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THE CRISIS EXPOSED BY *PARI PASSU*

*Preston M. Torbert**

To this practitioner, *The Three and a Half Minute Transaction*¹ by Mitu Gulati and Robert E. Scott describes a “crisis” in the Chinese sense of a situation that presents a danger and an opportunity. The danger is that the clients’ demands for lower legal fees, the mechanized contract-production process, and the unwillingness to subsidize research will lead to offshoring of this contract drafting service in the same way that much of the American manufacturing capacity has moved abroad. If the contracts are produced in “three and a half minutes” by rote usage, as the title suggests, and no innovative thinking is going into producing the contracts, it would seem that this task is ripe for outsourcing. In fact, law firms and legal departments are now outsourcing (including offshoring) more and more of their document preparation to legal-process outsourcing firms.² The logic for outsourcing these contracts seems unassailable.³ Perhaps the outsourcing will only start with the most standard documents, and would always involve review by a senior lawyer in the United States. But it could present a tremendous blow to young associates and to the future of this—and every other—contract drafting practice in the United States. How law firms deal with this challenge will depend on how creative and far-sighted they are. Their response is a topic for someone else to study. I would like to consider the opportunity that *The Three and a Half Minute Transaction* presents for legal education.

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1. MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* (forthcoming 2012) (on file with the Hofstra Law Review).

2. See *Law Firms: A Less Gilded Future*, *ECONOMIST*, May 7, 2011, at 74, 74. If some of this outsourcing involves American lawyers in the United States, this would lessen the risk to the American legal profession. Heather Timmons, *Where Lawyers Find Work: Outsourcing Firms Are Welcoming U.S. Talent*, *N.Y. TIMES*, June 3, 2011, at B1.

3. See *Law Firms: A Less Gilded Future*, *supra* note 2, at 74.

If the United States is to prevent the offshoring of substantial amounts of contract drafting, not just sovereign debt bonds, but the entire range of contract drafting, the legal profession needs to seriously upgrade its attention to contract drafting. *The Three and a Half Minute Transaction* makes clear that the “big law” firms are not in a position to do this.⁴ The current income expectations of partners and the demands for lower legal costs from clients mean that, as a whole, the firms will not be willing to make the investments necessary to generate significant innovations to improve contract drafting. That leaves the task to the law schools.

Currently, law schools are not particularly well prepared for this challenge.⁵ They suffer from an overemphasis on policy making, judicial lawmaking, and litigation as the central themes of legal education. Christopher Columbus Langdell’s Socratic method and case analysis, adopted by practically all law schools,⁶ focuses attention not on preparing students to think like practicing lawyers, but to think like law professors. Most practicing lawyers would probably agree that no legal discipline is more essential to practice than contracts—the drafting, negotiation, revision, termination, and analysis of contracts. These topics, beyond the first year contracts course, would seem to be the most important part of the legal curriculum in preparing future lawyers for practice, but they are not. Full-time law faculty members who have never extensively practiced are not comfortable or competent to teach the appropriate courses and the task, if given any recognition, is allocated to part-time adjuncts with low status or to clinical programs that have other goals. Nevertheless, an opportunity exists for those law schools that want to seize it.

The opportunity is to create in the law school a laboratory for creative innovation in contract drafting to fill the void left by the failure of the law firms to do so.⁷ The insights and innovations developed by such a laboratory would improve the quality of contract drafting, make it more intellectually challenging, and help to prevent the offshoring of a product that is currently commoditized. *The Three and Half Minute Transaction* points to one prominent example of this failure in the field

4. GULATI & SCOTT, *supra* note 1 (manuscript at 181-82).

5. See Preston M. Torbert, *Contract Drafting: A Socratic Manifesto*, SCRIBES J. LEGAL WRITING (forthcoming 2012) (manuscript at 7-9) (on file with author). But query whether further cost-cutting will force all outsourcing to be offshoring.

6. Alan A. Stone, *Legal Education on the Couch*, 85 HARV. L. REV. 392, 406 (1971).

7. See GULATI & SCOTT, *supra* note 1 (manuscript at 165, 171) (discussing the barriers to innovation in modern law firms).

of sovereign debt contracts,⁸ but the same is true for much contract drafting.

There would seem to be two essential elements for success in creating such a laboratory: creating a contract drafting program and attracting a few wise men to join with existing faculty to teach the courses. The program could include two courses. One would be a course to teach students about contract drafting from the perspective of the canons of contract interpretation. These canons address what is perhaps the core dilemma of contract drafting and what is arguably the major cause of litigation over contracts—ambiguity.⁹ And the *pari passu* clause¹⁰ is an excellent example of this dilemma. In most of its iterations, the language of the clause is so abstract and general that many different plausible interpretations of it have been made over the last hundred years and more.¹¹ Was the purpose and effect to avoid or prevent earmarking, the imposition of a receivership for a debtor country, haircuts for small banks, involuntary subordination, or existing or future legislation in the debtor country? Each of these interpretations was plausible, if not persuasive, in the historical circumstances in which it was advanced. But this ambiguity has imposed significant costs as noted by Gulati and Scott.¹² If lawyers could better understand the nature of ambiguity and how to deal with it in contract drafting, they should be able to reduce its deleterious effects.

Arguably the first step in that process is to gain an understanding of the canons of contract interpretation that help lawyers and judges to interpret ambiguous language. The immediate task in this regard is to correctly understand Karl Llewellyn's attack on the thrust and parry of the contrasting canons.¹³ His goal was to determine how judges arrived at decisions.¹⁴ His comments were apropos of that goal. But he never considered the implications of the canons for *drafting*, as opposed to *interpreting*, legislation and contracts. That should be the first task of a law school laboratory program on contract drafting.

Consider, for example, one canon—the presumption *contra proferentem*. The presumption is a tie-breaker that says that, other things being equal, an ambiguous provision in a contract will be interpreted

8. See generally *id.*

9. See THOMAS R. HAGGARD & GEORGE W. KUNEY, *LEGAL DRAFTING: PROCESS, TECHNIQUES, AND EXERCISES* 196-97 (2d ed. 2007).

10. GULATI & SCOTT, *supra* note 1 (manuscript at 21).

11. *Id.* (manuscript at 86-91).

12. See, e.g., *id.* (manuscript at 157-58).

13. KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 521-28 (1960).

14. See generally *id.*

against the drafter.¹⁵ In drafting a contract, therefore, it would seem that a drafter should consider preventing the application of this presumption, thus giving to the client the benefit, other things being equal, of an even chance of having the ambiguity interpreted in his or her favor. One would assume, therefore, that the drafting of every contract would start with a consideration of this presumption and whether it would be advisable to insert a provision preventing its application. But in order to do that, the drafter would have to know the answer to such questions as: How strongly or strictly is the presumption construed? Under what conditions? In what types of contracts? Between what types of parties? Against whom—only against the actual drafter or the party that benefits from the ambiguous provision? In a negotiated contract, who is the “drafter”—is it the drafter of the whole contract or the specific provision? What are the applicable precedents in the jurisdiction of the governing law of the contract? Contracts in the EDGAR database¹⁶ suggest that *contra proferentem* clause appears very infrequently. This may be because it was negotiated out, but my experience suggests it is probably to a large degree because practitioners are not well acquainted with it. Gulati and Scott have provided information on the application of some other canons of contract interpretation, such as *expressio unius est exclusio alterius*, and the “whole statute” presumption,¹⁷ but there is no mention of *contra proferentem* or of any effort to prevent its application in relation to sovereign debt instruments. Based on this absence and analogizing from the EDGAR contracts, one might draw the inference that few, if any, of these instruments contain such a clause. Even if one accepts Karl Llewellyn’s argument that the dueling canons cancel each other out in every contract or in every sovereign debt instrument, that still leaves *contra proferentem* as the tie-breaker. Would it not be interesting to know what the implications of *contra proferentem* are—or could be—for *pari passu*?

15. Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1121 (2006).

16. EDGAR Database–SEC Filings, GLOBAL SEC. INFO., <http://learn.westlawbusiness.com/features/edgar-database-sec-filings.html> (last visited Mar. 1, 2012).

17. GULATI & SCOTT, *supra* note 1 (manuscript at 77 n.129, 101). The authors also mention two potentially new canons of contract interpretation for standard form contracts: a presumption that the failure to change a contract means that the existing interpretation is correct and a presumption that a change to a contract means that the prior version was not clear or not on point. *Id.* (manuscript at 97-98). These potential canons could also be included in a law school laboratory program’s research on the canons of contract drafting.

While some articles have been written about this presumption,¹⁸ as far as I am aware, there is no systematic analysis for contract drafters of how this presumption affects contract drafting. The same appears to be the case for the other presumptions as well. It seems that no one has done a systematic study of the implications of these presumptions, not for *interpreting legislation*, but for *drafting contracts*. Yet the vast number of reported cases contain many instances in which courts have referred to these canons,¹⁹ which could be used to understand how courts have applied them and how drafters should draft to exclude them or have them apply. Research by professors and students as part of a course could develop materials systematically analyzing the canons that would be useful not only for the course, but as a laboratory resource for practitioners as well. Such a course would give the students the tools to perform two tasks at a very high level: to know how the contract will be interpreted when one's opponent does not²⁰ and to begin to gauge the risk of ambiguity and associated litigation for specific practices in drafting contracts—an ability contract drafters today generally do not have.²¹

A second course in a laboratory program would give the students the chance to apply what they had learned about the canons to actual contract samples, such as those assembled by the authors or from the EDGAR database of contracts reported to the Securities and Exchange Commission annually. This course would allow the students to consider how the contracts could have been drafted differently and why they were not. The study of the *pari passu* problem would be a good example of contract analysis. Reading materials could inform the students of the developments in the last century and beyond that led lenders to fear earmarking, the imposition of a receivership for a debtor country, haircuts, involuntary subordination, and existing or future legislation in the debtor country and then ask them to consider whether the then-existing *pari passu* provision covered that risk. After analysis of the particular developments and implications for the *pari passu* clause were discussed, *The Three and a Half Minute Transaction* could be used as a

18. See, e.g., Boardman, *supra* note 15; John T. Flynn, *The Rule Contra Proferentem in the Government Contract Interpretation Process*, 11 PUB. CONT. L.J. 379 (1980); David Horton, *Flipping The Script: Contra Proferentem and Standard Form Contracts*, 80 U. COLO. L. REV. 431 (2009).

19. See Horton, *supra* note 18, at 452-56.

20. See GULATI & SCOTT, *supra* note 1 (manuscript at 174-75).

21. *Id.* (manuscript at 181) (“[L]itigation risk, in its various forms, is thus the core competency from which lawyers can derive comparative advantage in designing transactions for their clients.”).

reading to provide students with an overall picture of these developments and their implications.

This second course could be taught by a combination of full-time law faculty, contract practitioners, and litigators. In addition, enrollment by business school students with real-world experience could be encouraged. The combination of students armed with a command of the interpretive presumptions, actual contract samples, and sophisticated practitioners and theorists to discuss the drafting issues would be an interactive collaborative process and a great educational experience. The students could write papers examining how the contracts under review could have been drafted differently. The materials developed in the course and related research could be made available to interested law firms, or published in print, or made available online. Perhaps the laboratory could produce another “poison pill.”²²

This proposal for a law school laboratory program does not address the dilemma of contract stickiness discussed in *The Three and a Half Minute Transaction*.²³ The factors that promote stickiness in the drafting of sovereign debt instruments should also prevent the innovations developed in any law school laboratory course from being implemented in the practice of sovereign debt instruments. That may be true. I am not arguing that the proposed laboratory course can necessarily solve the stickiness issue in sovereign bond instruments. But the issue of the future of contract drafting is much larger than simply the small community of lawyers located mainly in New York and London who draft sovereign debt instruments²⁴—it concerns the everyday work of most lawyers. So even if the laboratory proposal would not change the particular practices in the drafting of sovereign debt instruments, it should have an effect in other fields of contract drafting. And if it does not, is there another better solution to preventing the commoditization and offshoring of contract drafting? If so, the profession needs to hear it.

And beyond the danger of outsourcing, is not the substantial improvement of contract drafting something the academy and the bar should pursue for its own intrinsic merit?

22. *Id.* (manuscript at 164).

23. *Id.* (manuscript at 42-52).

24. *Id.* (manuscript at 71, 72 fig.2, 73 fig.3).