

CONSEQUENTIAL DAMAGES CLAUSES: ALIEN VOMIT OR INTELLIGENT DESIGN?

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PROLOGUE

Hadley v. Baxendale, 9 Exch. 341 (1854), is an old British case commonly taught in first-year contracts classes.¹ The case sets out a limitation on recoverable damages and introduces students to the concept of default rules and bargains around them.² Defaults provide a serviceable off-the-rack option, but sophisticated parties in commercial transactions will contract around the default because they want to capture precisely the risks and rewards of their transaction.

One year, one of us who teaches contract law put up an example from a recent merger transaction of a damages waiver clause to illustrate how parties bargain around the Hadley default. The goal was to show students how much more nuanced parties preferred their consequential damages provision to be than the simple Hadley default.

The clause was:

NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THIS AGREEMENT, NEITHER THE BUYER, THE SELLER NOR THEIR RESPECTIVE AFFILIATES SHALL BE LIABLE HEREUNDER TO ANY INDEMNIFIED PARTY FOR ANY (I) PUNITIVE OR EXEMPLARY DAMAGES OR (II) LOST PROFITS OR CONSEQUENTIAL, SPECIAL OR INDIRECT DAMAGES EXCEPT, IN THE CASE OF THIS CLAUSE (II), TO THE EXTENT SUCH LOST PROFITS OR DAMAGES ARE (X) NOT BASED ON ANY SPECIAL CIRCUMSTANCES OF THE PARTY ENTITLED TO INDEMNIFICATION (IT BEING UNDERSTOOD AND AGREED THAT NOTHING RELATING TO THE NEW COMMERCIAL

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1. *E.g.*, ROBERT E. SCOTT & JODY P. KRAUS, CONTRACT LAW AND THEORY 30 (6th ed. 2023).

2. *Id.*

AGREEMENTS, INCLUDING THE ENTRY INTO SUCH AGREEMENTS BY THE PARTIES THERETO SHALL CONSTITUTE SPECIAL CIRCUMSTANCES HEREUNDER) AND (Y) THE NATURAL, PROBABLE AND REASONABLY FORESEEABLE RESULT OF THE EVENT THAT GAVE RISE THERETO OR THE MATTER FOR WHICH INDEMNIFICATION IS SOUGHT HEREUNDER, REGARDLESS OF THE FORM OF ACTION THROUGH WHICH SUCH DAMAGES ARE SOUGHT, EXCEPT IN EACH CASE OF THE FOREGOING CLAUSES (I) AND (II), TO THE EXTENT ANY SUCH LOST PROFITS OR DAMAGES ARE INCLUDED IN ANY ACTION BY A THIRD PARTY AGAINST SUCH INDEMNIFIED PARTY FOR WHICH IT IS ENTITLED TO INDEMNIFICATION UNDER THIS AGREEMENT.

After a short pause, one of the 1Ls raised their hand and stated: “This is hard to read.” Given the laughter that ensued, this student might as well have said: “This is gibberish.” And that is what we thought.³ More important, it got us thinking: What fraction of the clauses out there were misdrafted? Maybe some of these clauses were not the product of an optimal bargaining process as is often assumed in contract theory.⁴

3. As Glenn West shows in his response piece, this clause is not in fact gibberish. While horribly written, the clause mostly works. See Glenn D. West, *Another Consequential Damages Redux: A Response to “Consequential Damages Clauses: Alien Vomit or Intelligent Design?”*, 102 WASH. U. L. REV. (forthcoming 2024).

4. See Robert E. Scott, Stephen J. Choi & Mitu Gulati, *Contractual Landmines*, 41 YALE J. REG. 307 (2024) (articulating the optimal bargain view and its inconsistency, in some areas of practice, with empirical realities).

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INTRODUCTION

A standard provision in many business contracts is one that excludes certain kinds of losses from recovery in the event of breach. This clause, referred to by many practitioners as a “consequential damages” provision, because it often excludes “consequential damages” from recovery, generally also excludes other categories of damages, such as “special,” “exemplary,” “punitive,” and “indirect.” (We henceforth refer to these as “Excluded Losses” or “EL” provisions.) From an optimal contract design perspective, the foregoing makes sense. Parties who are unsatisfied with the background default rule, usually deriving from *Hadley v. Baxendale*, will rationally seek to contract around it.⁵

But some practitioners have questioned this account of the EL provision, particularly in the M&A context.⁶ They have suggested that the EL provisions used in practice are sometimes far from the theoretical ideal and

5. See Richard A. Epstein, *Beyond Foreseeability: Consequential Damages in the Law of Contract*, 18 J. LEGAL STUD. 105 (1989).

6. See Glenn D. West & Sara G. Duran, *Reassessing the “Consequences” of Consequential Damage Waivers in Acquisition Agreements*, 63 BUS. LAW. 777 (2008).

instead are unnecessary and befuddling. One eminent practitioner has described some versions of these clauses as akin to “alien vomit.”⁷

Conventional contract theory takes an optimal design perspective, under which all clauses in contracts between sophisticated commercial parties are optimal for their deal.⁸ Hence, it is interesting when multiple practitioners, in an area such as M&A, say otherwise. Our article seeks to investigate this dichotomy between the alien vomit view and the intelligent design one.

With the caveat that the actual articulation of what we call the “alien vomit” and “intelligent design” views have more nuance than we have given them, we use these opposing accounts of EL provisions as our frame. We cannot tell whether any given provision is optimal for a particular deal without knowing more about the deal itself. However, we can, using the writings of senior practitioners, tell whether the EL clauses in question use terms that are likely antithetical to the goals of a given deal (e.g., because the terms are ones whose meaning is unclear to courts themselves).

To do our comparison, we first constructed a measure of a “bad” EL provision. This measure allows us to examine how the drafting of these provisions has evolved over a thirteen-year period. We supplemented the quantitative findings with over eighty-five interviews of practicing lawyers.

What we found fits somewhere in between the two stylized stories we set out at the start. In the early part of our data, we do find many clauses with problematic provisions. But then, around about the midpoint of our study period, around 2015–16, drafting improves. That is, we have a shift along the alien vomit/intelligent design continuum that moves us more in the intelligent design direction. Interviews with lawyers help unpack how and why this shift occurred. The documentation of the shift and the explanations for how it happened are the contributions of this article.⁹

Part I sets out the theoretical background. Part II outlines the empirical questions raised by the theory. Part III reports on our data. Part IV boils down our findings. Part V concludes.

I. OPTIMAL DESIGN V. ALIEN VOMIT

The writings of M&A guru Glenn West introduced us to the phenomenon of badly drafted EL clauses. Certain problematic concepts, he conjectured,

7. Glenn West equates EL clauses to “brainless” sea squirts that can invade and destroy native shellfish beds, and which have been described by locals as “blob-like and yellowish-cream in color”—therefore looking very much like “alien vomit.” See Glenn D. West, *Do You Really Know What “Consequential Damages” Means?*, WEIL: GLOB. PRIV. EQUITY WATCH (May 18, 2020), <https://privateequity.weil.com/features/do-you-really-know-what-consequential-damages-means/> [https://perma.cc/BZ7V-N8KZ].

8. Scott et al., *supra* note 4.

9. This contribution is enhanced immensely by the comment on our piece by the practitioner, Glenn West, whose writings got us interested in this topic. See West, *supra* note 3.

might have migrated into M&A EL clauses from construction and supply contracts.¹⁰ To the extent transactional lawyers initially inserting these concepts thought that they were doing something useful for their clients, they were, as West puts it, “slaying mythical dragons.”¹¹ Worse, many of these clauses were poorly crafted, excluding an overindulgent list of unclear and undefined types of damages from potential recovery (“special,” “indirect,” “consequential,” “incidental,” and so on).¹²

Other senior lawyers have also expressed frustration with the drafting of these clauses, a list too long to reproduce here.¹³ A choice quote is from Roy Anderson, who wrote that “the most common way parties learn what consequential damages actually means is the same way ‘road bugs learn about MACK trucks.’”¹⁴

Courts have bemoaned them as well. Delaware judge Leo Strine described a version of the clause that showed up before him in a case as a “laundry list of precluded damages [that] might have been put in the Merger Agreement by lawyers who themselves were unclear on what those terms mean.”¹⁵

A caveat is in order. We do not read any of the commentators to say that writing provisions to exclude certain losses, beyond what are excluded by the common law default, is never warranted. Even in the M&A context, where there is a full-price purchase, one can construct scenarios where some constraints that go beyond the state-provided default rule might be appropriate. The point, as we read West and other gurus, is that a substantial

10. See Glenn D. West, *Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic “Excluded Losses” Provision in Private Company Acquisition Agreements*, 70 BUS. LAW. 971, 984 (2015).

11. Glenn D. West, *Excluded Loss Provisions and the Danger of Contractually Slaying Mythical Dragons*, WEIL: GLOB. PRIV. EQUITY WATCH (Dec. 13, 2021), <https://privateequity.weil.com/glenn-west-musings/excluded-loss-provisions-and-the-danger-of-contractually-slaying-mythical-dragons/> [https://perma.cc/7F7L-TBFG].

12. *Id.*

13. E.g., Timothy Murray, *Drafting Exclusion of Consequential Damages Clauses*, LEXISNEXIS (Dec. 19, 2018), <https://www.lexisnexis.com/community/insights/legal/practical-guidance-journal/b/pa/posts/drafting-exclusion-of-consequential-damages-clauses?srsId=AfmBOop-6rqZg2OAaQ7hWrN5v4sjOWwGQ2AJ4gZCC82-lq4qMUKGWwU9> [https://perma.cc/JP7U-UZQ7]; Eduardo Gallardo, *Avoiding Unintended Consequences of Damage Waiver Provisions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 26, 2012), <https://corpgov.law.harvard.edu/2012/07/26/avoiding-unintended-consequences-of-damage-waiver-provisions/> [https://perma.cc/X4B6-D5H9]; *Avoiding Unintended Consequences of Damage Waiver Provisions in M&A Agreements*, GIBSON DUNN (July 10, 2012), <https://www.gibsondunn.com/avoiding-unintended-consequences-of-damage-waiver-provisions-in-ma-agreements/> [https://perma.cc/6T33-KZDA]; John F. Clifford, Charlotte Conlin & Graham Bevans, *The Uncertain Consequences of Waiving Consequential Damages*, 63 CANADIAN BUS. L.J. 178 (2020); David Leinwand, *Considering the Consequential Damages Waiver*, MERGERS & ACQUISITIONS & CORP. GOVERNANCE, Oct. 2011, at 6.

14. Roy Ryden Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327, 353 (1987).

15. *Pharm. Prod. Dev., Inc. v. TVM Life Sci. Ventures VI, L.P.*, No. C.A. 5688, 2011 WL 549163, at *7 (Del. Ch. Feb. 16, 2011).

number of the EL provisions being used in practice may have been suboptimal. But in the wake of and perhaps because of substantial efforts by senior practitioners to educate their colleagues, we find widespread reform of the clauses in more recent deals.

II. PROJECTING THEORY INTO PRACTICE

To reiterate, we cannot rule out the possibility that some parties optimally contract out of the background default, which in most common law jurisdictions will be some version of the *Hadley v. Baxendale* rule. But we can tell the extent to which some clauses contain language that practitioners tell us is useless or harmful to those using them. We can also identify whether, after exhortations by the practitioners, there is a change in drafting practices.

Helpfully, practitioner articles lay out what aspects of an EL provision are problematic for the buy side of an M&A transaction and what words in the typical clauses are unnecessary verbiage. Drawing from two pieces, West and Duran in 2008 and West in 2015 (both in the *Business Lawyer*), and assorted blog posts by West, we lay these out below.¹⁶ In the data section that follows, we report the degree to which clauses contain these various problematic aspects.

The way the clauses are laid out in the typical contract is that there is first a broad definition of “Losses” that may be recovered in the event of breach. Then, there is a clause (often titled “Limitation on Losses” or “No Consequential Damages”) that limits these losses by excluding the recovery of certain types of losses. We describe these potentially problematic excluded losses below.

A. Ambiguous Exclusions

Each of the exclusions noted below presents a risk to both sides in the transaction (e.g., buyer and seller) because the term will be unclear to the courts, meaning that these sophisticated business transactors who think they are getting certainty out of the contract drafted by their lawyers do not actually get that. The terms West lists as ambiguous are as follows:

Consequential damages: The case law demonstrating that courts are unsure of what this term means goes back at least a half-century.¹⁷ In an optimal design world, one might expect that parties would define it with specificity. Almost no one does. West suggests that many

16. *Supra* notes 6–7, 10–11.

17. West, *supra* note 10, at 987.

drafting lawyers think that the term refers to speculative and remote damages.¹⁸ Not only is that not clearly the meaning of the term, but speculative and remote damages are not recoverable anyway.

Indirect damages: West and Duran explain that “many deal professionals and their counsel [exclude indirect damages] because they believe, wrongly, that the term ‘indirect damages’ . . . is simply a synonym for ‘consequential damages’” (a term that is itself unclear).¹⁹ But the concept of “indirect” versus “direct” damages muddies the waters further because it potentially adds the question of causality to the mix of what damages can be recovered.²⁰

Special damages: It is unclear what “special” means, but West says “special damages” are generally treated as a synonym for the similarly ambiguous “consequential damages.”²¹ Special is certainly not normal or ordinary.²²

Incidental damages: The term incidental can mean almost anything, including a range of damages that could be very direct, such as the costs incurred by a non-breaching party to mitigate damages.²³

B. Deadly Exclusions

Ambiguous terms are suboptimal because they present risks that clear writing would avoid. More concerning to the gurus of the field, particularly M&A, are provisions that articulate a meaning inconsistent with what the parties (or at least one party) intended. As Leigh Walton of Bass Berry explains in an ABA training video, there are often, in EL provisions, exclusions that “effectively gut the entire benefit of the indemnification provision with respect to any losses arising from a breach of the bargained-for representations and warranties.”²⁴ These contract-undermining terms are:

Declines in Value/Diminution in Value: These are broad terms that exclude recovery for all diminution in value that occurs as a result of the damage that was caused—one is essentially saying no damages are recoverable. That might make sense for a FedEx package where

18. *Id.*

19. West & Duran, *supra* note 6, at 793.

20. West, *supra* note 10, at 993–94.

21. West, *supra* note 11.

22. *Id.*

23. West & Duran, *supra* note 6, at 789; West, *supra* note 10, at 975 n.22.

24. Hotshot, Indemnifiable Losses: Drafting, AM. BAR ASS’N: BUS. L. SECTION (Dec. 1, 2023), <https://businesslawtoday.org/hotshot/indemnifiable-losses-drafting/> [https://perma.cc/U5A8-LFXE].

FedEx does not, for the delivery fee of a few hundred dollars for some documents that need to be delivered on time, take on the risk that a \$2 billion transaction would be undermined if delivery was late. But for a \$2 billion acquisition of a company, it is a different matter. The buyer would want to recoup the declines in value that occur if the representations made by the seller of that company turned out to be inaccurate.²⁵

Business Interruption: If the reason for a business interruption is that the seller has misrepresented something along the lines of having obtained all the necessary regulatory approvals, then the damages caused by that interruption could result in substantial losses to the business. But if a provision saying that no recovery for “business interruption” is in the EL clause, it destroys the usual expectation that a buyer should be able to recover these types of losses (akin to limitations for recovery for “decline in value” or “diminution in value”).

Lost Profits: To the extent the reason a company is being purchased is the profits the deal is expected to generate, the exclusion of lost profits can amount to excluding recovery for the thing that is being purchased not being that thing. This is a far cry from a situation where, for example, one company is providing IT services to another at some market rate and there is a system glitch that causes a full-scale shutdown for the company receiving the services. And, on a contract for a few hundred thousand dollars, they sue for their lost profits in the tens of millions. In this latter context, one can see the need for a provision excluding “lost profits” from the recovery basket. Less so in the former.

Multiples of Earnings: This term may seem innocuous and mostly has relevance in the M&A context. However, once one understands that what the buyer in an M&A transaction is likely paying for is an enterprise that generates future profits and that the purchase price was likely some multiple of earnings (because of the earnings expected to accrue in the future), the term is no longer innocuous.²⁶ It is at the core of what was purchased. If the purchase price was determined based upon a multiple of earnings, as is often the case, its exclusion may impact the most basic measure of normal damages for breach of

25. West & Duran, *supra* note 6, at 806.

26. West, *supra* note 10, at 996.

a representation and warranty—the difference between the purchased business as represented and the purchased business as delivered.

C. *Redundant Exclusions*

This is the least problematic category in that redundant words will mostly be harmless to either side. But as clauses become clogged up with additional words, they become more difficult to read and understand. Drawing from the practitioners again, here is a set of redundant words:

Punitive damages: As a general rule, one cannot recover punitive damages as a contract remedy. To the extent the focus is on limiting damages as a matter of contract law, there is no reason to exclude them.²⁷

Exemplary damages: This term is just another word that means punitive. No need, therefore, to include it.²⁸

Treble damages: The exclusion of recovery for “treble damages” seems to be a reference to punitive damages as well. But, again, one generally cannot recover these as a matter of contract damages. So, there is no reason to exclude them.²⁹

We have received some pushback on whether what we call “redundant” exclusions are in fact redundant, but we take no position on whether any of the foregoing exclusions are good or bad contracting. The goal is to use the fact that eminent practitioners expressed concern about these drafting practices in 2015–16 and engaged in an effort to induce change to examine whether and how change occurred. If change occurred in the direction the practitioners were urging, other things equal, that suggests the clauses did need improvement. Conversely, if there was no change, or change in a

27. West & Duran, *supra* note 6, at 779. To the extent, however, there might be tort or statutory sources of punitive damages that courts in some states allow parties to contract out of, this exclusion makes sense. See Glenn D. West, *Contracting to Avoid Tort-Based Punitive Damages Awards*, WEIL: GLOB. PRIV. EQUITY WATCH (Feb. 20, 2019), <https://privateequity.weil.com/glenn-west-musings/contracting-to-avoid-tort-based-punitive-damages-awards/> [<https://perma.cc/ZM7E-4E9S>]. A couple of our respondents pushed back on the exclusion of punitive damages being redundant as a matter of contract damages themselves. One M&A guru described the scenario where the buyer purchases a company that has represented that it has no unresolved legal or regulatory proceedings against it. But, after purchase, it discovers that there are such proceedings and the company that was just bought owes punitive or statutory damages to the government or some other party. Buyers would surely want these paid by the seller. And an exclusion for all punitive damages might be argued to bar this. Zoom Interview with Guru #23, Transactional Att’y (Mar. 20, 2024). However, many EL provisions that explicitly exclude punitive damages nonetheless permit their recovery to the extent that the buyer must pay those to a third party. The clause we start the article with operates this way. See also West, *supra* note 10, at 974 n.17 (making the third-party point).

28. West & Duran, *supra* note 6, at 779.

29. *Id.*

direction other than was urged, that suggests either that the market was comfortable with its drafting practices or that the efforts to communicate by the eminent practitioners failed. As we will see, change did occur in the direction urged by the gurus.

In the next section, we compare the evolution of the use of the foregoing exclusions over time between deals in the Private M&A category and that of Commercial Agreements. Our interest is in the effect of the network of senior practitioners urging change in M&A deals around 2015–16. But the data on Commercial Agreements provides a baseline comparison as we have no indication that practitioners were also urging change in Commercial Agreements.

III. DATA

Below, we describe the data on EL provisions from over a thirteen-year period, 2010 to 2023. In reporting the data, we construct a measure of the extent to which this clause contains landmines—particularly in the form of ambiguous and deadly exclusions. We also look at the use of redundant terms that clutter the document but are harmless. The goal is to see the prevalence, over time, of these landmines in two different areas: Private M&A deals and Commercial Agreements.

The category of Private M&A deals encompasses mergers and acquisitions filed with the Securities and Exchange Commission because they constitute “material” contracts that a publicly traded company with SEC disclosure obligations has entered into. They are categorized as “Private” because at least one of the companies involved is not public. This contrasts with Public M&A deals, where both companies are public. Unreported, we also collected data on over three hundred Public M&A deals for our dataset. EL clauses have little relevance in these deals since the representations and warranties being made typically expire at closing. A small fraction (under 10%) of these deals did nevertheless contain an EL provision.

The category of Commercial Agreements that we use as our comparison set for the Private M&A EL provisions comprises a wide range of non-M&A “material” contracts that public companies file with the SEC. This category includes things like supply agreements, consulting agreements, research collaboration agreements, and more. For our purposes, what is essential is that this is a category of important contracts that companies enter into which don’t readily fit into a practice area that has anywhere close to a

set of standardized forms such as those available in M&A.³⁰ Also, because these are not established practice areas on the scale of M&A, we assume that they also do not have established industry associations and education settings with regular meetings on the scale that the M&A world does. In sociological terms, the ties among lawyers are likely thinner.

The contracts are a random draw of roughly forty-five Commercial Agreements and thirty Private M&A contracts from the SEC filings each year between 2010 and 2023. For 2023, the year during which we collected our data, we stopped collection roughly at the midpoint of the year. The goal was to get a rough measure of the extent of the landmine phenomenon for each of these different categories.

Before proceeding to our findings, we note that the picture we see from our data is potentially biased. The bias comes from two directions. First, because these are “material” (i.e., important) contracts that public companies file, the data has a bias toward big contracts. We can say nothing about small and private transactions. Our guess is that the types of provisions used in those small deals are going to be even more problematic than the provisions we have seen. Second, we miss out on big transactions. Most common acquisitions by giant companies such as Apple, Cisco, or Microsoft are not going to be viewed as material (as they execute hundreds of those a year, usually “in the ordinary course of business”), so we do not get to see the contracts for these deals. And these deals are probably the best lawyered, with the most sophisticated provisions. Thus, our sample falls between small and private transactions and the “ordinary course” of very large companies.³¹

Table 1 reports on the incidence of an EL clause in our Private M&A and Commercial Agreement samples. Note that well over a majority of contracts in both contexts contain an EL clause. In the case of Private M&A, over 90% of our sample contracts contain an EL clause.

30. This is not to say that there are not standard form “supply agreements” or “research collaboration agreements.” The point is that these practice areas are smaller, with smaller numbers of deals than M&A. And that means that standard templates are going to be fewer.

31. Our data has the same bias as the ABA’s Deal Points Study, which has reported on trends in key provisions in the M&A world since 2006. See *Mergers & Acquisitions Deal Points*, AM. BAR. ASS’N: BUS. L. SECTION, https://www.americanbar.org/groups/business_law/about/committees/mergers-and-acquisitions/deal-points/ [<https://perma.cc/8EEN-HYVE>]. For a more detailed discussion of the biases, see Webcast, *This is It! M&A Nuggets*, DEALLAWYERS.COM (Nov. 17, 2016) (discussion among M&A gurus Wilson Chu, Joel Greenberg, and Rick Climan) (transcript on file with authors).

TABLE 1. SUMMARY STATISTICS ON EL CLAUSE FREQUENCY

	Number of Contracts	Percent of Contracts with an EL clause
Private M&A	423	90.3%
Commercial Agreement	627	79.4%
Total	1050	83.8%

As we will see from the interviews we report later, some lawyers perceive these provisions to be routine boilerplate that every contract contains. The gurus of M&A, however, think they are sometimes unneeded (in the M&A context), and can occasionally be dangerous. Table 1 tells us that the overall picture is that in both the Private M&A and Commercial Agreement contexts, EL clauses are prevalent.

Figure 1 reports the percentage of contracts containing an EL provision for our sample of Private M&A and Commercial Agreements over time, with a red line at 2015. We use 2015 as a rough marker because it is roughly the time that industry participants started paying closer attention to their EL clauses than before. Below, we describe what we heard from many eminent respondents that caused us to focus on whether there had been change in the post-2015 period.

A. Why 2015?

The year prior, in 2014, an important case, *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.*, came down, illustrating how difficult judges were finding EL provisions to interpret.³² It is also around that time that there

32. See *Biotronik A.G. v. Conor Medsystems Ir., Ltd.*, 11 N.E.3d 676, 680 (N.Y. 2014) (categorizing lost profits as general damages). The case received considerable attention from law firms, many of whom issued client memos about the case and its implications for contract drafting. See, e.g., Elisabeth A. Edmonson & Jenna E. Ross, *Lost Profit Damages Three Years After 'Biotronik'*, N.Y.L.J., Aug. 16, 2017; Michael Hefter, Ryan M. Philip & Matt Ducharme, *Direct vs. Consequential Lost Profits: Checking in Five Years After 'Biotronik'*, MONDAQ (Apr. 16, 2019), <https://www.mondaq.com/unitedstates/contracts-and-commercial-law/799156/direct-vs-consequential-lost-profits-checking-in-five-years-after-biotronik> [<https://perma.cc/QGR4-8CUP>].

were multiple articles and M&A industry meetings discussing the need to fix these clauses.³³ As one M&A guru described it:

If you go back a couple of decades, you would see a lot of practitioners . . . kind of mindlessly including exclusions for consequential damages, lost profits, diminution of value. . . . Now I think it's shifted dramatically . . . It was in a short period of time and I think, quite honestly, a combination of people talking about it a lot at CLE programs, Glenn's *Business Lawyer* articles. A lot of people see those things.³⁴

The guru continued:

I was certainly one of [the attorneys] who kept raising the issue at CLE presentations and the like . . . we were doing an annual program for the University of Texas, . . . for the American Bar Association. . . . I had this tendency to refer to Glenn's [2015] article a lot when I did that. There are also these meetings at Tulane and Northwestern and Rick [Climan] does an annual presentation.³⁵

As explained to us, information about how to better negotiate the clause was not only spread at CLEs, conferences, and ABA meetings, but was also transferred during the contract negotiation process. The gurus ran seminars and mock negotiations for lawyers and circulated sample "best practices" clauses. When one of the lawyers used what they had learned in an actual negotiation, it forced the lawyer on the other side to learn too. And so on and so forth.

In response to our asking about changes in drafting practices that may have occurred, a head of the M&A practice at a big firm recalled:

The two Glenn West articles were key. There was a short one in 2015, and a longer one some years prior, I think. I began using the shorter 2015 piece when I came up against someone who didn't understand these damage clauses. People were using these complicated word salad clauses when all you needed was to say "no damages that are unforeseeable." I would send them Glenn's article, if the negotiations stalled.³⁶

33. We have been told in our interviews of two such events that may have moved the needle further in terms of drafting practices: Glenn West's 2015 *Business Lawyer* article and a 2016 ABA Webcast of a discussion among three eminent M&A deal practitioners, Wilson Chu, Rick Climan and Joel Greenberg.

34. Zoom Interview with Guru #7, Litigator (Jan. 10, 2024).

35. Zoom Interview with Guru #7, Litigator (Apr. 2, 2024).

36. In-person Interview with Guru #29, Transactional Att'y (Apr. 10, 2024).

Another head illustrated the transmission of information with an amusing story: “Once, when someone was negotiating against Duran (West’s co-author on the 2008 article) and the [EL] clause came up, they sent her the article to help her understand. And then they realized that they had sent Duran her own article.”³⁷

Another guru took pains to explain to us that there were multiple industry research efforts done with the goal of improving drafting practices, some of which were tailored to segments of the M&A world that might have been skeptical of West’s views because of his practice perspective. This guru noted that West’s 2015 criticism of the continued failure of many M&A transactions to correct overexpansive EL clauses was not as applicable to large serial public company acquirers, as opposed to private equity acquirers. Senior practitioners in this other world (serial public company acquirers, such as Apple, Facebook, or Cisco) commissioned a different study (the “Buyer Power Ratio” or “BPR”) to help improve their drafting practices. The guru explained:

In 2015, Glenn’s article came out. . . . I and other practitioners felt that [it] to some extent reflected Glenn’s particular perspective as a private equity lawyer often representing private equity-backed target companies. . . . At the same time, the ABA [D]eal [P]oints studies were showing a very high incidence of consequential damages exclusions (close to 50%) in private company acquisitions, and [some of us] felt that too many buy-side lawyers were readily agreeing to these exclusions. . . . In part as a reaction to this . . . I was determined to set the record straight. I was of the view, which I still hold . . . that strategic buyers should almost never agree to exclude consequential damages from recoverable damages.

The key event [inducing change, to my mind] was . . . in January 2017. [It was the] M&A panel at the 44th Annual Securities Regulation Institute in Southern California, widely considered the top corporate and securities law conference in the country. Note . . . in the agenda the following topic: “*Negotiating consequential damages waivers in private company acquisitions.*”³⁸

The same guru explained, in a different exchange, referring to the Buyer Power Ratio study that was discussed at the aforementioned 2017 conference:

37. In-person Interview with Guru #30, Transactional Att’y (Apr. 10, 2024).

38. Email from Guru #28, Transactional Att’y, to author (Apr. 3, 2024) (on file with authors).

I previewed the [BPR] study at a number of conferences before its release. The practitioners who took particular note of [it] are the practitioners who represent large and mega-cap strategic acquirers, so it may not be mentioned in the interviews, as I don't think you interviewed many practitioners in that category. Sell-side practitioners didn't like what the BPR study had to say, and PE practitioners kept following their formulaic playbook on both the buy-side and sell-side, but the [BPR] study was influential nonetheless, because of the WSJ, Bloomberg, and Law360 coverage.³⁹

A few final notes before digging into the data. First, while we focus on 2015 as the key inflection point, West's article in 2015 followed a more extensive piece that he and Sara Duran wrote in 2008—both in the *Business Lawyer*. And, indeed, the ABA Deal Points Study started reporting data on the matter in 2009, we have been told, as a direct response to West's article.⁴⁰ So, the question is: Why was there not a big improvement in drafting starting in 2010? One answer is that there might have been but we cannot tell because our data starts in 2010. However, as West himself has told us, the impetus for his 2015 article, a retread of the 2008 piece, was that, despite some improvements after 2008, he continued to see bad drafting.⁴¹ The concerted efforts by him and other eminent folks in the ABA M&A committee were partly the product of frustration that not enough happened after 2008–09.

Second, while many of our respondents mentioned Glenn West's 2015 article, subsequent CLE/ABA meeting discussions, and the ABA Deal Points studies as key in producing change, we questioned whether something else occurred at the time that perhaps also helped induce change. For example, maybe buyer market power increased around then, which in turn meant that buyers could ask for better terms. We did not hear anything along these lines.

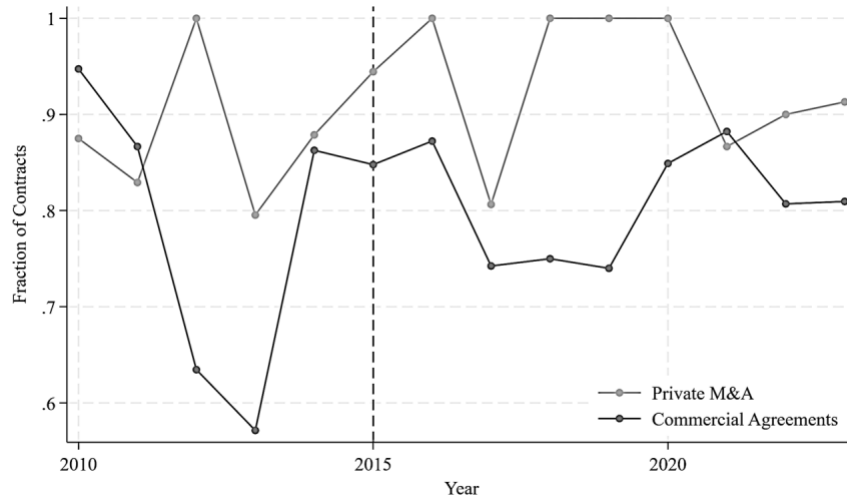
39. Email from Guru # 28, Transactional Att'y, to author (Apr. 17, 2024) (on file with authors).

40. Zoom Interview with Guru #3, Transactional Att'y (Apr. 10, 2024); Mergers & Acquisitions Comm., *2009 Private Target Mergers & Acquisitions Deal Points Study*, A.B.A. (Dec. 23, 2009), https://www.americanbar.org/digital-asset-abstract.html/content/dam/aba/administrative/business_law/deal_points/2009_private_target.pdf [<https://perma.cc/X8L5-468C>].

41. West, *supra* note 3.

B. Data Analysis

FIGURE 1. PRESENCE OF AN EXCLUDED LOSSES CLAUSE



Note from Figure 1 that there is no discernable decrease in EL clause use after 2015 in either the Private M&A or Commercial Agreement market.⁴²

But the fact that contracts continue to have an EL clause does not tell us how problematic the EL clause is. Indeed, the gurus advocated for a rationalized EL clause, not its complete exclusion. We are interested in the degree of badness of the EL clause and whether it changes after 2015. We next slice the data more finely into the use of Deadly Exclusions, Ambiguous Exclusions, and Redundant Exclusions.

Table 2 reports summary statistics on the overall number of problematic exclusions of any kind, and, separately, the number of ambiguous, deadly and redundant exclusions in an EL clause in our sample.

42. For Private M&A, 87.5% of contracts for 2015 and earlier had an EL provision compared with 93.2% after 2015 (difference significant at the 5% level). For Commercial Agreements, 77.9% of contracts for 2015 and earlier had an EL provision compared with 80.3% after 2015 (difference not significantly different from zero).

TABLE 2. SUMMARY STATISTICS ON EXCLUSIONS

	Number of Contracts	Number of Exclusions Overall	Number of Deadly Exclusions	Number of Ambiguous Exclusion	Number of Redundant Exclusion
(a) Private M&A	382	4.1	0.6	1.9	1.5
(b) Commercial Agreement	498	5.3	1.1	3.0	1.1
Total	880	4.7	0.9	2.6	1.3
p-value of (a)-(b)		0.000	0.000	0.000	0.000

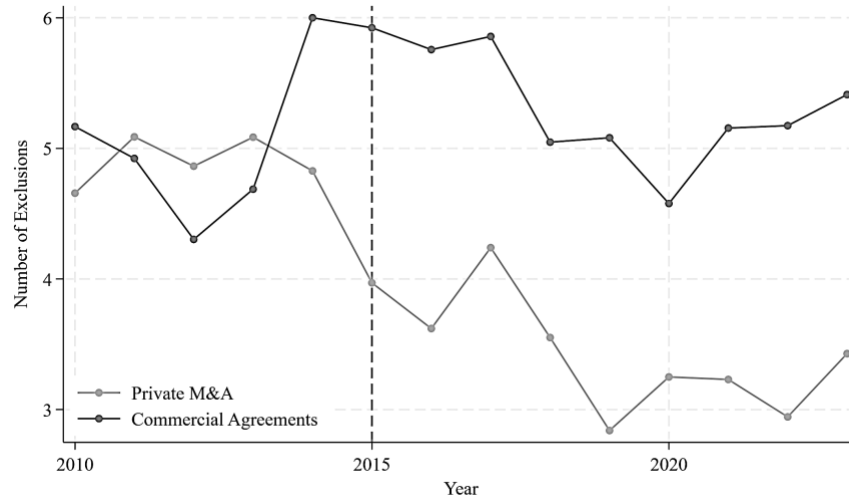
Number of exclusions are computed only for contracts with an EL clause.

The average EL clause in our sample has 4.7 problematic exclusions. EL clauses in Private M&A contracts have fewer (4.1) exclusions than commercial agreements (5.3). Similarly, EL clauses in Private M&A contracts have fewer deadly exclusions and ambiguous exclusions than Commercial Agreements. In contrast, EL clauses in Private M&A contracts have more redundant exclusions (1.5) compared with Commercial Agreements (1.1). All the differences are statistically significant.

To assess how barriers to contracting affect the Private M&A market compared with Commercial Agreements, we examine how contracts in both markets respond to a common shock related to the EL clause. In particular, we focus on how each market responds to *Biotronik* and commentary from a set of eminent practitioners that put pressure on lawyers to remove exclusions with increasing force, particularly around and after 2015. Our hypothesis is that the higher volume of contracts in the Private M&A market, coupled with the thicker ties among the lawyers in this world and the exhortations of key market actors such as Glenn West, will result in more contractual responsiveness in the Private M&A market compared with the more isolated context of Commercial Agreements. Isolated bespoke contracting poses high contracting costs to those who wish to modify an existing standard term in the market, leading to slower, if any, change to terms over time.

Figure 2 depicts the mean number of problematic exclusions overall for an EL clause over time for Private M&A. We use data on the same types of exclusions from Commercial Agreements as a comparison.

FIGURE 2. MEAN NUMBER OF PROBLEMATIC EXCLUSIONS



From Figure 2, we see a widening of the difference between the number of exclusions for Private M&A and Commercial Agreements. The number of exclusions largely remains the same for Commercial Agreements over the period of our study. For Commercial Agreements, EL clauses had 5.3 exclusions on average for 2015 and earlier and 5.3 exclusions after 2015. We see a different story for EL clauses in Private M&A clauses. There, we see change.

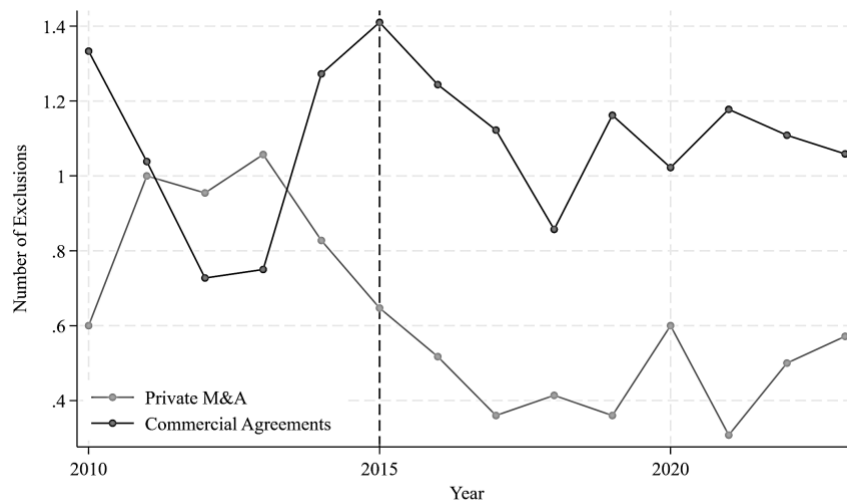
Our next three sets of analyses slice the data more finely into the use of Deadly Exclusions, Ambiguous Exclusions, and Redundant Exclusions.

C. *Deadly Exclusions*

The deadly exclusions, such as *lost profits*, *diminution in value*, and *multiples of earnings*, are exclusions that, for the buyer in an M&A transaction, can undermine the purpose of the deal. To reiterate, *we do not claim that these are deadly for the Commercial Agreements*. We use that category merely as a comparison figure.

Figure 3 illustrates that a substantial fraction of contracts in the Private M&A area contain deadly exclusions that we identified above as undermining the ability of the buyer to benefit from the bargain in the event of a contract breach of the reps and warranties.

FIGURE 3. MEAN NUMBER OF DEADLY EXCLUSIONS



Prior to 2015, the number of deadly exclusions is roughly similar for EL clauses found in Private M&A and Commercial Agreements. Starting around 2015, we see a steady drop in the number of deadly exclusions in the clauses as used in Private M&A contracts. This coincides with the practitioner exhortations after *Biotronik*, the publication of West’s 2015 article, and the many CLE meetings and industry conferences urging lawyers to be more careful with their drafting. And those exhortations were loudest in terms of these deadly exclusions.

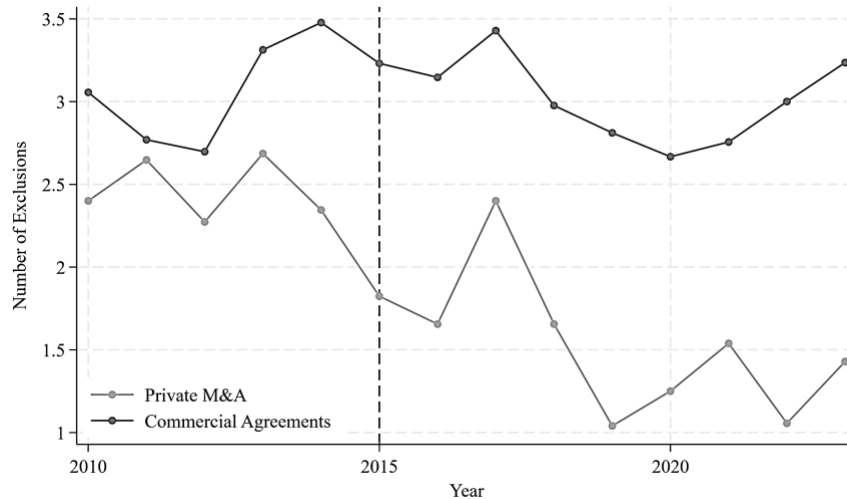
Relatedly, we see a widening of the difference between the number of deadly exclusions for Private M&A and Commercial Agreements. The number of exclusions that practitioners tell us are dangerous for buyers in the M&A context (but might not be so in the Commercial Agreement space) remains the same for Commercial Agreements—1.1 deadly exclusions throughout the period of our study. The fact that nothing much happens is either because these exclusions make sense in many of the Commercial Agreements or because there was no coordinated effort to induce change in drafting practices there, as there was around 2015 in the Private M&A area. For Private M&A contracts, EL clauses had 0.84 deadly exclusions on average for 2015 and earlier. This number dropped by almost half to 0.45 deadly exclusions on average after 2015.⁴³

43. This difference is significant at the 1% confidence level.

D. Ambiguous Exclusions

Ambiguous exclusions, for our purposes, include at least one use of previously mentioned terms like *consequential*, *special*, *indirect*, or *incidental* in the EL clause. Their presence is problematic to both buyer and seller because no one knows precisely what they mean—courts and practitioners alike. Figure 4 depicts the number of these exclusions for both Private M&A contracts and Commercial Agreements over our study period.

FIGURE 4: MEAN NUMBER OF AMBIGUOUS EXCLUSIONS



As Figure 4 reflects, prior to 2015, EL clauses in both the Private M&A and Commercial Agreement areas regularly employ ambiguous exclusions. The discouragement against ambiguous exclusions around 2015 correlates with only marginal change for Commercial Agreements. There, EL clauses had 3.1 ambiguous exclusions on average for 2015 and earlier and 3.0 ambiguous exclusions after 2015.⁴⁴ This lack of change in the number of ambiguous exclusions is consistent with the theory articulated before—there was no coordinated effort to induce change here. And remember, the category of Commercial Agreements includes a wide range of different types of contracts. In contrast, for Private M&A contracts, we see big change. EL clauses had 2.4 ambiguous exclusions on average for 2015 and earlier. This dropped to 1.5 ambiguous exclusions on average after 2015.⁴⁵

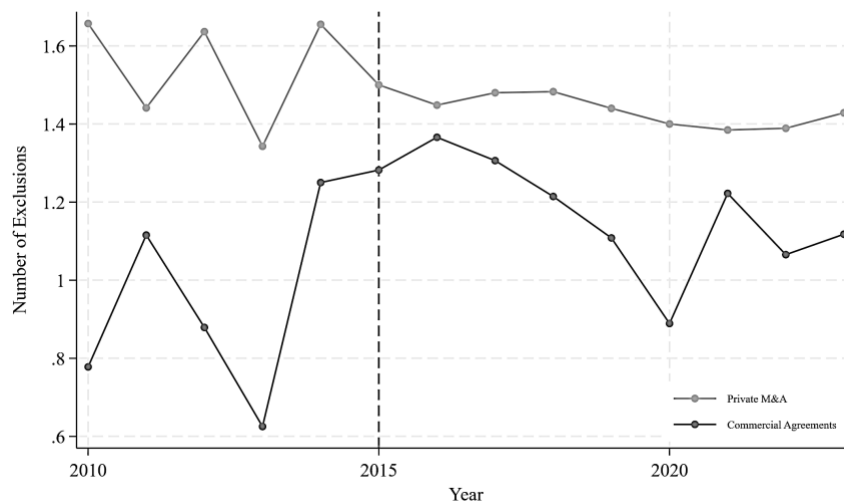
44. This difference is not significantly different from zero.

45. This difference is significant at the 1% confidence level.

E. Redundant Exclusions

Redundant exclusions, such as *exemplary*, *punitive*, and *treble*, are mostly harmless to either side but jeopardize the clause’s clarity by clogging it with unnecessary verbiage. Yet, as Figure 5 shows, there is wide and continued use of redundant exclusions in EL clauses found in both Private M&A contracts and Commercial Agreements.

FIGURE 5. MEAN NUMBER OF REDUNDANT EXCLUSIONS



Unlike for ambiguous exclusions, the number of redundant exclusions is persistently higher for Private M&A compared with Commercial Agreements across the period of our study. And we did not find any significant difference in the number of redundant exclusions for 2015 and earlier compared with after 2015 for either Private M&A or Commercial Agreements.⁴⁶ Perhaps these are viewed as largely harmless or even potentially useful.⁴⁷ These redundancies were not highlighted with the same fervor in the reform efforts. And, as one of our respondents laughingly said: “God forbid something should happen where the lack of one of these exclusions bites. No lawyer will risk going to Lawyer Jail by taking out

46. For Private M&A, EL clauses had 1.5 redundant exclusions on average for 2015 and earlier compared with 1.4 redundant exclusions after 2015 (difference not significantly different from zero). For Commercial Agreements, EL clauses had 1.1 redundant exclusions on average for 2015 and earlier compared with 1.2 redundant exclusions after 2015 (difference not significantly different from zero).

47. We did hear this in some of our interviews. See, e.g., Zoom Interview, *supra* note 27.

some provision that, even if it seems useless, might turn out to be important.”⁴⁸

* * *

Various factors, in theory, could affect the number of exclusions in a particular EL clause. Perhaps attorneys for larger deals are more willing to expend effort to modify contractual clauses. Companies in different industries may face different litigation risks and thus have different incentives to vary their EL clauses. More expert attorneys may bear lower costs to modify a contract term.

To control for these various factors, we estimate a difference-in-difference regression model with the overall number of exclusions as the dependent variable. We use Private M&A as our treatment group and Commercial Agreements as our control group. We also use the practitioner exhortations after *Biotronik* around 2015 as our “shock” and look at the difference in response between Private M&A contracts and the more bespoke Commercial Agreements. To assess the impact of our shock, we include an indicator variable for after 2015 (Post 2015) and an interaction term between Post 2015 and Private M&A, with Commercial Agreements as the base category of comparison. We also include the log of the deal amount and industry fixed effects based on the Westlaw What’s Market industry classification as control variables. To control for the importance of law firm scale and expertise, we include an indicator variable for whether either the seller or buyer’s law firm is one of the top six firms in the Vault 2020 ranking of private equity law firms.⁴⁹

We treat the overall number of exclusions as a measure of the degree of inattentiveness to contracts and the change in the number of exclusions as a measure of the effort parties and their attorneys put into changing their contracts after a shock. Accordingly, we estimate the following ordinary least squares model with robust standard errors:

48. In-person Interview with Guru #26, Litigator (Mar. 21, 2024).

49. The top six firms in the Vault 2020 ranking are: (1) Kirkland & Ellis, (2) Simpson Thacher, (3) Latham & Watkins, (4) Skadden Arps, (5) Cravath, Swaine & Moore, and (6) Wachtell Lipton. *Private Equity Lawyers*, VAULT (2019), <https://www.vault.com/best-companies-to-work-for/law/best-law-firms-in-each-practice-area/private-equity> [<https://perma.cc/X6A4-GK64>].

$$\begin{aligned} \text{Number of Exclusions} = & \alpha + \beta_1 \text{Private M\&A}_i + \beta_2 \text{Post 2015}_i + \\ & + \beta_3 \text{Private M\&A}_i \times \text{Post 2015}_i + \\ & + \beta_4 \ln(\text{Deal Amt})_i + \beta_5 \text{Top Seller Firm}_i + \\ & + \beta_6 \text{Top Buyer Firm}_i + \text{Industry Fixed Effects} + \varepsilon_i \end{aligned}$$

We report the results of the model as Model 1. We separately estimate the same model with number of ambiguous exclusions (Model 2) and number of redundant exclusions (Model 3) as dependent variables. We report the three models in Table 3.

TABLE 3. OLS MODELS OF THE NUMBER OF EXCLUSIONS

Difference-in-Difference Regressions				
	(1)	(2)	(3)	(4)
	Number of Exclusions	Number of Deadly Exclusions	Number of Ambiguous Exclusions	Number of Redundant Exclusions
Private M&A	1.173 (1.44)	0.352 (1.47)	0.0834 (0.16)	0.738** (3.87)
Post 2015	0.947 (1.14)	0.238 (1.07)	0.365 (0.71)	0.345+ (1.66)
Private M&A x Post 2015	-2.074* (-2.45)	-0.544* (-2.32)	-1.045* (-2.00)	-0.485* (-2.24)
ln(Deal Amount)	0.273** (4.17)	0.0582* (2.40)	0.162** (4.29)	0.0533** (2.79)
Top Law Firm	-0.00386 (-0.01)	0.0236 (0.22)	0.0111 (0.07)	-0.0385 (-0.51)
Constant	1.054 (1.08)	0.191 (0.63)	0.963 (1.64)	-0.0998 (-0.43)
<i>N</i>	477	477	477	477
adj. <i>R</i> ²	0.088	0.081	0.081	0.146

t statistics in parentheses; + $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Note that in all four models the coefficients on Private M&A x Post 2015 are negative and significant at the 5% levels, consistent with greater stickiness for boilerplate terms for the Commercial Agreements. By contrast, after 2015, Private M&A contracts have 2.1 fewer overall

exclusions on average compared with Commercial Agreements. From Model 2, note that after 2015, Private M&A contracts have 0.5 fewer deadly exclusions on average compared with Commercial Agreements. We also see that, after 2015, we have 1.0 fewer ambiguous exclusions and 0.5 fewer redundant exclusions in the Private M&A area on average compared with Commercial Agreements.

Put differently, the regression models show that the difference between Private M&A and Commercial Agreements increases after 2015. In particular, all the problematic categories of exclusions decline (with statistical significance) after 2015 for Private M&A relative to Commercial Agreements. Bottom line: There was a significant change in a direction suggested by gurus such as West in the Private M&A area.⁵⁰ It bears noting though that, even in the Private M&A area, at the end of our data collection in mid-2023, we find roughly half the Private M&A contracts containing at least one deadly exclusion and multiple ambiguous and redundant exclusions.

To better understand what we found in the data, we conducted interviews with over eighty-five lawyers. Below, we report the key takeaways from the interviews.

IV. INTERVIEWS

The data on EL provisions, once collected, served as our stepping stone to ask lawyers in practice about the provisions we were seeing. What did they think about these clauses? Did they think that many of them were problematic?

We report below on the results of our interviews with more than eighty-five lawyers—some junior lawyers, but mostly lawyers at the partner level or above. During the vast majority of these conversations, we did not know about the shift in the data that we see after 2015. As reported earlier, comments from a number of our most eminent respondents caused us to focus in on whether there *had* been a shift in the data in the post-2015 period.

Over thirty of these lawyers are those we categorize as “gurus.” The category is made up of senior lawyers who have either written explicitly about or opined in public settings about EL clauses or were lawyers who others in this category told us we should talk to. Although we primarily

50. As a robustness test, we treat the number of exclusions as a count variable and re-estimate the models in Table 3 with a negative binomial regression model. Unreported, we obtain similar qualitative results. In all four models, the coefficients on the Private M&A x Post 2015 interaction term are negative, although significant at the 10% (Model 1), 10% (Model 2), 14.5% (Model 3), and 5% (Model 4) levels.

spoke to transactional lawyers, we also spoke to some litigators who frequently see disputes over EL terms.

Although we do not report them in detail here, we conducted a set of over forty interviews with “non-guru” lawyers as a precursor to our guru interviews. The responses we got there did not quite answer our questions, so we decided to conduct guru interviews. So, as a precursor to reporting what we heard from the gurus, here is a summary of what we heard from the “non-gurus.”

A. Non-Gurus

With a few exceptions, the response to our questions from these senior lawyers was mostly one of disinterest, where several told us that we should read Glenn West’s articles (we did not respond that it was West’s articles and critical views of EL clause drafting that inspired our inquiry). But, boiled down, here is a summary of their responses:

EL provisions are “market”; these are boilerplate provisions that basically say the same thing with little bargaining around them;

If you want to know more, there is an article by Glenn West (some mentioned a Business Lawyer piece, others pointed to his blog posts);

Studying these provisions is not useful; they have little importance these days because of damages caps and “reps and warranty insurance”;

If you want to understand these clauses, talk to the litigators – they know the case law; for the corporate lawyers, these are boilerplate.

B. Gurus

Our gurus had more nuanced perspectives. But they did agree with portions of what we had initially heard and most of them did mention Glenn West’s writings as a good source for us (or as a source to which they themselves looked). Below are four distinctive points that the gurus made:

1. Borrowed Boilerplate

The gurus almost all had the view that many of the EL clauses in use were the product of borrowing from precedent. Further, they observed that borrowing was often done with minimal care as to whether the EL provision being used was tailored to the circumstances of the deal at hand. One veteran deal maker opined:

There are very strained time pressures, [which means] using not only boilerplate language, but boilerplate contracts. And so what becomes a key part of one contract . . . bleeds off into fifty more and then the attorney for somebody entirely different somehow stumbles across that contract, maybe in an SEC file and says, “dang, that looks good” . . . and all of a sudden it cross-pollinates across jurisdictions, and . . . the jurisdiction where it originated has law that’s completely different from the law of the jurisdiction where the copycat lawyer is situated.⁵¹

The point, as we took it, was that there was unlikely to be careful bargaining over the EL provisions themselves, at least not as part of the core deal terms. It was also unlikely that these EL provisions were fine-tuned to the latest developments in the case law. One respondent wryly noted, “No transactional lawyer is reading the case law. The last time most of them saw a case was in law school. Maybe they read a client alert [about a new case], but that’s it.”⁵² Another respondent, a New York litigator who had litigated a number of EL cases, explained:

[C]orporate lawyers, honestly, they don’t think about [EL] and they don’t understand them and they’ve never researched them. They don’t read cases. [By contrast] I’ve read every case involving consequential damages in New York.⁵³

This respondent went on to explain that the drafting process for deal lawyers instead involves building clauses out of provisions used in prior deals. The way transactional lawyers learn they need to modify their clauses is when they see problems arising in those deals, with case law developments quite distant from the drafting process. This lack of negotiation and thought at the drafting stage then becomes “the core issue of subsequent litigation.”⁵⁴

2. *Bargaining to Avoid Harm*

Every transactional guru we spoke to said that they always read the EL clauses in their deals and worked hard to ensure their clients were not hurt by a bad EL clause. Negotiations around EL provisions tend to be limited to whether the provisions, when they are bad, can be excluded. But none of the gurus reported getting pushback when they made their points. If one can explain, particularly with some authority in the form of an article or ABA

51. Zoom Interview with Guru #14, Transactional Att’y (Feb. 13, 2024).

52. Zoom Interview with Guru #9, Litigator (Jan. 19, 2024).

53. Zoom Interview with Guru #8, Litigator (Jan. 19, 2024).

54. *Id.*

study, the counterparty does not fight back. One guru also suggested that in recent years, with the advent of representations and warranty insurance and insurance lawyers who understand the relevance of EL clauses to how much they have to pay out, things have gotten easier on the negotiation front. On ridding contracts of problematic EL language, one guru expounded:

There's less pushback [these days], I think because the insurers [understand the relevance of these clauses]. . . . [On the other hand] people are [also] sort of out of the habit of fighting that hard over the definition because there's insurance and they don't care.⁵⁵

To the extent bargaining does occur over EL clauses, it occurred for our gurus mostly in terms of negotiating to clean up problematic language that the counterparty was asserting should come in simply because it was “standard” or “market.” One guru, paraphrased, explained:

In a fully priced merger or joint venture, it makes no sense to say that lost profits or diminution in value or out of pocket damages are not recoverable. That kind of limitation might make sense if [my company is] provid[ing] some minimal service, like IT support, and I'm not getting paid enough to take on the risk of all the lost profits that the firm suffers when there is an outage. But when I'm buying a company and there is some basic problem in the product I'm being sold, that was misrepresented, I definitely want [my client to be able to recover] lost profits.⁵⁶

To the extent meaningful bargaining did occur in these deals, it was not around EL clauses. Instead, it was about damages caps and the purchase of third-party insurance against misrepresentations that might have been made in the deal. Veteran negotiators explained:

People in the practice often make the mistake of negotiating the reps and warranties, covenants, and indemnity provisions before they have looked . . . at how losses and damages are defined.⁵⁷

There's a plague that's in law firms where all people do is execute [agreements] and it's really easy to negotiate a cap. That's a number. And then they just think [EL] are some boilerplate and just slap it in there.⁵⁸

[Deal makers] rely more on rep and warranties insurance and not so much on an indemnity obligation or an escrow where out of pocket

55. Zoom Interview with Guru #5, Transactional Att'y (Jan. 9, 2024).

56. Zoom Interview with Guru #8, Transactional Att'y (Jan. 16, 2024).

57. Zoom Interview with Guru #17, Transactional Att'y (Feb. 29, 2024).

58. Zoom Interview with Guru #13, Transactional Att'y (Feb. 5, 2024).

money that people just in broad senses think that if all kinds of consequential damages and these other measures of damages are permitted, then people will just eat up that basket faster because they can pile on more things that are allegedly damages.⁵⁹

One question we asked the gurus explicitly was in response to something we had heard from our non-guru lawyer conversations: lawyers did not need to worry about EL provisions because the deals almost always had dollar damage caps and some amount of deal or representations and warranty insurance. Every guru we spoke to responded that this was nonsense. It did not make sense to think that the presence of warranty insurance or damage caps obviated the need to pay careful attention to the EL provision. One explained:

[It] does not matter what the damage cap is. A lot of contracts don't have caps, or they might be enormously high . . . but if your [EL] provision says you cannot get lost profits, then you might get zero damages even if you negotiated a big damage cap. Similar story with insurance. Insurance will usually only cover a portion of the damages and only if there is no fraud – and there are often allegations of fraud. [But] do you actually want to be making a claim on your insurance? How expensive is your rep and warranty insurance going to be next time? [As a litigator,] I always turn to the [EL] provision first. That often determines the outcome. I wish my corporate colleagues would do the same. But they usually ignore the most important litigation provisions such as governing law, jurisdiction, and [EL] . . . that is, until the deal blows up . . . at which point they dump this into the lap of the litigators.⁶⁰

3. Why So Many Dodgy Clauses Still?

Our data showed that EL provisions in M&A deals still, as of 2023, contained some problematic exclusions. We asked the gurus why (and whether) these problematic clauses persisted even though considerable efforts had been made to educate lawyers about flaws in these clauses. Three answers stood out:

Drafting has improved. The best lawyers and the biggest deals do use well-drafted clauses. But those are missing from datasets built out of SEC filings because the very biggest companies (like Apple) are so

59. Zoom Interview with Guru #22, Transactional Att'y (Mar. 19, 2024).

60. Zoom Interview with Guru #4, Litigator (Jan. 9, 2024).

big that few of their transactions – even the hundreds of millions of dollars worth – are “material”,⁶¹

Many deals are done under time pressure. If there isn’t time to negotiate every point and the buyer side client wants to close, and is willing to disregard the risk of an unclear damages clause, then one lives with it; and

Sometimes the buyer is in a weak position, particularly in an auction when there are many buyers. Then one just must accept the clause that the seller advances.⁶²

4. *Flexibility in Vagueness*

A theory that we heard in some of our early non-guru interviews, and even from one M&A litigator, was that there was perhaps some value to having an unclear “alien vomit” type clause—that the ambiguity gives litigators “flexibility” at the back end to argue for their position.⁶³

But most of the gurus were dismissive of this theory on the grounds that parties in these transactions know at the front end what kinds of damages they are willing to be liable for. “No client thinks he is paying his lawyers thousands of dollars an hour to copy mush from some prior deal.”⁶⁴ Or they dismissed the theory on the grounds that deal lawyers are not thinking about what would best suit the litigators if a dispute ensued. One of the senior judges we spoke to (a former M&A lawyer), one of the few to whom we showed results, explained that these types of clauses were the product of pragmatic or time-constrained lawyering:

What you are really getting out of [the data and interviews] is a very powerful set of contrary evidence to that theory [of optimal bargaining]. There certainly are things that [deal lawyers] optimize. . . . This is another example of bounded rationality. They are prioritizing time. They have things . . . they focus on . . . reps and warranties . . . and covenants. . . . Damages provisions are down the list. . . . It is boundedly rational [to use] market terms as a comparator. [I want to make sure, with these kinds of terms] that I’m

61. We were pointed to a study of a large set of M&A deals by SRS Acquiom and specifically to the following tool that shows this point. *See MarketStandard: The Industry’s Most Powerful Deal Analytics Tool*, SRS ACQUIOM, <https://www.srsacquiom.com/marketstandard/> [<https://perma.cc/M46A-XWHP>]. This is the aforementioned “Buyer Power Ratio” study. *See infra* text accompanying notes 38–39.

62. On the flip side, the BPR study shows also that buyers with greater bargaining power are able to obtain better (more buyer-friendly) clauses. *See id.*

63. Zoom Interview with Guru #9, Litigator (Jan. 19, 2024).

64. Zoom Interview with Guru #15, Transactional Att’y (Feb. 16, 2024).

not far off market. And I look at ABA [Deal Points] survey and if [I see] everyone is using it . . . I'm going with it. This idea that putting in a vague term was optimal is . . . well, it is an after-the-fact justification. The real reason is that no one is thinking about these provisions – that's why so many of them look like what they do.

In theory, one option is to lawyer every [clause] – but [no] client will pay. So, you do path dependence. You hope you don't get your head chopped off – and you point to the ABA survey.⁶⁵

A different lawyer-turned-judge explained (starting with a reference to the clause in all caps that we begin our article with):

[There are two scenarios with a clause like this. The first is] that this was just copied. Whenever I see [a clause] in all caps, I know it has been copied. There was no thought. Transactional attorneys understand [what] is “market.” It is a lot easier in negotiation – so long as [the clause in question] is market. Don't have to spend time negotiating. If there is ever a dispute . . . courts will figure it out.

Scenario two is – maybe they did give some [minimal] thought. But if they have trouble with negotiation, they agree not to agree . . . if there is a dispute, the court can figure out. If it is boilerplate, you never go [and] tell a client . . . you could not do the deal because of some boilerplate clause. Deal lawyers [on both sides] want to get the deal done – so they leave things ambiguous purposely.⁶⁶

V. IMPLICATIONS

In contract theory, the image of the transactional lawyer is of a ninja drafter.⁶⁷ The drafter tailors each contract provision to meet the vigorously bargained-for rights and obligations. However, bargaining and then drafting the terms to capture this bargain is costly. Rather than contract nirvana where everyone designs the perfect term for themselves, the world we study is one where parties with limited time and resources focus on the key financial terms and maybe a couple of other key deal terms. There is relatively little attention to the set of legal terms the parties see as “boilerplate.” That results in the frequent use and reproduction of sub-optimal terms.

65. Zoom Interview with Guru #19, Judge (Mar. 15, 2024).

66. Zoom Interview with Guru #18, Judge (Mar. 12, 2024).

67. Our thanks to Nate Oman for this metaphor.

But while we find bad drafting, we also find, correlated with an effort by senior lawyers in the Private M&A bar, improvements in drafting. The boilerplate, despite being boilerplate, improves.

We close with what one of our gurus said in response to our question for why some flawed EL clauses persisted even as of 2024 (including in deals from his firm):

Sometimes, maybe often, deals have to be done quickly, and there is not enough time to negotiate every clause. Think about the lawyer and his client in a conference room at 2 a.m., trying to decide what's important and what's not important . . . we have one more negotiating session to go. Should I raise this? And in the end, I'm going to say, nah, who cares.⁶⁸

68. Zoom Interview with Guru #2, Transactional Att'y (Oct. 17, 2023).