



## CHAPTER 17

### *Overall Contract Structure*

#### **HIGHLIGHTS**

- Lengthy and complex contracts may begin with a cover page, a table of contents, and a definitions section.
- The introductory statement is the first textual paragraph of the contract; the clause refers to the title of the contract, states the date of the agreement, and identifies the contracting parties.
- Recitals are statements of fact regarding the background of the parties or the subject matter of the contract.
- A transitional clause signals the end of the recitals and the beginning of the body of the contract.
- Terms may be defined in the contract when they are first mentioned (embedded within the sentence), or, if there are many defined terms in the contract, the terms may be listed and defined in a separate section of the contract.
- The body of the contract includes terms of the parties' agreement and specifically addresses the details of the contract relationship or the transaction that is the subject matter of the agreement.
- The concluding statement formally ends the substantive provisions of the contract.
- The signature lines are placed at the end of the agreement and may include blank lines for dates if the parties are signing the contract at different times.
- Schedules and exhibits are attached to the contract.





## B. Preface for a Lengthy Contract

An extremely long and complex contract usually includes a cover page and a table of contents. A definitions section is sometimes also inserted after the table of contents. The cover page, a table of contents, and, if used, a definitions section precede the introductory statement of the contract. (Definitions sections are discussed in section G of this chapter.)

### 1. Cover page

A cover page formally introduces the contract by stating the title of the contract. (See Section C of this chapter.) The title is usually typed in large, bold letters and centered in the middle of the page. Oftentimes the title page also includes the name of the contracting parties and the date of the agreement.

### 2. Table of contents

The purpose of a table of contents is to assist the reader in quickly locating specific sections and subsections in a contract. Enumerated headings and subheadings are listed in the table of contents along with the page numbers on which these headings and subheadings appear in the contract. Additionally, all schedules and exhibits attached to the contract are included in the table of contents.



## C. Title of the Contract

If the contract does not have a cover page, the title is centered at the top of the first page of the contract. For emphasis, consider presenting the title in all capital letters, using bold type and a slightly larger font than the substantive text of the contract.

The title should adequately identify the contract. Using “Agreement” or “Contract” as the title is too generic and may lead to confusion later on, especially if the parties have entered into more than one contract. Include words that sufficiently convey the business of the contract. For instance, the example contract between Optex and Ecklander might be titled “Distribution Agreement” or “Distributorship Contract.”



## D. Introductory Statement

The first textual paragraph in a contract is the introductory statement, which formally introduces the name of the contract, gives the date of the contract, and

identifies the parties to the contract. It is not unusual to omit the verb from the introductory statement, thus making it an incomplete sentence. But for improved readability, write the introductory statement as a complete sentence. See Figure 17-1 for an example.

### Sample Distribution Agreement

#### DISTRIBUTION AGREEMENT

This Agreement, is dated as of August 1, 20XX, between Optex, Inc., a Solandia corporation (“Manufacturer”), and Ecklander Distributors, Inc., a Delaware corporation (“Distributor”).

#### BACKGROUND

Manufacturer designs and produces the Product (as defined in Section 1) in Solandia and desires to have the Product promoted, sold, and distributed in the Territory (as defined in Section 1).

Distributor promotes, sells, and distributes merchandise in the Territory, including merchandise similar to those of the Product.

The parties desire to enter into this Agreement for the purpose of granting Distributor the exclusive distributorship of the Product in order to promote, sell, and distribute the Product in the Territory.

Therefore, the parties agree as follows:

Figure 17-1

### 1. Date of the contract

The date of the contract, usually the day on which all the parties sign the document, is stated in the introductory statement. When the date of signing is not known or uncertain, leave the date blank to allow for the parties to fill in the appropriate date.

The words *as of* typically preface the date if the contract will be signed by at least one of the parties after the date of the contract. In this instance, each party should note the date he or she signed the contract in a space provided for this purpose next to that party’s signature line at the end of the contract.

The date of the contract is commonly the date when the agreed terms of the contract take effect. If the parties intend the agreed terms to take effect subsequent to the date of the contract, then a provision that states the effective date of the contract should be included in the body of the contract.

## 2. Identifying the parties

Use the preposition *between* in the introductory statement when referring to the relationship of the contracting parties, even in contracts with more than two contracting parties. Although the phrase *by and between* is often used in the introduction, the words *by and* don't add any legal effect and therefore should be omitted.

Identify the parties by their full legal names and their states or national citizenships. A corporation's citizenship is the place where it is incorporated. If relevant, the state of the corporation's principal place of business or the state where it is doing business can be identified along with its place of incorporation.

Refrain from inserting the parties' addresses in the introductory statement; this is not essential to identifying the parties. If the parties' addresses are necessary to give notice under the contract, then state the addresses in the notice provision in the body of the contract. (See section H of this chapter.)

For conciseness, the parties' names often are shortened when referring to the parties in the contract provisions. Introduce a party's shortened name as a defined term in the introductory statement. After the party has been fully identified, state the shortened name in quotation marks and parentheses. An example of this format is shown in Figure 17-1.

Choosing the shortened name is purely a matter of preference. Using Ecklander Distributors, Inc. as an example, a party's shortened name may be one or two words from the party's proper name ("Ecklander"), the party's initials ("EDI"), or a generic name that succinctly expresses the party's role in the contract ("Distributor"). Be careful, however, in choosing generic names for the parties that are spelled similarly. For instance, the difference between "licensor" and "licensee" is a matter of the *-or* and *-ee* on the endings. If both these names were used to identify the parties in a contract, it would be easy to overlook a typographical error that resulted in the use of *licensor* instead of *licensee*, or vice versa.

The advantage in choosing a generic name over a shortened proper name of a party is that it saves editing time if the contract is used as a model in future deals. The name does not need to be changed throughout the contract to coincide with the new party's proper name. As is the case with any defined term in a contract, refer consistently to the party throughout the contract by the party's defined term. If a generic name is used, ensure that the first letter of the generic name is always capitalized when referring to the party.



## E. Recitals

Recitals are a series of fact statements that set up the circumstances for the agreement. These statements might address the parties' backgrounds, their relationship to each other, or their motives for entering into the contract. Recitals also may state the purpose or the nature of the deal underlying the contract, or identify other documents

or transactions related to the contract. Recitals are not a required section in a U.S. contract, but when they are included, recitals may help resolve a later dispute between the parties over the interpretation of unclear or ambiguous substantive terms in the contract. Therefore, ensure that recitals accurately and concisely reflect the facts being reported.

If recitals are provided in a contract, state the recitals after the introductory statement. Do not state the substantive terms of the agreement in the recitals. All agreed terms of the deal belong in the body of the contract.

The archaic format for presenting recitals in U.S. contracts usually opened with the word *witnesseth*, followed by fact clauses beginning with *whereas*. Because these words have no legal effect, omit them from contracts.<sup>3</sup>

Recitals in modern U.S. contracts may include a heading, entitled either "Recitals" or "Background." Each fact statement may be numbered, though this is optional. See Figure 17-1 for an example of a recitals section.



## F. Transitional Clause

If recitals are used in the contract, a transitional clause is usually included to signal the end of the recitals section and the beginning of the body of the contract. The transitional clause is a simple statement, such as: "The parties agree as follows:"; "Agreed:"; or "Therefore, the parties agree as follows:". An example of a transitional clause is provided in Figure 17-1.



## G. Definitions

Deciding when to use defined terms is discussed in Chapter 18. The method chosen to introduce the defined terms depends on the number of defined terms in the contract and the drafter's preference. In a contract with relatively few defined terms, consider introducing each term in quotation marks and inside parentheses after the word or phrase that is being defined.

Distributor shall promote, advertise, and distribute Rio sunglasses (the "Product") within Canada and the United States of America (the "Territory").

<sup>3</sup>. *Witnesseth* and *whereas* are forms of legalese and thus should not be used in the contract. (Avoiding the use of legalese in a contract is discussed in Chapter 19.)









are located great distances from each other. The separately signed pages may be gathered together and attached to a copy of the contract to form a completely signed document. When contracts are signed in counterpart, a blank date line is included next to the signature line for each party so that the party can insert the date that he or she signed the contract. The date in the introductory statement should reflect an "as of" date because the parties will likely be signing the contract on different dates.



### *I. Concluding Statement*

The concluding statement formally ends the substantive provisions of the contract and transitions to the signature lines. The following is an example of an archaic form of a concluding statement found in U.S. contracts.

IN WITNESS WHEREOF the parties have caused these presents to be signed by their duly authorized officers on the date and year first hereinabove written.

This concluding statement, filled with legalese,<sup>18</sup> should be replaced with a simple statement.

The parties are signing this Agreement as of the date stated in the introductory statement.

If the parties are signing at different times, the concluding statement may merely state: Agreed.



### *J. Signatures*

#### *1. Signature lines*

The format of the signature line varies according to whether the signatory is an individual or a business entity. For an individual, the name of the person (the same name used in the introductory statement) appears under the signature line.

\_\_\_\_\_  
Robert R. Jones

18. Avoiding the use of legalese in a contract is discussed in Chapter 19.

For signatories that are U.S. corporations or limited liability entities, the entity's full name (the same name used in the introductory statement) is inserted as a heading above the signature line. The signature line is prefaced by the word "By:" to signify that the individual signing on behalf of the entity is acting in an official capacity as an agent for the entity. If the name and title of the individual is known, then this information should be typed underneath the signature line; otherwise, leave this information blank so it can be filled in at the time of signing.

#### *Example of a corporation*

Ecklander Corporation

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

A general partner always signs on behalf of a U.S. partnership.

#### *Example of a general partnership*

Ecklander, a general partnership

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
General Partner

For signatories that are U.S. limited partnerships, a slightly different format is used when the general partner is a corporation.

#### *Example of a limited partnership*

Ecklander, a limited partnership

By: Ecklander, Incorporated,  
General Partner

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_



terms between parties to a business deal. And even when the documents include provisions comparable to the agreed terms in the present deal, a lawyer would be wise to use these sample provisions with great caution. Many of these sample provisions may not be drafted as favorably for the client as they could be if the lawyer carefully considered the provision's effect and revised accordingly. For this reason, a lawyer may need to make extensive revisions involving deletions, additions, and rewording to adequately address the unique aspects of the present business deal and to maximize the protection of the client's interest. Equally troubling, form contracts (and sometimes previous contracts) can be poorly written and may not reflect current law applicable to the present business deal.

Ideally, the lawyer should create a contract for the present business deal that she can use as a resource in future deals. The author of a draft is intimately familiar with the provisions because she will have created the contract's organization, weighed all aspects of the provisions, conscientiously chosen the words, carefully structured the sentences, and considered the interaction between the provisions. Using a familiar contract will hasten the drafting process in future projects because the lawyer is knowledgeable about the provisions in the template, which ones were particularly negotiated by the parties in the previous deal and perhaps why other provisions were omitted that may be desirous to include in the present business deal. By applying the skills discussed in the following chapters, a lawyer can draft a contract that is far more clear and precise, and protect the client's interests better than any published form or other model contract.



## CHAPTER 18

### *An Overview of Basic Contract Provisions*

#### HIGHLIGHTS

- The first step in creating a contract is to determine the type of contract provision that will clearly and precisely communicate the parties' intent.
- Parties can use contract provisions to allocate risk, such as in the case of representations, disclaimers, or indemnifications.
- Definitions assign special meaning to words or phrases used in the contract.
- Action statements convey a party's performance that takes place contemporaneously with the parties' signing of the contract.
- Covenants impose an obligation on a party to perform, or to refrain from performing, an action.
- Discretionary powers give a party the option to act or refrain from acting.
- Conditions are possible future occurrences that, if they occur, will either
  - create an obligation, a discretionary power, or a situation; or
  - terminate an obligation, a discretionary power, or an existing situation.
- Representations are statements made by a party regarding present or past facts, or both, to induce another party to enter into a contract.
- Disclaimers repudiate warranties implied by the law governing the contract.
- Exceptions limit a party's obligations or rights created in the contract.
- Procedural statements provide rules or policies governing the contract relationship.



## A. The Importance of Choosing the Right Contract Provision

Provisions that commonly appear in U.S. contracts include action statements, covenants, discretionary powers, conditions, exceptions, representations, disclaimers, and procedural statements. Determining which contract provision best expresses the parties' intent is a primary concern that begins in negotiations and continues through the drafting process.

### 1. Promoting clarity and precision

The parties' intent can be expressed in a variety of ways. For example, let's say that the manufacturer of a product wants the distributor of that product to provide it with a report of the distributor's monthly sales of the product. It is possible to express this point either (1) as a covenant creating an obligation imposed on the *distributor* or (2) as a stated right of the *manufacturer*:

*Example of the point stated as covenant:*

On or before the 15th day of each calendar month, Distributor shall provide Manufacturer with a complete and accurate report of Distributor's sales of the Product during the preceding calendar month.

*Example of the point stated as a right:*

Manufacturer is entitled to receive from Distributor, on or before the 15th day of each calendar month, a complete and accurate report of the Distributor's sales of the Product during the preceding calendar month.

Clarity and precision influence the choice of whether this point should be expressed as a covenant or as a stated right in the contract. The statement imposing an obligation on the distributor by way of a covenant (discussed more fully later in this chapter) infers that the manufacturer receives a right that the distributor will provide a sales report. Similarly, the statement of the manufacturer's right infers that the distributor is obligated to provide a sales report. Either way, it accomplishes the same result. But, because the primary purpose of a contract is to create obligations and because stating the point as a right may lead to unnecessary wordiness, it is more clear and precise to express the point as a covenant.

## 2. Imposing legal remedies

Another consideration in determining the appropriate provision to use in a contract is whether and when a party will be entitled to a legal remedy if the provision is not satisfied. For instance, if a party makes a false representation of fact in the contract, the other party who relied on that representation may be entitled to damages. Similarly, a party's failure to perform a covenant may make that party liable for damages to the party receiving the right. A contract provision often will specify the damages available to the wronged party, such as monetary damages or specific performance. If damages are not specifically made available in the contract, then the law governing the contract may permit a wronged party to recover certain kinds of damages.

Conversely, other provisions do not provide for any right to recover damages. For example, if the agreed point is expressed as a discretionary power, giving the empowered party the choice to act or to not act, the empowered party is not liable for damages for simply making its choice.

## 3. Determining risk allocation

The parties' desire to allocate risk also influences the types of provisions that will be included in a contract. In addition to covenants, one of the primary methods for allocating risk is through a party's representation of past or present fact. A party may make representations to induce another party to enter into the contract.<sup>1</sup> Other contract provisions that allocate risk between the parties include disclaimers of implied warranties, indemnifications, and exceptions. The choice of words or phrases used in a provision also can serve to allocate risk, as discussed in Chapter 19.

No matter how the parties choose to allocate risk, however, they should be mindful of the law governing the contract. Governing law may limit the extent to which, or the manner in which, risks are allocated.



## B. A Note about Definitions

The need for brevity, clarity, and precision in a contract may require that certain words or phrases be defined within the document. Consider providing a defined term for words or lengthy phrases that are used repeatedly in the contract or that are assigned a special meaning in the contract. Providing a defined term ensures consistency in interpretation. And, in the case where a defined term is taking the place of a lengthy phrase, it can also shorten the length of the contract.

1. Representations are more fully discussed later in this chapter.

Two common methods for presenting definitions in a contract are (1) creating a separate section for definitions or (2) embedding a definition in the text of a contract provision. If the contract includes numerous definitions, consider presenting the definitions in a separate section of the contract. Here, the term and its accompanying definition are presented in sentence format. Each definitional sentence is listed alphabetically according to the defined term in the definitions section. Within each definitional sentence, the defined term is the subject of the sentence, followed by the verb *means*, and then the definition or explanation of the term is provided.

"Product" means Rio sunglasses.

"Territory" means Canada and the United States of America.

Be careful to limit the provision to the definition of the term. Never include a point of substantive agreement between the parties in a definition provision. Consider the following sentence.

"Territory" means Canada and the United States of America, *and Distributor shall promote, advertise, and distribute the Product in this area?*

The italicized passage is a substantive point of agreement and should be placed in a separate provision in the contract.

Alternatively, the defined term can be embedded within the text of a contract provision *the first time the word or phrase is used in the contract*. Here, the definition or explanation is followed by the term being defined.

Distributor shall promote, advertise, and distribute Rio sunglasses (the "Product") within Canada and the United States of America (the "Territory").

To ensure that the defined term will be consistently construed, make certain that the defined term is used properly throughout the contract. Thus, in the distribution contract example, always refer to Rio sunglasses as the "Product." To further ensure consistency in interpretation, capitalize the defined term throughout the contract. Word processing programs typically include a Find or Search function, which can be used to locate the term wherever it appears in the document to ensure it is properly capitalized.



### C. Action Statements

Action statements document a party's performance that takes place contemporaneously with the signing of the contract. Action statements are drafted using active voice,<sup>2</sup> and the verb is drafted in the present tense. Thus, in the case of the distribution agreement for sunglasses, the action statement documents the manufacturer's granting to the distributor the right to sell the sunglasses.

Manufacturer hereby grants to Distributor for the period of this Agreement and subject to the provisions of this Agreement the exclusive right to sell and distribute the Product in the Territory.

The adverb *hereby* is used to convey the immediacy of the action, that the act is being accomplished by the execution of the contract.



### D. Covenants

The primary role of a contract is to create obligations by the parties to perform or to refrain from performing certain actions. These obligations are expressed through covenants. To create a covenant, U.S. lawyers commonly use the verb *shall* followed by the base form of the verb describing the action. Although in British English, *shall* is usually reserved for use when framing the sentence in the first person, U.S. English uses *shall* in first, second, and third person sentences. Drafting third person sentences is common in U.S. contract drafting. When used in the context of third person sentences, the definition of *shall* states an obligation or a necessity.

Manufacturer shall assist Distributor in the sale of the Product by providing advertising material.

Some drafters prefer to use the term *must* instead of *shall* to create an obligation, but according to one authority, "/m/ust does not create a duty; it only asserts that a duty exists. By contrast, using *shall* in a contract provision conveys that the duty derives from that provision."<sup>3</sup> Another authority argues that using the word *must* to create a duty "disqualifies the word . . . from being used to create conditions, thus forcing drafters to

2. A sentence is written in active voice when (1) the subject of the sentence refers to the one performing the action of the verb and (2) the verb of the sentence refers to the action taken by the actor. (For a discussion of active voice versus passive voice, as well as examples, see Chapter 20.)

3. Kenneth A. Adams, *A Manual of Style for Contract Drafting* 24 (ABA 2004).







Further, Illinois courts interpreting the state's version of the UCC have found a disclaimer of warranty conspicuous when it was written in larger type and capitalized or when it appeared in boldface type.<sup>21</sup> Therefore, the drafter of the agreement would want to ensure that the disclaimer appeared in a similar fashion in the agreement and included the word *merchantability*.



### I. Exceptions

Contract provisions, such as those creating an obligation, right, discretionary power, condition, or disclaimer, may be limited by one or more exceptions. A simple exception is often expressed in an independent clause, either at the beginning or end of the sentence. If the exception is lengthy, place it after the basic statement of the provision, or if there are a series of exceptions, state the exception in a separate sentence following the provision that is being limited. Placing a lengthy exception or a series of exceptions at the end of the sentence or in a separate sentence promotes readability and understanding. Begin simple exception clauses with the word *except*. Avoid archaic expressions such as "provided, however, . . ." A typical exception removes something from the basic provision. The following example begins with the creation of an obligation within a territory and ends with those areas excepted from the territory.

Distributor shall promote and advertise the Product within the United States of America, except in the States of Alaska and Hawaii.



### J. Procedural Statements

Procedural statements provide rules or policies governing the contract relationship. Ideally, write procedural statements using the active voice, choosing a verb that expresses the intent of the sentence.

The initial term of the contract ends on the first anniversary date of this Agreement.

21. *Bowers Mfg. Co. v. Chicago Mach. Tool Co.*, 117 Ill. App. 3d 226, 234 (1983).

When stating a procedural statement in the passive voice, use the auxiliary verb *is* or *is not* together with the main verb. The doer of the action follows the main verb in a "by the . . ." phrase.

This Agreement is governed by the laws of the State of New York and federal law, as applicable.<sup>22</sup>

#### ● Exercise 18-A

Appendix M is a memo from the chief legal counsel of In-Play Sports, Inc., to you, an associate legal counsel, listing points for a licensing agreement between the corporation and Paulo Pessoa. For each of the points listed (and there are sometimes more than one agreed term listed in each numbered item), identify a contract provision discussed in this chapter that would best reflect the intent of the parties and protect your corporate client's interests. Briefly state the reason(s) for your choice.

#### ● Exercise 18-B

Appendix N is a memo from the senior partner at Bolton & Associates to you, an associate attorney, listing points for an employment agreement between CID Software, Inc., and John E. Young. For each of the points listed (and there are sometimes more than one agreed term listed in each numbered item), identify a contract provision discussed in this chapter that would best reflect the intent of the parties and protect your corporate client's interests. Briefly state the reason(s) for your choice.

22. The example merely shows the appropriate sentence structure for a choice of law statement. Important substantive considerations regarding choice of law, as well as choice of forum, are addressed in Chapter 17.