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WHY CONTRACTS ARE WRITTEN IN "LEGALESE"

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I. INTRODUCTION

Drafting and negotiating complex business contracts is difficult. It requires prodigious memory capacity as well as imagination. How does the lawyer know what the contract ought to cover besides the bare promises to buy and sell or borrow and lend?[1]

Not surprisingly, lawyers have come up with a production process by which each lawyer can access the accumulated wisdom of many: the "form." The form is typically not a form in the "fill-in-the-blanks" sense; rather, it is an actual contract the lawyer or someone she works with has used in one or more previous transactions.[2]

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1. Indeed, acquisition and financing agreements are the mainstays of large law firm corporate practice.

2. In my experience, some law firms have aspired to, but never quite achieved, the goal of having a firm-wide form. It's not as though the forms used within a firm, or for that matter, by different firms, differ enormously *in content*; they do, however, *look* quite a bit different. The provisions might be phrased differently or be in a different order. There might be different drafting conventions as to the defined terms, always an important aspect of agreements. And there are many other matters of this sort; again, the documents "do" more or less the same things but cannot really be said to be the same "form." There are a few *industry-wide* forms. The two most prominent such forms are a model indenture published by the American Bar Foundation, and the form for swap transactions. Both forms reflect regulatory and institutional conditions not generally present in the everyday world of mergers and acquisitions and financing agreements. Much of an indenture's content is dictated by statute, and/or details how nonadversarial, mechanical duties (such as issuing notes to replace lost or stolen notes) are to be performed. As to swaps, there is a fill-in-the-blanks form, developed by the International Association of Swap Dealers, a trade association. The individually negotiated terms are contained in an annex. Documentation plays a much different role in swap transactions than it does in acquisition or financing transactions: indeed, the swap documentation is often not completed until a month after the transaction has occurred. Furthermore, many, and perhaps most, terms of a swap are virtually incomprehensible to lawyers; if lawyers are to be involved at all in the transactions, which they typically are only if the swap is part of another transaction involving more legal structuring, a form, developed by finance professionals who understand swaps, is needed. Also, some lenders have fill-in-the-blanks forms for loans they will make. In my experience, these forms suffer many of the same defects as the actual contracts used as

Over time, the form evolves, mostly for the better. Many mistakes, especially those with serious consequences, get corrected. Contingencies discovered "the hard way," through painful and expensive experience, are addressed. And other improvements are made. But the results are far from perfect. The imperfections chiefly are unnecessary length and complexity—the very attributes often bemoaned in popular accounts.[3] Sometimes the imperfections are more serious: ambiguities that go uncorrected. As I will argue, the production process, meant to help lawyers learn quickly and efficiently from their experience and from that of others, leads, perhaps intractably, to these imperfections. For expository purposes, I characterize contract drafting and negotiating as a production process, addressing a question to which there's admittedly an obvious answer: Why aren't contracts drafted from scratch? My answer frames my account of the contract production process, illustrating how multiple iterations do not always improve, and sometimes even worsen, the form. My interest in considering contract forms is twofold. First, I want to show how rational, and, what some would consider irrational,[4] elements can combine to create a serviceable, but arguably second-best, product. Work on "standardized" or "boilerplate" contract terms has considered these issues.[5] My work

forms, and for many of the same reasons. The role of cumulation is different, but by the time the form was developed, much of the damage had been done. In support of this position, I direct readers to the Appendix, which contains a provision from such a form. Certainly, developers of these sorts of forms are not much concerned with clarifying the language, making major structural changes, or doing much else in the way of "clean up"—the main aims are to standardize the lender's loans, and to make sure the agreement "works."

3. For an example see *infra* Appendix. It sets forth an actual contractual provision used in many loan agreements. Indeed, the provision comes from a form developed *as a form*, making its unwieldiness all the more remarkable.

4. Herbert Simon explains the difference between rationality in economics and rationality in psychology as follows: economics' concept of rationality is "substantive" whereas psychology's is more "procedural." "Substantive" for this purpose means advancing particular ends (say, money and power); "procedural" rationality takes preferences as given, as ends, and asks whether the behavior was a sensible means to achieve the ends. All the behavior I describe is "rational" in the psychological sense; all of it may, however, not be rational in the economic sense. I generally attempt to avoid using the word "rational" because the phenomenon I am describing has both economic and psychological components. When I do use the word "rational," I am using the economics meaning, as defined by Simon. Herbert A. Simon, *Rationality in Psychology and Economics*, *in* RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 25, 26–27 (Robin M. Hogarth & Melvin W. Reder eds., 1986). It should be noted, however, that some economists use the term "rationality" rather more broadly, importing some part of the psychological use.

5. *See* Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting*, 83 VA. L. REV. 713 (1997) [hereinafter Kahan & Klausner, *Standardization and Innovation*]; Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior, and Cognitive Biases*, 74 WASH. U. L.Q. 347 (1996)

focuses on an overlapping but distinct phenomenon: the persistence of redundancy and the ubiquity of cumbersome, inartful, and sometimes imprecise drafting.

Second, and more generally, I want to illustrate that the demarcation between path-dependence and network-effect explanations on the one hand, and efficiency explanations on the other hand, may be more complex and nuanced than present literature acknowledges. Path-dependence and network-effect explanations explain how inefficient, "second-best" phenomena come about and survive. These types of explanations are increasingly becoming popular in the literature. By contrast, efficiency explanations present the phenomenon being explained as "first best." The debate between path-dependence theorists and efficiency theorists is sometimes couched, with only slight exaggeration, as a debate as to whether history matters in explaining the types of phenomena law and economics considers. Path-dependence theorists argue that it does; efficiency theorists ostensibly argue that it does not. The "same" phenomenon can be either the product of a path-dependent process (and hence second best or inefficient) or efficient depending on how the phenomenon itself is described. I show how business contracts can be characterized as second best, needing history as an explanation or, indeed, an excuse; or, alternatively, business contracts can be viewed as closer to efficient. The description of the phenomenon is critical.

This Article proceeds as follows. Part II explains the production process by which complex business contracts are drafted and negotiated in large law firms. It models the process as a way of imparting to each lawyer the accumulated wisdom of her predecessors. Part III considers how economic and psychological[6] dynamics operate in the contract drafting and negotiating process. Indeed,

[hereinafter Kahan & Klausner, *Path Dependence*]. These articles consider path dependence and network effects. For a general discussion of network effects, see Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479 (1998).

6. Increasingly, legal academics are considering the applicability of psychological (behavioral) forces to legal phenomena. For a general overview of the subject, see 50 STAN. L. REV. 1471 (1998) (containing a collection of articles on behavioral law and economics) and a Vanderbilt Law Review symposium, Symposium, *The Legal Implications of Psychology: Human Behavior, Behavioral Economics, and the Law*, 51 VAND. L. REV 1497 (1998). *See also* Donald C. Langevoort, *Ego, Human Behavior and Law*, 81 VA. L. REV. 853 (1995). Some of the most important work drawn on by legal scholars is by Daniel Kahneman and Amos Tversky. *See, e.g.*, Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974), *reprinted in* JUDGEMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (Daniel Kahneman, Paul Slovic & Amos Tversky eds., 1982). For a recent addition to the voluminous body of work connecting behavioral psychology to law and economics, see BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed., 2000).

some of the dynamics fall comfortably within the rubric of rational self-interest maximization. Others perhaps represent departures from "rationality," as that term commonly is used in economics. Part IV summarizes the imperfections of complex contracts. It considers why the form production process might persist despite these imperfections, stressing switching costs attributable to network and other effects. It also considers certain specialization benefits to the form production process. Finally, it compares other costs and benefits of retaining the process versus switching. Part V concludes, addressing why multiple iterations don't make contracts "perfect."

II. CONTRACT DRAFTING AND NEGOTIATION: GENESIS AND USE OF THE FORM

In *Anatomy of a Merger*, James Freund, a leading merger and acquisition lawyer in New York, includes a playlet describing a mock acquisition transaction, in which Suggestive Software, Ltd. is acquired by Proliferating Products, Inc.[7] In one scene, taking place on Friday, December 27, the junior associate, Peter Preppie, is being lambasted by his supervisor, the partner Perry Prudent, for having done a rotten job in his first draft of the acquisition agreement:

> PRUDENT: Merry Christmas, Pete. Now look fella, you'll just have to forgive my candor but time's short and this draft of the Proliferating-Suggestive agreement is an *inferior* job. The problem is that you *just didn't think!* You walked out of here, you went into the library, you grabbed that Screwloose binder off the shelf, you had a photocopy made of the final contract, and you marked it up for purposes of this draft. Don't you realize that the *final* Screwloose agreement represented the culmination of three weeks of intensive negotiation on the part of a pretty smart seller's attorney? You've got to start with the *first draft* of the Screwloose contract.
>
> All that stuff in there about their right to defend lawsuits, and all those materiality and knowledge caveats—they have no place in the *first draft* of an agreement to buy Software; plus which you forgot about the omission of the tax representation in Screwloose because of that special problem of theirs. And then you left in all that valuation language—average closing price, etc.—which was fine in the Screwloose deal where the pricing was based on the market price over a two-week period right before the closing, but is completely inapplicable here since we're using a fixed number of shares. You have to *think,* boy.

7. JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 500–01 (1975).

> And then, in the one place you *did* a little thinking, Pete, it seems to me you went too far. I know it's *possible* that they'll repeal the Copyright Act some day, but it doesn't really rise to a level of probability sufficient to warrant three pages of provisions conditional upon that event.[8]
>
> Get this thing fixed up, and let me see it first thing Monday.

This passage, meant in jest, nevertheless captures quite well a junior lawyer's initiation into contract drafting. Indeed, in large-firm practice, complex contracts are drafted and negotiated using a process that permits much of the work to be done by somewhat more experienced versions of Preppie. Such a process makes eminent sense. A new product, custom-crafted for the client from a form, can be produced quickly, and at far lower cost than a product crafted from scratch. The form design enables the product to be produced by lower-paid, less-senior and less-experienced lawyers. Given the complex nature of the task, and the quick turnaround time typically required, even the most experienced lawyer would have difficulty remembering every step and detail; the form is a useful reminder. The form also preserves the benefits of experience with its provisions, both in the transacting community and, sometimes, in judicial decisions. The form simplifies the mechanical task as well: a lawyer "marks up" a form, using the existing structure and changing only what's needed. A contract for client #2 is created quickly from client #1's contract; global searches change the names and some other words. The remaining changes are input mechanically, and the new contract quickly emerges from the laser printer.

Within the present structure, it is hard to imagine drafting any other way. Without a form, how would most junior lawyers have any idea of what a contract should address? They have never bought a multimillion-dollar company or taken out a multimillion-dollar loan.[9] And they are not trained to reason by far-flung analogy, which might permit them to use information from their past experiences in quite different contexts. Furthermore, many conventions, such as drafting conventions, have arisen; intuiting such conventions would be impossible. Seniority and increasing judgment help. But even

8. *Id.*

9. In my view, law and economics can be enormously helpful to students by helping them characterize perils and rewards generically. The students then have a systematic way to consider perils and rewards in new contexts.

Freund would probably not want to draft from scratch.[10] Ready access to others' experience is crucial.

Returning to Freund's playlet: Preppie, who is quite inexperienced, nevertheless has major drafting responsibility for the contract. Prudent, Freund's alter ego, presumably told Preppie to use the form from the Screwloose transaction, a transaction on which Prudent himself had worked.[11] If Prudent had not worked on a similar transaction in the recent past, he would tell Preppie to get a form from another senior lawyer Prudent trusted,[12] and who had worked on a similar transaction recently. Preppie decides how to "mark up" the form—what to retain, what to change, and what to add. Prudent reviews Preppie's draft, as described in the quote above; Preppie then revises it and sends it to the other side. Prudent and Preppie both attend the negotiations. Preppie's principal role is as scribe; he drafts the agreed-upon changes and sends out the revised agreements to the multi-person distribution list. Prudent probably wants to see important changes before Preppie sends out the revised draft. However, Prudent probably trusts Preppie to make minor changes without supervision.

In this playlet, Prudent does the negotiations himself. However, except in the largest transactions, someone as senior as Prudent (and with as high a billing rate) would be unlikely to do the bulk of the negotiations. Indeed, in many cases, someone at an early stage in his career—say, a midlevel to senior associate—might do a great deal of the negotiation, and perhaps all of it. One can readily imagine a similar conversation in which a still comparatively junior Preppie reports back to Prudent as to the results of the negotiations. Prudent asks which of the contested points Preppie won, Preppie responds, and Prudent perhaps rants that Preppie succeeded only on the less-

10. He might, however, fantasize about the perfect form. In my experience, many lawyers have such fantasies. The perfect forms are sometimes even begun, but almost never completed. And even if they are completed, they are not regularly updated for changes in law and other matters.

11. Prudence sometimes dictates using two or more forms to make sure there's nothing omitted; after all, it is far easier to spot an unnecessary provision than a missing one.

12. In many firms, especially those which admitted many "lateral" partners and associates, a particular "group" of lawyers may be more comfortable with the way members of the group practice than the ways nonmembers might practice. The groups' formation may reflect commonality of subject matter or approach. There might be historical reasons why one group thinks its way of doing things is far better than another's. For instance, one partner might be admitted to the firm on account of the business that partner can bring in; others might feel his style of practicing does not accord with the norms of the firm and would not want to use his "forms" for their clients.

important points but failed on the more important ones. Preppie then is sent back to negotiate further. Over time, Preppie comes to understand what is important and what is not, and what sorts of arguments win and lose.[13]

Like any junior lawyer, Peter Preppie needs to learn how to draft and negotiate contracts. In the passage I quoted, Prudent is doing a reasonable job of teaching him. He tells Preppie to think about which form to use, and to think while marking up the form. He also tells Preppie to consider the differences between the deal for which Preppie is drafting the contract and the deal for which the contract form was used.

The lesson Prudent is teaching Preppie is much more complex than it appears. Preppie will presumably know, as would just about anyone in Preppie's position, not to have three pages describing consequences of the repeal of the Copyright Act next time he gives Prudent a first draft. He will almost certainly know not to give such a draft to any other senior lawyer. But Prudent wants Preppie to learn a far more general lesson: he wants Preppie to learn not to write in new provisions addressing contingencies *as remote as* the repeal of the Copyright Act. Which contingencies are as remote as repeal of the Copyright Act? How is Preppie to know? The generic instruction "think" is scarcely much of a guide. But, coupled with a few examples, it may be the best Prudent can do—Preppie will have to look to his imagination and judgment, and, as time goes on, experience, hopefully not so hard-won as in his encounter with Prudent. Prudent speaks as though "thinking" were a matter of brawn rather than brains—something you could simply do by trying to do it. But Preppie's problem, as Prudent surely would agree, is not lack of effort. After all, Preppie produced this draft quite quickly, in the week that included Christmas Day. Preppie's problem is that he doesn't know what to think *about*—and there may be no good way to tell him.[14]

13. Preppie may eventually become another Freund; he also might never rise much beyond his present level of ability. Most likely, he'll end up somewhere in the middle.

14. Can a lawyer be scared into "thinking"? In some cases, perhaps. I have known some partners who terrify associates as a strategy; the strategy is to put the associates on notice that they'll have to justify every provision in the agreement or suffer being shouted at by the partner. This strategy sometimes may work in the short-term. The associates do "think," at least more (and maybe better) than they would have otherwise. However, the strategy often backfires. The desirable associates, the ones who can and do think, then avoid being assigned to the shouting partner. Maybe firms keep these partners around to make the other partners get the benefit of the shouting-induced training to "think" while looking good and reasonable by comparison—a "good cop–bad cop" dynamic?

This dynamic extends far beyond determinations about which contingencies to include in a contract. Learning effectively from experience requires generalizing to an experience's salient features. There is no formula to determine which features of an experience are salient. Overgeneralizing is common in everyday life, and can sometimes take the form of superstition (I'd better not do X because the last time I did X. . .). Undergeneralizing is common as well, and is a particular peril for the corporate lawyer. A lawyer suffers professionally if she addresses in the B contract a bad outcome that occurred in the A transaction but not a similar bad outcome that actually occurs in the B transaction. ("We prohibited liens on property the company purchased for more than $200,000; we didn't prohibit liens on property the company purchased for less but improved so that their aggregate expenditure exceeded $200,000.")

The 1967 movie Bedazzled[15] illustrates the difficulties of learning from experience. In the movie, Stanley Moon sold his soul to the Devil for seven wishes. All Stanley wanted was to win over Margaret, the waitress from Wimpy's. He tried various ways of accomplishing this end, but every time the Devil managed to grant his wish in fact but violate it in spirit. For instance, Stanley had always been tongue-tied around Margaret; for his first wish, he asked the Devil to make him articulate. Stanley wanted to converse so well with Margaret that she'd fall in love with him. As the wish progresses, Margaret is passionate about conversation, emboldening Stanley to take the next step and suggest romance; needless to say, her passions don't carry over into the romantic realm. His next wish is that she be very physical; she is, but with everyone except Stanley. Next, he wishes for them to be in love; they are, but they are married to other people. And so on. Each time, Stanley crafts his wish precisely, so as to prevent what has gone wrong before. But after several wishes, he is no closer to landing Margaret than he was when the Devil discovered him trying to hang himself in despair.

Stanley is undergeneralizing from his experience. He should have learned to think about not just what had gone wrong, but what else could have gone wrong—what *sort of thing* the thing that went wrong *was*. And what *sort of thing* did not go wrong but could have.

There is no one correct level of generalization. More generally, there is no one correct level of effort to be spent determining what a

15. BEDAZZLED (20th Century Fox 1967).

contract should provide for. In some transactions, the contract's words may be particularly crucial. For instance, the more devilish the other side is known to be, the more effort one may need to spend; reputational forces will not constrain a devilish party from taking advantage of every gap in the contract, no matter how tiny. But at a certain point, the effort may not be worthwhile: the Devil can always find a way to grant Stanley's wish in fact but violate the spirit, no matter how well-crafted the wish had been.[16]

Prudent is trying to impart a much more general lesson: that Preppie should defer to the form, but not unthinkingly—not "too much." But again, how is Preppie to know how much is too much? And it's not as though he can learn this lesson once and for all. He presumably will learn the lesson better and better as time goes on; nevertheless, he will likely continue to err for a long time in his career. Some lawyers by temperament (risk lovers? overconfident?) might tend to defer too little; in my experience, most will defer too much.

The form provides a baseline from which to determine what the contract should address. For instance, when Preppie is trying to determine whether a contingency is sufficiently likely that it warrants being addressed in a contract he's drafting, he will naturally apply a different standard for contingencies the form already addresses. Consider why: deleting a provision is an affirmative act. Why do it without a good reason? But thinking of new contingencies takes effort—brawn—as well as brains; Preppie simply might not think of new contingencies as remote as some of those already addressed in the form (or, for that matter, he might not think of new contingencies far less remote than those already in the form).

When Prudent reviews Preppie's draft, he presumably focuses more on deviations from the form—on things he is *not* used to seeing. Prudent's reviewing strategy is sensible and intuitive. He trusts the lawyers in his firm who created and "vetted" the form.[17] He therefore feels no need to review their work: the form—that is, the contract given to Preppie to mark up. But Prudent has no reason at this point to trust Preppie.[18] Thus, whatever Preppie's done by himself will

16. In this regard, consider "work-to-rule" job actions in which employees disrupt the employer's business by abiding strictly to every applicable work rule.

17. The term "vetted" originally meant "given a security clearance." It has become a metaphor for "approved" in various contexts.

18. Prudent indicates he has worked with Preppie before when he tells Preppie that Preppie "forgot" about the special situation applicable to the previous draft. But we do not

warrant particular scrutiny. But if each person skips over the more familiar provisions quickly, assuming her (competent) predecessors have considered it, many provisions may never have been vetted. Nevertheless, given Prudent's billing rate, he is likely acting in his client's best interest by conducting only the more abbreviated review. A review from scratch would be quite costly; the likelihood that Prudent would detect anything warranting this cost is small.

If something goes wrong later, both Preppie and Prudent can argue that they acted reasonably, in accordance with an industry-wide standard: the form production process.[19] Preppie, Prudent, and Prudent's firm will look very bad if they do not provide for a commonly provided-for remote contingency that actually occurs; they will not look nearly as bad if they do not provide for an equally remote contingency[20] not commonly provided for.[21]

Thus, Preppie accords a rebuttable presumption to provisions in the form. For particular provisions, he weighs whether the presumption has been rebutted. The presumption will not be rebutted for benign provisions (such as the typical boilerplate about references to one gender including the other and captions of provisions not being part of the meaning of the provision); saving trees (or secretarial overtime or shipping charges) will not be a sufficient counterweight. His best guess may be that a provision seems benign, but he's not completely sure: the calculation will favor keeping the provisions. Indeed, Preppie will make as few changes as possible. He

know what level of responsibility Preppie had; he might have done no more than fetch the coffee, which is indeed his main role in this playlet as well. If that is the case, Prudent's criticism is, in my view, quite unfair. It is easy for Prudent, who understood what was going on at the time, to have filed away in his mind the "special situation" story, but far harder for Preppie, who might barely know what a representation and warranty is: Preppie might be so overwhelmed with the new library he has to construct in his head that he might have difficulty shelving away for later use the books (experiences) that he's been given.

19. Different firms' forms are not identical; indeed, firms compete in part by touting the superiority of their forms. But the forms are sufficiently similar, as are the firms' staffing practices, that an industry-wide standard, among firms doing the kinds of transactions this essay addresses, does exist.

20. This discussion makes Preppie's determination seem simpler than it actually is: it's not as though degrees of remoteness were determinable easily or, in some cases, at all. Still, there is a sufficient consensus as to the more common sorts of contingencies that lawyers can, and do, get a general sense of degrees of remoteness.

21. A lawyer always suffers for not having anticipated a contingency that occurs, regardless of how remote the contingency was. The effect is far greater than the effect of having anticipated and provided for a contingency that does not occur. The result is a bias in favor of overinclusion. *See generally* Kahan & Klausner, *Path Dependence*, *supra* note 5. There are costs to providing for remote contingencies; however, these weigh much less heavily in the lawyers' computation. I discuss this matter further *infra* Section III.A.

will often favor "band-aids," requiring the least tinkering possible, over a more elegant, structural solution. The paradigm band-aid says "anything else in this agreement to the contrary notwithstanding" or other words to that effect. Preppie has been told that the form—the contract he's marking up—"works": that the provisions, in the aggregate, create internally consistent rights and duties, and cover the appropriate universe of events and contingencies. He will worry that any larger changes might make the contract not work.

Preppie's deference to the form accords with lawyers' preferences generally, including lawyers on the other side in the Suggestive transaction. A lawyer used to seeing an article entitled Representations and Warranties immediately preceding an article entitled Covenants and Agreements will find it easier to review a document with these same articles in this order. Indeed, lawyers often use other forms, as well as mental "forms," to compare forms they are asked to review: in this respect, the reviewing process is similar to the drafting process. Consider again Prudent's description of the problems with Preppie's first draft: Prudent depicts himself and Preppie as using physical (and mental) forms as a baseline, checking off inclusion of all the usual items, noting deviations, and limiting in-depth consideration mostly to those deviations.

After the transaction closes, neither Preppie nor Prudent will have any incentive to review the final contract as signed, to "clean up the form," replacing band-aids with more elegant solutions, and, more generally, incorporating the insights they may have gotten during time-pressured negotiating or drafting sessions. Who would such a review benefit? Probably not the client, especially given what such a review would cost.[22] Moreover, since drafting and negotiating is almost always done in the heat of the moment, the form likely would not stay "clean" for long, unless the firm were willing to commence an expensive, regular form-cleaning process.[23] Finally, Prudent and Preppie probably have moved on to other transactions. And Preppie would just as soon not see the contract in the cold light of day, where, he thinks, all the mistakes he's made will become glaringly obvious.

22. One exception: if the transaction were a loan, Preppie might be asked to prepare a compliance checklist for the borrower or lender. He would look through the agreement to identify the duties imposed on the party and list them in some user-friendly way.

23. The firm also could develop a perfect fill-in-the-blanks-style form it updated regularly and required all its lawyers to use. I discuss the difficulties with developing such a form *infra* Part IV.B.3.

In Prudent's next transaction, he probably will tell the junior lawyer assigned to him, Josephine Preppina,[24] to ask Preppie for the Suggestive contract. And the process will unfold very much as it did with Preppie. Or perhaps he will work again with Preppie; the process will still unfold substantially as it does above, since Preppie is still far from having unlocked the mysteries of drafting and negotiating contracts.

In the next part, I analyze the dynamics behind the story I have just told. I discuss the incentives of firms, and lawyers within firms, at both the junior and senior levels, to use the form production process. I described above how this same process leads to the notoriously cumbersome, difficult to read, inartfully drafted contracts. I identify below economic and psychological factors accounting for this result.

III. WHY CONTRACTS AREN'T MORE PERFECT

A. Economic (External) Dynamics

Using time-tested forms, and changing them as little as possible, makes sense for many reasons, even where the forms are unwieldy and convoluted.[25] Once a lawyer invests in learning how to use the process and understanding the terms and structure of typical contracts, the incremental cost for each subsequent use of the process will be small, and the process will provide the cheapest and quickest way to produce a contract. Reviewing contracts will be expedited as well. Moreover, the transactional community has considered and interpreted the standard provisions (including both boilerplate and the more substantive provisions) many times. These are "network effects," wherein each firm benefits from having firms generally using similar forms,[26] independent of the substantive merit of the particular forms.[27] A provision's lack of substantive merit as contrasted with a less common alternative is not irrelevant; however, network benefits can sometimes trump benefits of a "better" provision. There also

24. Josephine Preppina is my invention, not Freund's.

25. We need not explain the first mistake or imperfection. First iterations tend not to be successful; indeed, multiple iterations have the job of improving on first and subsequent attempts.

26. Kahan & Klausner, *Standardization and Innovation*, *supra* note 5. Kahan and Klausner distinguish between learning benefits, which are in the present, and network benefits, which are in the future. *Id.* Here, I characterize both as network effects because the distinction is not relevant for my analysis.

27. *Id.*

may have been some judicial interpretations of particular provisions.[28] Preserving the benefits of these existing interpretations provides another reason to disfavor innovation.[29]

Other reasons are important as well. In the community of large law firms, success need not require being a "star"—rather, meeting some industry-wide standard of competence suffices.[30] But meeting this standard requires effort, skill, and luck. Furthermore, whether one meets the standard turns in part on whether one is *perceived* as meeting the standard: in an appreciable number of cases, there is no authoritative source to settle the matter. Information is not just incomplete because it is costly; imperfection here is virtually intractable.

The transactional community sets the standard to be met: use of a production process whereby an existing contract, vetted by several senior members of the firm (that is, an existing contract some of the firm's lawyers have drafted and negotiated), is used as a form and revised for a new transaction. There are many accepted ways to staff a transaction; many factors are considered, including the complexity of the transaction and the parties involved. But there is always some senior-level oversight and often much junior-level day-to-day drafting, revising, negotiating, and distributing of the contract. For each lawyer, and indeed, for the lawyers' firms, following the standard makes avoiding a bad outcome—that is, a bad outcome for which the lawyer is blamed—easier and less costly.[31] And indeed, avoiding a bad outcome is tantamount to a good enough outcome. In large-firm corporate practice, if a lawyer continues to pass muster at

28. Certainly, lawyers can better advise their clients as to the likely legal outcome if a provision has already been interpreted by the courts: even the clearest new provision may provide less certainty than a less clearly written provision with a settled judicial interpretation. But in my experience, such benefits are rarely at issue; indeed, there has usually been no interpretation of the provisions involved.

29. *See generally* Kahan & Klausner, *Standardization and Innovation*, *supra* note 5; Kahan & Klausner, *Path Dependence*, *supra* note 5.

30. *See* Kahan & Klausner, *Path Dependence*, *supra* note 5, at 353–58 (expanding on this point, and considering it as an instance of "herd behavior"). An analogy can be made with money managers. I discuss this dynamic as it applies to money managers in Claire A. Hill, *Why Financial Appearances Might Matter: An Explanation for "Dirty Pooling" and Some Other Types of Financial Cosmetics*, 22 DEL. J. CORP. L. 141, 174–78 (1997).

31. Moreover, when something goes wrong, a natural tendency is to locate the blame somewhere within one's own choices, so as to believe that next time one can make a different choice leading to a good outcome. Lawyers are thus well situated to take blame: the client may want to believe that if he hires another lawyer next time, there will be a good outcome. If there's no authoritative source in a fair number of cases, lawyers will need to make sure they're able to pass muster with whatever serves as the alternative to the authoritative source.

the senior level, doing her job competently and keeping her clients satisfied, she will do quite well by most measures of "success."

Thus, the payoff to effort spent avoiding bad outcomes is high. And this effort is coextensive with efforts to pursue ordinary good outcomes: taking care overall. By contrast, the payoff to effort spent pursuing extraordinarily good outcomes is lower. Exceptionally good outcomes would require innovation: say, a different production process with quite different-looking contracts with quite different provisions. Innovation increases the risk of bad outcomes. Thus, one cannot pursue extraordinarily good outcomes without incurring a greater risk of bad outcomes.[32] Lawyers therefore rationally would direct their energies more towards slightly exceeding the standard—avoiding bad outcomes and pursuing ordinary good outcomes—than on innovation.

The foregoing considers dynamics equally applicable to lawyers and their firms. Junior lawyers also may benefit in ways that are neutral or adverse to their firms by showing due deference to the form production process and generating contracts that "do the job" but concede little to elegance. The junior lawyer would, for instance, make smaller, band-aid changes, and would refrain from making structural changes or changing others' bad but serviceable drafting. She may draft very clearly herself, or she may not: her language, again, might do the job but only by using now-accepted, but circuitous, formulations. She may be seen as signaling desirable "mover-and-shaker" status: she is showing that she cares about the transaction documents only insofar as required to get any particular job done, and will not waste the client's money catering to more aesthetic concerns. (Indeed, among the indicia of caring too much about aesthetics is not only taking the trouble to make one's own changes to the form beautiful, but also revising the language already in the form to that end.) Junior lawyers also may benefit by not subjecting their supervising lawyers to changes the seniors would have to spend more time reviewing, and, indeed, might not understand. Finally, as I will explore at greater length below, the lawyer is not diversified in her employment. She will appraise a remote risk of

32. Pursuing exceptionally good outcomes, like innovative structures, likely only can be done by exposing oneself more to bad outcomes. *See* Kahan & Klausner, *Path Dependence*, *supra* note 5, at 353–58. Pursuing good, but not extraordinarily good, outcomes energetically, so as to slightly exceed the industry standard, may be quite consistent with avoiding bad outcomes. Examples include a quicker turnaround time and a more careful drafting job with fewer inapt definitions.

being fired differently than she would appraise a remote risk that one of the many stocks in her portfolio will lose all its value.[33]

B. Psychological (Internal) Dynamics

1. Overestimating the Likelihood of Bad Events

Many lawyers in large firms, even some at relatively senior levels, seem to assign higher probabilities to certain bad events than is warranted.[34] Lawyers overestimate the probability that: (a) they have made a mistake; (b) the mistake will be detected (since, they believe, their supervisors have near-superhuman powers); (c) the mistake will have really bad consequences for them; (d) the mistake will have really bad consequences for the client; and/or (e) they're less competent than their peers. My evidence as to the actual probabilities, and lawyers' estimates thereof, is solely anecdotal; still, I have collected many anecdotes, and they have all supported this view.[35] Bad outcomes are more heavily weighted in part because they are more available and more vivid. As Daniel Schacter reports in his work on memory, subjects recall most accurately events of high emotional arousal.[36] Some of the literature suggests physiological and evolutionary reasons why memories associated with charged events might be remembered more vividly.[37]

If many lawyers overestimate the probability of bad events, they might practice law defensively, doing mostly that which they can defend. They therefore should favor relying on the form, which someone, and indeed, many people, some of who are quite senior, has

33. *See* Milton Friedman & L.J. Savage, *The Utility Analysis of Choices Involving Risk*, 56 J. POL. ECON. 279, 285–86 (1948); Duke Power Co. v. Carolina Envtl. Study Group, 438 U.S. 59, 86 n.28 (1978). On problems in estimating remote risks, see Christine Jolls et al., *A Behavioral Approach to Law and Economics*, *in* BEHAVIORAL LAW AND ECONOMICS, *supra* note 6, at 13, 38.

34. Part of the story may be an "availability heuristic," where the image of some bad outcome that befell the lawyer's compatriot is etched in the lawyer's brain. *See generally* Tversky & Kahneman, *supra* note 6.

35. A related dynamic is the tendency to overestimate remote likelihoods. See Friedman & Savage, *supra* note 33, as to overestimating the likelihood of remote, catastrophic outcomes. The dynamic I am describing can accommodate, but does not require, that the initial likelihood be remote. In any event, overestimation of remote bad outcomes may be outweighed by underestimations reflecting unrealistic optimism. *See* Cass R. Sunnstein, *Introduction* to BEHAVIORAL LAW AND ECONOMICS, *supra* note 6, at 1, 4–5.

36. DANIEL L. SCHACTER, SEARCHING FOR MEMORY: THE BRAIN, THE MIND, AND THE PAST 192–217 (1996).

37. *See id.*

vetted, rather than relying on themselves, whom no one has vetted. They also should favor fewer changes in the aggregate, and less changes that are structural. But they also may be willing to make benign additions, such as new boilerplate as to such matters as "he" also meaning "she" where applicable, with little regard to the ever-increasing size and unwieldiness of the contract.

2. Imperfect Information and Ambiguity

In the same vein, lawyers might respond to imperfect information by clinging unduly to the known. Indeed, assessing how much information one has, how much sense it makes to acquire more, how to acquire information, and, even more fundamentally, what constitutes information, is often difficult. Economics typically glosses over these types of problems, speaking as though one could easily assess how much information one had and whether the costs of acquiring additional information exceed the benefits. But the problems are real: for instance, if you ask someone a question, how do you appraise whether they've given you the right answer? Economics deals with the many ways people signal authoritativeness and credibility. But a need for information can arise without an authoritative or credible source close at hand. For lawyers, this problem is most acute at the junior levels, but it never goes away completely. The junior lawyer may have difficulty knowing who to believe as to whether bylaws must be filed with the secretary of state or not: does he believe the midlevel associate who says they do? Or does he draw the contrary inference from the statute saying that the certificate of incorporation is filed with the secretary of state but silent as to the bylaws? And there may be political reasons why he cannot ask someone he knows is authoritative: very early, he will learn enough to know not to ask a senior lawyer, especially his supervisor, a question that parades his ignorance. Ostentatious, or serious, mistakes likely will be caught; lesser, or less obvious, mistakes may not be. The incentive to rely on precedent, and shy away from one's own judgment, is clear: knowing that you do not know impels you towards relying on someone else's knowledge—that of the authors of the form.

Indeed, scholars have considered extensively how people make decisions under imperfect information. One strain of literature distinguishes between "risk" and "uncertainty." The paradigm of risk is traditional gambling: the odds—probabilities—are known; the

outcome is not. By contrast, in situations of uncertainty one cannot assign precise probabilities.[38] When asked to choose between uncertainty and risk, people choose risk. The more uncertainty there is, the greater temptation to retreat to something potentially offering greater certainty, or at least a good defense. In this regard as well, the form offers comfort.

3. Other Dynamics

Various other psychological dynamics give precedent an edge over innovation. Three such dynamics are a status quo bias, an "anchoring effect," and a conformity bias.[39] The status quo bias favors, not surprisingly, the status quo. The form—the way things have been done in the past—counts as the status quo for this purpose; the bias is towards retaining the status quo rather than changing it. Indeed, such a bias would also favor continuing to draft in legalese even when clearer formulations were close at hand. I know from personal experience that fluency in legalese is all too readily acquired; the translation becomes automatic and unconscious. Similarly, the anchoring effect favors one's initial starting point, which, in this case, is again the form. Finally, the conformity effect also favors the form, since each lawyer is surrounded by others using the form; the lawyer will want to conform to his peers and seniors. Intuition supports the existence of these dynamics: if we see something done a certain way, we think of that way as being the right way; doing the thing any other way would be noticeable and jarring, and would seem wrong.

IV. THE FORM'S IMPERFECTIONS AND WHY THEY PERSIST

A. The Form's Imperfections

The imperfections this essay seeks to explain chiefly are unnecessary length and complexity, and, sometimes, ambiguities that too readily allow for multiple interpretations. I've discussed above the context in which such imperfections arise. Lawyers need a way to

38. *See* FRANK H. KNIGHT, RISK, UNCERTAINTY AND PROFIT, 198–99 (Augustus M. Kelley 1964) (1920). *See also* Craig R. Fox & Amos Tversky, *Ambiguity Aversion and Comparative Ignorance*, 110 Q.J. ECON. 585 (1995); Hillel J. Einhorn & Robin M. Hogarth, *Decision Making Under Ambiguity*, *in* RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY, *supra* note 4, at 41.

39. *See generally* Kahan & Klausner, *Path Dependence*, *supra* note 5; BEHAVIORAL LAW AND ECONOMICS, *supra* note 6.

access other lawyers' experience; forms are well suited for this purpose. Forms are used and revised in the heat of the moment; there is almost never time to go back and "fix" things more elegantly. Indeed, there is a fundamental tension between the contract's status as contract and its status as form. A contract is drafted for a client; its use as a form is, from the client's perspective, incidental and not something the client will subsidize. If a lawyer were supposed to be drafting a form rather than a contract, she could attend more to structural integrity—she could address problems with more than the smallest band-aids. But, as discussed in Part II above, many forms are full of the paradigm band-aid, "anything in the foregoing to the contrary notwithstanding," because someone in one transaction argued that section 7.2 might raise an intimation contrary to the intent of 4.3, and someone in another transaction argued that section 4.7 might be read as contradicting section 2.2(a) and so on. The cumulative effect of such clauses can readily be imagined.

Moreover, the contract production process does not contemplate, nor could it, all its participants having full information about the present, much less the future. And circumstances, including "noise," may make it difficult to determine what provisions work and what provisions don't work. Things may go wrong for many reasons. If they do, clients may blame their lawyers, and senior lawyers may blame their juniors, regardless of where fault lies. And lawyers may worry more than is warranted that things will go wrong and that they will be blamed. Finally, because the form is one's point of departure, its provisions necessarily have a mantle of correctness; deviations have to be, in a sense, "justified." Things already written down come pre-legitimized—not just in the political sense that there's no payoff in challenging them, but also in the psychological sense that they "look like they belong."

As a result, deviations from the form, especially more structural or innovative deviations, are disfavored. Necessary changes to use the form in the new transaction are more apt to be as limited as possible to "do the job." Deletions generally must meet a high threshold of justification: omitting a provision because it doesn't do much, but does clutter up the form, rarely suffices. But inclusion of new boilerplate that doesn't seem to help but couldn't hurt requires much less justification.[40] Contracts get progressively longer and more cumbersome, and usually not to any positive end.

40. Movers and shakers won't spend their time including lots of new boilerplate. However,

B. Why the Imperfections Persist

1. Switching Is Costly

Recent scholarship has discussed economic reasons why deference to a form might exceed that warranted on substantive grounds.[41] These reasons echo the reasons I discussed *supra* Part III.A. Moreover, once the production process using the form is in place throughout the transacting community, incremental costs of using it are low; costs of switching to another method are higher. Other switching costs may also be at issue. As I have discussed, the production process involves forms created and updated in actual transactions, where junior level scribes do most of the drafting, and senior lawyers review in carefully honed bursts. Switching from this process would be costly. An alternative mechanism to make lawyers' accumulated wisdom available throughout the firm, and make changes reflecting new conventions and law, would need to be devised. Indeed, personnel requirements for the firm might be different, such that hiring would have to be done more carefully. If scribes no longer could play an important role, the firm would have to figure out how to weed out scribes who wouldn't soon progress to more responsible work, or, better yet, figure out how never to hire them. As I discuss below, firms now have the luxury of hiring first and weeding out later.

2. The Production Process May Offer Benefits

The production process may offer specialization benefits. And the process may help firms distinguish between promising and less-promising junior lawyers while making profitable use of both.[42] The less-promising juniors may take full advantage of the form's ability to let them do their jobs without thinking very much, staying at a level only slightly above Preppie's. The more promising reveal themselves as such by taking a more active approach, and understanding more about the form and the production process. Less-promising lawyers

those aspiring to mover-and-shakerdom but doomed to failure sometimes think it looks impressive to include lots of new boilerplate; a few such people is all it takes to add appreciably to the "miscellaneous" article at the end of most contracts.

41. *See* Kahan & Klausner, *Standardization and Innovation*, *supra* note 5.

42. The less-promising lawyers must, of course, meet a certain baseline, or they could not even function as scribes. But firms are, in my experience, generally capable of weeding out those falling below that baseline at the pre-hiring stage.

may be difficult to detect in the hiring process; they also may be in larger supply than more-promising lawyers. Thus, the firm may benefit by using a production process that makes profitable use of less-promising lawyers, and defers the need to make fine differentiations among varying levels of skill until such differentiations are easier to make.

3. The Net Benefits to Seeking Perfection May Be Small

Why don't the Freunds of this world exploit these imperfections to their benefit?[43] Perhaps because the benefits to doing so may not exceed the costs. Developing a perfect form, and a production process to keep it pristine, would be one way to exploit the imperfections. But who would pay to develop this form and process? It is hard to imagine clients paying. The benefit to each client is small; moreover, how and why would clients band together for such a purpose, especially in these days where clients often turn to (fairly mobile) lawyers rather than firms, and use different firms for different sorts of transactions?

Thus, the form and process would have to be developed at firm expense. Some of the firm's more talented lawyers would be diverted from client-servicing, revenue-generating activities. And, unless the firm's leadership was perceived as being committed to the project, talented junior lawyers with political savvy (and, in my experience, most talented junior lawyers do have political savvy) would somehow be "busy" when the form project taskmasters were seeking volunteers. Talented senior lawyers might need to be heavily involved, and the revenue loss might be sizeable.

Moreover, the task itself is difficult and complex, even for talented lawyers.[44] How much should one change? How different can the form look from that used by other firms? And which provisions are only vestiges of history, serving no useful function today? Is it worthwhile to truncate the typical granting clause in a secured loan agreement, which "grants, bargains, sells, assigns, transfers, conveys, mortgages, pledges, and confirms" unto the lender a security interest in the collateral? What about words like "whereas," "witnesseth"

43. I do not ask why Freund and his ilk don't arbitrage the imperfections until they disappear; money may theoretically be in infinite supply, but Freund-like attributes clearly are not.

44. Indeed, the task may be amenable to specialization. Some lawyers may be better at seeing the "big picture," others may know the history of the various provisions, and others may be the best draftspeople.

and "know these men by their presents?" And what about the deeper structural issues? For instance, there are separate "articles" entitled "representations and warranties" and "indemnities." Conceptually, the difference between the two types of articles is murky at best.[45] It seems unlikely that someone smart but completely ignorant would write a contract from scratch treating the two as qualitatively different. But is it worthwhile to integrate the two sections? Perhaps; perhaps not.

Even if the form and production process could be developed, how would the firm get its lawyers to use them? The firm might need to make an institutional commitment to this end, a commitment it would need to sustain throughout the transitional period. Indeed, habit-propelled lawyers might use the form once and then use their own versions of the form subsequently, defeating the project's whole purpose. And how would other firms react to the firm's use of a different-seeming form? Most likely, the result would be additional costs as the other firms bridle at having to learn something new. They might fear competition from the perfect form; or they might think the firm was hoisted by its own petard by elevating aesthetics over "getting the job done." In either case, the other firms' reactions might be unfavorable.

A more modest endeavor would be cleaning up the form: allotting time after transactions to clean up the more egregious clutter. But keeping the forms clean would be expensive or short lived. Since negotiated changes to contracts are almost always narrowly tailored to satisfy the particular parties, potential for damage to the contract's structural integrity is ever present. Preventing or quickly repairing damage would require frequent, costly "inspections."

Finally, the benefits of an improved form might be smaller than they initially appear. The improved form should be substantively better. It also should be easier to use, after an initial learning investment has been made. But lawyers who read and write contracts for a living have already made the investment in learning about the

45. One difference may be that representations and warranties are used to elicit information. For instance, the buyer, who typically does the first draft of the acquisition agreement, includes many "flat" representations, such as that the seller has furnished all his contracts, no one is suing or even threatening to sue the seller, the seller is not in violation of any laws, and so on. As the negotiations proceed, the seller explains which of these representations he can give and which need to be "qualified" with knowledge or materiality. (I discuss this further in my work-in-progress, *What We Do (and Don't) Complete In Incomplete Contracts*.) However, even given this function of representations, the Representations and Indemnities articles nevertheless coexist less than elegantly.

present form, with all its imperfections. They have learned its foibles, and now scarcely notice them. They incur only small incremental costs on account of the form's unwieldiness and inartful drafting. Indeed, such lawyers may value contracts' seeming inaccessibility: it may help them justify their fees. And it may help them set up barriers to entry by lawyers in less-sophisticated firms.

4. Why Multiple Iterations Don't Make the Form (More) Perfect

The form represents the accumulated wisdom of everyone who has worked on it. Every mistake caught has been fixed, including mistakes of commission and omission. But what set of mistakes has been caught: those caught through routine reviews, those caught serendipitously (or because they run afoul of the reviewer's pet peeve[46]), and those that were recognized to have caused trouble. The mistakes that are caught are necessarily a subset of the mistakes made: the subset likely does not include most mistakes, and may very well not include many big mistakes. Even catching a mistake is no assurance that it gets corrected in a way that really helps. In this regard, consider the discussion in Part II, *supra*, about Stanley Moon: he figures out that he needs to tell the Devil that he and Margaret should be in love with each other but not married to other people; the Devil makes them nuns in a convent.

Moreover, the iterations are not always efficient at correcting mistakes. Doing routine reviews is rarely a way for a lawyer to endear herself to her seniors or clients; moreover, considering the extremes under which most transactions are done, even if a lawyer were so inclined, she would scarcely have the time. (And whom would she bill for the time?) Even mistakes caught are not always fixed. Mistakes are often discovered when one party is determining its rights under the contract—that is, when things are not going well. There may be noise as to what the mistake is. More importantly, the parties' first priority is to reach an accommodation. The accommodation might involve a contract amendment; more likely, it does not. Even if it does, the amendment is more likely to be a band-aid for these particular parties in this particular situation than a correction of the form. Any urgency is likely to wither once the parties have come

46. For example, some lawyers routinely read the "notice" provisions and replace references to "telex" with "fax" and "e-mail"; however, not all "forms" have been fixed, and, for a long time after anybody was using telex, many contracts still expressly permitted notice only by telex.

to an accommodation; fixing the form likely stays at the bottom of the lawyer's "to do" list, and never gets done. New mistakes are made too, offsetting the gains of cumulated mistake correction. Mistake correction also does not occur efficiently in the ordinary course of negotiation: like negotiations in distress situations, initial negotiations resolve contentious points with band-aids that change the offending provision with little regard to the effects on the rest of the contract.

The mistake correction process is far from smooth. But mistake correction would seem to provide the best case for multiple iterations' perfecting powers. Multiple iterations seem less well suited to cleaning up inartful language, deleting outdated boilerplate or redundancy, or making structural changes beyond what's necessary to "do the job" in a particular transaction. Thus, even with multiple iterations, practice does not make perfect.

V. CONCLUSION

In sum, looking at particular features of contracts, and, indeed, contracts as a whole, the conclusion that we could do better might seem inescapable. Yet, looking at the process by which contracts are created, and considering lawyers' incentives and proclivities, we might wonder whether unwieldiness and inartfulness might not be the smallest price we could pay for the benefits the process offers.

APPENDIX

"Subordinated Indebtedness" means unsecured Funded Indebtedness of the Company which

A. On the date on which the status of such Funded Indebtedness is determined for any purpose hereof,

(1) has a final maturity not earlier than the maturity date of the last installment of principal then payable on the outstanding Notes,

(2) has a Weighted Average Life to Maturity at least as long as the remaining Weighted Average Life to Maturity of the Notes, and,

(3) is not subject to payment, redemption or other retirement by means of any installment, sinking fund, serial maturity or other required payments at a rate greater than the rate at which the unpaid principal amount of the outstanding Notes shall be payable in installments as herein and in the Notes provided; and

B. Is issued or assumed pursuant to, or evidenced by, an indenture or other instrument which contains provisions for the subordination of such Funded Indebtedness (to which appropriate reference shall be made in the instruments evidencing such Funded Indebtedness if not contained therein) to the Notes (and, at the option of the Company, if so provided, to other Indebtedness for Money Borrowed of the Company, either generally or as specifically designated) substantially as follows (without limitation as to further, not inconsistent, provisions, if so desired):

Subordination. Anything in this Subordinated Note to the contrary notwithstanding, the indebtedness evidenced by this Subordinated Note shall be subordinate and junior in right of payment, to the extent and in the manner hereinafter set forth, to all indebtedness of the Company evidenced by its X% Senior Notes from time to time outstanding (whether outstanding at the date of this Subordinated Note or issued after the date of this Subordinated Note and as said X% Senior Notes may at any time and from time to time be modified or amended in any respect) and to (All such indebtedness to which this Subordinated Note is subordinate as aforesaid being sometimes hereinafter referred to as 'Superior Indebtedness'):

(i) In the event of any insolvency or bankruptcy proceedings, and any receivership, liquidation, reorganization or other similar proceedings in connection therewith, relative to the Company or to

its creditors, as such, or to its property, and in the event of any proceedings for voluntary liquidation, dissolution or other winding up of the Company, whether or not involving insolvency or bankruptcy, then the holders of Superior Indebtedness shall be entitled to receive payment in full of all principal, premium (if any) and interest on all Superior Indebtedness (including interest thereon accruing after the commencement of any such proceedings) before the holder of this Subordinated Note shall be entitled to receive any payment on account of principal, premium (if any) or interest on this Subordinated Note. Pursuant to the foregoing (but subject to the power of a court of competent jurisdiction to make other equitable provisions reflecting the rights conferred herein upon Superior Indebtedness and the holders thereof with respect to the subordinated indebtedness represented by this Subordinated Note and the holder hereof by a lawful plan of reorganization under applicable bankruptcy law) the holders of Superior Indebtedness (until payment in full of all principal, premium (if any) and interest on all Superior Indebtedness, including interest thereon accruing after the commencement of any such proceedings) shall be entitled to receive for application in payment thereof any payment or distribution of any kind or character, whether in cash or property or securities, which may be payable or deliverable in any such proceedings in respect of this Subordinated Note (including any such payment or distribution which may be payable or deliverable by virtue of the provisions of, or any security for, any securities which are subordinated and junior in right of payment to this Subordinated Note), except securities which are subordinated and junior (to at least the same extent as this Subordinated Note) in right of payment to the payment of all Superior Indebtedness then outstanding. The holder of this subordinated Note shall not exercise or attempt to exercise any right of setoff or counterclaim in respect of any obligations of the holder of this Subordinated Note to the Company against the obligations of the Company under this Subordinated Note if the effect thereof shall be to reduce the amount of any such payment or distribution to which the holders of Superior Indebtedness would be entitled in the absence of such setoff or counterclaim; and if and to the extent that, notwithstanding the foregoing, the holder of this Subordinated Note is required by any mandatory provision of law to exercise any such right of setoff or counterclaim, each reduction of the amount owing on account of the principal of or premium (if any) or interest on this Subordinated Note by reason of such setoff or counterclaim shall be

deemed to be a payment by the Company in a like amount in respect of this Subordinated Note to which the second sentence of this paragraph (i) shall apply.

(ii) In the event that this Subordinated Note is declared due and payable before its expressed maturity because of the occurrence of an event of default hereunder (under circumstances when the provisions of the foregoing paragraph (i) or the following paragraph (iii) shall not be applicable), the holders of Superior Indebtedness then due, or becoming due by acceleration or otherwise prior to the expiration of a period of 75 days after the date on which the Company or a holder of this Subordinated Note gives to the holders of the Superior Indebtedness the written notice provided for below in this paragraph (ii), shall be entitled to receive payment in full of all principal, premium (if any) and interest on all such Superior Indebtedness before the holder of this Subordinated Note shall be entitled to receive any payment on account of the principal, premium (if any) or interest on this Subordinated Note other than any such principal, premium (if any) and interest due otherwise than by reason of such declaration. For the purpose of this paragraph (ii) the Company agrees, for the benefit of the holders of Superior Indebtedness as well as the holder of this Subordinated Note, that, if any such declaration remains unrescinded for 15 days, the Company will promptly give written notice thereof to all holders of Superior Indebtedness. If the company fails to give such notice, the holder of this Subordinated Note may do so on behalf of the Company. At any time within 75 days after the date on which such notice is given, any holder of outstanding Superior Indebtedness shall have the right to declare all Superior Indebtedness held by such holder to be due and payable, whereupon such Superior Indebtedness shall forthwith become immediately due and payable regardless of the expressed maturity date thereof. Nothing herein shall prevent the holder of this Subordinated Note from seeking any remedy allowed at law or in equity so long as any judgement or decree obtained thereby makes provision for enforcing this paragraph (ii).

(iii) In the event that any default shall occur and be continuing with respect to any Superior Indebtedness permitting the holders of such Superior Indebtedness to accelerate the maturity thereof, the holder of this Subordinated Note shall not be entitled to receive any payment on account of principal, premium (if any) or interest hereon (including any such payment which would cause a default) if either

(a) judicial proceedings shall be pending in respect of such default, or (b) written notice of such default shall have been given to the Company by any holder of Superior Indebtedness and a period of 180 days in the case of a monetary default or 90 days in the case of any other default shall not have expired since the giving of such notice; provided, however, that this paragraph (iii) shall apply to only one such notice given in any 12 months' period. The Company, forthwith upon receipt of any such notice, shall send a copy thereof to the holder of this Subordinated Note.

No present or future holder of Superior Indebtedness shall be prejudiced in such holder's right to enforce subordination of this Subordinated Note by any act or failure to act on the part of the Company. The provisions of this Section are solely for the purpose of defining the relative rights of the holders of Superior Indebtedness on the one hand, and the holder of this Subordinated Note on the other hand, and nothing herein shall impair, as between the Company and the holder of this Subordinated Note, the obligation of the Company, which is unconditional and absolute, to pay to the holder hereof the principal and interest hereon in accordance with the terms hereof, nor shall anything herein prevent the holder of this Subordinated Note from exercising all remedies otherwise permitted by applicable law or hereunder upon default hereunder, subject to the rights, if any, under this Section of holders of Superior Indebtedness to receive cash, property or securities otherwise payable or deliverable to the holder of this Subordinated Note and all amounts which are deemed to be payments in respect of this Subordinated Note by reason of setoff or counterclaim in respect of any obligations of the holder of this Subordinated Note to the Company against the obligations of the Company under this Subordinated Note.