order for a security interest to attach to such claim.[10] Security agreements generally take this into account by requiring debtors to give prompt notice to the secured party when any commercial tort claim arises and to supplement the security agreement to describe the tort claim.

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[6] § 9-102; § 9-203.
[7] § 9-203(b)(3)(A)
[8] *See, also,* § 9-108(a).
[9] *See,* § 9-108(b)(3) (see definition of "general intangibles" for a list of the Article 9 categories of collateral).
[10] § 9-108(e)(i); § 9-204(b)(2).

(b) "After-acquired property" can also be pledged, but only if specifically stated. Note after-acquired property can never include commercial tort claims since a claim must be described with specificity.

(c) "Wherever located" (this makes clear, for example, that a secured party's security interest will attach to goods located outside of the US).

(d) "Whether now owned or hereafter acquired" will give the secured party a security interest in personal property acquired after the effective date of the security agreement.[11] However, remember that the security interest cannot attach until the debtor has rights in the collateral or power to transfer rights in the collateral.

(e) "Proceeds" can be specifically stated in the granting clause, but a security interest in collateral automatically extends to proceeds even if not mentioned.[12]

(f) "Products" can be specifically stated in the granting clause, but if goods become physically united and identification is lost, the security interest automatically extends to products even if not mentioned.[13]

(g) "Insurance" is excluded by Section 9-109(a)(8), so unless such claims are proceeds of collateral, Article 9 is not applicable. A security interest can be granted in insurance, but such security interest would be governed by law other than Article 9 (e.g., common law).

B. Example:

The Debtor hereby grants and pledges to the Secured Party, to secure the payment and performance in full of all of the Obligations, a security interest in all:

a. Accounts;

b. Chattel paper;

c. Commercial tort claims (described on Schedule I hereto);

d. Deposit accounts;

e. Documents;

f. General intangibles;

g. Goods;

[11] § 9-204(a).
[12] § 9-102(a)(12)(A); § 9-203(f); § 9-315(a)(2).
[13] § 9-336.

h. Instruments;

i. Investment property;

j. Letter-of-credit rights;

k. Letters-of-credit;

l. Money; and

m. All other personal[14] and fixture property whether governed by Article 9 of the UCC or other law wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof (collectively the "Collateral").

IV. PERFECTION

A. Overview:

To insure perfection, it is crucial to correctly classify the collateral. Classification frequently depends on the debtor's use of the collateral. For example, a titled vehicle can be consumer goods if it is used primarily for personal, family, or household purposes, inventory if it is leased or held for sale or lease, or equipment if it is held for use. Perfection of a security interest therein is achieved by compliance with requirements administered by the governmental department responsible for registration and licensing of such vehicles, which commonly require a notation of the lien on the certificate of title. If it is held for sale by a person in the business of selling goods of that kind, it is inventory and perfection of a security interest therein is achieved by a properly filed financing statement.

B. Example:

Following is a chart that indicates the various methods of perfection for most Article 9 collateral.

Type of Collateral	**Automatic or Temporary**	**Possession**	**Control**	**Financing Statement**
Accounts, general intangibles (except for sales of payment intangibles), described commercial tort claims				X
Instruments (except sales of promissory notes)	X	X		X

[14] Prior to extraction oil, gas, and other minerals are treated as real property and as such lie outside the scope of Article 9. It is only upon extraction that such minerals become goods and subject to Article 9. See Official Comment 4c to Section 9-102.

Goods, negotiable documents	X	X		X
Tangible chattel paper		X		X
Investment property, electronic chattel paper			X	X
Certificated securities	X	X	X	X
Deposit accounts, letter-of-credit rights			X	
Money		X		
Payment intangibles (sales)	X			
Promissory notes (sales)	X			

1. Filing:

A. Overview:

Other than those in sales of payment intangibles and promissory notes, deposit accounts, letter-of-credit rights and money, all security interests in personal property subject to Article 9 can be perfected by a properly filed financing statement. Authorization to file financing statements is automatic if the collateral description used in the financing statement is the same description provided in the security agreement. Specific authorization is required to file an "all assets" financing statement if collateral is less than all assets.

B. Negotiable Provisions:

Fixtures are goods, and are therefore perfected by properly filing a financing statement centrally in the debtor's location. However, the secured party may also request a "fixture filing."[15] Both perfect the security interest in fixtures. The significance of a fixture filing is not whether it is sufficient to perfect the security interest, but whether it will provide priority over the encumbrancer of the underlying land.[16] Note, a duly recorded mortgage can be effective as a fixture filing if it (among other things) indicates the goods, and the goods are, or are to become, fixtures.[17] Since a fixture filing gives additional priority in the real property records, it is a negotiable requirement under a security agreement.

C. Example:

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[15] § 9-501(a)(2); Comment 4 to § 9-501.
[16] *See,* § 9-334.
[17] *See,* § 9-502(c).

The Debtor hereby irrevocably authorizes the Secured Party at any time and from time to time to file in any Uniform Commercial Code jurisdiction financing statements (including amendments and continuations thereto) that (a) indicate the Collateral (i) as all assets of the Debtor or words of similar effect, regardless of whether any particular asset comprised in the Collateral falls within the scope of Article 9 of the Uniform Commercial Code of the State or such jurisdiction, or (ii) as being of an equal or lesser scope or with greater detail, and (b) contain any other information required for the sufficiency or filing office acceptance of any financing statement or amendment, including (i) whether the Debtor is an organization, the type of organization and any organization identification number issued to the Debtor (if required by the applicable jurisdiction) and, (ii) in the case of a financing statement filed as a fixture filing or indicating Collateral as as-extracted collateral or timber to be cut, a sufficient description of real property to which the Collateral relates. The Debtor agrees to furnish any such information to the Secured Party promptly upon the Secured Party's request. *[The Debtor also ratifies its authorization for the Secured Party to have filed in any Uniform Commercial Code jurisdiction any like initial financing statements or amendments thereto if filed prior to the date hereof.]*

2. Possession:

A. Overview:

Even though a security interest can be perfected in certain collateral by the proper filing of a financing statement, greater priority is afforded by taking possession of certain collateral (e.g., instruments, tangible chattel paper, certificated securities, negotiable documents).

B. Negotiable Provisions:

The requirement for possession of such collateral is negotiable, and may include thresholds for delivery (e.g., "value in excess of $____") or requirements for time of delivery (e.g., promptly, quarterly, upon default, after the continuance of an Event of Default).

C. Example:

If the Debtor shall at any time hold or acquire any promissory notes or tangible chattel paper in an amount in excess of $______ individually or $ _____ in the aggregate, the Debtor shall endorse, assign and deliver the same to the Secured Party *on or before the first Quarterly Update Date following the acquisition thereof*, accompanied by such instruments of transfer or assignment duly executed in blank as the Secured Party may from time to time specify.

3. Control:

A. Overview:

Whereas a security interest in letter-of-credit rights and deposit accounts can only be perfected by control, a security interest in other collateral can be perfected by the proper filing of a financing statement or control, and priority is afforded by obtaining control of such collateral (e.g., electronic chattel paper, investment property (including uncertificated securities) where the secured party may enter into a control agreement with the issuer or arrange for the uncertificated security to be registered on the books of the issuer in the secured party's name), and certificated securities. Note that the secured party's security interest in the financial assets (or deposit accounts or commodity accounts) perfected by control are superior to a security interest in the financial asset (or deposit accounts or commodity accounts) claimed by another secured party as proceeds of other Article 9 collateral.[18] However, the secured party's security interest will be junior to a security interest in favor of the securities intermediary (or depositary or commodity intermediary), unless the securities intermediary (or depositary or commodity intermediary) subordinates its security interest to the secured party's security interest.[19]

B. Negotiable Provisions:

Requirements regarding control are negotiable and may include (i) thresholds for getting and exercising control, (ii) whether deposit accounts are excluded from the control requirement, (iii) timing to obtain control, and (iv) commercially reasonable efforts to obtain control. With respect to the latter, extension of time should be in the sole discretion of the collateral agent (if more than one secured party) to facilitate a quick response.

C. Example:

For each Deposit Account that the Debtor at any time opens or maintains, the Debtor shall, at the Secured Party's request and option, within 60 days of such request, such time to be extended in Secured Party's sole discretion, pursuant to an agreement in form and substance satisfactory to the Secured Party, either (a) cause the depositary bank to agree to comply without further consent of the Debtor, with instructions from the Secured Party directing the disposition of funds from time to time credited to such Deposit Account, or (b) arrange for the Secured Party to become the sole customer of the depositary bank with respect to the Deposit Account, with the Debtor being permitted, only with the consent of the Secured Party, to exercise rights to withdraw funds from such Deposit Account. *[The Secured Party agrees with the Debtor that the Secured Party shall not give any such instructions or withhold any withdrawal rights from the Debtor, unless an Event of Default has occurred and is continuing.]* The provisions of this paragraph shall not apply to Excluded Deposit Accounts.

4. Collateral in the Possession of a Bailee:

A. Overview:

A security interest in possessory collateral perfected by a properly filed financing statement will lose priority to another secured party that takes possession of such collateral.[20] To avoid this loss of priority, secured parties often require that the bailee acknowledge in an authenticated record that the bailee is holding such collateral for the benefit of the secured party.

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[18] § 9-328(b)(1).
[19] § 9-328(3).
[20] *See, e.g.,* § 9-328 (certificated securities); § 9-330 (tangible chattel paper); § 9-331 (negotiable chattel paper generally).

Such authenticated acknowledgment by the bailee will perfect the secured party's security interest by possession, thereby ensuring the priority of its security interest.[21]

B. Negotiable Provisions:

A Debtor should never permit a third party to have the ability to put it in default. Therefore, this requirement should be negotiated with respect to (i) whether commercially reasonable efforts are to be used to obtain bailee acknowledgement, (ii) the effects of failing to obtain such an acknowledgment (e.g., Event of Default or decrease in borrowing base) or (iii) whether the requirement is subject to a threshold based on the value of the collateral, individually or in the aggregate.

C. Example:

If any Possessory Collateral at any time is in the possession of a bailee, the Debtor shall promptly notify the Secured Party thereof and, at the Secured Party's request and option, shall promptly obtain an acknowledgement from the bailee, in form and substance satisfactory to the Secured Party, that the bailee holds such Collateral for the benefit of the Secured Party and such bailee's agreement to comply, without further consent of the Debtor, at any time with instructions of the Secured Party as to such Collateral. The Secured Party agrees with the Debtor that the Secured Party shall not give any such instructions unless an Event of Default has occurred and is continuing.

5. Agreed Security Principles:

A. Overview:

Agreed Security Principles are applicable to debtors organized under the laws of a jurisdiction outside of the United States, any state thereof or the District of Columbia. Under some foreign laws, a guaranty may cause financial assistance laws or capitalization rules to become applicable and non compliance may result in civil or criminal liability of officers and directors of the guarantor. It may also be difficult to create a security interest in certain types of collateral, or it can take a long time and the documents may be different than US security agreements.

B. Negotiable Provisions:

Even if Debtor does not have any foreign subsidiaries or collateral located outside of the US at the time of closing, the debtor could acquire a foreign subsidiary or move collateral outside of the US after closing. Therefore the debtor should always request the grant of a security interest be subject to the Agreed Security Principles.

C. Example:

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[21] § 9-310(b)(6); § 9-313.

(1) No lien or provision of a guarantee by any person organized outside the United States shall be made that would result in any breach of corporate benefit, financial assistance, capital preservation, fraudulent preference, thin capitalization rules, or any other law or regulation (or analogous restriction) of the jurisdiction of organization of such person; or result in any risk to the officers or directors of such person of a civil or criminal liability; (2) it is expressly acknowledged that in certain jurisdictions (a) it may be impossible or impractical (including for legal and regulatory reasons) to grant guarantees or create security over certain categories of assets in which event such guarantees will not be granted and security will not be taken over such assets or (b) it may take longer than agreed to grant guarantees or create security over certain categories of assets in which event the Collateral Agent will act reasonably in granting the necessary extension of timing for obtaining such guarantees or security; provided that in each case with respect to subclauses (a) and (b) the relevant Guarantor has exercised due diligence and reasonable efforts in providing such guarantees or security; and (3) it is expressly acknowledged that the form of the Security Documents may vary from the forms attached to the Credit Agreement or Security Documents in order to conform to local requirements and customs as well as potential impracticality of complying with local requirements in respect of every item of collateral.

6. Other Actions:

A. Overview:

(i) Article 9 generally precludes financing statements from perfecting a security interest in goods subject to state certificate of title statutes. Rather, perfection is achieved by compliance with the departments administering registration and licensing, which commonly require a notation of the lien on the certificate of title.

(ii) Similarly, if perfection of collateral is governed by US treaties, statutes or regulations, the filing of a financing statement is not effective to perfect a security interest in such personal property. Examples of such collateral include registered copyrights, aircraft, rolling stock, and ship mortgages. Note, some courts have held that security interests in registered trademarks, even though governed by a federal registration system, are not perfected by filing with the Patent and Trademark Office.[22] However, secured parties frequently require such filing because it may be necessary to defeat subsequent purchasers for value.

(iii) Security interests in personal property that is excluded from Article 9 (e.g., insurance policies) is perfected by complying with applicable state law other than Article 9.

(iv) Whereas perfection of a security interest in a government contract is achieved by a properly filed financing statement, enforcement of a security interest in such government contract can only be achieved if the debtor complies with the Federal Assignment of Claims Act of 1940 ("FAOCA"), 31 U.S.C. § 3727 and 41 U.S.C. § 15.

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[22] *In re Together Development Corp.,* 227 B.R. 439 (Bankr. D. Mass. 1998).

(v) Further assurance clauses imply future performance and help parties to a contract achieve their contractual purpose, even though not every required future action is identified therein. They are used by the secured party to require acts that are not included in the security agreement, but are necessary to achieve the objective of the security agreement (e.g., to grant and perfect a security interest in collateral and provide remedies if there is an Event of Default).

B. Negotiable Provisions:

The requirement for a debtor to comply with state and federal perfection and enforcement laws is negotiable. It can be required, for example, only after the continuance of an Event of Default or only if the value of the personal property exceeds a certain amount.

V. REPRESENTATIONS, WARRANTIES AND COVENANTS CONCERNING THE DEBTOR

A. Overview:

(i) The representations and warranties confirm information that is necessary for the secured party to perfect its security interest by filing and to determine whether any earlier filings covering the same collateral exist. Perfection by filing is accomplished by filing a financing statement in the state in which the debtor is located, unless the collateral is timber to be cut or as-extracted collateral, or the financing statement is filed as a fixture filing and the applicable real estate is located in another state.[23] To file an effective financing statement and to search for other secured liens, among other things, the secured party needs the debtor's exact legal name and location.[24] For example, if the debtor is a registered organization organized under state law, as defined in Section 9-102, the debtor will be located, for purposes of Article 9, in the state in which the debtor is organized.[25] If the debtor is a general partnership, the debtor will be located in the state in which it has its chief executive office.[26] That or like information (e.g., the debtor's mailing address, if different than the address of its chief executive office, is also required to be contained on the financing statement itself in order for the secured party to avoid the risk of the filing office rejecting the filing, or the risk of its security interest being subordinated to a later secured party or purchaser that relies upon incorrect or missing information in the financing statement.[27]

(ii) The debtor should covenant to provide to the secured party notice of the debtor's change of legal name, place of business (or chief executive office, if the debtor's location is so determined under Section 9-307), type of organization (e.g., if the debtor's limited partnership converts to a limited liability company) or jurisdiction of organization (e.g., if the debtor reincorporates in another state). In these situations, the secured party may need to amend its financing statement or file a new financing statement in order to avoid the lapse of perfection

[23] § 9-301.
[24] *See,* §§ 9-503(a) and 9-506.
[25] § 9-307(e).
[26] §§ 9-307(b)(2)-(3).
[27] § 9-338; § 9-516(b)(5).

or loss of priority of its security interest.[28] A secured party generally has a minimum of four months from the date such a change is effective to continue the perfection of its security interest. Other changes in information reflected on the filed financing statement may not need to be amended for the secured party to preserve the perfection or priority of its security interest.[29] However, the secured party may wish to amend that information out of caution.

B. Negotiable Provisions:

The requirements regarding certain changes are negotiable, including (i) when the Perfection Certificate needs to be updated, (ii) whether a change in debtor's name, location or type of organization is prohibited, or (iii) whether notice has to be given prior to such change or after such change. A secured party has a minimum of four months to change filing if required, due to change in name or location of the debtor.

C. Example:

The Debtor has previously delivered to the Secured Party a certificate signed by the Debtor and entitled "Perfection Certificate" (the "Perfection Certificate"). The Debtor represents and warrants to the Secured Party on the date hereof and on each Quarterly Update Date as follows: (a) the Debtor's exact legal name is that indicated on the Perfection Certificate and on the signature page hereof, (b) the Debtor is an organization of the type, and is organized in the jurisdiction, set forth in the Perfection Certificate, (c) the Perfection Certificate accurately sets forth the Debtor's organizational identification number or accurately states that the Debtor has none, (d) the Perfection Certificate accurately sets forth the Debtor's place of business or, if more than one, its chief executive office, as well as the Debtor's mailing address, if different, (e) all other information set forth on the Perfection Certificate pertaining to the Debtor is materially accurate and complete, and (f) other than as disclosed from time to time as required hereby, there has been no change in any of such information since the date on which the Perfection Certificate was signed by the Debtor.

The Debtor covenants with the Secured Party as follows: the Debtor shall provide notice to the Secured Party (i) on or before the earlier of the first Quarterly Update Date or 90 days after (a) changes to Debtor's name, and (b) changes to Debtor's type of organization, jurisdiction of organization or other legal structure, and (ii) on or before the first Quarterly Update Date following changes to Debtor's organizational identification number if it has one or if it obtains an organizational identification number (if it does not yet have one).

VI. REPRESENTATIONS, WARRANTIES AND COVENANTS CONCERNING THE COLLATERAL

A. Overview:

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[28] *See,* § 9-316(a)(2) (change of debtor's location when the security interest had attached and was perfected at the time of the change); § 9-316(a)(3) (a transferee of the collateral becoming a debtor, or a new debtor becoming bound by the security agreement, when the security interest had attached and was perfected at the time of the transfer or the new debtor becoming bound); § 9-507(c) (change of debtor's name); § 9-508(a) (assets acquired by a new debtor after the new debtor is bound by another debtor's security agreement).

[29] *See, e.g.,* § 9-338 ("incorrect at the time the financing statement was filed") and § 9-507(b).

(i) The debtor typically represents and warrants to the secured party that (a) the debtor has sufficient rights in, or power to transfer rights in, the collateral for the secured party's security interest to attach,[30] (b) the collateral is either not encumbered or, if encumbered, the encumbrances are permitted under the credit agreement ("Permitted Liens"), and (c) the debtor will take all actions necessary to insure continued perfection of the secured party's security interest in the collateral, including (if applicable) actions necessary to perfect a security interest in after-acquired collateral.

(ii) If any of the collateral constitutes "farm products"[31] the debtor should inform the secured party, so that the secured party can decide whether to take appropriate steps to obtain governmental consents under federal agricultural entitlement programs, to obtain waivers or subordinations from suppliers whose claims for unpaid purchase prices for agricultural supplies may have priority under federal law (e.g., the Packers and Stockyards Act of 1921, 7 U.S.C. § 196, and the Perishable Agricultural Commodities Act of 1930, 7 U.S.C. § 499e(c)), or to preserve its security interest, or the proceeds thereof, following the disposition of the farm product collateral under the Food Security Act of 1985, 7 U.S.C. § 1631. If any of the accounts or other rights to payment comprised in the collateral are owned by governmental account debtors, the debtor should inform the secured party, and the secured party may wish to take steps under the FAOCA or any similar state statute to receive payments directly from the governmental account debtors.

(iii) The secured party may request a representation and warranty that the debtor has complied with labor and environmental laws where failure of the debtor to comply may result in a superior claim against, or interest in, the collateral. There is often an analogous representation and warranty in the credit agreement – the two should be drafted consistently. Similarly, other representations, warranties and covenants may be covered in both documents, including those relating to insurance, inspection, books and records, and disposition of collateral. If covered in both the credit agreement and security agreement it is crucial that the provisions be the same.

(iv) Some security agreements include a representation and covenant that all subsidiaries that are limited partnerships and limited liability companies have opted into Article 8 of the UCC, so that all limited partnership interests and the limited liability company interests are Article 8 securities rather than general intangibles, thereby enabling the secured party to perfect by filing, possession and/ or control, rather than perfecting only by filing (i.e. general intangibles can only be perfected by filing).[32] This is because circumstances may change after closing that could affect the characterization of the collateral. A limited liability company's operating agreement may not, on the closing date, classify the membership interests as "Article 8 securities." If so, they will be general intangibles, and a UCC-1 filing is the only method of perfection. If, after the closing, the operating agreement is amended to provide that the membership interests are Article 8 securities the secured party will be at risk that a subsequent secured party will take a security interest in the membership interests and perfect the security

[30] § 9-203(b)(2).
[31] as defined in Section 9-102(a)(34).

[32] §§ 9-310; § 9-313(a); § 9-314.

interest by taking "control." It is preferable to perfect by obtaining "control" because a security interest perfected by control will have priority over a security interest perfected by filing (even when the secured party perfecting by control is aware of the existing security interest perfected by filing).[33] Perfection by control varies depending upon the type of security involved, but the three general methods are: (a) becoming the registered owner of the security, (b) taking physical possession of the security with all necessary endorsements (e.g., stock power, bond power), or (c) in the case of an uncertificated security or an account at a brokerage firm, getting a "control" agreement signed by the owner of the security, the issuer of the security (or, in the case of a brokerage firm, the brokerage firm) and the secured party in which the brokerage firm agrees to follow the instructions of the secured party with regard to the disposition of the security (or securities in the account) without further consent of the owner of the securities (or the account).[34]

B. Negotiable Provisions:

Requirements regarding representations and warranties are negotiable and may be negotiated with respect to (i) whether they are always true, (ii) whether they are true on funding dates, and (iii) when they need to be updated. Rather than opting into Article 8, the debtor can covenant not to opt into Article 8 during the term of the loan. It is in debtors' best interests to keep the representations, warranties and covenants limited to perfecting a security interest in the collateral and avoid provisions that deal with the quality of the collateral and the maintenance of the collateral. Debtors will want quality of collateral provisions limited by phrases such as "to the extent reasonably likely to cause a material adverse effect" and maintenance of collateral provisions limited by phrases such as "in debtor's prudent business judgment to be decided in good faith".

C. Example:

The Debtor further represents and warrants to the Secured Party as follows: (a) the Debtor is the owner of *[or has other rights in or power to transfer rights in]* the Collateral, free from any right or claim of any person or any adverse lien, security interest or other encumbrance, except for the security interest created by this Agreement *[and Permitted Liens]*, (b) *[other than as disclosed on the Quarterly Update Dates,]* none of the Collateral constitutes, or is the proceeds of, "farm products" as defined in §9-102(a) of the Uniform Commercial Code of the State, (c) *[except for [describe]] and other than as disclosed on the Quarterly Update Dates,]* none of the account debtors or other persons obligated on any of the Collateral is a governmental authority owing in excess of $_______ annually, covered by the FAOCA or like federal, state or local statute or rule in respect of such Collateral, (d) the Debtor holds no Commercial Tort Claims except as indicated on the Perfection Certificate and *[other than as disclosed on the Quarterly Update Dates*, (e) *the Debtor has at all times operated its business in compliance with laws to the extent required by Section __ of the Credit Agreement,]* (f) all other information set forth on the Perfection Certificate pertaining to the Collateral is materially accurate and complete, (g) there has been no change in any of such information since the date on which the Perfection Certificate was signed by the Debtor other than as disclosed, *[and (h) the*

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[33] § 9-328(a).
[34] *See,* § 9-106; § 8-106.

Memorandum of Grant of Security Interest in Copyrights identifies all now existing material registered copyrights and other rights in and to all material registered copyrightable works of the Debtor, identified, where applicable, by title, author and/or Copyright Office registration number and date.]

The Debtor further covenants with the Secured Party as follows: (a) other than in the ordinary course of business the Collateral, to the extent not delivered to the Lender pursuant to § __, will be kept at those locations listed on the Perfection Certificate and the Company will not remove a material portion of the Collateral from such locations, without providing at least 30 days prior written notice to the Lender, (b) except for the security interest herein granted *[and Permitted Liens]*, the Debtor shall be the owner of *[or have other rights in]* the Collateral free from any right or claim of any other person or any lien, security interest or other encumbrance, and the Debtor shall defend the Collateral against all claims and demands of all persons at any time claiming the Collateral or any interests therein materially adverse to the Secured Party, (c) the Debtor shall not pledge, mortgage or create, or suffer to exist any right of any person in or claim by any person to the Collateral, or any security interest, lien or other encumbrance in the Collateral in favor of any person, or become bound (as provided in Section 9-203(d) of the Uniform Commercial Code of the State or any other relevant jurisdiction or otherwise) by a Security Agreement in favor of any person as Secured Party, other than the Secured Party *[and Permitted Liens]*, (d) *to the extent deemed prudent business conduct (to be determined by the Debtor in its good faith discretion)* the Debtor will keep the Collateral in good order and repair, (e) *[as provided in the Credit Agreement,]* the Debtor will permit the Secured Party, or its designee, to inspect the Collateral at any reasonable time, wherever located, (f) *[except as otherwise provided in the Credit Agreement],* the Debtor will pay promptly when due all taxes, assessments, governmental charges and levies upon the Collateral or incurred in connection with the use or operation of such Collateral or incurred in connection with this Agreement, (g) the Debtor will continue to operate its business in compliance with all laws *as required by Section __ of the Credit Agreement*, (h) other than in the ordinary course of business, the Debtor will not sell or otherwise dispose, or offer to sell or otherwise dispose, of the Collateral or any interest therein except *[as permitted by the Credit Agreement][unless an Event of Default has occurred and is continuing, sales or other dispositions of equipment consistent with prudent business practices], and (i) on or before the first Quarterly Update Date following the Debtor's acquisition thereof, to provide to the Secured Party like identifications of all material registered copyrights and other rights in and to all material registered copyrightable works hereafter acquired by the Debtor, and to execute and deliver to the Secured Party a supplemental Memorandum of Grant of Security Interest in Copyrights, in form and substance satisfactory to the Secured Party, modified to reflect such subsequent acquisitions and registrations].*

VII. EXPENSES INCURRED BY THE SECURED PARTY AND RIGHTS OF SECURED PARTY PURSUANT TO § 9-207(C)(3)

A. Overview

If the secured party incurs expenses to protect the collateral (e.g., cost of repairs, filing fees, insurance premiums), such expenses usually are added to the debt and secured by the collateral. Interest on these expenses usually are also included, as they are considered an involuntary advance. Reasonable expenses incurred by the secured party to protect the collateral are almost always paid for by the debtor in secured transactions.

(v) The secured party has the right pursuant to Section 9-207(c)(3) to create a security interest for the benefit of its lenders in any collateral in its possession or control pursuant to Sections 9-104, 9-105, 9-106 or 9-107.

B. Negotiable Provisions:

To avoid the risk of losing ownership of a debtor's subsidiary (or other consequences), debtor should get secured party to waive its rights under Section 9-207(c)(3). Note, if there is more than one secured party and a collateral agent has possession or control pursuant to Sections 9-104, 9-105, 9-106 or 9-107, there is no need to get such a waiver because collateral agent must hold such collateral for the benefit of the secured parties.

VIII. REMEDIES AND STANDARDS FOR EXERCISING REMEDIES

A. Overview:

(i) The secured party's rights upon the debtor's default are generally set forth in Part 6 of Article 9. Part 6 of Article 9 gives three types of rights: (1) rights provided for in the security agreement, (2) rights provided for in Part 6 of Article 9 (including (a) collecting or obtaining performance from third parties, (b) foreclosure and (c) strict foreclosure, and (3) judicial procedures. But it is often helpful, especially in the case of non-Article 9 personal property collateral, for the debtor to acknowledge in the security agreement the rights of the secured party. The secured party, in turn, owes various duties to the debtor.[35] Many of these duties may not be waived by the debtor, in the security agreement or otherwise, or may be waived by the debtor only after default.

(ii) Many security agreements set forth a period of time which the parties agree to be "reasonable" to provide the debtor advance notice of the disposition of collateral by the secured party.[36] Article 9 provides a "safe harbor" such that 10 days' prior notice is per se reasonable in a transaction in which the debtor is not a consumer.[37]

(iii) Although many of the secured party's duties to the debtor may not be waived by the debtor, in the security agreement or otherwise, or may be waived by the debtor only after default, there is no reason why the parties may not agree in the security agreement to "not manifestly unreasonable" standards for the secured party to fulfill those duties.[38] Such standards may include setting forth the publications in which advertising of a public disposition of the collateral should be placed, the identity and bidders to be solicited in a private sale, or particular markets in which collateral dispositions should be made. If the secured party has determined a "reasonably convenient" location where, after default, the debtor should assemble the collateral

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[35] *See,* § 9-602.
[36] § 9-612(a).
[37] § 9-612(b).
[38] *See,* § 9-603.

and make it available to the secured party, and that determination is not "manifestly unreasonable," the location may be set forth in the security agreement.[39] When reviewing such provisions, debtor's counsel needs to be cognizant of the enforceability opinion that the secured party will likely require as a condition of closing.

(iv) After default, there are three general remedies which may be exercised. It is best practice for the secured party to accelerate the loan prior to exercising any remedies to ensure that the default covers all of the secured obligations.

Sell the collateral.

(a) Section 9-610 permits the secured party to sell, lease, license or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing. Every aspect of the sale must be commercially reasonable. Failure to sell the collateral in a commercially reasonable manner will adversely affect the ability of the secured party to collect any deficiency and will expose the secured party to damages.[40]

(b) The sale can be accomplished through a public disposition or a private disposition. Article 9 does not define the term "public disposition," but the Official Comments indicate that it is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity," according to the Comments, is meant to imply that some form of advertisement or public notice must precede the sale or other disposition, and that the public must have access to the sale or disposition.[41]

(c) The secured party cannot purchase the collateral at a private disposition unless the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.[42]

Negotiate a partial or full strict foreclosure with the debtor after default.

(a) Section 9-620 provides a procedure in which the debtor and secured party can agree to transfer some or all of the collateral to the secured party in satisfaction of some or all of the obligations secured by the collateral.

(b) There is a procedure that must be followed and the rules are technical. The procedure requires: (1) an agreement after default to accept the collateral, and (2) that notice of the transaction must be given to

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[39] *See,* § 9-603(a); § 9-609(c).
[40] § 9-625; 9-626).
[41] Comment 7 to § 9-610.
[42] § 9-610(c).

persons having a security interest in the collateral (who can block the transaction). If the transaction is completed, the transaction transfers title to the secured party and discharges any subordinate liens.[43] However, Section 1-203 imposes an obligation of good faith on the secured party in enforcing its rights and this obligation cannot be disclaimed.[44] Comment 11 to Section 9-620 states that a proposal and acceptance made under Section 9-620 in bad faith (e.g., accepting $1 million of collateral for a $10 debt) would not be effective.

(c) Potential pitfalls when foreclosing on limited liability and partnership interests include (1) transfer restrictions, (2) absence of the right to cause the admission of the purchaser as a partner/member, (3) capital contribution obligations that may be imposed on the new partner/member, (4) illiquidity (may not have a right to distributions or to resell), (5) securities law considerations in conducting a sale, and (6) lack of limited liability if this is a general partnership or general partnership interest as collateral if formalities are not observed.

Collect from third parties after default.

(d) If the collateral consists of rights to payment or performance by third parties, the secured party may collect from, or obtain performance by, the third parties. Note, that if the third party obligor is paying debtor in installments this can take a long time.

(e) Sweep all funds from controlled deposit accounts and financial assets from controlled securities accounts.[45]

(f) Typically, the security agreement will provide that after the occurrence and continuance of an Event of Default, a secured party may (1) accelerate the payment of the Obligations "without further notice or demand on the debtor and (2) have the right to take possession of the collateral in any jurisdiction in which enforcement is sought, in addition to all rights and remedies of a secured party under the UCC of the state or any other relevant jurisdiction, and any additional rights and remedies as may be provided by applicable law. As noted, Article 9 provides 10 days' notice of sale as a safe harbor for notice requirements. Therefore, the security agreement typically provides for 10 days' notice. The security agreement may also indicate what is agreed to be commercially reasonable (e.g., regarding advertising, notice, location of sale).

[43] § 9-622.
[44] *See also*, § 1-102.
[45] *See*, § 9-607.

B. Negotiable Provisions:

To the extent the *Remedies* section of the security agreement conforms to Part 6 of Article 9, this section is minimally negotiated. However, make certain that all provisions are in compliance with Article 9, e.g., don't permit the waiver of any rights that are not waivable under Article 9.[46]

C. Example:

After an Event of Default has occurred and is continuing, the Secured Party shall, without any other notice to or demand upon the Debtor, thereafter have in any jurisdiction in which enforcement hereof is sought, in addition to all other rights and remedies, the rights and remedies of a secured party under the Uniform Commercial Code of the State or any other relevant jurisdiction and any additional rights and remedies as may be provided by applicable law, including the right to take possession of the Collateral, and for that purpose the Secured Party may, so far as the Debtor can give authority therefor, enter upon any premises on which the Collateral may be situated and remove the same therefrom. The Secured Party may in its discretion require the Debtor to assemble all or any part of the Collateral at such location or locations within the jurisdiction(s) of the Debtor's principal office(s) or at such other locations as the Secured Party may reasonably designate. Unless the Collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, the Secured Party shall give to the Debtor at least ten days prior written notice of the time and place of any public sale of Collateral or of the time after which any private sale or any other intended disposition is to be made. The Debtor hereby acknowledges that ten Business Days prior written notice of such sale or sales shall be reasonable notice. In addition, the Debtor waives any and all rights that it may have to a judicial hearing in advance of the enforcement of any of the Secured Party's rights and remedies hereunder, including, without limitation, the Secured Party's right after an Event of Default has occurred and is continuing, to take immediate possession of the Collateral and to exercise its rights and remedies with respect thereto.

To the extent that applicable law imposes duties on the Secured Party to exercise remedies in a commercially reasonable manner, the Debtor acknowledges and agrees that it is not commercially unreasonable for the Secured Party (a) to fail to incur expenses reasonably deemed significant by the Secured Party to prepare Collateral for disposition or otherwise to complete raw material or work in process into finished goods or other finished products for disposition, (b) to fail to obtain third party consents for access to Collateral to be disposed of, or to obtain or, if not required by other law, (c) to fail to obtain governmental or third party consents for the collection or disposition of Collateral to be collected or disposed of, (d) to fail to exercise collection remedies against account debtors or other persons obligated on Collateral or to remove liens or encumbrances on or any adverse claims against Collateral, (e) to exercise collection remedies against account debtors and other persons obligated on Collateral directly or through the use of collection agencies and other collection specialists, (f) to advertise dispositions of Collateral through publications or media of general circulation, whether or not the

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[46] *See*, § 9-602.

Collateral is of a specialized nature, (g) to contact other persons, whether or not in the same business as the Debtor, for expressions of interest in acquiring all or any portion of the Collateral, (h) to hire one or more professional auctioneers to assist in the disposition of Collateral, whether or not the collateral is of a specialized nature, (i) to dispose of Collateral by utilizing Internet sites that provide for the auction of assets of the types included in the Collateral or that have the reasonable capability of doing so, or that match buyers and sellers of assets, (j) to dispose of assets in wholesale rather than retail markets, (k) to disclaim disposition warranties, (l) to purchase insurance or credit enhancements to insure the Secured Party against risks of loss, collection or disposition of Collateral or to provide to the Secured Party a guaranteed return from the collection or disposition of Collateral, or (m) to the extent deemed appropriate by the Secured Party, to obtain the services of brokers, investment bankers, consultants and other professionals to assist the Secured Party in the collection or disposition of any of the Collateral. *[Specify other standards applicable to any specific type of Collateral.]* The Debtor acknowledges that the purpose of this Section is to provide nonexhaustive indications of what actions or omissions by the Secured Party would not be commercially unreasonable in the Secured Party's exercise of remedies against the Collateral and that other actions or omissions by the Secured Party shall not be deemed commercially unreasonable solely on account of not being indicated in this Section. Without limitation upon the foregoing, nothing contained in this Section shall be construed to grant any rights to the Debtor or to impose any duties on the Secured Party that would not have been granted or imposed by this Agreement or by applicable law in the absence of this Section.

IX. SURETYSHIP WAIVERS

Waiver of notice of loans made, extensions of due dates, failure to perfect, and release of collateral are relevant only if the debtor is not the borrower (e.g., debtor is granting a security interest in its assets to secure a loan to its subsidiary).

X. NOTICES

The UCC distinguishes the act of giving notice from the receipt of notice. Such notice provisions allocate risks depending on whether the notice deemed is given upon delivery or upon receipt. Some of the provisions to consider include whether notice has to be in writing or can be oral, whether notice must it be signed by a certain party, and how notice has to be delivered (email, fax, first class mail, registered mail, certified mail, overnight carrier, who must receive the notice, and will recipient sign proof of evidence of receipt?

XI. CONFLICTS

If there is an intercreditor agreement, it should always control if there is a conflict between the security agreement and the intercreditor agreement.

XII. POST-CLOSING

A. Overview:

Frequently, conditions precedent to closing, for example, requirements for delivery of control agreements and landlord waivers, are modified to become post-closing requirements to avoid extended delays in closing.

B. Negotiable Provisions:

Certain provisions are crucial for debtors, including giving the secured party the sole discretion to extend such time period to satisfy such post-closing requirements. In addition, debtors do not want to risk allowing third parties the power to put them in default. Thus, debtors should try to obtain a commercially reasonable efforts standard for delivery of post-closing requirements.

XIII. TERMINATION

A. Overview:

Liens should automatically be released upon payment in full of the Obligations and termination of the commitment to extend credit. Exceptions include letters of credit that get cash collateralized rather than terminated and indemnities that survive the termination of the credit agreement. Note that in the case of consumer goods, a secured party has an affirmative duty to file a termination statement. In non-consumer goods contexts, if the secured party does not terminate or authorize the termination of financing statements within twenty days after it receives an authenticated demand from the debtor, the debtor may file the termination statement if the termination statement indicates the debtor authorized such filing.[47]

B . Example:

Upon the indefeasible payment in full of the Obligations, including the cash collateralization, expiration, or cancellation of all Obligations, if any, consisting of letters of credit, and the full and final termination of any commitment to extend any financial accommodations under the Credit Agreement, the security interests granted herein shall automatically terminate and all rights to the Collateral shall revert to Debtor. Upon any such termination, Secured Party will, at Debtor's expense, execute and deliver to Debtor such documents as Debtor shall reasonably request to evidence such termination. Such documents shall be prepared by Debtor and shall be in form and substance reasonably satisfactory to Secured Party.

XIV. CHOICE OF LAW PROVISIONS

A. Overview:

(vi) *Governing Law.*

Article 9 provides the rules for determining what law governs perfection because third parties need certainty in where to look to obtain notice of a lien. The parties to a security agreement (with certain exceptions) cannot pick the law that governs perfection.

(vii) *General Rules for Law Governing Perfection.*

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[47] *See* Comment 6 to 9-509 and 9-513(c).

In general, the law of the jurisdiction in which the debtor is "located" will govern the perfection of security interests by filing.[48] Section 9-307 outlines the determination of where a debtor is "located":

(a) Individuals are located in the jurisdiction of the location of their principal residence.[49] It may be difficult to determine a debtor's principal residence if the debtor has more than one residence. If representing the secured party, it is best to file in all jurisdictions where the debtor has a residence, drivers license, voting card, or state identification card.

(b) Registered organizations organized under state law are located in the state under the laws of which they're organized..[50] Not every entity organized under state law is a "registered organization." Generally, these entities include corporations, limited liability companies, limited partnerships, and other entities that are organized solely under the law of a single state and for which the state must maintain a public record showing that the entity has been organized.[51] General partnerships typically do not meet this definition. Registered organizations organized under federal law may be located, variously, in the state designated by federal law, in the state designated as its location, or in the District of Columbia.[52]

(c) Foreign entities are located in the jurisdiction of the location of their place of business (or chief executive office, if the entity has more than one place of business), if such location is in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording or registration system as a condition or result in the security interest's obtaining priority over the rights of other lien creditors (a notice filing system similar to Article 9). If the location is not in a jurisdiction with a notice filing system similar to ours, the debtor is deemed located in the District of Columbia.[53] If the foreign jurisdiction has not adopted Article 9 or a previous version of our Article 9 it is safest to file with the District of Columbia and retain foreign counsel to perfect the security interest under foreign law.

(d) "Fallback Rule" / Other entities (e.g., general partnerships):

(1) organizations are located in the jurisdiction of the location of their place of business;

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[48] § 9-301.
[49] § 9-07(b)(1).
[50] § 9-307(e).
[51] § 9-102(a)(70).
[52] § 9-307(f).

[53] §§ 9-307(b)-(c).

(2) organizations with more than one place of business are located in the location of their chief executive office.

(viii) _Special Rules: Bank Accounts._

The law of the depository institution's "jurisdiction" governs the perfection of a security interest in a deposit account maintained by the debtor with that bank.[54] Although there are several rules to determine this, the parties (i.e., the bank and the debtor) can pick the "jurisdiction" for purposes of Section 9-304(b). As noted below, the only method by which to perfect a security interest in a bank deposit account is by obtaining "control" of that account. Typically this will be accomplished through an "account control agreement" among the debtor, the secured party and the depository institution or it is accomplished automatically if the secured party is the depositary institution. The account control agreement should state the law that governs perfection.

(iv) _Perfection by Possession_

The law of the jurisdiction where the collateral is located governs the perfection of collateral that is perfected by possession.

XV. GOVERNING LAW & FORUM DESIGNATION CLAUSES

A. Overview:

(ix) Most contracts designate a particular state's law to govern the contractual relationship and provide for application of such law in resolving disputes that arise out of such contracts, including whether the security interest has attached and rights of enforcement. Such governing law provisions provide a degree of predictability of how the contract will be interpreted and how disputes will be resolved. The designated state should bear some relationship to the contract (e.g., where parties conduct business, where contract was negotiated, where performance occurs). If there is no such relationship, there is a risk that such governing law provision will be unenforceable.

(x) The forum designation clause works together with the governing law provision to maximize the predictability of interpreting contractual provisions and resolving disputes. The forum does not need to be the same as the state of the designated governing law (though it is preferable to ensure that a court is interpreting its own state's laws rather than the law of another state).

(xi) The forum designation may be exclusive or nonexclusive.

(a) Exclusive -- The action may be brought only in that jurisdiction. This must be express. In such circumstances a party can enjoin the opposing party from litigating elsewhere.

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[54] § 9-304(a).

(b) Nonexclusive -- Serves only as a consent to jurisdiction in a particular forum. An action may be commenced elsewhere.

B. Examples:

Example 1: Exclusive Forum Designation

Forum Designation. Any action or proceeding against any of the parties hereto relating in any way to this Agreement or the subject matter hereof shall be brought and enforced exclusively in the competent courts of New York, and the parties hereto consent to the exclusive jurisdiction of such courts in respect of such action or proceeding.

Example 2: Exclusive Forum Designation

Designation of Forum. Any suit brought by either party against the other party for claims arising out of this Agreement shall be brought in the United States District Court for the Southern District of New York, or in the event that court lacks jurisdiction to hear the claim, in New York State Supreme Court for New York County.

Example 3: Nonexclusive Forum Designation

Forum Designation; Submission to Jurisdiction. (i) The Company agrees that any legal action or proceeding with respect to this Agreement or the transactions contemplated hereby may be brought in any court of the State of New York, or in any court of the United States of America sitting in New York, and the Company hereby submits to and accepts generally and unconditionally the jurisdiction of those courts with respect to its respective person and property and irrevocably consents to the service of process in connection with any such action or proceeding by personal delivery to the Company or by the mailing thereof by registered or certified mail, postage prepaid to the Company at the address for the Company.

(ii) Nothing in this paragraph shall affect the right of the Company to Serve process in any other manner permitted by law or limit the rights of any party or person to being any such action or proceeding against the Company or property in the courts of any other jurisdiction. The Company hereby irrevocably waives any objection to the laying of venue of any such suit or proceeding in the above described courts.

Example 4: Nonexclusive Forum Designation

Forum Designation; Submission to Jurisdiction. This Agreement and the documents referred to herein shall be governed by, and construed in accordance with, the law of the State of New York. Each Party hereto hereby submits to the nonexclusive jurisdiction of the United States

District Court for the Southern District of New York and of any New York state court sitting in New York City for the purposes of all legal proceedings arising out of or relating to this Agreement or the transactions contemplated hereby. Each party hereto irrevocably waives, to the fullest extent permitted by applicable law, any objection which it may now or hereafter have to the laying of the venue of any such proceeding brought in such a court and any claim that any such proceeding brought in such a court has been brought in an inconvenient forum.

Example 5: Submission to Jurisdiction

Submission to Jurisdiction. (i) For the purposes of this Agreement, each party irrevocably submits to the jurisdiction of any court in __________ or any courts of the United States of America located in New York and each party hereby agrees that all suits, actions and proceedings brought by such party hereunder shall be brought only in any court in __________ and courts of the United States of America located in New York.

(ii) Each party irrevocably waives, to the fullest extent permitted by law, any objection which it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in any such court, any claim that any such suit, action or proceeding brought in such a court has been brought in an inconvenient forum and the right to object, with respect to any such suit, action or proceeding brought in any such court, that such court does not have jurisdiction over such party or the other party.

(iii) In any such suit, action or proceeding, each party waives, to the fullest extent it may effectively do so, personal service of any summons, complaint or other process and agrees that the service thereof may be made by certified or registered mail accompanied by first class prepaid ordinary postage, addressed to such party at its address.

(iv) Each party agrees that a final non-appealable judgment in any such suit, action or proceeding brought in such a court shall be conclusive and binding.

XI. Waiver of Jury-Trial Provisions

In New York and Delaware, courts regularly have upheld contractual jury-trial waiver provisions as valid and enforceable.

A. Waiver of Jury-Trial Provisions in New York

(ii) In *Barclays Bank of New York v. Heady Electric Co.,* the court held that "contract provisions waiving a jury trial are valid and enforceable, unless adequate basis to deny enforcement is set forth by the challenging party."[55]

(iii) The leading federal case in New York discussing this issue is *Morgan Guaranty Trust Co. of New York v. Crane,* 36 F. Supp. 2d 602 (S.D.N.Y. 1999). The court held that the parties to a contract may, by prior written agreement entered into knowingly and voluntarily, waive the right to a jury trial.[56] The *Morgan Guaranty* court applied a four-factor test in determining whether a contractual waiver of a right to jury trial was entered into knowingly and voluntarily.[57] Once the test had been met, the waiver was deemed to be enforceable. The four factors include:

> (1) the negotiability of contract terms and negotiation between the parties concerning the waiver provision;
>
> (2) the conspicuousness of the waiver provision in the contract;
>
> (3) the relative bargaining power of the parties; and
>
> (4) the business acumen of the party opposing the waiver.[58]

B. Waiver of Jury-Trial Provisions in Delaware

(iv) In *Tracinda Corp. v. Daimlerchrysler AG*, the Delaware Chancery court discussed the enforceability of a broadly worded jury trial waiver clause contained in a Stockholder Agreement.[59] As in *Morgan Guaranty*, the *Tracinda Corp*. court set fourth four factors in determining whether a contract effectively provides for a waiver of jury trial which include:

> (1) the negotiability of the contract terms;
>
> (2) any disparity in bargaining power between the parties;
>
> (3) the business acumen of the party opposing the waiver; and
>
> (4) the conspicuousness of the jury-waiver provision.[60]

C. Waiver of Jury-Trial Provisions in General

(v) In addition to the general standards examining the enforceability of a contractual jury-trial waiver, there are other courts' holdings regarding the enforceability of the

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[55] *Barclays Bank of New York v. Heady Electric Co.*, 571 N.Y.S.2d 650, 652 (3d Dep't 1991).
[56] *Morgan Guaranty Trust Co. of New York v. Crane*, 36 F. Supp. 2d 602, 603 (S.D.N.Y. 1999).
[57] *Id.* at 603-604.
[58] *Id.*
[59] *Tracinda Corp. v. Daimlerchrysler AG*, 2003 WL 22769051, 2 (D.Del. 2003), *affd*, 502 F.3d 212 (3rd Cir. 2007).
[60] *Id.* at 2.

jury-trial waivers which are worth noting. New York courts have held that "unless a party alleges that its agreement to waive its right to a jury-trial was itself induced by fraud, the party's contractual waiver is enforceable vis-a-vis an allegation of fraudulent inducement relating to the contract as a whole."[61]

(vi) Courts have also held that a jury-trial waiver provision in a contract affects only the rights of the parties to that contract, rather than any other parties who did not execute the agreement in their own personal capacity.[62] Moreover, depending on the specific contract language used in the jury-trial waiver provision, courts have held some actions may not fall within the scope of the waiver. For example, in *In re Oakwood Homes, Corp.*, the provision at issue purported to waive any right to a jury trial in any action "relating directly or indirectly" to the agreement. The court held that the provision was unenforceable as to the party's breach of boarder duties which did not arise from the contract.[63]

XII. INDEMNIFICATION

A. Overview

(vii) An indemnification clause limits a party's liability or loss. The indemnification clause typically states that one party (the indemnitor) will reimburse another party (the indemnitee) for "all claims, demands, losses, expenses, damages, and causes of action asserted by any person or entity arising out of, caused by or relating to the Security Agreement and the Collateral and suffered by the indemnitee.

(viii)In New York, it is well established that, in most cases involving commercial contracts negotiated by sophisticated parties, indemnification clauses will be given the deference accorded freely negotiated contracts. In Delaware, the approach is even more deferential to the terms of the clause.

(ix) Security agreements typically contain clauses where the debtor agrees to indemnify the secured party for liabilities and losses other than liabilities and losses caused by the secured party's gross negligence or willful misconduct.

B. Negotiable Provisions

Whether the indemnity will cover agents of the secured party and employees of the secured party can be negotiated. Also consider whether it is an indemnity against "liability" or "loss". An indemnity against liability requires payment by the indemnitor when the indemnitee becomes liable. An indemnity against loss requires that the indemnitee first suffer loss (i.e., that the indemnitee pay the injured person prior to recovering from the indemnitor). Although not common in security agreements, in certain circumstances consideration should be

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[61] *Merrill Lynch & Co. v. Allegheny Energy, Inc.,* 500 F.3d 171, 188 (2d Cir. 2007).
[62] *See, Husley v. West*, 966 F.2d 579, 581 (10th Cir. 1992) (holding that the guarantor of a corporate loan was not bound by the jury waiver provision).
[63] *See, In re Oakwood Homes, Corp.*, 378 B.R. 59 (Bankr. D. Del. 2006); *see, also, Nichols Motorcycle Supply Inc. v. Dunlop Tire Corp.,* 913 F. Supp. 1088 (N.D. Ill. 1995) (holding that a broad jury waiver in a Distributor Agreement did not encompass any claims that do not directly arise in the Distributor Agreement).

given to providing for notice of pending claims, control of litigation, payment of expenses, control of litigation costs, limitation on number of counsel, and who chooses counsel.

XIII. CONCLUSION

There is really no such thing as "Security Agreement Boilerplate". All provisions in a security agreement are negotiated to achieve the goals of the parties thereto. The resulting agreement reflects the power struggle between the parties. If a debtor has a good credit rating, it will obtain a more favorable security agreement. It is all a mater of allocating risks.

WHAT'S AMISS? THE WORK OF "MISCELLANEOUS" CONTRACT PROVISIONS

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Prepared For: *Never Really Thought About It: Understanding "Miscellaneous" Provisions and Other Background Text in Agreements*

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Introduction

Why do contracts contain "miscellaneous" provisions?

This basic question raises several subsidiary questions. First, what do we mean by "miscellaneous" provisions? How do we distinguish the miscellaneous from the "important" parts? Second—and more important—how do we assess the merits of various miscellaneous provisions? What work—if any—do these provisions do in the contracts of which they are a part?

1. *What are Miscellaneous Provisions?*

In general usage, "miscellaneous" implies a collection of items that may or may not share common characteristics. Wiktionary—as good a source as any—tells us that "miscellaneous" means "Consisting of a variety of ingredients or parts[;] Having diverse characteristics, abilities or appearances."[2] The term derives from the Latin "miscellāneus, from miscellus ("mixed"), from misceō ("mix")." It is synonymous with "sundry" and "various" but not necessarily "random".

In legal usage, "miscellaneous provisions" appear to be the common terms found at the back of most negotiated agreements pertaining to, among other things, choice of law, choice of jurisdiction, modification, and so forth. These may appear under a general heading of "miscellaneous" provisions, as is the case in Section 12 of the Revised Model Stock Purchase Agreement.[3] The form of All Assets Personal

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[2] http://en.wiktionary.org/wiki/miscellaneous (visited June 21, 2010).

[3] *SEE* COMMITTEE ON MERGERS AND ACQUISITIONS OF THE BUSINESS LAW SECTION OF THE AMERICAN BAR ASSOCIATION, MODEL STOCK PURCHASE AGREEMENT, REVISED (forthcoming 2010). According to the table of contents of this work, miscellaneous provisions are the following:

Property Security Agreement Developed by the Task Force on Forms under Revised Article 9, by contrast, has a single paragraph on "miscellaneous" matters, although that paragraph is part of a larger series of paragraphs of seemingly comparable variety.

Intuitively, miscellaneous provisions will be those that stand substantively apart from the "heart" of the agreement. Business contracts, for example, often include provisions on choice of law, choice of forum, means of interpretation, the effect of waivers, the use of a jury, and so on. We can think of these provisions as *secondary* or ancillary to the *primary* terms of the contract (the sale of assets, the loan of money). Although secondary, they nevertheless perform important—and sometimes non-obvious—functions in agreements.

They also present at least three puzzles. First, scholars sometimes wonder why sophisticated commercial actors use boilerplate, a term which would certainly describe many miscellaneous provisions.[4] "Why," Robert Ahdieh has asked, "do . . . standard terms—a species of boilerplate—persist notwithstanding the ready opportunity of sophisticated parties to abandon them in favor of tailored terms more suited to their particular circumstances?"[5] Here, the question goes to the title of the program for which this paper was prepared: *Never really thought about it.* If lawyers do not think about miscellaneous provisions (a claim I will challenge below), why not? Is there not some advantage to be gained—for the lawyer, if no one else—in rethinking as bespoke each piece of the contract, including those at the back of the agreement?

Second, and more practically, miscellaneous provisions sometimes simply restate the obvious. Consider, for example, the "cumulative remedies" term in a form of security agreement: *"All rights and remedies of the Secured Party with respect to the Obligations or the Collateral, whether evidenced hereby or by any other instrument or papers, shall be cumulative and may be exercised singularly, alternatively, successively or concurrently at such time or at such times as the Secured Party deems expedient.*."[6] This is, in a sense, "obvious" because UCC § 9-601 essentially says the same thing, providing that a secured party's

12.21 Counterparts and Electronic Signatures

[4] Although boilerplate is usually a somewhat derisive term (akin to "adhesion contracts"), implying terms that a powerful seller foists on a weak consumer, there is much thoughtful scholarship on the role that boilerplate plays in more sophisticated commercial contracting. *See, e.g.*, Robert B. Ahdieh, *The Strategy of Boilerplate,* 104 MICH. L. REV. 1033, 1037 (2006); Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 MICH. L. REV. 953 (2006); William W. Bratton, Jr., *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. L. REV. 667; Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 EMORY L.J. 929 (2004); Claire A. Hill, *Why Contracts Are Written in "Legalese"*, 77 CHI.-KENT L. REV. 59 (2001). *See also* citations in note 26, *infra.*

[5] *See,* Ahdieh, *supra,* at 1034.

[6] *See* UNIFORM COMMERCIAL CODE COMMITTEE, FORMS UNDER REVISED ARTICLE 9, 2nd Edition (C. Chernuchin ed. 2009).

enforcement rights "are cumulative and may be exercised simultaneously."[7] Since UCC Article 9 has been enacted in all jurisdictions relevant to domestic personal property secured transactions, it is fair to ask: What work does this provision perform?

There are several ready responses, although they create other subsidiary questions. One is that a security agreement may also cover real estate or other property that might be outside the scope of Article 9. Different states have different rules about the election of remedies. Perhaps a provision of this sort would protect a secured party whose transaction fell outside Article 9—and perhaps not.[8] The net result is that the most we can say about the problem this miscellaneous provision is meant to address is that existing, background law is either clearly favorable to the secured party (as in 9-601) or is uncertain. But in either case, the provision itself is unlikely to do much work. If the law is clear then, as noted, it is simply restating the obvious. If the law is not clear, then this means that a court may or may not enforce the provision: Its mere presence at the back of the agreement does not, it would appear, assure the secured party the outcome it seeks as to this issue. Similar observations could be made about choice of law[9] and choice of forum clauses.[10]

Third, some miscellaneous provisions may be facially ineffective, at least if given an ordinary meaning. Consider the following "miscellaneous" provisions from the same form of security agreement:

> ***MISCELLANEOUS***. *The headings of each section of this Agreement are for convenience only and shall not define or limit the provisions thereof. . . . If any term of this Agreement shall be held to be invalid, illegal or unenforceable, the validity of all other terms hereof shall in no way be affected thereby, and this Agreement shall be construed and be enforceable as if such invalid, illegal or unenforceable term had not been included herein. The Debtor acknowledges receipt of a copy of this Agreement.*

This provision, conveniently enough, really does collect several miscellaneous points in one place. Start at the end. The "Debtor acknowledges receipt of a copy of

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[7] U.C.C § 9-601(c). Comment 5 explains that this section "permits the simultaneous exercise of remedies if the secured party acts in good faith." Id. cmt 5.

[8] *Cf.* ESPN, Inc. v. Office of the Commissioner of Baseball, 76 F. Supp. 2d 383, 390 (S.D.N.Y. 1999) ("Put simply, an election is not a waiver of rights but an exercise of rights. As a result, I conclude that a standard "no-waiver" provision does not immunize or excuse parties from the requirements and consequences of election.").

[9] *See, e.g.*, Commercial Credit Group, Inc. v. Falcon Equip., LLC, 2010 U.S. Dist. LEXIS 1385, 9 (W.D.N.C. Jan. 8, 2010) ("The parties' choice of law is generally binding on the interpreting court as long as the parties had a reasonable basis for their choice and the law of the chosen state does not violate a fundamental public policy of the state or otherwise applicable law" but declining to apply chosen law to claims of conversion or fraudulent transfer.").

[10] *See* Boutte v. Cenac Towing, Inc., 346 F. Supp. 2d 922, 925 (S.D. Tex. 2004) ("A choice of forum agreement is unenforceable if (1) enforcement of the clause would effectively prevent the plaintiff from having his day in court; (2) the forum agreement was procured by overreaching or fraud; or (3) the Court's enforcement of the forum selection clause would violate a strong public policy.").

this Agreement." What work does this provision do? If the debtor's signature is authentic and authorized, will that not be pretty good evidence of "receipt" by the debtor? If, by contrast, the debtor's signature is not authentic (or authorized), does the recitation to the contrary here make any difference? Delivery and receipt of the contract may be predicates to enforceability, but does saying it happened actually make it so?

Next, consider the "savings" provision, which tells us that a lousy slice of pizza should not taint the whole pie. But that cannot really mean what it says. If, for example, the debtor's signature (or the acknowledgment of receipt) is held invalid, does that mean the rest of the agreement remains in force? Not likely.

Finally, consider the first sentence—that headings are for convenience, and shall not define or limit the provisions of the agreement. The goal here seems to be that if a drafting glitch creates an inconsistency between a heading and the content, the content wins. Fair enough. But are courts likely to feel themselves bound? Probably not. In any case, what is the difference between "convenience" and "definition"?

The point here is not to quibble with the legitimacy or enforceability of these or similar miscellaneous provisions. Nor is the point to suggest that lawyers are ill-advised to include them. Rather, the point is simply to illustrate that the presence and function of these provisions may not be quite as obvious as we would hope. In short, these and other miscellaneous provisions likely do some work, but what is it, and does it matter?

2. *The Function of Miscellaneous Provisions: Conventional Explanations*

Conventional academic wisdom offers two related explanations for the value of miscellaneous contract provisions: (i) these provisions are "economically efficient" in the sense that they create affirmative value for the parties or are too costly to remove; and (ii) lawyers are cognitively conservative—"we fear change," in the famous words of Garth Algar[11]—and so simply adopt (and adapt) the language received from some prior authority.

2.1 *Transaction Cost Engineering*

Most explanations—especially the first—owe a debt to Professor Ronald Gilson, whose article, *Value Creation by Lawyers*, asked the unsettling question: How, if at all, do lawyers in private transactions justify their cost? [12] Gilson began by considering and rejecting two common hypotheses about the value that business lawyers might create: (i) that a lawyer may improve her client's deal, even at the expense of the other

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[11] *Memorable quotes for Wayne's World (1992), available at* http://www.imdb.com/title/tt0105793/quotes (visited June 22, 2010).

[12] Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE. L. J. 239, 274-77 (1984).

party by "redistributive bargaining", and (ii) that lawyers reduce costs associated with the regulatory structure that is often in play in many large and complex transactions.[13]

He rejected the first because he observed that the important economic question was not whether business lawyering increased a particular party's share, but whether the overall value of the transaction was increased due to the lawyer's contributions. If business lawyers engaged only in distributive bargaining, rational clients would choose not to use lawyers at all because "net of lawyers' fees, the surplus from the transaction to be divided between the clients would be smaller as a result of the participation of the lawyer, rather than larger."[14] He rejected the second explanation—regulatory arbitrage—because "it does not get us far enough."[15] There are simply too many lawyered transactions in which regulation plays little role for this to be persuasive.[16]

Gilson argued instead that business lawyers are "transaction cost engineers" who, in a variety of ways, reduce the gap between the value that rights (viewed as "capital assets") would command in a perfect market (i.e., on the capital-asset pricing model)[17] and the price actually agreed-to in the imperfect world we all occupy:

> Lawyers function as transaction cost engineers, devising efficient mechanisms which bridge the gap between capital asset pricing theory's hypothetical world of perfect markets and the less-than-perfect reality of effecting transactions in this world. Value is created when the transactional structure designed by the business lawyer allows the parties to act, for that transaction, as if the assumptions on which capital asset pricing theory is based were accurate.[18]

Gilson argued that business lawyers reduce information asymmetries (and therefore produce value) in two important ways (i) by producing information, and (ii) by providing a bonding mechanism by which the information can be verified.

2.1.1 *Information Production*

Often, the parties will be the best producers of information about themselves. Thus, the seller of a business will know a great deal (or at least more than the buyer,

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[13] *Id.* at 245-246.

[14] *Id.* at 245-46.

[15] *Id.* at 247.

[16] *See* Gilson, *supra* at 247 ("business lawyers frequently function in a world in which regulation has made few inroads.").

[17] The "capital asset pricing model" ("CAPM") posits, in part, that markets will, over time, always correctly price assets. *Id.* at 251. If the theory held, "business lawyers cannot increase the value of a transaction. Absent regulatory-based explanations, the fees charged by business lawyers would decrease the net value of the transaction." *Id.* As Gilson acknowledges, the CAPM is not without its critics, who question many of its assumptions, including that its two parameters – risk and return – are the only ones of significance. *Id.* at 251, n. 31 (collecting citations of criticisms of the CAPM). Nevertheless, Gilson argues, the value of the CAPM is "normative: It describes why the factors it specifies [i.e., risk and return] should count." *Id.*

[18] *Id.* at 255.

ex ante) about the value of the business. But Gilson recognized that the "[p]roduction of certain information concerning the character of the seller's assets and liabilities simply requires legal analysis."[19]

> For example, determination of the seller's proper organization and continued good standing under state law, the appropriate authorization of the transaction by seller, the existence of litigation against the seller, the impact of the transaction on the seller's contracts and commitments, and the extent to which the current operation of the seller's business violates any law or regulation, [all] represent the production of information which neither the buyer nor the seller previously had, by a third party-the lawyer-who is the least-cost producer [of the information].[20]

Information production should not, Gilson thinks, be adversarial because "reducing the cost of information necessary to the correct pricing of the transaction is beneficial to both buyer and seller."[21] Rather than argue about many of the things that in fact concern lawyers who assist in transactions—concealing potentially embarrassing information, creating needlessly lengthy documents—lawyers should principally be concerned with "the cost of producing the information" required by the transaction.[22]

2.1.2 *Verification – Reputation Bonding*

Lawyers also act as reputational intermediaries, placing their own credibility at risk in order to assure the other party that the client and the deal are legitimate. Traditionally, certain common contract provisions have been thought to do this. Thus, indemnification provisions, purchase-price hold-backs, and earnouts are all thought to signal the veracity of the information the seller gives to the buyer (and on which the buyer bases the purchase decision). These contract provisions work because, the thinking goes, if the seller's promises about the business are wrong, she doesn't get paid (or is paid less than the buyer originally promised).

Nevertheless, Gilson argued that these types of contract provisions "are imperfect because they do not entirely eliminate the potential for opportunism inherent in one-time transactions," such as asset sales.[23] The solution, he suggested, lies in the reputational bond posted by the lawyer in various ways (e.g., delivering a third-party closing opinion). Unlike the parties (who may expect no future involvement with one another, and for whom final-period opportunism may be quite attractive) Gilson argued that professionals reliably post their reputation as a bond—act as "reputational intermediaries"[24]—because they expect future play. "If the

[19] *Id.* at 274.

[20] Gilson, *supra*, at 275.

[21] *Id.* at 275-76.

[22] *Id.* at 276.

[23] *Id.* at 288-89.

[24] *Id.* at 290.

intermediary cheats in one transaction—by failing to discover or disclose seller misrepresentations—its reputation will suffer and, in a subsequent transaction, its verification will be less completely believed."[25]

Although Gilson was talking about the value created by lawyering per se in private transactions, the analysis easily maps onto questions presented by common miscellaneous provisions in business contracts. The list of standard terms at the back of the agreement in effect forces parties to produce information about the transaction that will, on this model, more accurately price the deal. If, for example, one state's law provides materially better treatment for the deal (or a party in it), that would be chosen, and the benefit shared by the parties in some way. Miscellaneous provisions also perform an indirect verification function, as they signal threats about how the deal will be litigated if it turns out one side concealed something important.

Like lawyering in general, miscellaneous provisions are not exclusively explained by the value they add. Another economic reality appears to be that, like many legal practices, change is costly. In academic terms, we would say that miscellaneous provisions are susceptible to the problem of "path dependence." Path dependence simply means that where we are today on a given path—say, the path that reflects a chosen form of contract—is really the product of a much longer chain of events that creates a particular vector with a particular velocity. One can deviate from the path—change its direction or step off it entirely—but it can be extremely costly to do so.[26]

Thus, miscellaneous contract provisions become a bit like barnacles. "Encrusted" on documents, they are hard to remove, but may house various life-forms over time.[27] Individually, they may be innocuous—harmless to the hull of the ship, so to speak—but in the aggregate may cause it to decay or otherwise fail. Path dependence may explain why some miscellaneous provisions are "second best" choices that, in Herbert Simon's terms "satisfice,"[28] but they also imply a rather dim view of lawyers' roles in drafting them. On this view, miscellaneous provisions persist despite, not because of, the contributions of lawyers.

2.2 *Cognitive Conservatism*

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[25] *See* Gilson, *supra*, at 290.

[26] Leading academic works on the role of path dependence in transactional practice include Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting*, 83 VA. L. REV. 713 (1997); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996).

[27] *See* Jonathan C. Lipson, *Price, Path & Pride: Third-Party Closing Opinion Practice Among U.S. Lawyers (A Preliminary Investigation)*, 3.1 BERKELEY BUS. J. 59, 113-14 (2005).

[28] Nobel prize-winning social scientist Herbert Simon coined the term "satisficing", which is generally taken to be a mash-up of "satisfy" and "sufficient." Satisficing implies that in many cases, it will not be rational to seek an optimal, or perfect, solution to a problem. *See, e.g.,* HERBERT A. SIMON, MODELS OF MAN: SOCIAL AND RATIONAL (1957). Instead, it may make more sense to satisfice—to accept a second-best, but nevertheless reasonably effective, solution.

A second—and perhaps more controversial—explanation is that lawyers are cognitively biased in ways that make it difficult for them to imagine removing or materially altering miscellaneous provisions.[29] Consider, for example, the "status quo bias." The "status quo bias," which sometimes elides with the "endowment effect," [30] stands for the proposition that, all things equal, we prefer a familiar state to one that is unknown.[31] This questions a conventional tendency (e.g., in the Gilson model) to assume that the initial distribution of rights (e.g., ownership) will not affect their ultimate disposition, because rights will always come to rest with the highest valuing user.

The problem, as Professor Russell Korobkin has observed, is that "the initial allocation of legal entitlements can affect preferences for those entitlements."[32] Donald Langevoort has identified a variant of this bias, which he characterizes as "cognitive conservatism," [33] and which may help to explain certain aspects of business lawyering that the rational actor/transaction cost engineer model cannot. Cognitive conservatism, Langevoort argues, is an "extremely robust behavioral construct showing that people change their views slowly even in the face of persuasive evidence."[34]

Cognitive conservatism posits that managers who operate in "noisy informational environments" adopt simplifying heuristics in order to protect against information overload.[35] A manager does this, Langevoort argues, by developing

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[29] The legal literature that develops these insights tends to draw from the work of Kahneman and Tversky. *See, e.g.,* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974), reprinted in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman, Paul Slovic & Amos Tversky eds., 1982). Although there is much to be said for the intuition behind this work, its development in the legal literature has been controversial. *See, e.g.,* Charles R. Plott and Kathryn Zeiler, *The Willingness to Pay-Willingness to Accept Gap, the "Endowment Effect," Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005) (questioning the empirical basis of claims about certain forms of cognitive bias); Charles R. Plott and Kathryn Zeiler, *Asymmetries in Exchange Behavior Incorrectly Interpreted as Evidence of Endowment Effect Theory and Prospect Theory?*, 97 AM. ECON. REV. 1449 (2007).

[30] *See, e.g.* Donald Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review,* 51 VAND. L. REV. 1499, 1503-04 (1998) (calling the endowment effect "manifestation of" the status quo bias). *See also* Russell Korobkin, *The Endowment Effect and Legal Analysis,* 97 NW. UNIV. L. REV, 1227, 1227-31 (2003) [hereinafter, "Korobkin, *Endowment*"]. The "endowment effect" reflects the tendency for individuals to value items more when they own them than when they do not. *See* Richard Thaler*, Toward a Positive Theory of Consumer Choice*, I J. ECON. BEHAV. & ORG. 39, 44 (1980).

[31] *See, e.g.* William Samuelson & Richard Zeckhauser*, Status Quo Bias in Decision Making,* I J. RISK & UNCERTAINTY 7 (1998); Russell Korobkin, *Behavioral Economics, Contract Formation and Contract Law, in* BEHAVIORAL ECONOMICS, *supra*, at 116, 118 ("individuals favor maintaining the status quo of affairs to adapting to alternative states, assuming all other things are equal.")[hereinafter, "Korobkin, *Formation*"].

[32] Korobkin, *Formation, supra*, at 116.

[33] Langevoort, *Illusions*, *supra* at 147-49.

[34] Langevoort, *Animal Spirits, supra*, at 144 ("In other words, people cling as long as possible to what they previously believed.").

[35] Langevoort, *Animal Spirits, supra*, at 147.

"schemas" or "scripts" that enable the rapid assimilation of information into what the manager believes to be the "best available" interpretation.[36] While this is an understandable and frequently healthy feature of behavior, it has a potentially troublesome side-effect: bias against revising the schema or script. "The normal cognitive strategy," Langevoort argues, "is to construe information and events in such a way as to confirm prior attitudes, beliefs, and impressions."[37]

A second and related phenomenon that draws into question the transaction cost engineer model would derive from the "availability heuristic." This holds that people assess probabilities based on the ready availability of memorable examples of similar circumstances.[38] When similar examples do not come to mind, however, they may substitute examples that are not appropriately analogous. If, for example, we know that snipers are on the loose in Washington, D.C. (as actually happened several years ago), we might overestimate the risk of being shot, even the real risk of being shot remained quite low.[39] The salient or memorable event dominates our thoughts, and perhaps clouds judgment.

Cognitive theory offers an alternative explanation of miscellaneous contract provisions. Lawyers seem to be especially conservative cognitively—some would say that's what clients pay us for—and miscellaneous provisions may simply be an extension of that professional temperament. Law is a business that depends heavily for its effectiveness on "authority," a surprisingly tricky concept. In transactional practice, authority often comes from perceptions about the lineage and quality of a given form of document. The "best" form, we say, is the one laboriously developed by an ABA committee of experts in the field. We are biased toward the status quo because the status quo is, in a sense, the authority (precedent) on which we rely.

The availability heuristic has comparable explanatory power here: We use standard miscellaneous provisions because they are (literally) what is available in the form we choose (or were given) to use.

3. *Another View of the Work of Miscellaneous Provisions—Lawyers as Informational Intermediaries*

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[36] *Id*. at 148. I use the term "schema" loosely, and in essence by analogy. Strictly speaking, schemas are mental – not physical – structures. *See* William F. Brewer & Glenn V. Nakamura, *The Nature and Functions of Schemas*, in 1 HANDBOOK OF SOCIAL COGNITION 119, 140 (Robert S. Wyer, Jr. & Thomas K. Srull eds., 1984) (schemas are "unconscious mental structures and processes that underlie the molar aspects of human knowledge and skill"). *See also* Ronald Chen & Jon Hanson, *Categorically Biased: The Influence of Knowledge Structures on Law and Legal Theory,* 77 S. CAL. L. REV 1103, 1131 n. 111 (2004) (collecting descriptions of "schemas").

[37] Langevoort, *Animal Spirits*, *supra*, at 147.

[38] *See* Cass R. Sunstein, *What's Available? Social Influences and Behavioral Economics,* 97 NW. L. REV. 1295, 1297 (2003)[hereinafter "Sunstein, *Available*"] (citing Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases, in* JUDGMENT AND DECISION MAKING: AN INTERDISCIPLINARY READER 38, 46-49 (Hal R. Arkes & Kenneth Hammond eds., 1986).

[39] Sunstein, *Available*, *supra*, at 1296-97.

Conventional academic explanations of miscellaneous provisions certainly make sense. The provisions likely exist as they do for some economic reasons. Moreover, it is not hard to imagine that we are biased in some ways that permit (or require) us to use miscellaneous contract terms as we do.

I would like to offer a third, related, explanation, which is informational. I think that miscellaneous provisions persist in negotiated business agreements not just because of what they tell the parties (or a court asked to interpret the parties' agreement). We also use them because they help business lawyers do a better job.

There is a tendency to think that lawyers ignore miscellaneous provisions. They are at the back of the agreement for a reason: they appear literally to be an afterthought. There is a similar tendency to treat miscellaneous provisions as "boilerplate," provisions that seem more a product of word processing convenience than legal analysis.[40] While it may be true that lawyers spend less time on miscellaneous provisions than they do on the primary terms of the contract, they nevertheless can perform at least two related, and important, functions.

First, and consistent with Professor Langevoort's views about cognitive conservatism, miscellaneous provisions function as schemas. We know other professionals—doctors, for example—use schemas as templates or mental checklists of important matters to consider in diagnosing and solving a problem.[41] Although the provisions at the back of the agreement are primarily for the benefit of (and presumably bind) the parties, my claim here is that they also function to benefit the lawyers, by forming a checklist of important issues that good lawyers should at least consider before letting the client sign on.[42]

Thus, in the same way that prudent lawyers will work methodically and diligently through a closing checklist to make sure the various components of the deal are present, she will also review the miscellaneous provisions in the various contracts to make sure that they will work for the client. They may resemble boilerplate, in the sense that they will appear similar across broad ranges of transactions. They may (or may not) be heavily negotiated. And, as noted at the outset, they may (or may not) be binding on the parties. But what they really do is help the lawyer organize her thoughts about the deal.

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[40] *See* authorities cited in note 4, *supra*.

[41] *See* Mark P. Higgins & Mary P. Tully, *Hospital Doctors and Their Schemas About Appropriate Prescribing*, 39 MED. EDUC. 184, 185–86 (2005).

[42] *See* Hill, *supra* note 40, at 63 ("Given the complex nature of the task [of drafting contracts], and the quick turnaround time typically required, even the most experienced lawyer would have difficulty remembering every step and detail; the form is a useful reminder. The form also preserves the benefits of experience with its provisions, both in the transacting community and, sometimes, in judicial decisions. The form simplifies the mechanical task as well: a lawyer "marks up" a form, using the existing structure and changing only what's needed.").

But this begs a question: Thoughts about what aspect of the deal? The answer reflects the second function of miscellaneous provisions: They are largely about anticipating how problems will be resolved should they develop. Consider again the sorts of miscellaneous provisions we frequently see. Mostly, they offer what I have called *secondary* rules, rules about how to deal with problems that might arise in the *primary* terms of the agreement.

Thus, the primary terms of the security agreement will be the provisions creating and delimiting the security interest; in a stock purchase agreement, the primary term will be provisions conveying rights in the stock to be sold. The miscellaneous provisions will be secondary because they will largely matter only if there is some problem with the primary term. Thus, the miscellaneous provisions are a set of rules on how to understand a party's rights to enforce the security interest (cumulatively, not alternatively); how to figure out which state's law will (likely) apply; where to send notice so that it is legally effective; how to interpret the terms if there is a later dispute about their meaning (the headings don't count), and so on.[43]

The claim here is not that miscellaneous provisions fully predict the outcome of a dispute about the primary contract terms. We know that at least some miscellaneous terms may not be enforced, so fortune-telling cannot be the work that they do. Rather, they remind the lawyers—who are likely to be transactional lawyers, and who do not necessarily spend a great deal of time in court—that it is important at the outset to anticipate how disputes are likely to be resolved should they arise. They perform what some academics call a "reflexive" function: They lead the lawyers—not necessarily the parties—to reflect on what future legal process might look like.[44]

The idea that law performs a "reflexive" function is somewhat controversial. It refers to the idea that law "attempts to influence decision-making and communication processes with required procedures."[45] Reflexive views of law "capitalize on the idea that if we are forced to tell the world what we are doing, we may reflect more carefully on our actions than would otherwise be the case."[46] This

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[43] *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713, 722 (1997) ("A related attraction of a term commonly used in the past is that such a term may have been litigated and ruled upon by courts. Judicial opinions can reduce uncertainty regarding the validity and meaning of a term and the interaction of the term with relevant legal requirements, such as those contained in corporate, securities, and bankruptcy laws.").

[44] *See* Jonathan C. Lipson, *Secrets and Liens: The End of Notice in Commercial Finance Law*, 21 EMORY BANKR. DEV. J 421, 506 (2005).

[45] David Hess, *Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness*, 25 J. CORP. L. 41, 51 (1999); (citing J. Bregman & Arthur Jacobson, *Environmental Performance Review: Self-Regulation in Environmental Law*, *in* ENVIRONMENTAL LAW AND ECOLOGICAL RESPONSIBILITY 211 (Gunther Teubner et al. eds., J. Wiley & Sons 1994)).

[46] Lipson, *supra* note 44, at 507.

theory about the function of law is often advanced to explain (or justify) reporting regimes under, for example, the federal securities and environmental laws.[47]

Contracts are typically not publicly disclosed and, in any event, the important point about their reflexive function is not about the world's view of miscellaneous terms in any given contract. Rather, the idea is that by channeling and standardizing certain promises about how future problems will be resolved, the lawyers will be cautioned in how they approach the deal. They will consider, at least to some extent, the implications that flow from a failure of the deal.

What is missing from our understanding of miscellaneous provisions, therefore, is an appreciation of their informational function. This comports with my more general view that lawyers are not so much transaction cost engineers as they are informational intermediaries: They translate the (private) aspirations and expectations of the parties into terms that (public) fora (e.g., courts) will recognize.[48] One side's lawyer may get it wrong—she may choose the "wrong" law, or include a forum selection clause that, ex post, is held unenforceable—but in the first instance, these miscellaneous provisions are guiding the lawyers to make standardized decisions about the information that the parties should consider if they want the deal—including its ancillary, dispute-anticipating features—to work as expected.

The claim of this paper, therefore, stands in opposition to the sub-title of the program for which it was prepared. "Never really thought about it" suggests that lawyers robotically cut and paste miscellaneous provisions from one deal to the next. While it may be—indeed, should be—true that these sorts of provisions receive less attention than the primary terms of the deal, it ill-serves lawyers to suggest that they are not really thinking about miscellaneous provisions. My claim is that their mere presence in standardized form, across transactions, forces lawyers to think about them and their implications for the deal more than they would if they relied simply on background (e.g., statutory or common) law, even if the provisions in substance offer little more than would already be the case under that background law.

Conclusion

I suspect that lawyers do think about the miscellaneous provisions in their contracts. The question I have set out to address is what work the provisions do in the face of some obvious puzzles about them. While I think conventional economic and behavioral explanations have traction here, miscellaneous contract provisions also exist as a series of protocols or tools that help lawyers do a better job by anticipating what is likely to happen if (excuse the pun) things go amiss.

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[47] *See* Hess, *supra* note 45; Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

[48] *See* Jonathan C. Lipson, *Cost-Benefit Analysis and Third-Party Opinion Practice,* 63 BUS. LAW. 1187 (2008).

ASSIGNMENT, DELEGATION AND CHOICE OF LAW PROVISIONS IN COMMERCIAL AGREEMENTS

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ASSIGNMENT AND DELEGATION

INTRODUCTION

Commercial agreements usually convey some rights and some duties to each contracting party. It is no surprise, then, that almost every commercial agreement has something to say about the assignment of rights, the delegation of duties, or both. The negotiation and drafting of an assignment provision provides an opportunity for contracting parties to address potentially competing business interests: the desire to freely assign and delegate one's own contractual rights and duties to a third party, while seeking to limit the other party's freedom to assign or delegate its rights and duties.

Assignment provisions tend to be located among the "boilerplate" or "standard" provisions of commercial agreements, except for perhaps in commercial leases (which customarily place emphasis on assignment). Contrary to this grouping, though, there is no standard form assignment provision suitable for use in every commercial transaction. It could be a mistake for practitioners to assume that an assignment provision suitable in one transaction or jurisdiction is suitable in another.

The following example presents a common scenario between two parties negotiating a commercial agreement: Each party wants the ability to freely assign its valuable rights under the agreement, but each also wants to control the identity of the party with whom it does business by denying the other party the ability to assign its rights. In this situation, the parties might attempt to reach compromise by agreeing to the following commonly used provision: "Neither party may assign this agreement without the consent of the other party, which consent will not be unreasonably withheld." Although the parties may be satisfied with this resolution, comfortable that they have reserved the authority to grant or deny a proposed assignment, they (and their lawyers) could be unhappy to learn that this provision likely fails to prevent an assignment of rights, as discussed further in this outline. To avoid such an undesirable result, it is incumbent upon the practitioner to ensure that every commercial agreement within his or her care contains an assignment provision tailored to address the needs of his or her client and the law of the applicable jurisdiction.

This outline addresses a myriad of topics relating to the law of assignment and delegation, with a tilt towards providing practical pointers for drafting a suitable assignment (or anti-assignment) provision. Part I of this outline provides an overview of the common law rules governing the assignment of contractual rights. It also explores the important distinction between the "power" and the "right" to assign. Part II summarizes the basic common law principles governing the delegation of contractual duties. Part III discusses the potential requirement to act "reasonably" when granting or denying consent to an assignment, as well as the application of implied covenants of good faith and fair dealing. Part IV addresses the interplay between assignment provisions and corporate restructuring events. Part V briefly discusses assignment-related issues in the context of the Uniform Commercial Code and the transfer of intellectual property licenses. Part VI concludes by presenting a few additional considerations in drafting assignment provisions.

Note: Unless otherwise noted, the term "assignment provision" is used throughout this outline to refer to a contractual provision that addresses both assignment and delegation.

I. ASSIGNMENT

If a contractual right is transferable, its value is enhanced. One way contracting parties may seek to realize on this added value is to negotiate a favorable assignment provision. To this end, it is important for contracting parties and practitioners alike to acquire a working knowledge of the laws that facilitate, and sometimes prohibit, assignment.

A. Definition and Requirements

(i) Definition. When a party to a contract transfers its rights under the contract to a third party, it has made an assignment. Calamari and Perillo's Hornbook on Contracts, § 18-25 (3d ed. 1987). A lengthier definition of assignment is found in the Restatement (Second) of Contracts [hereinafter "Restatement"] § 317(1), which states that "[a]n assignment of a right is a manifestation of the assignor's intention to transfer it by virtue of which the assignor's right to performance by the obligor is extinguished in whole or in part and the assignee acquires a right to such performance."

(ii) Word "Assign" Not Required. As the Restatement indicates, the use of the word "assign" is not essential to effect a valid assignment. Instead, any act or words are sufficient which show an intention of transferring a right to the assignee, if the assignor is divested of all interest in that right. See Banque Arabe Et Int'l D'Investissement v. Bulk Oil (US), Inc., 726 F. Supp. 1411, 1417 (S.D.N.Y. 1989).

(iii) General Rule. Absent an express provision to the contrary, contract rights are freely assignable. See Scott v. Fox Bros. Enter., Inc., 667 P.2d 773, 774 (Colo. Ct. App. 1983).

(iv) Writing Not Required. Moreover, a writing is usually not required to have an effective assignment, so an oral assignment is generally effective. See Buck v. Illinois National Bank and Trust, 223 N.E.2d 167, 169 (2nd Dist. 1967). A few assignments requiring a writing include assignments of interests in land and assignments intended as security interests under Article 9 of the Uniform Commercial Code. See American Card Company, Inc. v. H.M.H. Co., 196 A.2d 150 (R.I. Sup. Ct. 1966).

(v) Assignment of Less Than All Rights Permitted. Generally, a party may choose to assign less than all of its rights under a contract, in which event it will maintain its interest in the retained rights. The Restatement provides that "an assignment of a part of a right, whether the part is specified as a fraction, as an amount, or otherwise, is operative as to that part to the same extent and in the same manner as if the part had been a separate right." Restatement § 326.

B. Assignor's Rights Extinguished

Upon assignment of a right, generally the assignor's interest in that right is extinguished. Authorities agree that an assignment operates to transfer to the assignee all of the assignor's right, title, and interest in whatever right is assigned. See John P. Toepper et al. v. Brookwood Country Club Road Association, 561 N.E.2d 1281, 1287 (Ill. 1990).

C. What Rights Are Not Assignable?

Most contractual rights may be assigned. See Peterson v. District of Columbia Lottery and Charitable Games Control Board, 673 A.2d 664, 667 (D.C. 1996). The common exceptions include:

(i) assignments prohibited by law, whether such prohibition is embodied in a statute or case law (notable examples include claims subject to the Federal Anti-Assignment Act and wages, in some jurisdictions);

(ii) assignments that would materially change the duty of the non-assigning party;

(iii) assignments that would materially decrease the likelihood that the non-assigning party would receive the intended return performance from the assignee;

(iv) assignments that would materially reduce the value of the return performance of the non-assigning party;

(v) assignments that would materially increase the burden or risk of the non-assigning party; and

(vi) assignments of non-exclusive software, copyright, and patent licenses.

See Restatement § 317(2), with respect to (ii) through (v); See Section V, supra, with respect to (vi).

With the exception of assignments prohibited by law or public policy, the parties are free to agree to the assignment of any rights, including those otherwise considered non-assignable.

D. Contractual Provisions Prohibiting Assignment

Parties frequently agree to limit the ability to assign contractual rights. There are innumerable reasons why a party may want to limit the other party's ability to assign rights, perhaps none more basic than wanting to control the identity of the party with whom it does business.

(i) Strictly Construed. Although generally enforceable, anti-assignment provisions are not looked upon by the courts with full favor, because they prohibit the alienation of property rights, thus depriving the owner of the full enjoyment and control thereof. See Inter-Southern Life Ins. Co. et al. v. Humphrey, 84 So. 625, 626 (Miss. 1920). Accordingly, when disputes arise, anti-assignment provisions tend to be strictly construed by the courts. See Mrs. C.W. Lawrence v. Cooper Independent Theaters, 276 P.2d 350, 354 (Kan. 1954).

(ii) Assignment of "Contract" Versus "Rights." Practitioners should avoid using an anti-assignment provision that generally prohibits an "assignment of the contract." Courts have expressed difficulty in interpreting anti-assignment provisions which prohibit the "assignment of the contract," as opposed to the "assignment of rights." The ambiguous phrase "assignment of the contract" has been inartfully used by contracting parties to refer solely to an assignment of rights, solely to a delegation of duties, or to encompass both assignment of rights and a delegation of duties. However, unless intent to the contrary is shown, a contractual prohibition against "assignment of the contract" without further specificity is likely to be presumed as a matter of law to prohibit only the delegation of contractual duties, and not to prohibit an assignment of rights. See Cedar Point Apartments, Ltd. V. Cedar Point Inv. Corp., 693 F.2d 748, 753 (8th Cir. 1982). If parties intend to restrict the assignment of rights, the anti-assignment provision should be drafted to expressly prohibit the "assignment of rights."

E. Distinction between the "Power" and the "Right" to Assign

Courts have distinguished the "power" to assign from the "right" to assign. The Third Circuit has explained that a party's "power" to assign is only limited where the parties have manifested an intention to limit such power. To reveal the intent necessary to preclude the power to assign, an anti-assignment clause must contain an express provision that any assignment shall be void or invalid if not made in the way specified. To meet this standard, the assignment provision must generally state that any non-conforming assignment (i) shall be "void" or "invalid" or (ii) that the assignee shall acquire no rights and the non-assigning party shall not recognize any such assignment. In the absence of such language, the anti-assignment provision will likely be interpreted merely as a covenant not to assign or an agreement to follow specific procedures before assigning. Breach of such a covenant may render the assigning party liable in damages to the non-assigning party, but the noncompliant assignment would likely be valid. See Bel-Ray Company, Inc. v. Chemrite (PTY) Ltd., 181 F.3d 435 (3d Cir. 1999). Moreover, as a practical matter, damages could be minimal or difficult to prove.

The Restatement parallels this view and provides that "a contract term prohibiting assignment of rights under the contract, unless a different intention is manifested…gives the obligor a right to damages for breach of the terms forbidding assignment, but does not render the assignment ineffective." See Restatement § 322(2)(b).

II. DELEGATION

A. Definition and Requirements

(i) Definition. A delegation is the act of giving another person the responsibility of carrying out the performance agreed to in a contract. If a party to the contract appoints a third party to render performance under the contract, it has made a delegation. Calamari and Perillo's Hornbook on Contracts, § 18-25 (3d ed. 1987).

(ii) Word "Delegate" Not Required. There is no requirement that the word "delegate" be used. Any generally accepted words of transfer may be used.

(iii) Writing Not Required. A delegation of duties may be either written or oral.

B. Delegator Remains Secondarily Liable

One commentator has colorfully described the assignment-delegation distinction as follows: "[i]f assigning a right is like passing a football, then delegating a duty resembles more the dissemination of a catchy tune or a communicable disease: passing it on is not the same as getting rid of it." C. Knapp, Problems in Contract Law, 1161 (1976).

(i) Secondary Liability. Generally speaking, upon the delegation of a contractual duty, the delegating party remains secondarily liable under the contract, unless the contract provides otherwise or there is a novation. See Lonsdale v. Chesterfield, 662 P.2d 385, 388 (1983).

(ii) Novation. A novation is the act of replacing one party to an agreement with a new party. A novation is valid only with the consent of all parties to the original agreement. The obligee must consent to the replacement of the original obligor with the new obligor for the novation to be effective. A contract transferred by novation transfers all duties and obligations from the original obligor to the new obligor, and releases the original obligor of the duties subject to the novation. See Rosenberg v. Son, 491 N.W.2d 71, 75 (N.D. 1992).

C. What Duties Are Not Delegable?

(i) Most Duties Delegable. With a few exceptions, most duties may be delegated.

(ii) Duties Under Personal Service Contracts Non-delegable. Generally, purely personal service contracts are not assignable. See Sisco v. Empiregas, Inc., 237 So. 2d 463, 466 (Ala. 1970). In describing the personal service relationship, one court stated that personal service contracts tend to involve a relationship of personal confidence between the parties. See Conference America, Inc. v. Telecommunications Cooperative Network, Inc., 885 So.2d 772, 776 (Ala. 2003). The Restatement describes the personal service relationship as one in which a party would have a substantial interest in having that particular person perform or control the acts promised.

To illustrate the nature of personal service contracts which renders them non-delegable, the California Supreme Court stated:

> All painters do not paint portraits like Sir Joshua Reynolds, nor landscapes like Claude Lorraine, nor do all writers write dramas like Shakespeare or fiction like Dickens. Rare genius and extraordinary skill are not [delegable], and contracts for their employment are therefore personal, and cannot be [delegated]. But rare genius and extraordinary skill are not indispensable to the workmanlike digging down of a sand hill or the filling up of a depression to a given level, or the construction of brick sewers with manholes and covers, and contracts for such work are not personal, and may be [delegated]. Taylor v. Palmer, 31 Cal. 240, 247-248 (1866).

In line with this distinction among service contracts, one court has held that the performance of an agreement by the unidentified agents, servants, or employees of an impersonal corporation to provide teleconferencing services to customers of another corporation may be delegated. See Conference America, Inc. v.

Telecommunications Cooperative Network, Inc. et. al., 885 So.2d 772, 776 (Ala. 2003).

(iii) Duties may be non-delegable if performance is based on the integrity, credit, or responsibility of a party. C.J.S. Assignments § 33 (1975).

D. Contractual Provisions Against Delegation Generally Enforceable

Sometimes a party depends upon the integrity and reputation of a particular entity in connection with an obligation under a commercial agreement. To secure the benefit of that bargain, a party may seek to add a non-delegation provision to the commercial agreement. The Restatement provides that a party may delegate its duties unless contrary to the terms of the commercial agreement. See Restatement § 318(2).

E. Implied Assumption of Duties

(i) Majority Rule. The majority rule is that an assignee must expressly assume duties in order to be obligated to perform the assignor's duties. See Sillman v. Twentieth Fox Film Corp., 3 N.Y.2d 395, 402 (1957).

(ii) Minority Rule. An assignee may be deemed to have impliedly assumed the assignor's duties under an agreement, even without an express assumption of an assignor's duties.

(a) Texas courts have found implied assumptions of duties under a contract. The Texas Court of Appeals ruled that the assignee of a contract is not bound to perform the assignor's obligations under the contract unless they are expressly or impliedly assumed by the assignee. In interpreting whether an assignee impliedly agreed to assume an assignor's duties, courts in Texas look to the language of the assignment and to the surrounding circumstances. The question of interpretation is ordinarily more a question of fact than of law. See El Paso Natural Gas Company v. Lea Partners, L.P., 2003 Tex. App. LEXIS 7003, 8-9 (Tx. Ct. App. 2003). Texas courts have found implied assumptions where (1) the benefit was so entwined with the burden that the assignee was estopped from denying assumption and (2) the assignee would otherwise be unjustly enriched. See Lone Star Gas Company v. Mexia Oil & Gas, Inc., 833 S.W.2d 199 (Tx. Ct. App. 1992).

(b) Similarly, a Washington court found an implied assumption. The court held that that an assignee could be estopped from denying assumption where the assignee's beneficial use of a culvert, which was the subject of an agreement between obligor and assignor, was entwined with the obligor's right to a provision requiring indemnity for damage to the culvert.

See Northern Pac. Ry. Co. v. Sunnyside Valley Irrigation District, 527 P.2d 693, 695 (1974).

(c) Alabama courts imply the assumption of duties "only in the absence of circumstances showing a contrary intention." See Louise T. Meighan v. Watts Construction Co., 475 So.2d 829, 834 (Ala. 1985).

(iii) To avoid an implied assumption, practitioners should consider including language in the assignment provision that expressly negates any implied assumption of duties by an assignee.

III. CONSENT TO ASSIGNMENT AND DELEGATION

A. Consent

(i) Consent. Conflict may exist between parties who each want the power to assign while preventing the other from assigning. This clash is often resolved through a compromise requiring each party to obtain the other party's consent prior to making an assignment.

Example: No party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party hereto. Any purported assignment, delegation or transfer in violation of this section is void.[1]

(ii) Reasonableness. A popular middle ground is to require that the non-assigning party's consent is not to be unreasonably withheld.

Example: No party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party hereto. No party shall unreasonably withhold its consent. Any purported assignment, delegation or transfer in violation of this section is void.

(iii) Reasonableness Standard. One commentator has noted that the standard of reasonableness by itself is both narrow and vague and may ultimately leave the determination to a judge or jury. See Friedman on Leases § 13:4:2. To help regain a measure of certainty, a party may seek to include certain "reasonableness factors" in the assignment provision.

[1] *For those interested in a more complete analysis of various "boilerplate" contractual provisions and additional drafting suggestions, the author highly recommends Negotiating and Drafting Contract Boilerplate (1993) by Tina L. Stark, which is probably the definitive work on such matters and is a useful resource for any business law library.*

Example: No party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party hereto. No party shall unreasonably withhold its consent. Any purported assignment, delegation or transfer in violation of this section is void.

In determining whether to grant its consent to a party's assignment request, the non-assigning party may consider any reasonable factor. The parties agree that the assigning party's failure to satisfy any one of the following factors (or any other reasonable factor) will be grounds for reasonably rejecting the assigning party's request:

> *(i) the net worth of the proposed assignee is equal to or greater than the assigning party's net worth both a) at the time this Agreement is executed by the non-assigning party, and b) at the time of the proposed assignment;*
>
> *(ii) the proposed assignee enjoys a national reputation and level of prestige that is at least as good as that of the non-assigning party; or*
>
> *(iii) Assignor is not in default of its obligations under this Agreement beyond any applicable grace, notice or cure period.*

(iv) Implied Covenants. If an assignment provision by its terms does not require a non-assigning party to act reasonably in withholding consent, the non-assigning party may nevertheless be subject to an implied covenant of good faith and fair dealing to respond reasonably to requests for consent. See Business Information Group v. Bell Atlantic Systems Leasing International, Inc., 1992 U.S. Dist. LEXIS 15491, 9-10 (N.D. Ill. 1991). Depending on the law of the applicable jurisdiction, the implied covenants may apply even if the assignment provision allows the non-assigning party to "withhold consent in its sole and absolute discretion." See White Stone Partners, LP v. Piper Jaffray Companies, Inc., 978 F.Supp. 878, 882-883 (D. Minn. 1997) (quoting Tymshare, Inc. v. Covell, 727 F.2d 1145, 1154 (D.C. Cir. 1984), in holding that the phrase "sole discretion" did not mean "for any reason whatsoever no matter how arbitrary or unreasonable").

In jurisdictions that do not recognize the implied covenants of good faith and fair dealing, a party would seem at liberty to act unreasonably when deciding to withhold consent if not otherwise limited by the assignment provision.

(v) Pre-approval. When a party knows in advance that it may want to assign its rights or delegate its duties to a certain entity, such as an affiliate or subsidiary, such party should obtain the pre-approval of the non-assigning party within the text of the assignment provision itself.

Example: No party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party hereto; provided that any party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement to [its affiliates or subsidiaries] without such prior written consent. No party shall unreasonably withhold its consent. Any purported assignment, delegation or transfer in violation of this section is void.

(vi) No Waiver. Finally, the parties might want to clarify that the non-assigning party's consent to one assignment does not waive the consent requirement for subsequent assignments.

IV. MERGER AND SALE OF STOCK

A. Corporate restructuring

Parties to an agreement should consider whether they intend for a merger, sale of stock, or involuntary transfer by one of the parties to violate a prohibition on assignment. The parties may have different views on how the anti-assignment provision should be drafted to address this issue. As noted in Friedman, one party might desire a broad anti-assignment provision that would be violated upon the occurrence of any number of corporate transactions, while the other party might seek to preserve the ability (without the other's consent) to restructure its business and sell or otherwise transfer assets or the business itself as needed over the term of the agreement.

Courts employ a range of analyses to determine whether a corporate restructuring event is treated as an "assignment." One approach courts take is to consider the relevant state's merger statute, while another approach focuses on the facts and circumstances surrounding the transaction.

(i) Emphasis on Merger Statute. The merger statute approach adopted by some courts to determine whether a merger is tantamount to an assignment focuses on the language of the applicable state merger statute. The statutory language usually provides that the surviving corporation in a merger is vested with the rights, franchises and obligations of the disappearing corporation. Emphasizing that the vesting process occurs "automatically," these courts tend to conclude that an assignment by operation of law is not an assignment within the meaning of an anti-assignment provision.

For example, in Dodier Realty & Inv. Co. v. St. Louis Nat. Baseball Club, Inc., 238 S.W.2d 321 (Mo. 1951), a landlord leased a baseball park to a tenant. The plaintiff landlord claimed the tenant breached its lease by merging into another corporation without obtaining the landlord's consent. The lease contained a typical anti-assignment provision forbidding an assignment of the lease without the landlord's consent:

> The second party covenants and agrees that it will not assign the right hereby granted to it, without the previous written consent of the first party, and that the assignee or successor in interest of the second party, from time to time, shall be and remain liable for the due and faithful performance of all the covenants, agreements, conditions and stipulations hereof, to be kept, observed and performed by the second party, it being further understood that such assignment shall not release the second party from the responsibility herein contained.

The lease also provided that an assignment without proper consent would constitute a breach of the lease. The merger of the tenant was accomplished pursuant to a Missouri merger statute which provided that the surviving corporation would possess all the rights, privileges, and franchises of each of the merging corporations. The Missouri court found that the tenant, which was the disappearing corporation, transferred all of its assets to the surviving corporation; however, following the merger statute approach, the court held that the transfer was "effected under and by force of the statute itself," and that such transfer did not constitute a prohibited assignment under the meaning of the anti-assignment provision in the lease. Id.

Similarly, Alabama courts have held that a merger does not constitute a "transfer" or an "assignment." The Alabama Supreme Court has stated that "[w]hile the constituent corporation may no longer survive for some purposes, the rights and privileges which it enjoyed … survive the merger and inhere in the surviving corporation following merger." See International Paper Co. v. Ernest Broadhead, 662 So.2d 277 (Ala Civ. App. 1995).

(ii) Emphasis on the Facts and Nature of the Transaction. Other courts take a holistic view of whether a merger constitutes an assignment. These courts tend to focus on whether the merger creates any quantifiable risk of loss or increased hazard to the non-assigning party.

For example, the Fifth Circuit applying Georgia law has addressed this issue in the context of a transfer of an insurance policy from a disappearing corporation to a surviving corporation. In Imperial Enterprises, Inc. v. Fireman's Fund Insurance Co, 535 F.2d 287 (5th Cir. 1976), a subsidiary merged into its parent corporation. The parent corporation, which survived the merger, attempted to seek recovery on a loss under the disappearing corporation's insurance policy. The court framed the issue as "whether a no-assignment clause in a fire insurance policy is violated by a transfer, without consent, resulting from the statutory merger of two companies, unaccompanied by any demonstrated increase in risk or hazard." The insurance policy had an anti-assignment provision that stated "[a]n assignment of interest under this policy shall not bind the [Insurer] until its consent is endorsed thereon." Neither the disappearing corporation nor the surviving corporation sought the insurer's consent prior to the merger. Id.

After the merger, a fire occurred. The surviving corporation filed a claim with the insurer, but was denied coverage on the basis that the merger was a prohibited assignment in violation of the policy. The district court ruled for the insurer, holding that the transfer pursuant to the Georgia merger statute was a transfer in violation of the anti-assignment provision in the policy; however, the Fifth Circuit reversed the lower court and ruled that the merger statute rendered the policy language "at least ambiguous" because the anti-assignment provision failed to include or exclude an assignment by operation of law. Id.

In rendering its decision, the Fifth Circuit chose to look to the facts of the transaction and policy as a whole and determine whether the assignment via merger increased the risks or hazards to the insurer. In its holding, the court stated "[w]e do not base our opinion on the fact that a statute directs distribution of assets, since, obviously, in many situations, an assignment of an occurrence policy could occur under this law which would substantially affect the risk and hazard of loss. It is the nature of the transfer in this particular case which controls this decision, not the mere fact that the transfer may have been accomplished in a manner directed by state law." Id.

In another case, a Connecticut court held that "whether a change in the form of a lessee's business from a partnership to a corporation violates a covenant against assignment is a factual question, to be resolved by reference to factors as to whether there was an essential change in personnel, whether the change was substantial or merely one of form, and whether the interests of the landlord are affected by the change." See Aiello v. Austrian, 479 A.2d 1234 (1984).

(iii) Sale of Stock Generally Not an Assignment. With respect to the sale of stock, the general rule is that a change in ownership effected through the sale of stock will not be treated as an assignment. Illinois courts adhere to this rule and have stated "it is well settled that the transfer of all of the stock issued by a tenant corporation does not effect an assignment of the tenant's lease unless the lease so provides." See National Bank of Albany Park in Chicago v S.N.H, Inc., 336 N.E.2d 115 (1st Dist. 1975). Nevertheless, the parties can contractually agree that the sale of a majority interest in a party will be deemed an assignment. See Assoc. Cotton Shops v. Evergreen Pk. Shopping, 170 N.E.2d 35, 39 (1st Dist. 1960) stating that "a lease may by express provision prohibit the sale of corporate stock." One commentator has noted that "[s]o strong…is the rule that a sale of all of the stock of a corporate tenant does not constitute an assignment of the tenant's lease, absent a change of control provision in the lease, that practitioners are well advised to include such a provision." See Kranzdorf, Problems of the Developer, 1965 U. Ill. L. F. 173 (1965).

In Branmar Theatre Co. v. Branmar, Inc., 264 A.2d 526, 528 (Del. Ch. 1970) the court ruled that the sale of stock by the stockholders of a corporate tenant under a commercial lease did not constitute a breach of an anti-assignment provision requiring the landlord's consent to an assignment. The court was unpersuaded by the landlord's argument that it had leased a movie theater to the corporate tenant based on the specific expertise of the tenant's stockholders, who were to be personally involved in the operations of the theatre. In rejecting the landlord's position, the court stated that at the time of lease execution, the landlord knew that the tenant's stock might foreseeably be transferred by the then current stockholders. Therefore, the landlord could have drafted the lease to include a provision for a forfeiture in the event the tenant corporation's stockholders sold their shares. Id.

Following this authority, it would be wise for parties to commercial agreements to consider in advance the desired outcome in the event that a party has a change in ownership by virtue of a sale of stock, and to specifically address assignability of the agreement in such context.

(iv) Public Companies. Publicly traded companies frequently insist that transfers of shares shall not be treated as an assignment.

Example: Party A shall not assign, mortgage, pledge, or otherwise transfer or encumber its rights under this Agreement without obtaining on each occasion Party B's prior written consent, which consent Party B may deny in Party B's sole discretion. Any transfer or sale of (i) any corporate stock (except on a nationally-recognized stock exchange, i.e. NYSE, AMEX, or NASDAQ) of Party A; (ii) any partnership interest in Party A; or (iii) any membership interest in Party A, or any merger, consolidation, sale, mortgage or pledge of all or substantially all of Party A's assets or liquidation of or by Party A, either voluntarily or by operation of law, shall be deemed an assignment and shall require Party B's consent as stated above. Any purported assignment, delegation or transfer in violation of this section is void.

(v) Private Companies. The owners of privately held companies may desire the flexibility to transfer shares to certain specific groups of people without being deemed to have made an assignment.

Example: Notwithstanding the foregoing provisions, any transfer of stock among the current stockholders of a party, or any transfer of stock among the current stockholders of a party and their immediate families (i.e. spouses, parents, brothers, sisters, children, grandchildren or any spouse of any such parent, brother, sister, child or grandchild), or any transfer of stock to such immediate family members by will or devise shall not constitute an assignment for the purposes of this Agreement.

(vi) To be enforceable, anti-assignment provisions intended to encompass mergers, sales of stock and changes in control should be "clear, definite and unambiguous." Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del. Inc., 170 N.E.2d 35, 38 (Ill. App. Ct. 1960).

V. SPECIAL ISSUES: INTELLECTUAL PROPERTY LICENSES AND UNIFORM COMMERCIAL CODE

A. Intellectual Property Licenses

(i) Non-exclusive Patent and Copyright Licenses Not Assignable by Licensee. It is widely accepted that non-exclusive patent and copyright licenses may not be assigned by the licensee absent express language in the license agreement specifically permitting assignment. See Verson Corp. v. Verson International Group PLC, 899 F. Supp. 358, 363 (N.D. Ill. 1995) (regarding patent license); Harris v. Emus Records Corp., 734 F.2d 1329, 1333-1334 (9th Cir. 1984) (regarding copyright license).

This principle is based upon the rationale that a non-exclusive patent or copyright license (which may be in writing or oral) constitutes a contractual promise by the licensor not to sue the licensee for infringement, which promise is personal to the licensee and hence nontransferable absent consent of the licensor. See Raymond T. Nimmer, The Law of Computer Technology, Section 7.78 (2005). The non-assignable nature of non-exclusive patent and software licenses is at least in part attributable to the rationale behind patent and copyright laws, which are intended to protect authors and inventors and promote authorship and new inventions by reserving to the patent or copyright owner the exclusive right to determine to when and to whom license rights are granted. See Everex Systems, Inc. v. Cadtak Corp., 89 F.3d 673, 678 (9th Cir. 1996).

(ii) Non-exclusive Software Licenses Not Assignable by Licensee. As software is uniquely situated as eligible for either patent or copyright protection, it follows that courts have found non-exclusive software license agreements to be non-assignable by the licensee unless assignment is expressly permitted by contractual agreement. See SQL Solutions Inc. v. Oracle Corp., 1991 WL 626458 (N.D. Cal. Dec. 18, 1991) (regarding assignment of software license by operation of law).

(iii) Exclusive Patent and Copyright Licenses Probably Assignable Unless Prohibited. There is a split of authority regarding whether or not an exclusive patent or copyright license (including software licenses) may be assigned without consent of the licensor. While the Ninth Circuit has found as a matter of law that exclusive copyright licenses are assignable only with the consent of the copyright [and by analogy patent] owner, Gardner v. Nike, Inc., 279 F.3d 774, 780-81 (9th Cir. 2002), other courts have found such exclusive licenses to be assignable by the exclusive licensee absent a prohibition of assignment in the agreement, see Golden Books Family Entertainment, 269 B.R. 311 (Bankr. D. Del. 2001); In re Sentry Data, Inc., 87 B.R. 943 (Bankr. N.D. Ill. 1988). This view in favor of an exclusive licensee holding the right to further assign its rights is supported by a leading copyright treatise, which supports this position with the rationale that an exclusive licensee is treated as the copyright owner to the extent of the exclusive rights granted by the license and should have the right to further transfer such rights unless expressly prohibited by the agreement. Nimmer on Copyright, Section 10.92 [b][4] at 10-25 to 10-28 (2005). However, if a license only grants exclusive rights to a portion of the rights owned by the licensor in and to the intellectual property (e.g., such as a grant of the exclusive right to distribute software, with the owner of the software retaining other rights such as the rights to make copies and derivative works), then it is possible that such "limited" exclusive license would be treated more like a non-exclusive license and be found non-assignable without the licensor's consent. See In re Sentry Data, Inc., 87 B.R. 943 (Bankr. N.D. Ill. 1988).

(iv) Trademark License May Not Be Assignable. There is legal authority that supports the position that trademark licenses are personal to the licensee and cannot be assigned by the licensee without consent. See, Tap Publ'ns. Inc. v. Chinese Yellow Pages Inc., 925 F.Supp. 212, 218 (S.D.N.Y. 1996) ("The general rule is that unless the license states otherwise, the licensee's right to use the licensed mark is personal and cannot be assigned to another."); In re N.C.P. Marketing Group, Inc., 337 B.R. 230 (D. Nev. 2005), aff'd No. 05-17384, 2008 BL 109962 (9th Cir. 2008) (trademark license is personal and non-assignable by a Chapter 11 debtor licensee without consent of licensor).

(v) Intellectual Property Licenses Freely Assignable by Licensor Absent Restriction. As the owner of the rights granted, the licensor of intellectual property rights (whether by exclusive or non-exclusive license) retains the right of assignment, absent restriction in the agreement.

(vi) Tips for Software Licensees. The licensee of intellectual property rights should be aware of the uncertainties in the law and be careful to ensure that its license agreement contains an assignment provision and license grant that will meet the licensee's future needs. For example, software licensees should include assignment language to allow the licensee to meet its future business needs, which could include the sale or acquisition of business units that may need use of the licensed software. Further, the licensee should consider whether the licensee intends to use any third parties (such as outsourcing companies) to manage, run, operate or otherwise use the software, which third party use could be in violation of the agreement and construed as an unauthorized assignment of rights, absent consent of the licensor. Last, the licensee should seek appropriate restrictions on the licensor's ability to assign its rights and obligations under the agreement to ensure that any assignee has the resources and capability to meet the licensor's rights under the license, such as any obligations to support and maintain software in the software license context.

(vii) Tips for Software Licensors. The licensor of software should be careful to protect its rights of ownership by limiting assignment by the licensee. For example, the licensor should use appropriate assignment restrictions to prevent a licensee from assigning its rights to a competitor of licensor. Further, if the software license agreement makes performance commitments that, for example, could be impacted by the number of users or quantity of data processed, it would be advisable for the licensor to retain the ability to prohibit assignment of the license to a company significantly larger than the original licensee, subject to performance commitments and licensee fee being adjusted accordingly.

(viii) Contracts Ancillary to Software Licenses. Parties to software license agreements which have ancillary agreements that may not be the subject of federal copyright or patent law (such as services agreements, including support and maintenance or development agreements related to the license) should be careful to consider whether a uniform assignment provision is desirable across all related contracts, keeping in mind that in the absence of a specific assignment provision, different law may govern the contracts, potentially resulting in different outcomes on the issue of assignment.

B. Uniform Commercial Code ("UCC")

With respect to commercial agreements governed by Article 2 and Revised Article 9 of the Uniform Commercial Code ("UCC"), practitioners should take care to review the provisions of the UCC relating to assignment. Although an adequate examination of these provisions is beyond the scope of this outline, the following provides the general contour of the rules:

(i) Revised Article 9. Revised Article 9 contains provisions favoring the free assignability of accounts, leases, and other contract rights. See Sections 9-401 through 9-409. These "anti-anti-assignment" provisions were adopted to increase the availability of credit, primarily by enlarging the pool of assets readily available for use as collateral. Toward that goal, Sections 9-406, 9-407, 9-408, and 9-409 generally nullify or override contractual or statutory prohibitions on assignment with respect to certain categories of collateral, and further provide that an assignment of rights in such collateral will not cause a default, breach, right to terminate, or similar adverse event under the commercial agreement containing the anti-assignment provision; however, the sections in Article 9 prohibiting anti-assignment provisions are not all identical, and practitioners should take care to understand the nuances of each section when drafting commercial agreements governed by Article 9.

(ii) Article 2. While Section 2-210(2) expressly provides that parties to a commercial agreement can agree to a contractual prohibition on assignment, there is some uncertainty regarding the remedies available when an assignor breaches an anti-assignment provision. Some commentators have suggested that the prohibited assignment may remain effective and that the assignor will be liable for damages to the non-assigning party. See 1 White and Summers, Uniform Commercial Code § 3-13 (4th ed. 1995).

(iii) Governing Law. In light of the fact that some states have adopted Revised Article 9 and Article 2 with variations from the Official Text, it is important that a practitioner check the commercial code of the applicable jurisdiction to determine the effect of those laws on an anti-assignment provision.

VI. ADDITIONAL DRAFTING CONSIDERATIONS

A. Miscellaneous Considerations

A party may want to ensure that its right to assign passes to its assignee. This right to assign may have particular relevance to a party that intends to assign it rights to an affiliate or subsidiary, who in turn may desire to make a subsequent assignment.

Example: A party's right to assign shall be a continuing right. Accordingly, persons to whom a party's interest is assigned shall have the right to further assign its rights.

B. Rights Non-Divisible

A party may want to prevent another party from dividing its rights and making multiple assignments. This issue may be significant in commercial agreements involving intellectual property, where the owner of the intellectual property rights desires to avoid transfer of rights granted apart from the other rights and obligations.

> *Example: The rights granted in this Agreement to Party X shall be non-divisible and shall not be transferable or assignable, in whole or in part, without Party Y's prior written consent. Any purported assignment, delegation or transfer in violation of this section is void.*

C. Ancillary Agreements

A commercial transaction may involve the execution of a definitive agreement and related ancillary agreements, as is commonly the case in asset purchase transactions. The practitioner should ensure that the closing documents contain matching assignment provisions, when appropriate, to ensure that the entire closing package is similarly assignable.

D. Who is the "Party" After Assignment

Commercial agreements typically utilize "labels" to define the parties (e.g., "Landlord," "Company," "Contractor," "Supplier," etc…). Following an assignment, there could be a question as to the identity of the party identified by the label, and whether the label now refers to the assignor, assignee, or both. For example, an agreement may provide that the insolvency of the "Supplier" constitutes a default under the agreement. After an assignment by the assignor-supplier to the assignee-supplier, would the insolvency of the assignor still trigger default under the agreement? The parties can avoid this uncertainty with proper drafting.

> *Example: An assignee shall have all rights of Supplier under the Agreement, to the extent assigned, separately exercisable by such assignee independently of Supplier. Upon any such assignment and except as may otherwise be provided therein, all references in the Agreement to Supplier shall include such assignee; provided, however, that all references to Supplier in Sections ____ and ____ of this Agreement shall mean solely such assignee.*

E. No Waiver

As mentioned above, the parties might want to clarify that the non-assigning party's consent to one assignment does not waive the consent requirement for subsequent assignments.

CHOICE OF LAW

INTRODUCTION

Though a mainstay of the modern commercial agreement, the law concerning application and enforceability of choice of law provisions is at best confusing and at worst a moving target. Indeed, commentators have described conflicts of law as "a 'veritable jungle' and as 'cumbersome and unwieldy,' giving rise to 'confusion, uncertainty, and inconsistency.'" See 16 Am. Jur. 2nd, Conflicts of Laws § 1 (internal citations omitted).

This outline seeks to identify the pertinent issues and pitfalls in drafting choice of law provisions. To that end, Parts I and II discuss the default rule and why parties often prefer to draft around it. Part III briefly discusses the interaction between choice of law provisions and choice of forum provisions. Part IV examines a typical choice of law clause, and proposes best practice language to ensure consistent interpretation. Part V discusses the duty of the drafting attorney to become familiar with the law of the chosen jurisdiction, either through careful research or retention of counsel, with an eye towards avoiding malpractice claims. Finally, Part VI discusses the primary differences and quirks in choice of law application promulgated under the UCC, Restatement (Second) of Conflicts of Law, and various local jurisdictions.

I. THE DEFAULT RULE: CHOICE OF LAW DETERMINED ACCORDING TO THE "LEX LOCI CONTRACTUS"

In the absence of clear agreement by the parties as to which jurisdiction's law applies in interpreting a contract, the traditional common law rule is that the substantive law of the "lex loci contractus" governs. See 16 A.L.R.4th 967. This standard encompasses both (i) the place where the contract was entered into and (ii) the place where it is to be performed. Similar analysis occurs where there is no express governing law when a dispute is brought in a forum which has adopted the approach of the Restatement (Second) of Conflicts of Laws. See Restatement (Second) Conflicts of Laws [hereinafter "Restatement"] §§ 6, 188; see also id. § 201, cmt. a (noting that where questions of misrepresentation, duress, undue influence and mistake are involved, and the contract does not contain an express choice of law provision, the principles outlined in § 188 apply).

II. THE UTILITY AND DESIRABILITY OF CHOICE OF LAW PROVISIONS

A. Certainty as to Contract Interpretation

The primary impetus for the negotiation and inclusion of a choice of law provision is to ensure certainty as to the interpretation of the contract in line with the expectations of the parties. For example, the laws of prominent commercial jurisdictions such as Delaware, New York, and California are often invoked in commercial transactions due to the extensive and well-settled body of commercial law in those jurisdictions. As a result the parties and their attorneys can be relatively certain in relying on such laws that the agreement will be interpreted by courts according to their understanding.

B. Multi-state Operations

For parties with operations in several states, the ability to focus on the law of one particular jurisdiction, such as the jurisdiction of their primary base of operations, is appealing both from the standpoint of drafting form customer contracts and of efficient resolution of subsequent disputes. Moreover, concentration in jurisdictions where there is clear, favorable, and familiar law can provide significant cost savings in terms of litigation expense and settlement of claims.

C. Selection of Laws Favorable to the Drafting Parties

Both the drafters and parties alike prefer to avoid the specter of future frivolous litigation and unnecessary cost in dispute resolution when negotiating terms. As such, prospective defendants often desire to choose governing law which provides caps on damages and other favorable liability-limiting provisions. Alternatively, prospective plaintiffs may seek to avoid these jurisdictions, and may alternatively seek jurisdictions that are more sympathetic to their claims.

D. Jurisdictions Catering to Particular Industries and Types of Businesses

Many jurisdictions cater to specific industries by providing legal and procedural incentives for businesses and industries to incorporate and operate within their boundaries. Choosing governing law from these jurisdictions can ease regulatory compliance burdens and allow effective incorporation of standard industry terminology and shorthand into agreements.

III. PROCEDURAL V. SUBSTANTIVE: INTERACTION OF THE CHOICE OF LAW PROVISION WITH THE LAW OF THE FORUM STATE

Though generally beyond the scope of this outline, brief mention must be made of the interaction between the choice of law provision of an agreement and the choice of forum provision, if any. Parties may (and frequently do) specify the forum where claims relating to or arising out of the agreement may be brought. While often this choice of forum is aligned with the jurisdiction whose law governs under the choice of law provision, this is not always the case.

When different jurisdictions are chosen for the governing law and the forum, it is critical that the drafting parties and their counsel understand that the forum court will apply the laws of its own jurisdiction in determining *procedural* matters (i.e., matters of judicial administration), See Restatement § 122, including whether or not the choice of law provision is enforceable. See Kronovet v. Lipchin, 415 A.2d 1096, 1106 (Md. 1980) (citing Restatement § 187(b)(2), which stands for the proposition that the choice of law jurisdiction agreed upon usually governs, unless the law of the jurisdiction which would govern in the absence of an effective choice of law provision (as determined by Restatement § 188) has a "materially greater interest" than the chosen state in determining the particular issue).

For *substantive* matters generally the law cited in the choice of law provision governs. The law of the forum is used to characterize whether an issue is itself procedural or substantive. See Restatement § 122, cmt. b.

IV. CHOICE OF LAW PROVISION DRAFTING CONSIDERATIONS

A. Sample Provision —"Bare Bones"

(i) A typical "bare bones" choice of law provision reads as follows:

This Agreement is governed by the law of the State of [insert name of State]."

(ii) While this clause is sufficient to identify the pertinent governing law, it is inherently flawed in that it fails to address a number of issues that conventionally hamper effective interpretation of choice of law provisions. These concerns are enumerated immediately below, followed by a suggested refined clause compiling each element.

B. Barriers to Proper Interpretation

(i) Renvoi. The bare bones choice of law provision described above ignores the potential circularity known as "renvoi," i.e., the application of the designated governing law's own choice of law statutes. For example, if a suit was brought in State A regarding a contract that contained a provision choosing State B's law as controlling, the State A court might, in applying State B's choice of law rules, determine that State B law in fact requires the law of State A to apply under the State B conflict of law statutes. State A's conflict of law provisions might then point back to State B. As such, the court effectively faces a "hall of mirrors" in determining the applicable governing law.

(a) Avoid Renvoi. To avoid renvoi, many drafters expressly exclude the governing state's choice of law provisions, or alternatively refer to the state's "internal" or "substantive" laws. For example:

"*This Agreement is governed by the internal laws of the State of [name of State]*"

or

"*This Agreement is governed by the laws of the State of [name of State], without reference to its conflicts of laws principles*"

(b) Restatement Treatment. Because many courts look to the Restatement in non-UCC cases involving interpretation of choice of law provisions, it is useful to examine the Restatement treatment of renvoi. The Restatement essentially infers the necessary language excluding a state's choice of law principles. See Restatement § 187, cmt. h. Section 187 of the Restatement provides that:

> the reference, in the absence of a contrary indication of intention, is to the 'local law' of the chosen state and not to that state's 'law,' which means the totality of its law including its choice-of-law rules . . . . [T]o apply the 'law' of the chosen state would introduce uncertainties of choice of law into the proceedings and would serve to defeat the basic objectives, namely those of certainty and predictability, which the choice-of-law provision was designed to achieve. Id.

In other words, the Restatement effectively reads the phrase "without reference to its conflicts of law principles" into the "bare bones" provision described above.

(c) Best Practice. Although the Restatement view is widely adopted, prudence suggests that an express reference to a state's law without reference to its choice of law principles is still the best practice to ensure that a choice of law provision is interpreted in accordance with the parties' intent.

(ii) Depaçage. In line with the general principle that the parties are free to choose the law governing the agreement, parties may in fact choose to have different bodies of law govern different issues or sections of the agreement as they see fit. This practice of issue-by-issue determination is known as "depeçage." See Arthur T. von Mehren, Special Substantive Rules for Multi-State Problems, 88 Harv. L. Rev. 347, 356 n.24 (1974); however, this "pick and choose" approach may in fact invite more litigation than it wards off.

Although the parties are free to provide for the application of different bodies of law for different issues within the agreement, in practice doing so runs the risk of increasing the odds that each provision of the contract will be subject to litigation regarding which body of law actually applies. As such, from a practical standpoint parties will likely wish to avoid depaçage if possible by agreeing on a single body of law.

(iii) Claims Arising in Contract v. Tort. Courts often hold that, absent an agreement to the contrary, the choice of law provisions of a contract will govern disputes arising from the construction of the contract but not tort claims which ostensibly arise out of or are related to the contract.

(a) For example, the 2001 Eighth Circuit case of Inacom Corp. v. Sears, Roebuck & Co., 254 F.3d 683, 687-88 (8th Cir. 2001), a choice of law provision expressly applied Illinois law to contracts made and to be performed within the state of Illinois. With respect to the plaintiff's claim for fraudulent concealment in connection with the making of the contract, the court held that Illinois law could not be applied because the concealment claim opened the door to tort remedies, which were not usually contemplated when entering into a contract. The court noted instead that a broader provision pertaining all rights and duties "arising from or in any way relating to" the contract would have had a better chance of incorporating tort claims into the choice of law provision. Id. at 687-88 (internal citations omitted). As such, the Court concluded that the district court's application of Nebraska law to the fraudulent concealment claim was correct. See id. at 688.

(b) In contrast, however, the 2010 Nebraska District Court case of Peter Kiewit Sons', Inc. v. Atser, LP, 684 F. Supp. 2d 1126, 1134-1135 (D. Neb. 2010), in applying the Inacom framework, held that a tort claim for misappropriation of trade secrets was "sufficiently intertwined" with a related contract claim and the interpretation of the contract itself so as to be governed by the applicable choice of law provision. See id. at 1135.

(c) Therefore, because courts apply choice of law provisions unevenly to tort claims in the absence of express inclusion, best practices suggest an explicit clause contemplating any and all non-contract claims arising out of or relating to the making, performance and construction of the contract.

(d) Restatement View. With respect to tort claims, § 145 of the Restatement states as follows:

> the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties including the place where the injury occurred; the place where the conduct causing the injury occurred; the domicile, residence, nationality, place of incorporation and place of business of the parties; and; the place where the relationship, if any, between the parties is centered. See also Restatement § 148(2) (outlining similar criteria for the treatment of fraud claims).

(e) Best Practices Language. Because courts typically only apply choice of law provisions to matters of construction of the contract absent express agreement otherwise, See, e.g., Camp Creek Hospitality Inns v. Sheraton Franchise Corp., 139 F.3d 1396, 1408-1412 (11^{th} Cir. 1998); see also Shelley v. Trafalger House Public Ltd Co., 918 F.Supp. 515, 521 (D.P.R. 1996); see also Maltz v. Union Carbide, Chems & Plastic Co., Inc., 992 F.Supp. 286, 295 (S.D.N.Y. 1998); Cottonwood Holding, Inc. v. C3, Inc., 1995 WL 276196, *9-11 (S.D.N.Y. 1995) best practices should include language which broadens the scope of applicability to include tort and all other related claims. Such a provision might read as follows:

"The [laws of the State] govern this agreement and all of the transactions contemplated by it, as well as all other matters arising out of and relating to it, including without limitation claims as to its validity, interpretation, construction, performance and all claims sounding in tort."

C. Visibility of Provision

Some jurisdictions require that the choice of law provision be conspicuously set out from the remainder of the document. See, e.g., Fairfield leasing Corp. v. Technique-Graphics Inc., 607 A.2d 703, 707 (N.J. Sup. Ct 1992); see also Tex. Bus. & Com. Code § 1.301; but compare Cohen v. Chase Bank, N.A., 679 F. Supp. 2d 582, 591-92 (D. N.J. 2010) (refusing to apply the Fairfield holding). This could be accomplished through the use of bold or underlined text, for example. Even in jurisdictions where such enhanced visibility is not required, the drafting party may wish do so in order to avoid potential claims by the non-drafting party that the choice of law provision was a non-negotiated part of a contract of adhesion.

D. Sample Provision – Refined Choice of Law Provision

Applying the principles in this section, the following clause likely provides a more refined and certain application of the governing jurisdiction's substantive law:

> THE LAWS OF THE STATE OF [INSERT STATE NAME], WITHOUT REFERENCE TO [STATE]'S CONFLICT OF LAWS PRINCIPLES, GOVERN THIS AGREEMENT AND ALL OF THE TRANSACTIONS CONTEMPLATED BY IT, AS WELL AS ALL MATTERS ARISING OUT OF OR RELATING TO IT, INCLUDING WITHOUT LIMITATION CLAIMS AS TO ITS VALIDITY, INTERPRETATION, CONSTRUCTION, PERFORMANCE, AND ALL CLAIMS SOUNDING IN TORT.

V. THE ATTORNEY'S DEEMED KNOWLEDGE OF THE LAW OF THE GOVERNING STATE

Apart from the careful consideration of the best applicable law with respect to a particular transaction, drafters must also take into consideration their own familiarity—or lack thereof—with the chosen governing law. Selection of a particular jurisdiction without knowledge of the way its laws will apply in interpreting the agreement could result in unenforceability of key provisions, as well as potential malpractice claims in certain jurisdictions. As such, a lawyer who is unfamiliar with the law of a selected jurisdiction is well advised to heed his or her duty of reasonable care and skill by either educating themselves on the law or retaining counsel within such jurisdiction.

A. Duty of Care Implications

Though case law imposing direct liability for a lawyer's incompetence based on his or her unfamiliarity with the laws of a given jurisdiction is relatively scarce, the 1995 New

York case of Hart v. Carro, 211 A.D.2d 617 (N.Y. 1995), serves as a cautionary tale with respect to failure to familiarize oneself with a foreign jurisdiction's law.

In that case, a law firm was successfully sued for malpractice by a client for failure to advise them of the need for filing a lien to secure their collateral under the law of the Bahamas, despite the firm's urging the client to retain Bahamian counsel. The court noted that when "counsel is retained in a matter involving foreign law, it is counsel's responsibility to conduct the matter properly and to know, or learn, the law of the foreign jurisdiction." See id. at 620. Essentially, then, the firm had a duty to become competent in the law of the foreign jurisdiction, not merely a duty to suggest that the client obtain local counsel.

While obviously this holding is merely persuasive outside of New York, it should be noted that it is essentially in line with the duty of competence described in the ABA Model Rule of Professional Conduct 1.1. That Rule states that "[c]ompetent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." For purposes of Rule 1.1., "[a] lawyer can provide adequate representation in a wholly novel field through necessary study [or] through the association of a lawyer of established competence in the field in question." See ABA Model Rules of Professional Conduct § 1.1, cmt. [2]. Although there have been a few cases, see Fenaille and Despeaux v. Coudert, 44 N.J.L. 286, 291-92 (N.J. Sup. Ct. 1882), and Rekeweg v. Federal Mut. Ins. Co., 27 F.R.D. 431, 436 (N.D. Ind. 1961), which hold that an out of state lawyer is not presumed to know the law of a foreign jurisdiction, and therefore a prudent client should take it upon themselves to retain foreign counsel, it is likely that Rule 1.1 overrides any comfort a drafter might take in such precedent.

B. Reducing Malpractice Potential – Have Your Client Retain the Foreign Lawyer

In order to reduce the likelihood of success of any malpractice claim based on a lawyer's unfamiliarity with the laws of the chosen jurisdiction, a lawyer would be wise to retain counsel in the relevant jurisdiction to assist in illuminating any potential pitfalls in application of its laws. While doing so would seemingly mitigate any claim based on the lawyer's failure to exercise reasonable care, there is still the possibility that the lawyer could be held liable for malpractice if the foreign lawyer himself commits malpractice with respect to his or her representations regarding the application of the foreign jurisdiction's law to the agreement.

As such, ideally the best practice would be to recommend that the client retain the foreign lawyer directly. In so doing, the drafter would only be liable for malpractice to the extent that the selection of the specific lawyer in the foreign jurisdiction was malpractice. That is, the drafter will not be held liable to the client for any actions which themselves rise to the level of malpractice on the part of the foreign lawyer. Of course, such independent retention of foreign counsel is not always a viable option depending on the timing of the deal, the client's willingness to hire another attorney, and so forth. As a result, this simply may not be practicable. Where such an arrangement can be achieved, it likely provides the most reasonable means of ensuring that the drafter's liability for malpractice relating to the unenforceability or unintended application of a choice of law provision is kept to a minimum.

VI. CHOICE OF LAW APPLICABILITY ISSUES UNDER THE UCC, RESTATEMENT, AND CERTAIN LOCAL LAWS

A. "Substantial Relationship" Limitation

In order for the body of law in a given choice of law provision to be applicable in a jurisdiction which follows the Restatement, the chosen law must (A) (i) have a "substantial relationship" (ii) to *either* the transaction or the Parties, or (B) have some other "reasonable basis" as the parties' choice of law. See Restatement § 187(2)(a).

B. Public Policy Limitation

A second limitation in the Restatement requires that the chosen law not be "contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of a particular issue and which would [otherwise] be the state of applicable law in the absence [of the choice of law provision]." See id. § 187(2)(b).

(i) One example of the "Fundamental Policy" limitation of the Restatement is the so-called "Internal Affairs Doctrine." Essentially, this doctrine states that internal corporate relationships are governed by the law of the state of incorporation, and the parties may not agree to the application of another jurisdiction's laws to such matters through an otherwise valid choice of law provision. See VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112 (Del. 2005) (citing McDermott Inc. v. Lewis, 531 A.2d 206, 215 (Del. 1987)); see also Restatement (Second) of Conflict of Laws § 302(2), comment (g) (citing CTS Corp v. Dynamics Corp., 481 U.S. 69, 90 (1987)). Similarly, in matters relating to franchising there are often issues when the chosen governing law conflicts with the forum state's franchising requirements. See generally Note: The Choice-of-Law Dilemma in Franchising, 20 Okla. City U.L. Rev. 391 (1995).

(ii) Another example of the unenforceability of a choice of law provision as against public policy appears in National Glass v. J.C. Penney Properties, 650 A.2d 246 (Md. App. Ct 1994). In that case, although the contract had an enforceable choice of law provision which selected Pennsylvania law, the Maryland Court would not uphold a provision for a waiver of a mechanic's lien, even though such action was valid under Pennsylvania law. Noting that the law of the state where the real property is located generally governs the creation of a mechanic's lien, the court held that because the situs of the underlying real property was Maryland, and because Maryland law disallowed waiver of mechanic's lines, public policy dictated that the choice of law provision applying Pennsylvania law was unenforceable with respect to the waiver provision. See id. at 611-12.

However, the court did note that the application of foreign law would not rise to the level of a public policy violation merely because the foreign law was dissimilar to Maryland's. Rather, for another state's law to be unenforceable there must be a "strong" public policy against its enforcement within the state. *See id.* at 612-13 (quoting Bethlehem Steel v. G.C. Zarnas & Co., 498 A.2d 605, 608 (1985)).

C. "Reasonable Relationship" Limitation (UCC)

(Unrevised) UCC § 1-105 provides that a foreign jurisdiction's law may be applied to a transaction via an enforceable choice of law provision when (i) the transaction (ii) bears a "reasonable relationship" to that jurisdiction.

Official Comment 1 of section 1-105 states that "the test of 'reasonable relation' is similar to that laid down by the Supreme Court in Seeman v. Philadelphia Warehouse Co., 274 U.S. 403 (1927)." In other words, "the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs." See Uniform Commercial Code § 1-105, official comment 1.

Note that unlike the Restatement, the UCC limitation provision does not contemplate a relationship with the Parties; rather it is interested in a relationship between the governing law jurisdiction and the transaction.

(i) No Public Policy Limitation. Unlike the Restatement, UCC § 1-105 does not contain an express public policy limitation with respect to choice of law provisions.

(ii) UCC Provisions Not Subject to UCC § 1-105. The following UCC sections are not subject to the general conflict of law rules set out in UCC § 1-105:

(a) Rights of creditors against sold goods (Section 2-402);

(b) Applicability of the Article on Leases (2A-105 & -106);

(c) Governing law in the Article on Bulk Sales (6-103);

(d) Applicability of the Article on Investment Securities (8-110); and

(e) Law governing perfection and priority of certain liens (9-301 through -307).

See id. § 1-105(2).

D. Slow Adoption of Revised UCC § 1-301

Although Revised UCC Art. 1 has been adopted in some jurisdictions, few among those jurisdictions have adopted the broader choice of law provisions of Revised UCC § 1-301; instead the majority of jurisdictions still use (unrevised) UCC § 1-105. See generally UCC Reporting Service, State UCC Variations with Optional Language & Fee Tables, at xxvii, "Table of Enactments of 2001 Amendments (Revised Art. 1)" (West Group 2010); see also Jack M. Graves, Party Autonomy in Choice of Commercial Law: The Failure of Revised U.C.C. 1-301 and a Proposal for Broader Reform, 36 Seton Hall L. Rev. 59 (2005).

E. Local Law

In addition to the general rules regarding the enforceability of choice of law provisions in the UCC and Restatement outlined above, some jurisdictions have their own unique statutory requirements or permissive thresholds which pertain to the application of the jurisdiction's law to contracts that bear some (or no) relationship to it.

For example, both Delaware and New York have enacted statutes which allow parties to choose their respective state laws as governing, even if the underlying contract or parties bear *no* relationship (substantial, reasonable, or otherwise) to the state, provided that the transaction embodied in the contract meets a certain dollar amount threshold. See N.Y. Gen. Oblig. L. § 5-1401(1); 6 DEL. CODE ANN. § 2708.

CONCLUSION

It is little wonder that seemingly innocuous boilerplate choice of law provisions often masks a "veritable jungle." As discussed above, the general rule that the parties are free to choose the governing law belies the complexity of applying that provision in practice. Matters of procedure versus substance, the relationship of the selected law to the making or performance of the agreement, and the familiarity of the drafting attorney with the chosen jurisdiction all come to bear on the effectiveness and enforceability of such provisions.

Moreover, drafters must be precise in the wording of their provisions to ensure that claims which relate to the transaction, but which are rooted outside of the four corners of the document, are contemplated by the provision. As noted above, best practices dictate that the drafter should at a minimum consult with competent counsel in a foreign jurisdiction to ensure proper understanding of the foreign jurisdiction's laws to the agreement in question, and at best suggest that the client should directly retain such foreign counsel to mitigate potential malpractice claims.

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Some Provisions to Think About In Guarantees

A. Guarantee Overview

1. A guarantee is an agreement whereby a Guarantor agrees to fulfill the payment or performance obligations of a Borrower to a Lender. The guarantee provides additional credit support to the Lender by allowing the Lender to look to the assets of both the Borrower and the Guarantor for payment.

2. A Guarantee involves three relationships:

   (a) Lender and Borrower -- the underlying debt obligation (e.g., the Lender's loans to Borrower);

   (b) Lender and Guarantor -- the guarantee obligation in the event that the Borrower fails to pay the Lender the amount due on the underlying debt obligation; and

   (c) Guarantor and Borrower -- "reimbursement" obligation requiring the Borrower to make the Guarantor whole for its performance under the guarantee.

3. A guarantee is contingent, triggered by the Borrower's default. However, a guarantee of payment (as opposed to a guarantee of collection) allows the Lender to pursue the Guarantor directly without first enforcing its payment or performance rights against the Borrower.

4. A guarantee provides a legal claim: the Lender becomes a direct creditor of the Borrower, thus avoiding structural subordination issues.

5. A guarantee allows a Lender to collect against the Guarantor if the Borrower has a defense to performing the underlying debt obligations.

6. If the Guarantor performs under its guarantee it has the right to be reimbursed by the Borrower. Such Guarantor is also entitled to contribution, requiring any co-Guarantors to pay a pro rata share of the amount paid by such Guarantor. After the Lender is fully paid the Guarantor has subrogation rights allowing it to "step into the shoes" of the Lender. Pursuant to these subrogation rights, the Guarantor can enforce the Lender's rights in any collateral that the Lender obtained from the Borrower.

7. There are issues in designating Guarantors:

   (a) Parent or Holding Company Guarantees

      (i) Typically, the Parent or Holding Company will not have assets other than the equity of the Borrower, given that a Lender would not want any creditor claims against its equity position in the Borrower, nor would it want any productive assets at a location where structural subordination would leave the Lender without any claim.

(ii) Fraudulent conveyance claims are less likely with "downstream" guarantees because the Parent or Holding Company is obtaining value from the loans (through its wholly owned subsidiary) in return for the guarantee.

(b) Subsidiary Guarantees

(i) Fraudulent conveyance issues are a hazard with "upstream" and "cross-stream" guarantees, based on the argument that the guarantee is given for less than "reasonably equivalent value." If the Guarantor is not rendered insolvent, inadequately capitalized or unable to pay its debts due to the issuance of a guarantee, it is not a fraudulent conveyance.

(ii) Guarantees from foreign subsidiaries in respect of the debt obligations of a U.S.-domiciled Borrower present a "deemed dividend" issue. If a guarantee is taken from a foreign subsidiary that qualifies as a "controlled foreign corporation" for purposes of U.S. tax law, the Borrower may be construed as receiving a dividend from that foreign subsidiary, which dividend will be subject to U.S. Federal income taxes.

(iii) Guarantees from foreign subsidiaries also raise potential enforceability issues under foreign law.

B. Guarantee Provisions

1. The Guarantee.

"Each Guarantor irrevocably and unconditionally guarantees, jointly with the other Guarantors and severally, as primary obligor and not merely as surety, the punctual payment and performance of the Obligations. Each Guarantor further agrees that the Obligations may be extended or renewed, in whole or in part, without notice to or further assent from it, and that it will remain bound upon its guarantee hereunder notwithstanding any such extension or renewal of any Obligation. Each Guarantor waives presentment to, demand of payment from and protest to the Borrower or any other Loan Party of any of the Obligations, and also waives notice of acceptance of its guarantee and notice of protest for nonpayment."

(a) The Guarantee is irrevocable -- it cannot be withdrawn until it expires in accordance with its terms. The Guarantor has the common law right to revoke the guarantee, so this defense requires an express waiver.

(b) The Guarantee is unconditional -- no conditions are required to be satisfied before exercising the guarantee. Examples of conditions are "acceptance" of the guarantee by the Lender, or failure to satisfy a minimum financial condition. However, the "unconditional" guarantee does not in itself waive suretyship defenses. Restatement of Suretyship & Guaranty 3d, Section 48, comment d.

(c) Joint and Several -- The Lender will want to be able to collect the full amount of the guaranteed debt from any Guarantor; making the guarantee joint and several will allow that. However, this condition gives rise to a greater potential for the trustee in bankruptcy/creditors' committees to bring an action that the Guarantee gives rise to a fraudulent conveyance claim.

(d) "Primary obligor, not surety" -- This provision will allow the Lender to avoid potential surety defenses. However, merely stating the words will not prevent a court from recharacterizing the relationship as a surety if the facts so warrant. See Chemical Bank v. Meltzer, 93 NY2d 296, 690 NYS2d 489 (1999) (hereinafter "Meltzer")

(e) Waives presentment to, demand of payment from and protest to Borrower -- there must be an explicit waiver of statutory defenses, such as presentment and protest under UCC Article 3. If such waivers are absent, the Guarantor can be released from its obligations under the guarantee.

2. Guarantee of Payment; Continuing Guarantee.

"Each Guarantor further agrees that its guarantee hereunder constitutes a guarantee of payment when due (whether or not any bankruptcy or similar proceeding shall have stayed the accrual of collection of any of the Obligations or operated as a discharge thereof) and not merely of collection, and waives any right to require that any resort be had by the Administrative Agent or any other Secured Party to any security held for the payment of the Obligations or to any balance of any deposit account or credit on the books of the Administrative Agent or any other Secured Party in favor of the Borrower, any other party, or any other Person."

Each Guarantor agrees that its guarantee hereunder is continuing in nature and applies to all Obligations, whether currently existing or hereafter incurred."

(a) Guarantee of payment is an "absolute" obligation of the Guarantor to make a payment to the Lender. A guarantee of collection requires the Lender first to establish that the debt cannot be collected from the Borrower after exhausting remedies against the Borrower. Thus, a guarantee of collection is a "conditional" guarantee. See NYUCC 3-416 and Revised UCC 3-419(d).

(b) It is important to provide that the guarantee is "continuing" so that the Guarantor is responsible for all the obligations of the Borrower incurred in a series of transactions over an unspecified period of time, such as under a revolving facility. See <u>Meltzer</u>. The guarantee at issue in <u>Meltzer</u> only extended to one series of obligations (first lien). The Guarantor was allowed the subrogation rights of a surety to the first mortgage serving as collateral for his guarantee, allowing the Guarantor to come ahead of the bank's second mortgage.

3. No Limitations.

"Except for termination of a Guarantor's obligations hereunder as expressly provided in [this Agreement's termination provision], the obligations of each Guarantor hereunder shall not be subject to any reduction, limitation, impairment or termination for any reason, including any claim of waiver, release, surrender, alteration or compromise, and shall not be subject to any defense or set-off, counterclaim, recoupment or termination whatsoever by reason of the invalidity, illegality or unenforceability of the Obligations, any impossibility in the performance of the Obligations, or otherwise. Without limiting the generality of the foregoing, the obligations of each Guarantor hereunder shall not be discharged or impaired or otherwise affected by:

(i) *the failure of the Administrative Agent or any other Secured Party to assert any claim or demand or to enforce any right or remedy under the provisions of any Loan Document or otherwise;*

(ii) *any rescission, waiver, amendment or modification of, or any release from any of the terms or provisions of, any Loan Document or any other agreement, including with respect to any other Guarantor under this Agreement;*

(iii) *the release of any security held by the Administrative Agent or any other Secured Party for the Obligations or any of them;*

(iv) *any default, failure or delay, wilful or otherwise, in the performance of the Obligations; or*

(v) *any other act or omission that may or might in any manner or to any extent vary the risk of any Guarantor or otherwise operate as a discharge of any Guarantor as a matter of law or equity (other than the indefeasible payment in full in cash of all the Obligations)."*

(a) There are a number of common law defenses that are available to Guarantors, unless such defenses are expressly waived. Cautious lenders should not rely on a general waiver of common law defenses, but rather should include express waivers for such defenses. These common law defenses include:

(A) increasing or altering the risk without the consent of the Guarantor (see Hall & Co. v. Continental Casualty Co, 34 AD2d 1028, 310 NYS2d 950 (1970), aff'd, 30 NY2d 517, 330 NYS2d 64 (1972), "a surety is discharged by any alteration of the contract which his guarantee applied, whether material or not, and the courts will not inquire whether it is or is not to his injury;" even if the guarantee provides that the Guarantor can give advance consent to any modification of the principal obligation, the Guarantor should still reaffirm its guarantee if there are significant changes to the guarantee),

(B) impairment by the Lender of the subrogation right (for example, failure to perfect a security interest in the Borrower's collateral),

(C) the guarantee itself being unauthorized,

(D) release of a co-Guarantor, since such release would impair the contribution rights of the remaining Guarantors, and

(E) unenforceability of the underlying obligation. Such waivers are common and have held to be effective in New York (see Manufacturers Hanover Trust Co. v. Green, 95 AD2d 737, 464 NYS2d 474 (1983), appeal dismissed, 61 NY2d 760 (1984).

(b) The guarantee should clearly state which law governs, since some defenses derive from state statutes (such as the Uniform Commercial Code, statute of limitations and statute of frauds as well as state fraudulent conveyance claims, which are incorporated into the federal Bankruptcy Code by Section 544(b)). Under the UCC, a number of protective rules are not waivable by the Borrower or the Guarantor. See 9-602 vs. 9-624.

4. Savings clause.

"Anything herein or in any other Loan Document to the contrary notwithstanding, the maximum liability of each Guarantor hereunder and under the other Loan Documents shall in no event exceed the amount which can be guaranteed by such Guarantor under applicable federal and state laws relating to the insolvency of debtors (after giving effect to the right of contribution established in [Section [ ]])."

(a) This language is typically included in guarantee agreements. Recently, in In re TOUSA, Inc., Adv. Pro. No. 08-1435 (JKO), 2009 Bankr LEXIS 3311 (Bankr S.D. Fla Oct. 13, 2009), the court called into question the efficacy of a generic savings provision such as this, but most Lenders are still of the view that this clause, when coupled with rights of indemnification and contribution, remains effective to guard against possible fraudulent conveyance actions.

(b) Some variations of this clause can include a dollar cap on liability.

5. Security.

"Each Guarantor expressly authorizes the Secured Parties to take and hold security for the payment and performance of the Obligations, to exchange, waive or release any or all such security (with or without consideration), to enforce or apply such security and direct the order and manner of any sale thereof in their sole discretion or to release or substitute any one or more other guarantors or obligors upon or in respect of the Obligations, all without affecting the obligations of any Guarantor hereunder. To the fullest extent permitted by applicable law, each Guarantor waives any defense based on or arising out of any defense of the Borrower or any other Loan Party or the unenforceability of the Obligations or any part thereof from any cause, or the cessation from any cause of the liability of the Borrower or any other Loan Party, other than the indefeasible payment in full in cash of all the Obligations. The Administrative Agent and the other Secured Parties may, at their election, foreclose on any security held by one or more of them by one or more judicial or nonjudicial sales, accept an assignment of any such security in lieu of foreclosure, compromise or adjust any part of the Obligations, make any other accommodation with the Borrower or any other Loan Party or exercise any other right or remedy available to them against the Borrower or any other Loan Party, without affecting or impairing in any way the liability of any Guarantor hereunder except to the extent the Obligations have been fully and indefeasibly paid in full in cash. To the fullest extent permitted by applicable law, each Guarantor waives any defense arising out of any such election even though such election operates, pursuant to applicable law, to impair or to extinguish any right of reimbursement or subrogation or other right or remedy of such Guarantor against the Borrower or any other Loan Party, as the case may be, or any security."

(a) This provision allows the Lender to apply the Guarantor's property to the debt, which would otherwise not be permitted under the common law. Unless there is an express waiver of impairment of collateral, the Guarantor may use this defense (see above, most often used when the Lender fails to perfect collateral, or releases it without the Guarantor's consent).

6. Reinstatement.

"Each of the Guarantors agrees that its guarantee hereunder shall continue to be effective or be reinstated, as the case may be, if at any time payment, or any part thereof, of any

Obligation is rescinded or must otherwise be restored by the Administrative Agent or any other Secured Party upon the bankruptcy or reorganization of the Borrower, any other Loan Party or otherwise."

(a) The Guarantor remains responsible on its guarantee obligation until the Borrower makes a final, indefeasible payment. Thus, the Guarantor's liability is reinstated if payment to the Lender is recovered by the Borrower's bankruptcy estate (for example, in a voidable preference, see section 547 of the Bankruptcy Code).

(b) The Lender's claims against the Guarantor may not be affected by the automatic stay of the creditor action against the Borrower in bankruptcy.

(c) Contrast the need for a reinstatement of a security interest. There is no need for reinstatement if the security interest is properly secured. For example, a bankruptcy preference is a transfer, including a security interest, that is made when the debtor is insolvent, within 90 days of the commencement of a bankruptcy proceeding (1 year if the transferee is an insider), on account of an antecedent debt, and the transferee receives more than it would have in a straight liquidation of the debtor. If the Lender receives payment that is commensurate to the amount of collateral in which such Lender has a first-lien security interest, the Lender would be entitled to the collateral and the trustee in bankruptcy would likely not bring a preference action on any payment by the Borrower.

7. Information.

"Each Guarantor (a) assumes all responsibility for being and keeping itself informed of the Borrower's and each other Loan Party's financial condition and assets, and of all other circumstances bearing upon the risk of nonpayment of the Obligations and the nature, scope and extent of the risks that such Guarantor assumes and incurs hereunder, and (b) agrees that none of the Administrative Agent or the other Secured Parties will have any duty to advise such Guarantor of information known to it or any of them regarding such circumstances or risks."

(a) The purpose of this provision is to make the Guarantor responsible for conducting its business in a way that will make it possible for it to repay the loan if necessary. This provision clarifies that it is not the Lender's responsibility to update the Guarantor as to the financial condition of the Borrower.

8. Agreement To Pay; Subrogation.

"In furtherance of the foregoing and not in limitation of any other right that the Administrative Agent or any other Secured Party has at law or in equity against any Guarantor by virtue hereof, upon the failure of the Borrower or any other Loan Party to pay

any Obligation when and as the same shall become due, whether at maturity, by acceleration, after notice of prepayment or otherwise, each Guarantor hereby promises to and will forthwith pay, or cause to be paid, to the Administrative Agent for distribution to the applicable Secured Parties in cash the amount of such unpaid Obligation. Upon payment by any Guarantor of any sums to the Administrative Agent as provided above, all rights of such Guarantor against the Borrower or any other Loan Party arising as a result thereof by way of right of subrogation, contribution, reimbursement, indemnity or otherwise shall in all respects be subject to [this section]."

(a) Under the common law, the Guarantor has basic rights such as subrogation, reimbursement and contribution. The Lender usually requests that the Guarantor waive these rights until the Lender has been repaid in full.

(b) Such a waiver would have resulted in a better outcome for the bank in <u>Meltzer</u>!

9. Indemnity and Subrogation.

"In addition to all such rights of indemnity and subrogation as the Guarantors may have under applicable law (but subject to [Section on Subordination herein]), the Borrower agrees that (a) in the event a payment in respect of any obligation shall be made by any Guarantor under this Agreement, the Borrower shall indemnify such Guarantor for the full amount of such payment and such Guarantor shall be subrogated to the rights of the Person to whom such payment shall have been made to the extent of such payment and (b) in the event any assets of any Grantor shall be sold pursuant to this Agreement or any other Security Document to satisfy in whole or in part an Obligation owed to any Secured Party, the Borrower shall indemnify such Grantor in an amount equal to the greater of the book value or the fair market value of the assets so sold."

(a) When the Guarantor makes a payment on behalf of the Borrower, the Guarantor is subrogated to the rights of the Lender against the Borrower. Subrogation is an equitable remedy and is subject to the common limitations on equitable remedies (e.g., laches). Subrogation can give the Guarantor the same rights as the creditor, including remedies against the collateral.

(b) The Borrower separately agrees to indemnify the Guarantor (which creates in favor of the Guarantor a contractual claim against the Borrower for reimbursement of amounts paid on the guarantee, which claim is in addition to the Guarantor's equitable remedy of subrogation).

(c) The rights of subrogation and indemnification are subordinated to the full and indefeasible payment in full in cash of the Obligations. The intent is to avoid competition for the resources of the Borrower between the

Guarantor and the Lender (until such time as the obligations owed to the Lender are paid in full).

10. Contribution and Subrogation.

"Each Guarantor and Grantor (a "Contributing Party") agrees (subject to [Section on Subordination herein]) that, in the event a payment shall be made by any other Guarantor hereunder in respect of any Obligation or assets of any other Grantor (other than Holdings or the Borrower) shall be sold pursuant to any Security Document to satisfy any Obligation owed to any Secured Party and such other Guarantor or Grantor (the "Claiming Party") shall not have been fully indemnified by the Borrower as provided in [Section on Indemnity and Subrogation herein], the Contributing Party shall indemnify the Claiming Party in an amount equal to the amount of such payment or the greater of the book value or the fair market value of such assets, as the case may be, in each case multiplied by a fraction of which the numerator shall be the net worth of the Contributing Party on the date hereof and the denominator shall be the aggregate net worth of all the Guarantors and Grantors on the date hereof (or, in the case of any Guarantor or Grantor becoming a party hereto pursuant to Section [on Additional Subsidiaries], the date of the supplement hereto executed and delivered by such Guarantor or Grantor). Any Contributing Party making any payment to a Claiming Party pursuant to this Section shall (subject to [Section on Subordination herein]) be subrogated to the rights of such Claiming Party under [Section on Indemnity and Subrogation herein] to the extent of such payment."

(a) If a Guarantor makes a payment on behalf of Borrower and is not reimbursed in full by the Borrower pursuant to such Guarantor's indemnification claim, each other Guarantor is required to contribute its pro rata share of the guarantee payment.

(b) Determination of pro rata share of each initial Guarantor is based on the net worth of such Guarantor on the date of the security agreement.

(c) Determination of pro rata share of each additional Guarantor is based on the net worth of such Guarantor on the date on which it becomes a party to the security agreement.

(d) Contributing Guarantors benefit from subrogation rights against the Borrower.

(e) Contribution rights are subordinated to the full and indefeasible payment in cash of the Obligations.

(f) Contribution rights (together with the indemnification and subrogation rights) are important for making the case that the guarantee (or the grant thereof) does not result in a fraudulent conveyance (on the theory that the Guarantors, taken as a whole, are solvent).

(g) Guarantee payments by the Parent or Holding Company need not benefit from the contribution requirement, given that it is easier to make the argument that the Parent or Holding Company is receiving reasonably equivalent value for its guarantee (as discussed above).

11. Subordination.

"Notwithstanding any provision of this Agreement to the contrary, all rights of the Guarantors and Grantors under [Indemnity, Contribution and Subrogation Sections herein] and all other rights of the Guarantors and Grantors of indemnity, contribution or subrogation under applicable law or otherwise shall be fully subordinated to the indefeasible payment in full in cash of the Obligations. No failure on the part of the Borrower or any Guarantor or Grantor to make the payments required by [Indemnity, Contribution and Subrogation Sections herein] (or any other payments required under applicable law or otherwise) shall in any respect limit the obligations and liabilities of any Guarantor or Grantor with respect to its obligations hereunder, and each Guarantor and Grantor shall remain liable for the full amount of the obligations of such Guarantor or Grantor hereunder. Each Guarantor and Grantor hereby agrees that all Indebtedness and other monetary obligations owed by it to, or to it by, any other Guarantor, Grantor or any other Subsidiary shall be fully subordinated to the indefeasible payment in full in cash of the Obligations."

(a) This provision ensures that the Lenders will be repaid before any Guarantor is repaid for any amount it advanced on its guarantee, even if the Borrower commences a bankruptcy case.