

LEO STRINE: You may not think you want to be a business lawyer, but think about whether you might want to be an environmental lawyer. Are you going to have to do complex agreements? You are. Actually, a lot of those things, when you sign up, remediate a site, you're going to have to do a thing.

I'm going to do family law. I'm interested in family law. I don't do contracts. Well, you will do contracts, because divorce agreements, separation agreements, child custody agreements all involve contracts. Oh, I'm doing criminal law. Well, what do you think plea agreements are? What do you think sentencing agreements are?

So the reality is, this is one area of the law where you really just can't escape it if you're going to be a lawyer, I think, because people say that criminal-- it just isn't that way. That is, I've seen many people mess up cases on the criminal side of things because they're actually not careful about how they document a sentence or something like that. It matters very much to people, and in every area of civil law.

And so I have often thought there should be a complex agreement. There can be different tracks. But there's a tension that you see in many of your classes. And I think I want to put ABRY in a broader context [INAUDIBLE] so people understand this tension between doing situational justice or equity, and having dependable rules.

And there's always this temptation in the contracting [INAUDIBLE] get to the [? further, ?] that contracting gets at this in a big way, which is, oh, can we really stick Rick with this bargain when he signs something stupid? This couldn't have been what they meant. Or, how do they do that?

And I think the problem with that is-- and especially, then, Lee comes in and says, well, this is what Rick and I really meant. Rick says, no, no, no, we had all these conversations. The written agreement doesn't really reflect what we do. Well, how do you know who's telling the truth?

And one of the things you have when people sign a piece of paper-- and they're presumed to be sentient and capable of bargaining for themselves. We're not talking about a credit card contract or-- there's 47 people on this call. Given your generation, you probably have even more of these than the oldsters, people who literally are not actually young enough to be the people that they're talking about in [? progressive ?] [? ads ?] were the actual parents, or whatever-- is, all those contracts you signed just because you wanted to get a new video game or you wanted to get a new platform.

We're not talking about those adhesion contracts. That's a whole different thing. We're talking about things that are more bespoke, when you buy a home, when you buy-- and certainly when two companies decide to engage in a sales agreement. But there's this tension between, do we hold people to the written word, or do we allow situational equitable principles to come in and have people talk about the overall context?

You've probably heard about parole evidence, the parole without an E. Very confusing in the law to have "parole" with an E and "parol" without an E. But that's a whole [? bar ?] thing, too, you've talked about, which is, to what extent do we want to bring in all this stuff and then have contracts turn on that, or to hold people to the letter?

And what I would say is, I think, in terms of-- the farther you get away from adhesion contracts, the more inequitable it arguably becomes to allow situational equity to come into play. Why? Because you've got to think about the overall benefit-to-cost ratio of contracts.

And you have to also think about how likely it is that judges are always going to get it right about what people are saying about what they said they meant as opposed to reading what they both signed and objectively interpreting it, right? And so if you have too much situational equity, no one can really rely on the written agreement. That means that there's going to be barriers to people arguably doing transactions which could be good for them both. You're going to have excessive litigation costs.

And I would actually say the error rate will go up because judges-- I know some judges, and some of them are friends of mine. And they can see into people's souls like W could see into Putin's. And they're very good about reading everybody.

I don't feel that way. I was taught, in my religious tradition, there's only one thing that knows everything. And it ain't a human being. [CHUCKLES] And it certainly ain't me.

But I do think that I'm better at-- if both Lee and Rick signed an agreement, and they both had lawyers and bargaining power, and no one was making them do it, I do think it gives me a tether to reality to rely on those written words and to be very cautious about bringing in considerations that are more arguable, like oral testimony about what was said or other things.

So let's put it in the context of ABRY as where we come at, students. There's always been this odd relationship, students, between tort law, so-called fraud, the idea that someone made a statement that was false, and with some level or no level of scienter, but that arguably led somebody to enter into a contract.

And in many states, that's a tort. There are some states that treat it as an aspect or an adjunct to contract law. But in most states, I think it's seen as a tort. That stands along a contract, like you see in ABRY, where there are representations of warranties, where people actually put down in writing, in the contract, certain statements about the world.

And the way I look at it-- don't be afraid to ask your professor about things like, what is a representation of warranty? What is a covenant? What is a condition?

I've had people write exams. Rick and I taught together. Lee and I taught together [INAUDIBLE]. They'll write about breach of condition. Well, breach of condition means you should see an OB-GYN very quickly. Get to the hospital. There's no such thing as a breach of a condition.

Now I'll give you [INAUDIBLE] a representation of warranty is basically a statement-- imagine if you're a seller in this ABRY thing. It's a statement about the what you're selling, that the financial statements are accurate, and other things like that. And so it's a representation you make about what? The what you're selling.

The covenants tend to be things like promises by the seller-- we're going to look at the seller side-- to keep the what, as described in the reps and warranties, as same as possible to what it was at signing, between then and closing. So you won't do anything out of the ordinary course of business, trying to run the company basically in the same way so that it will be in the condition at closing that's the same as it was at the time you signed up the contract in the first place. And so you have various covenants of that kind that tend to preserve how it's [INAUDIBLE].

Then what are the conditions? That's when you get to closing, like the measuring rod. In many ways, what you do is, how different can the company be at the time of closing between how it was defined by the reps and warranties at signing? And what is the tolerance of variation where the seller might get to-- that the buyer might get to walk because there's been a change? And so these things work together.

Now what you see in ABRY is this idea that I'm a seller. I don't want-- I have-- imagine a deal where you've got environmental considerations. You've got employee considerations. You've got others. You've probably heard about due diligence.

There are many people in an M&A transaction. Rick and Lee will talk about it. There are many people speaking. There are many questions asked. There are many conversations.

You won't be able to monitor all of them. You will try to. There will be documents changing hands. There will be drafts of documents that have changed hands. There will be iterations of things that are in [? data ?] [INAUDIBLE].

Part of what you're saying, as a seller, is, I don't want to be responsible for everything that's said. I will be responsible for certain things that are foundational to the deal. And so the whole idea of the nonreliance clause [INAUDIBLE] was to avoid having fraud claims-- the ability to get out of a deal over something that you weren't even sure was said.

And the easiest way is to say this. We have 28 reps and warranties. The seller stands behind them and says, I'm representing and warranting this. And if one of those is false-- say, you have a very strong [INAUDIBLE] where if any of those is false-- was false at signing or is not true at closing-- you can walk away. So you get to walk away for any of those reasons.

But you can't get out of the deal over something that's not set forth. You can't argue that Leo said X, and X is not in those reps and warranties. And so what ABRY, at the bottom line, said is, if you have a provision in the contract that says that the buyer acknowledges that the only statements that it's relying upon, the only information in the statements, are the ones in the reps and warranties in the agreement, then that can circumscribe the basis for any future suit, both under the contract and in fraud law, because you're making a promise that you didn't rely on anything, except those 28. And so that deals with this sort of epistemological uncertainty about who's telling the truth, who's doing that.

But then there's the question of, once you've restricted that-- and this was a central issue in ABRY, is, can you limit that? If you put a provision in the contract that for a breach-- assume you close-- this is post close-- so you didn't find out about a falsity until after you close. The contract says that the limitation for any breach of rep and warranty is \$20 million. Can that hold if the buyer alleges you engaged in fraud?

And what I did-- and Matt, I think you may remember, we talked about this. One of Matt's colleagues, who's a friend, is dean. I think he's still-- is he still dean? Gordon?

MATT: Yeah. Yeah, he's still going.

LEO STRINE: Well, if you notice, students, I surveyed the Anglo-American law here. And I took on this limitation thing. I took a more aggressive pro-contractarian view than anybody ever had, because if you look at the restatement, the restatement says you cannot exculpate even reckless misstatements. If it's a reckless misstatement of fact, there cannot be a contractual cap on liability.

I reviewed the law, and I reviewed Delaware public policy. And that's when I came, essentially, to the knowing-- the lie standard, which is that public policy would not allow a cap on liability as to a false statement made with scienter, essentially, the difference between a lie and an innocent misstatement or even a reckless misstatement. And I grounded that in Delaware public policy.

What was funny was, Gordon and my friend Steve Bainbridge, [? Matt-- ?] both friends of mine-- wrote a blog post that Strine had cut back on contractual freedom. And I said to the students, it's interesting how you could cut back on a freedom that never existed, and that you could somehow-- but it also shows law and economics professors are often light on what comes before the ampersand law.

And I said to them, how could I cut back on what never existed? My hair-- I did used to have a hairline. And God cut back on what did exist. But in this case, there was no there there ever. There was no [INAUDIBLE].

But I think what this case is-- and I'll relate it to the statistics that students [INAUDIBLE], it's the balance being struck between integrity, the need for some basic rules of integrity, and the reliability of the written word. And what it comes down to is that you can define the basis for what you can get sued for in fraud so that you know, if you look at the-- if you've got it on all the boxes, that all the fraudulent misstatements are listed in the boxes. That's what you can rely upon.

If any of them are false but not because of a lie, but just because they're false, you can cap the liabilities then, if you are the seller, so that you can allocate responsibility, essentially, for errors in judgment, errors in speech, in those things, and cap that to a monetary amount. But what public policy prohibits is capping responsibility for that confined group of statements in the contract for misstatements of fact that cause harm and that people rely upon and that were, in fact, lies.

And so if you think-- I think about the evolution of architecture this century. Part of what you're dealing with, Matt, I think, was, originally, it wasn't really sure what the nonreliance clause-- how reliable that was [INAUDIBLE]. So students, from the first instance, it wasn't really sure that you could even confine the statements on which people could sue. People got more comfortable with that.

But there were instances, like ABRY itself, that showed that the caps were not necessarily inadequate. They were efficient but with an exception. The fraud exception, then-- again, it's very important to look at choice of law, students, and choice of forum in these things.

And I also wrote some decisions. One of the things that this is important about is the choice of law, and cohering the fraud choice of law with the contract choice of law, because I would tell [INAUDIBLE] that was not always the case. Do you know what I mean? And you could have a separate tort with a different state.

Fraud is also not a self-defining term. It comes to mind with a scienter basis, and that's right. That's the original. When you think about fraud, you are kind of going, somebody defrauded me. You're thinking about a lie.

But over time, there's been much more expansion of the concept of misrepresentation to cover things like negligent misrepresentation, so-called equitable fraud, which is essentially a statement by a fiduciary. And so I think part of this fraud exception also came with [INAUDIBLE] defined the state of mind of the statement more precisely.

And then, students, there's also this emergence of an insurance product here. And I don't know. Rick and Lee and your professors would know a lot more about this than me. But insurance products were being developed to essentially insure against the risk of misstatements, but I think primarily designed to cover the indemnity bucket, those statements that were really within the basket of, say, 20-- whatever the basket level was, and not get into a fight about fraud.

And so I think what's developed is to have a strong nonreliance clause that you can insist on if you're a seller, an indemnity basket for non-scienter-based breaches of reps and warranties that are found out, but with a fraud exception, with a scienter definition that allows for recovery if you can prove, essentially, an intentional misstatement that caused harm. That's at least my sense.

And what happens, students-- and it bothers Rick and Lee and I a lot-- is, once something becomes market, it's hard to argue against unless you have a lot of leverage or a patient client. A lot of times, clients aren't willing to exercise their leverage, because CEOs get in what we call deal heat. They really want to close. And one of the roles of the lawyer here is to use the contract to protect them against risk. But that requires them to exercise patience and to exert leverage.

And if they're told-- if you have to honestly tell them-- like, if Lee tells the CEO [INAUDIBLE] I keep asking-- well, Lee, is what they're asking for market? Is this pretty standard? And Lee has to say, yes, but it's not in our interest, and you have leverage, and you can get better than market. Well, I might say, well, if it's market-- if they're just asking for market, I want to get this deal done.

And so it's often as much a thing on your own side of the table. And so we're not urging you. We urge you to represent your client situationally, to use your leverage. If anybody ever says to you, I've never given a deal-- I've never done that in my career, say, who cares what you've done? You've never represented a client with so little leverage. And if your client doesn't want to do the deal, that's fine. But I don't really want to hear about your history, or who turned you down to the prom in high school, or whatever your inadequacies you're bringing to the table. We're negotiating this deal.

But as a matter of reality, so-called market [INAUDIBLE], it does provide a kind of-- there's a kind of presumption in its favor. And given business people's impatience, it often plays more of a role than it should. And here's another dirty little secret. Students, a lot of times, the price is struck, and then you work backwards through this stuff, which makes that even more difficult.

So that's some context. I'm happy, [? students. ?] But I wanted to give it-- just keep in mind that basic tension between the reliability of the written word and situational equity. And just realize that when human beings do situational equity based on after-the-fact oral testimony about oral statements, there's actually the risk that they're buying the wrong story, and that they're actually relieving a party that knew what it was doing, in writing, of the bargain it made, because the court is subject to error too. It's not easy to tell, necessarily, who's telling the truth.

Bargaining is bargaining, and so there'll often be ambiguous parol evidence, because that's what haggling is about. And I think Lee and Rick will also tell you that when you bargain against market, what people will also do is try to, to be honest, create ambiguity when they have a weak position, which is, introduce something in the contract [INAUDIBLE] that may not be clear your way but opens the door to a litigable issue, to give you some leverage to get a better settlement, or open the door to parol evidence. And so there's that sort of tactical thing as well that comes in. And that's just the real world, and it's part of the art of the lawyer.