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Investigating the Contract Production Process

Stephen J. Choi
Mitu Gulati
Robert E. Scott*

Contract law and theory have traditionally paid little attention to the processes by which contracts are made. Instead, contracts among sophisticated parties are assumed to be full articulations of the desires of the parties; whatever the process, the outcome is the same. This article compares sovereign debt contracts from US and UK firms, with different production processes, that are trying to do the same thing under very similar legal regimes. We find that that the production process likely matters quite a bit to the final form that contracts take.

Introduction

The traditional mode of contract analysis assumes a world in which contracting parties choose, from among the universe of linguistic formulations, the precise terms that express the combination of rights and duties that will maximize their expected joint welfare. Since the parties know what combination of terms will maximize the expected returns from contracting, they express the appropriate terms in a document that both binds them and communicates their intentions to courts. In this version of the world, there is no need to consider the process by which these terms are produced. If contracts are reliable expressions of what parties want each other to do, then the process that produces these expressions is irrelevant. Whatever the process, the outcome is the same.

* Faculty at, NYU Law School, Duke University Law School, and Columbia University Law School respectively. Our thanks to Lachlan Burn, Lee Buchheit, John Coyle, Glenn West, Mark Weidemaier and Yannis Manuelides, for conversations about these topics.

Consider a less idealized, alternate version of the world in which it is very costly, starting from scratch, to write a complete contract that specifies accurately the many contingencies that may affect contractual rights and duties. In this world, parties look first to default rules provided by the state and then to their precedents—standard terms used by the parties in prior transactions—to provide a baseline for the precise formulation of the provisions they need. Thereafter, parties may adapt the standard language to fit their unique circumstances but they are generally reluctant to stray too far from their established precedents. There is a reason for this: Having a menu of established contract terms from which a drafter can choose greatly simplifies and reduces the cost of contracting. The value of these precedents goes far beyond a mere saving of the resource costs that would be incurred if a drafter had to write out the terms for each contract. There are many ways in which a contract drafter can misdescribe an intended allocation of risks. Precedents thus bring to bear a collective wisdom and experience that drafters are unable to generate individually.

When precedents that are developed for use by contract drafters coalesce and become standardized across a market, they emerge as boilerplate—standard language that is widely used by most if not all of the parties who trade in that market. The unique benefits of boilerplate derive from the process by which these prior precedents mature and are recognized by all the parties in that market as having consistent meaning. A principal effect of this evolutionary process is the testing of language for dangerous but latent defects. The problem, however, is that boilerplate and the precedents that precede it evolve in distinctly different ways: this evolutionary process is not uniform across the market. Ideally, precedents will evolve as exogenous changes in the market dictate new allocations of rights and responsibilities. But,

in addition, precedents evolve endogenously. Parties in a heterogenous market may be unable to coordinate on efficient revisions to boilerplate terms. Here, evolution may proceed randomly and at different rates in different markets. Most significantly, precedents will evolve as a function of the actions of the drafting lawyers charged with updating obsolete terms. Here, not only agency costs between lawyers and their clients but differences in law firm structure and culture will affect the nature and pace of change.

Commercial contracting today takes place in this world of precedents, boilerplate and marginal adaptations.¹ In this world, the production process—how the standard forms or precedents are developed and how the process of adaptation occurs—critically determines how successfully any given contract specifies rights and obligations that mirror the intentions of the contracting parties. The heterogeneity of the evolutionary process suggests that contracts will differ as a function of different production processes, even when the parties to those contracts intend to exchange exactly the same combination of rights and obligations.² In this paper we test that proposition. We ask: Do differences in the process of producing contract language that is intended to allocate a specified risk in a particular way generate differences in the meaning of the resulting contract term? If yes, then we may be able to draw connections

¹ Prior writing on this topic includes, Barak D. Richman, *Contracts Meet Henry Ford*, 40 HOFSTRA L. REV. 77 (2011); Lee C. Buchheit, *A Note on Contract Paleontology*, 9 CAP. MKTS L. J. 251 (2014); Elisabeth de Fontenay & Adam Badawi, *Is There a First Drafter Advantage in M&A?*, 107 CAL. L. REV. 1119 (2019); Matthew Jennejohn, *Transaction Cost Engineering*, 2020 WIS. L. REV. 574 (2020); Robert Anderson, *Path Dependence, Information and Contracting*, 2020 WIS. L. REV. 553 (2020); Cathy Hwang, *Value Creation by Transactional Associates*, 88 FORDHAM L. REV. 1649 (2020); Glenn D. West, *No Third-Party Beneficiary Clauses and the Ever Evolving Contractual Arms Race*, Weil Gotshal Private Equity Watch (Sept 9, 2020), at <https://privateequity.weil.com/glenn-west-musings/no-third-party-beneficiary-clauses-and-the-ever-evolving-contractual-arms-race/> (last visited, May 6, 2021).

² Matthew Jennejohn, Julian Nyarko & Eric Talley, *Contractual Evolution*, 89 U CHI. L. REV. (forthcoming 2021)

between the nature of the contract production process and the degree to which the written contract accurately embodies the intentions of the contracting parties.

We attempt to gain traction on this question empirically by using data from changes in boilerplate terms relating to the governing law clause in sovereign bond contracts. Boilerplate terms, by their nature, do not change frequently and instead are replicated across different contracts for different contracting parties. For our empirical tests, we examine the process by which change occurs in boilerplate terms and focus on the principal agents of change, the law firms that are charged with drafting the terms. We posit that the way law firms organize the research and development ("R & D") of new and revised terms will affect the formulation of those terms and the speed of their adoption in the market.

We compare the R & D process for commercial contracts governed by English law and New York law. UK law firms primarily draft sovereign bond contracts governed by English law. UK law firms typically have internal groups devoted to the research and design of new boilerplate contract terms. UK law firms, moreover, formally coordinate over the introduction of new boilerplate terms. In contrast, US law firms primarily draft sovereign bond contracts governed by New York law. The process of contract drafting in US law firms is more decentralized. Within US law firms, specific partners typically draft their own boilerplate terms using their own precedents. US law firms also do not typically coordinate over the creation of new terms.

We predict that the different processes of contract production between UK and US law firms will result in a differing output of boilerplate terms. In response to the need for an amendment to a boilerplate term, contracts governed by English law will change more rapidly

compared with contracts governed by New York law. New amendments to terms should also be more standardized for English law governed contracts, reflecting the greater coordination over the terms and the need for change. In addition, we conjecture that when lawyers attempt to amend or revise a boilerplate term, the temptation exists to tinker with other, unrelated language of the term. This attempt to perfect prior formulations can result in the introduction of additional verbiage—that we call "encrustations"—that provides no useful clarity but instead adds uncertainty to the meaning of the boilerplate term. We posit that the greater emphasis on research, design, and coordination by UK law firms will result in fewer encrustations when a change occurs in a boilerplate term compared with change driven by US law firms.

As an empirical test, we focus on the governing law clause of sovereign bond contracts. In 2009, lawyers dealing with both governing law clauses for English and New York law called for changes to the clause to make explicit the application of the clause to non-contractual matters. These calls were in response to developments in the case law in the US and a clarification about the background law via a European regulatory pronouncement that included English law. In both sets of circumstances, prominent lawyers at leading law firms saw the developments as important enough to urge other lawyers drafting contracts in the market to modify their contract provisions. The needed modification was simple and cheap: the addition of a handful of words in the governing law clause that made clear that the clause was meant to cover both contractual matters and any non-contractual matters arising out of the contract (for example, fraud claims relating to the making of the contract).

Helpful to us is that (a) these exhortations on both sides of the Atlantic occurred roughly around the same time (in 2009) and (b) the failure to make the change in question (that non-

contractual matters might be governed by a law other than the one selected by the parties) carried the same consequences. We examine the rates of revision in both settings around 2009. We treat the exhortation by leading lawyers from both countries in 2009 as an exogenous shock and examine how contracting parties and their attorneys adjusted the governing law clause in sovereign bond contracts in response.

The results are stark as Figures 1 and 2. Sovereign bond contracts governed by English law responded rapidly to the 2009 shock while contracts governed by New York law responded slowly. And this is despite the fact that the possible shock hits the New York market before the English one. Further, not only did English law-governed contracts rapidly incorporate a term covering non-contractual issues around the time of the 2009 shock, but the term adopted was largely identical in language across different issuers. Our conjecture is that these differences in reaction rates can be explained in large part by differences in the ways in which firms in the US and the UK produce their contracts.

In addition to collecting data on the rates of revision in responses to the appeals from leading lawyers described above, we also collected data on “encrustations” in the clause. Our conjecture is that when lawyers revise contracts by relying on precedents from other documents, their revisions may incorporate additional language from those other contracts. Absent any centralized process by which contracts are monitored for the accretion of purposeless language, there will be a likelihood of encrustations being added over time.³

³ See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice, An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985) (describing the presence of rote and encrusted terms in contract).

Consistent with the foregoing model of drafting, we find that the number of encrustations for governing law clauses under English law as compared with New York law clauses decreased after the 2009 shock. The more centralized and coordinated contract production for UK law firms corresponded not only to the more rapid adoption of a useful term (the non-contractual term) but also a concurrent reduction in more problematic contractual encrustations in English governed bonds relative to New York governed bonds.

I. The Production Process and Predictions

We start with an examination of the differences in the contract production processes between the New York and UK law firms that produce sovereign debt contracts. We draw here on a set of conversations with leading lawyers with experience at prominent large firms in both the US and UK about how the production and innovation processes for contracts tend to differ across both environments. To set up our empirical inquiry, we simplify what we heard from these lawyers.

In this paper, we draw in particular from the observations of Yannis Manuelides, head of the sovereign debt practice at Allen & Overy. Manuelides, in a recent podcast discussion of this topic, points to two features of the UK law firms that are different from US law firms and that might predict differences in the contracts that are produced in the two jurisdictions.

Paraphrased, the two features are:

- The lawyers at the large elite law firms in the UK have a tradition of coordinating by forming specialized committees for various industries. These committees produce frequent reports on appropriate “best practices” for standard terms. In the sovereign

debt field, the London-based group is the International Capital Markets Association.⁴

There are also expert groups, such as the Financial Markets Law Committee, that produce reports on developing contract provisions to deal with new risks. Neither type of institution exists in the US in the sovereign debt market.

- The large UK law firms tend to have dedicated internal research departments staffed by experienced lawyers who follow developments in the case law and write internal reports on needed modifications to standard forms.⁵ The large New York firms generally do not have dedicated research and development departments. At the New York firms—at least in the sovereign debt area—research is done only if there is a particular client willing to pay for it.

The two structural differences between UK and New York firms described by Manuelides, suggests several differences regarding contracts produced under English law versus New York law. The presence of R&D departments in the UK law firms and trade organizations that regularly recommend “best practices” modifications to standard provisions and the absence of either feature in New York will lead UK law firms to respond more rapidly than US law firms to external shocks that affect a particular boilerplate clause. The response to a shock on the part of the UK law firms will also be more coordinated, producing a greater standardization in changes to the boilerplate clause. If the response requires the addition of

⁴ *Id.* at 76.

⁵ *Clauses and Controversies*, Episode 18, ft. Yannis Manuelides (Apple Podcasts, 2020), at <https://podcasts.apple.com/us/podcast/ep-18-ft-yannis-manuelides/id1528208049?i=1000498846213> (last visited, May 6, 2021).

new language, the new language will be similar if not identical across UK law firms as compared with New York firms. We thus make the following two predictions:

- English contracts will respond faster to external shocks (such as a surprising interpretation from a court) than their New York counterparts.
- The response on the part of English contracts will be more uniform, involving more standardization of language, than their New York counterparts

Not all contract language serves a purpose. Some words may be unnecessary or redundant and introduce only uncertainty to the meaning of a contract; when repeated over time, this verbiage becomes an encrustation. We conjecture that encrustations occur when drafting attorneys attempt to modify a boilerplate clause. Once editing begins on one portion of a boilerplate clause, drafters may also start to modify the traditional formulation of the clause in other ways by adding language that attempts to qualify or clarify the meaning of the clause. Over time, these efforts generate redundancies, the addition of legal jargon that reduces the communicative properties of the standard term. We posit that this effort to clarify—to avoid any possible misunderstanding of meaning—will lead to a greater number of encrustations, in environments, such as New York, where contract drafting is more decentralized. Accordingly, we have the following additional prediction:

- The response to an external shock will result in fewer encrustations on the part of English contracts than the response on the part of New York contracts.

There are undoubtedly other factors that may affect how law firms draft boilerplate terms. One might think that differences in how courts interpret contracts might drive

differences in contract language. If courts in New York interpret contract language as a function of the plain contemporary meanings of the words, then lawyers in New York have an incentive to draft using simple language and using words in contemporary use, as opposed to arcane legalese. Alternatively, if courts in England, in interpreting terms in commercial contracts, tend to give importance to industry customs, in addition to the written words, then drafting incentives change. The English drafters then have incentives to use words that make clear whether they wish to invoke industry custom or deviate from it. Default rules provided by the state might be another explanation for differences in contract drafting. In a state that provides more and better default rules, there is less need for detailed contract language.

We focus, however, on a context that reduces the importance of these other factors. The comparative setting that we utilize is that of sovereign debt contracts drafted under New York and English law. These are common law jurisdictions with similar philosophies regarding contract interpretation—perhaps that is why they are the two leading jurisdictions for the issuance of cross-border contracts. The primary focus for judges in both jurisdictions is on the plain meaning of the contractual text and on giving the contract meaning that the parties intended (as expressed through the text).⁶ Moreover, in neither jurisdiction have courts sought to provide default rules governing the field of sovereign debt. The text of the contract is the primary source of law in both jurisdictions.⁷ Consequently, we posit that a comparison of the

⁶ See, e.g., Andrew Taylor, *A Comparative Analysis of US and English Contract Law - Interpretation and Implied terms*, 9 INT'L. IN-HOUSE COUNSEL J. 1, 7 (2015).

⁷ A concrete illustration of the fact that the background legal systems do not call for differences in how the contracts are drafted in the sovereign debt area is the recent reform effort in the area of “collective action clauses” (CACs), where, under pressure from the International Monetary Fund, these collective action clauses in both jurisdictions were modified to achieve the same goal (making it harder for a minority of creditors to hold out from a restructuring plan that a majority had agreed to). Lawyers on both sides of the Atlantic used essentially the same words in their contracts. See, e.g., Ian Clark & Dimitrios Lyratzakis, *Toward a More Robust Sovereign Debt*

differences in how UK and US law firms react to the shocks affecting boilerplate terms in a sovereign bond contract will largely reflect differences in the contract production processes in these two sets of firms.

III. The Innovation and the Encrustations

The governing law provision is the contract clause we use for our comparison of English and New York law sovereign bonds. This ubiquitous contract term appears in every cross-border debt instrument. In sales documents, the governing law clause typically is prominently featured (and on multiple occasions) in the summary of key terms and subsequently in more detail in the Terms and Conditions.

Only seven words—“The agreement is governed by Ruritania Law”—are required to express a governing law clause with sufficient clarity and completeness to answer almost all relevant questions. We compare this basic template with governing clauses we observe in sovereign bond contracts governed by both English and New York law.

We approach the examination of English versus New York contracts from two directions: innovation and encrustation. By innovation, we mean the speed with which contracts incorporate changes in the external environment, such as when a court or regulator provides new information as to how a contract will be interpreted according to its plain language wording. By encrustation, we mean the accumulation of extraneous, redundant and

Restructuring Architecture: Innovations from Argentina and Ecuador, 16 *CAP Mkts.* L. J. 31 (2021) (discussing the English versus New York style CACs).

purposeless words in a clause—language that increase the length of the clause, reduce its intelligibility and thus impair parties ability to communicate their intentions to courts.

a. The Innovation

To conduct our analysis of comparative rates of innovation, we look for an external event that occurred at roughly the same time in both the English law and New York law settings, and that motivated lawyers in both contexts to revise their contracts. As described earlier, the events that we use occurred in 2009 in both the UK and the US.⁸ These were developments in the law (regulatory in the European context and case law in the US) that posed a risk that the basic governing law clause could be construed as not covering non-contractual issues.⁹

In the case of New York, these legal developments had in fact occurred some years earlier. The most important development was in 2005, in a Second Circuit Court of Appeals

⁸ In Europe, see, e.g., Latham & Watkins Client Alert, *Rome II and the Law Applicable to Non-Contractual Obligations*, # 789 (Jan. 20, 2009); McDermott, Will & Emory, *Choice of Law Clauses for Non-Contractual Claims – the Impact of Rome II*, Lexology (March 30, 2009). In the US, see, Glenn D. West & Benton Lewis, *Contracting to Avoid Extra-Contractual Liability – Can Your Contractual Deal Ever Really be the “Entire” Deal?* 64 BUS. LAWYER 999, 1029-31, 1036 (2009); Mitchell J. Geller, *Ensuring Choice-of-Law Provision Includes Non-Contractual Claims*, N.Y. L.J. at 1 (July 7, 2009).

⁹ John Coyle, the leading expert on governing law clauses, explains the line of cases under New York law:

The Appellate Division (First Department) first took this position in a case decided in 1980. See *Knieriemen v Bache Halsey Stuart Shields Inc* [1980] 427 NYS 2d 10, 12–13 (NY App Div 1980). The Second Department subsequently adopted this position in a case decided in 2001. See *Twinlab Corp v Paulson* [2001] 724 NYS 2d 496, 497 (App Div 2001). This rule was first applied by the Federal District Court for the Southern District of New York in 1984. See *Klock v Lehman Bros Kuhn Loeb, Inc* [1984] 584 F Supp 210, 215 (SDNY 1984).

Coyle then goes on to quote a Second Circuit case, *Finance One Public Company v. Lehman Brothers Special Financing*, that in 2005, to our reading, explicitly tells lawyers to draft their governing law clauses to explicitly say that matters such as tort issues relating to the contract are to be governed by the law of the contract if that is what they wish. The quoted language from *Finance One Public Company* reads:

Under New York law, then, tort claims are outside the scope of contractual choice-of-law provisions that specify what law governs construction of the terms of the contract, even when the contract also includes a broader forum-selection clause. Presumably a contractual choice-of-law clause could be drafted broadly enough to reach such tort claims.

John F. Coyle, *Choice-of-Law Clauses in US Bond Indentures*, 13 CAP. MKTS L. J. 152, 156-57 (2018) (citing *Finance One Public Company v Lehman Brothers Special Financing, Inc* [2005] 414 F 3d 325, 335 (2d Cir 2005)).

opinion, *Finance One Public Company v. Lehman Brothers Special Financing*, that explicitly urged lawyers to revise their contract clauses if they wanted to contract around the default rule that governing law clauses were not assumed to cover non contractual matters relating to the contract unless the contract said so expressly. It was in 2009, however, that two articles in the most important practitioner publications—the *Business Lawyer* and the *New York Law Journal*—advised US lawyers to revise their governing law clauses.¹⁰ Assuming that transactional lawyers generally do not follow developments in the case law unless they are made salient, we take the two practitioner articles in 2009 as the salient events.¹¹

For English law, the relevant event in 2009 was the Rome II regulation.¹² This regulation was aimed at harmonizing the various background laws in the European Union. Specifically, Rome II clarified for the entire EU, including the UK, that non-contractual matters such as tort claims would be governed by the law of the location where the events occurred. As in the US, Article 14 of the Rome II regulation clarified that parties could contract around the default by specifying that they wanted non-contractual matters relating to the contract to be governed by a different law.¹³

¹⁰ See Glenn D. West & Benton Lewis, *Contracting to Avoid Extra-Contractual Liability – Can Your Contractual Deal Ever Really be the “Entire” Deal?* 64 BUS. LAWYER 999 (2009); Mitchell J. Geller, *Ensuring Choice-of-Law Provision Includes Non-Contractual Claims*, N.Y. L.J. at 1 (July 7, 2009).

¹¹ The fact that transactional lawyers tend to spend very little time thinking about the wording of their governing law clauses has been detailed in a series of articles by John Coyle. See, e.g., John F. Coyle, *Choice-of-Law Clauses in US Bond Indentures*, 13 CAP. MKTS L. J. 152 (2018).

¹² See REGULATION (EC) No 864/2007 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL, at <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32007R0864:EN:HTML>

¹³ See Mayer Brown, *Corporate Legal Alert: Non Contractual Obligations and Governing Law* (Feb. 2009), at https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2009/02/noncontractual-obligations-and-governing-law--what/files/newslcorpfeb09legalalertnonconobspdf/fileattachment/newsl_corp_feb09_legal_alert_non_con_obs.pdf

Senior lawyers from prominent law firms in both jurisdictions issued advice to their colleagues on how to revise their governing law clauses. The advice to drafting lawyers was the same in both cases: If contracting parties wanted non-contractual matters arising out of the contractual relationship to be governed by the law chosen in the contract, they had to specify that preference explicitly.¹⁴ In the absence of an explicit direction to courts, the law of the locus where the events in question occurred would apply.

Given the change in the legal environment together with leading practitioners explicitly calling for drafting attorneys to provide for non-contractual coverage in their governing law clauses, we expect a change in the language of the governing law clause in sovereign bonds under both English and New York law after 2009.¹⁵ To assess the impact of the difference in the production process between English law contracts and New York law contracts, we compare the rates of innovation—measured by the inclusion of a non-contractual term—for each regime. We predict that the more centralized and coordinated process of producing standard boilerplate used by the law firms that specialize in English law governed contracts will result in both more rapid and more uniform responses to the demand for a non-contractual term under English law compared with New York law.

b. The Encrustations

We posit that boilerplate terms, such as the governing law clause, will accumulate encrustations over time that serve no useful purpose at best and, at worst, may lead to

¹⁴ See materials cited in *supra* note ____.

¹⁵ If one takes the view that transactional lawyers are carefully following developments in the case law on matters relating to conflicts of laws (we do not), then one might predict that the US changes would have begun prior to 2009, perhaps after the above mentioned Second Circuit decision in 2005. In that case, the contracts in the US would be ahead of their English counterparts in terms of rates of innovation.

unintended consequences for the contracting parties. In comparing firms oriented to New York law with those oriented to English law, we conjecture that the firms oriented to English law have production processes that better reduce the rate of encrustations than the New York firms. We also conjecture that the rate of encrustations increases when lawyers are motivated to change a boilerplate term. Once charged with the task of revising the boilerplate language, drafting attorneys may change more language than is necessary, leading to encrustations unrelated to the non-contractual term. The more centralized contract production processes for law firms oriented to English law may dampen this tendency to add encrustations following a shock as compared with the firms oriented to New York firms. Indeed, the centralized process used by the English-law firm may result in streamlining the governing law clause, leading to an overall reduction in the number of encrustations.

To assess the presence of encrustations and the rate of change of encrustations after the 2009 shock, we focus on several terms frequently added to a governing law clause that we have identified from the literature and in conversations with practitioners as serving either no purpose or a purpose inconsistent with the typical goals of a governing law clause.

i. Construed

Many governing law provisions say that the agreement will be “governed” by the law of Ruritania, others say that it will be “governed and construed” by the law of Ruritania, yet others use the words “governed and interpreted”, and some use all three words. All of the bonds we have examined use the word “governed,” which then begs the question of whether adding the words “construed” and/or “interpreted” clarifies or expands the meaning of the clause. Both the literature and conversations with senior practitioners suggest these additional words are

historical artifacts that do not add any more nuanced meaning to the basic governing law clause.¹⁶ In our dataset, 67% of the governing law clauses contained the term “construed”.

ii. Authorization and Execution

Some sovereign debt contracts specify explicitly that matters of “authorization and execution” will be governed by the local law of the state in question, as opposed to the relevant foreign law (either New York or England, in our study). It is not clear what this specification adds, other than confusion. If a debt has been issued improperly by the government of Ruritania—for example, the constitutional debt limit was violated—then the question of whether the debt was improperly authorized or executed is a matter of Ruritanian law. It does not matter that the contract explicitly says or does not say that matters of authorization and execution are governed by the law of Ruritania. They are. No other law is relevant. One might have valid arguments about which law governs the consequences of these violations, but that is a different matter altogether. In other words, these are extraneous words that only add to the risk of additional litigation.¹⁷ In our dataset, 39% of the governing law clauses contained the “authorization and execution” term.

iii. Interpreted

Some governing law provisions state that the agreement will be “governed and interpreted” by the law of Ruritania. Similar to the addition of the word “construed,” adding the word “interpreted” does not clarify or expand the meaning of the governing law clause. Like “construed”, the use of the word “interpreted” appears to be an historical artifact and is

¹⁶ See John F. Coyle, *A Short History of the Choice-of-Law Clause*, 91 Colo. L. Rev. 1147 (2020); Stephen J. Choi, Robert E. Scott & Mitu Gulati, *Are M&A Lawyers Better Contract Drafters?*, U. TORONTO L. J. (forthcoming 2022).

¹⁷ See W. Mark C. Weidemaier & Mitu Gulati, *Unlawfully-Issued Sovereign Debt*, VA. J. INT’L L. (forthcoming 2021).

unnecessary verbiage.¹⁸ In our dataset, 31% of the governing law clauses contained the “interpreted” term.

iv. Conflict of Laws/Choice of Law

A few debt contracts add to the basic governing law provision described earlier a phrase that provides “except for Ruritania’s conflicts of laws [and/or choice of law rules].” The goal here is presumably to tell courts they should not look to the Ruritanian “choice of law” rules so as to produce the result that the relevant applicable law is that of a jurisdiction other than the one that the parties explicitly asked for in their contracts. But the background doctrine under both English and New York law is unambiguous: parties may have had reason for concern a half century ago, but now the law now is clear—parties do not need to fear the choice/conflicts rules.¹⁹ In our dataset, 17% of the governing law clauses contained either the “conflicts of law” or “choice of law” term.

IV. Tests and Data

The tests we run are straightforward. On the innovation question, where we had an external shock in the form of advice to transactional lawyers to revise their governing law clauses in 2009, we look to see how fast the contracts in England and New York respond.

¹⁸ See John F. Coyle, *A Short History of the Choice-of-Law Clause*, 91 COLO. L. REV. 1147 (2020); Stephen J. Choi, Robert E. Scott & Mitu Gulati, *Are M&A Lawyers Better Contract Drafters?*, U. TORONTO L. J. (forthcoming 2022).

¹⁹ For a discussion of discussions in both the case law and literature on this matter in the US context, see Choi et al. *supra* note __; Coyle, *supra* note __. Almost none of the English law contracts contain this language and, given that, there is no literature on it that we are aware of. Practitioners whom we spoke to, however, confirmed what we say in the text. In fact, these additional words produce a circularity. The conflicts of law rules of a state, after all, are the very rules that allow parties to select their governing law clause. Read strictly, the exclusion of the conflicts rules of the state could render the governing law clause a nullity, which the parties surely did not intend. See Michael Gruson, *Governing Law Clauses Excluding Conflicts of Laws*, 37 INT’L LAW 1023, 1030 (2003).

On the encrustation question, we do not have a shock that tells parties that they should revise their contracts. In part, this is because the encrustations that we identify are extraneous verbiage, and at least until a court gives these words an unexpected meaning, they are harmless. As Glenn West and Philip Wood, eminent lawyers from both sides of the Atlantic, have explained in their writing, these extraneous words are like barnacles.²⁰ Each on its own is harmless. But an accumulation of these encrustations makes the contract clunky and hard to read. Plus, each unnecessary word presents the risk that a court will give it an unexpected meaning. To measure the degree of encrustation, we count the number of encrustations in each governing law clause.

In addition to simple counts of the number of encrustations, we also examine the evolutionary path of the clauses in the two jurisdictions. Our working theory for how drafting works is that lawyers are loathe to alter the language of their standard contract precedents from deal to deal. If a clause worked in a prior deal, it is unlikely to be reexamined in a new deal. And one of the goals of transactional lawyers is to avoid being seen by their clients as barriers to the deal closing. That means that contract provisions are likely to be revised only when there is some reason that motivates the lawyers to have to modify the contract language despite their inclinations not to do so. Receiving an external directive to modify a clause—such as the one both English and New York law lawyers received in 2009—would be such a reason. It could also be a reason to add purposeless verbiage (we call this "tinkering") or it could be a reason to remove such verbiage ("streamlining"). Using 2009 as our inflection point, we look to see whether encrustations were removed or added around the same time.

²⁰ See Choi et al., *supra* note __ (citing to the pieces by West and Wood).

a. Dataset

As described, we focus on sovereign bond contracts. We collected information from the Perfect Information database on the governing law clause for sovereign bond deals governed either under New York or English law. That is essentially the world of sovereign bonds issued under a foreign law. We exclude the United States and the United Kingdom since New York and English law are domestic laws for them. We collected data on all foreign law governed sovereign bond deals available in Perfect Information from 2000 to 2020. The number of such sovereign bond deals under either New York or English law ranged from 16 to 35 per year in our dataset.

b. Non-Contractual Term

We term "implied" non-contractual terms as terms that specify that the governing law clause will apply to non-contractual terms in substance without using the specific phrase "non-contractual". The following is an example of an implied non-contractual term:

The Fiscal Agency Agreement and the Notes shall be construed and interpreted in accordance with the law of the State of New York, which shall govern them and *any controversy or claim arising out of or relating to any of them.*

We noted that the phrase "non-contractual" started to appear in governing law clauses shortly after the demand for practitioners to use this explicit language in 2009. To separately track the increase in the use of a clause that uses the phrase "non-contractual," we define an "express" non-contractual term as one that uses the phrase "non-contractual". The following is an example of an express non-contractual term:

The Notes and *any non-contractual obligations arising out of or in connection with the Notes* are governed by English law.

We report the yearly number of governing law clauses with no non-contractual term, an implied non-contractual term, and an express non-contractual term for New York-law governed bonds in Figure 1. Note from Figure 1 that none of the New York-law governed bonds used the express version of the non-contractual term from 2000 to 2020. Moreover, despite calls from prominent attorneys to insert a non-contractual term, we observe that the incidence of the implied non-contractual term is both low (under 5% of the bonds issued in any given year) and relatively constant from 2000 to 2020.

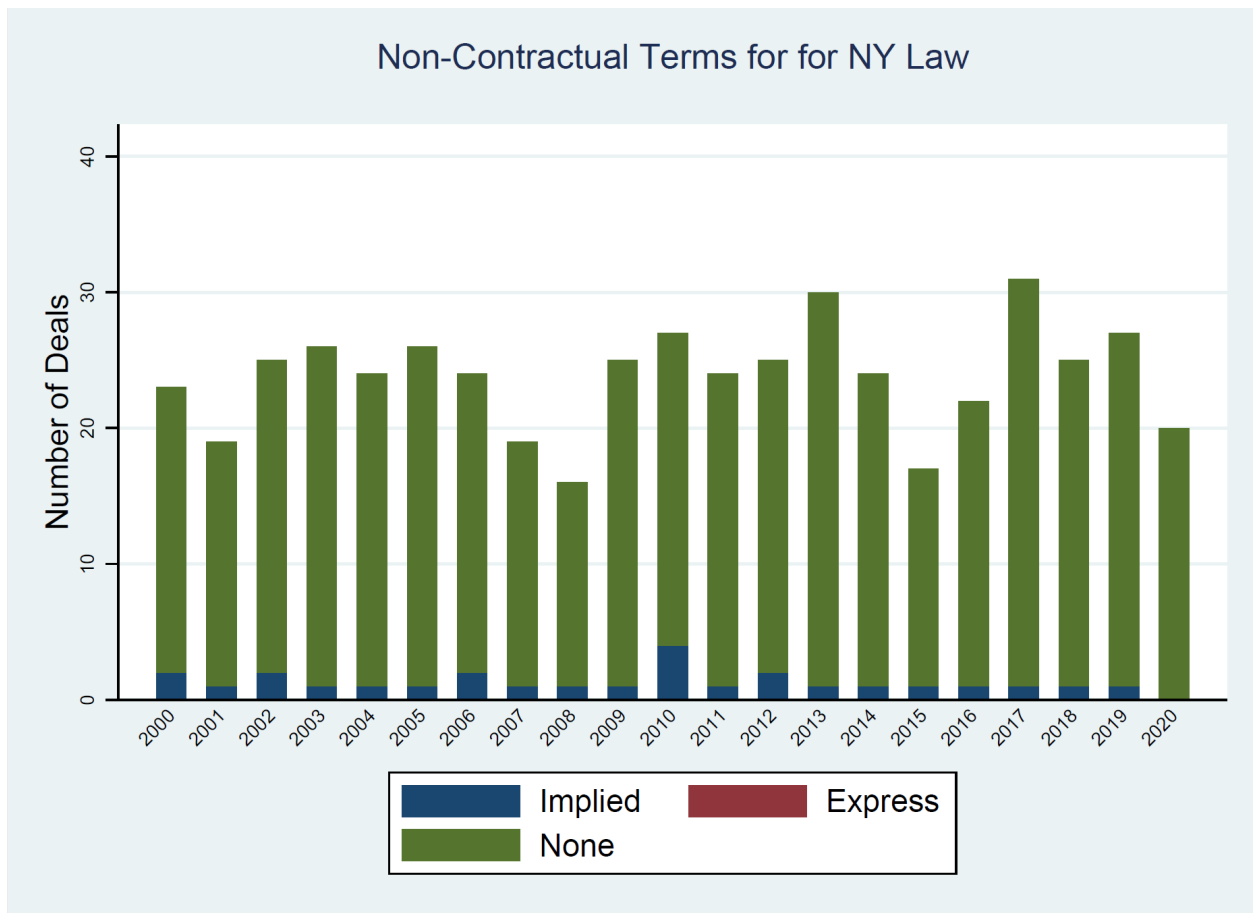


Figure 1

Figure 2 reports the same comparison for English law governed bonds. In Figure 2 note that there is a major shift in the incidence of a non-contractual term for English law governed bonds starting in 2009. From 2000 to 2008, 20% of the bonds had a governing law clause with some form of non-contractual term. From 2009 to 2020, 89% of the bonds had a governing law clause with some form of the non-contractual term. This shift is driven by a large increase in the use of an express non-contractual term. In 2008, only 1 out of the 18 sovereign bond deals used an express version of the non-contractual clause. By 2020, 19 out of the 20 sovereign bond deals used an express version of the non-contractual clause.

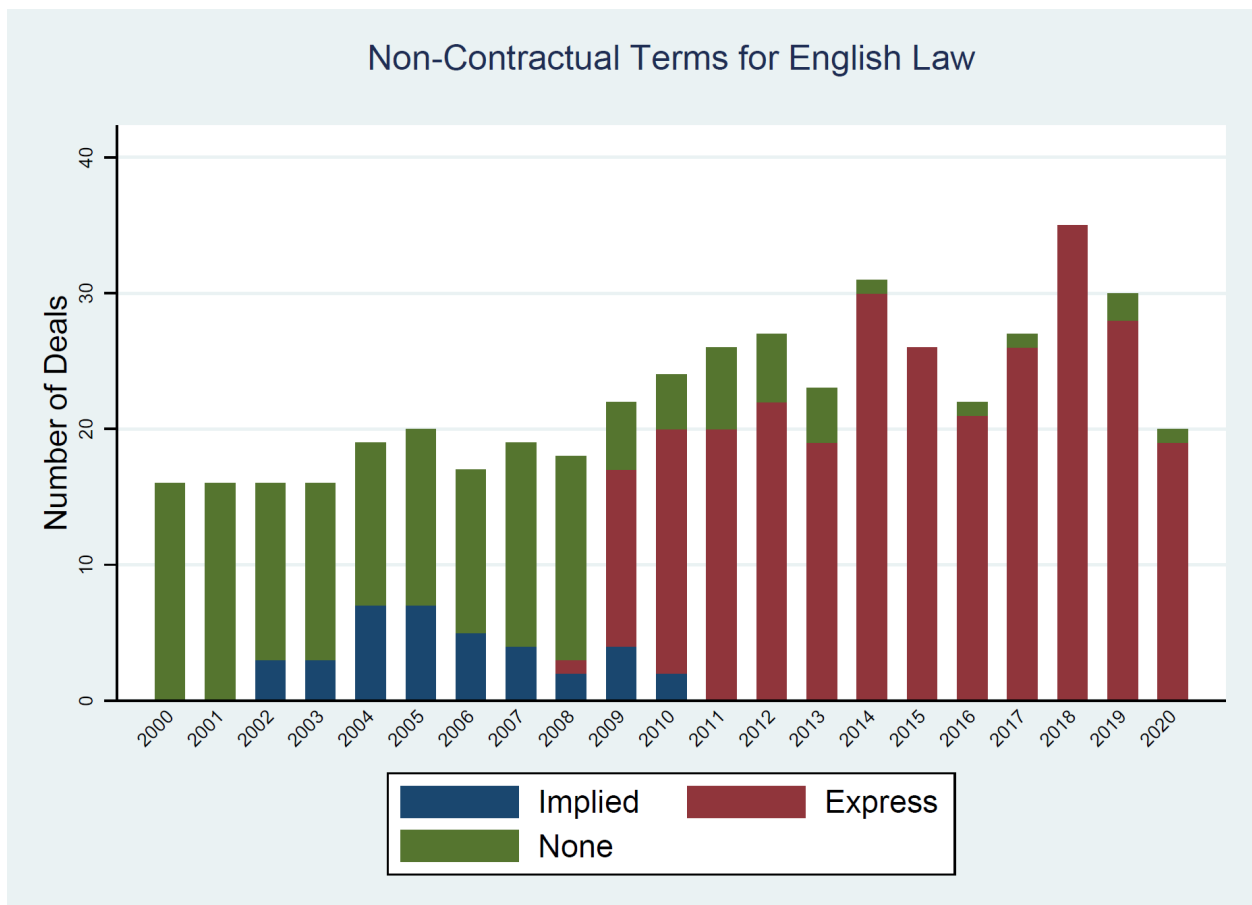


Figure 2

The comparison in Figure 2 is for all bonds issued under English law by year. The comparison does not control for characteristics of the bond issuances, including the identity of the issuers. To assess how the shift to the explicit non-contractual term occurred for specific issuers, we focus on the two issuers with the largest number of English law governed bonds (Sweden and Poland) in our dataset. Figure 3 depicts the fraction of bond issuances by year for these two issuers that use the explicit version of the non-contractual clause.

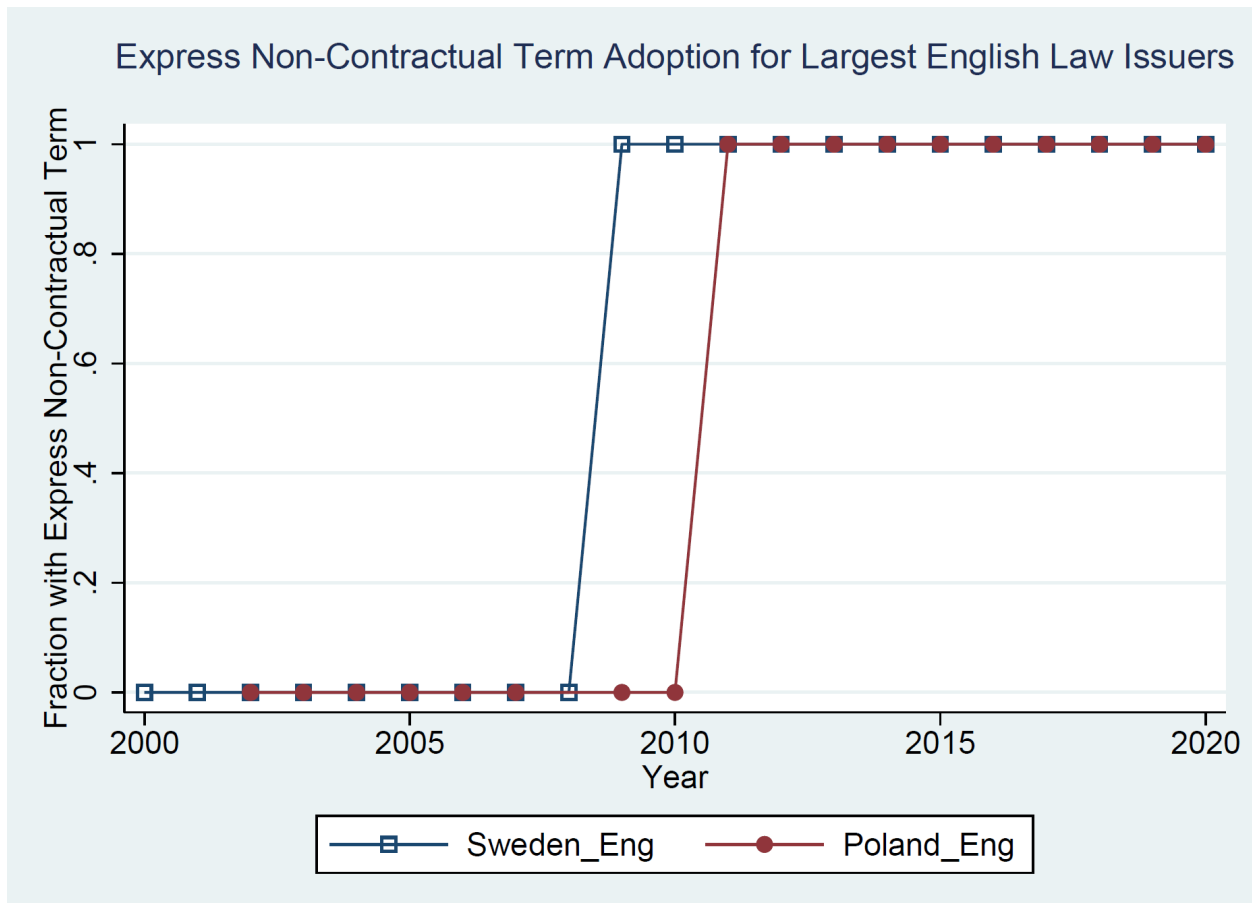


Figure 3

Note from Figure 3 that both Sweden and Poland shift to the explicit version of the non-contractual clause near the 2009 shock. Sweden shifted in 2009 and Poland shifted in 2011. After the shift, both sovereigns issued bonds that uniformly contained the explicit version of the non-contractual clause. Once attorneys took the effort to add the explicit version of the non-contractual clause to the boilerplate governing law clause, this change propagated in identical form thereafter in subsequent bond issuances.

Not only was there a rapid shift to the express non-contractual term within English governing law clauses, but the new language was largely standardized. In 66% of those bonds with governing law clauses that expressly used the word “non-contractual,” the added language was as follows: “any non-contractual obligations arising out of or in connection with.” The remaining 34% of the bonds contained largely minor variations, such as replacing the word “any” with the word “all”.

These results suggest that the process of contract production matters for the responsiveness of a jurisdiction to a shock calling for a change in a boilerplate term. The more centralized contract production process for law firms oriented to English law leads to a more rapid and coordinated response compared with US law firms.

A question that might be asked is whether, for reasons we cannot observe, lawyers in the US believed that they did not need to change their contracts. And, that it was not impediments affecting the contract production process for US law firms in the sovereign debt market but rather the lack of importance of a non-contractual term to US law firms that explains the lack of change. But that hypothesis is undermined when we look at another US legal market where the process of producing contracts faces fewer impediments to change

compared with the sovereign bond market. In a related paper, we found rapid changes in the governing law boilerplate language after 2009 designed to address non-contractual matters for merger and acquisition deals involving private equity firms governed by New York law . This rapid change indicates that the shock in New York was of sufficient magnitude to result in changes in the boilerplate term in other US markets with, in the case of merger and acquisition deals involving private equity firms, sophisticated principals driving this change.²¹

c. Encrustations

We analyze encrustations that add the words (i) construed, (ii) authorization and execution, (iii) interpreted, and (iv) conflicts of law or choice of law to the basic governing law clause. For our measure of the degree of encrustation, we count the number of encrustations in the governing law clause for each deal in our dataset.²²

We conjecture that the contract production process for those law firms dealing in contracts governed by English law will produce fewer encrustations over time compared with law firms dealing in New York law-governed contracts. The mean number of encrustations in New York law-governed bonds in our dataset from 2000 to 2020 is equal to 2.8. In comparison,

²¹ See Choi et al., *supra* note ___ (reporting that roughly 50% of US M&A contracts were using the “non contractual” term by the end of the 2010-20 period); see also John F. Coyle, *Choice-of-Law Clauses in US Bond Indentures*, 13 CAP. MKTS L. J. 152, 157-58 (2018) (finding that 12% of corporate bond indentures had clauses broad enough to cover non-contractual matters in a sample from 2016); John F. Coyle & Christopher R. Drahozal, *An Empirical Study of Dispute Resolution Clauses in International Supply Contracts*, 52 VAND. J. TRANSNAT’L L. 323, 338 (2019) (finding that 20% of International supply contracts, in a sample from 2011-15 had clauses broad enough to cover non-contractual matters in their governing law clauses).

²² We note that a simple count may not capture the importance of different encrustations. Some encrustations may be more benign, increasing the length of the governing law clause without adding a great amount of uncertainty. Other encrustations may add more uncertainty and open the issuer up to the possibility of later litigation over this uncertainty. For purposes of this study, we do not differentiate between encrustations but leave this to future research.

the mean number of encrustations for bonds governed by English is equal to 1.0 (difference significant at the 1% confidence level).

While various factors could lead to encrustations, we conjecture that encrustations are more likely to appear when drafting attorneys actively modify a contract term. Attorneys who “open up the hood” of a contract in response to an exogenous legal change (such as the clamor for the addition of a non-contractual term in 2009) may both respond to the legal shock and then, in an effort to improve other aspects of the boilerplate term, create encrustations (tinkering). We focus on the number of encrustations in the two years immediately before and after 2009 to assess whether law firms drafting contracts under New York versus English law responded differently to the non-contractual term shock. Figure 4 depicts the mean number of encrustations for NY and English law governed bonds separately for the 2007 to 2011 period.

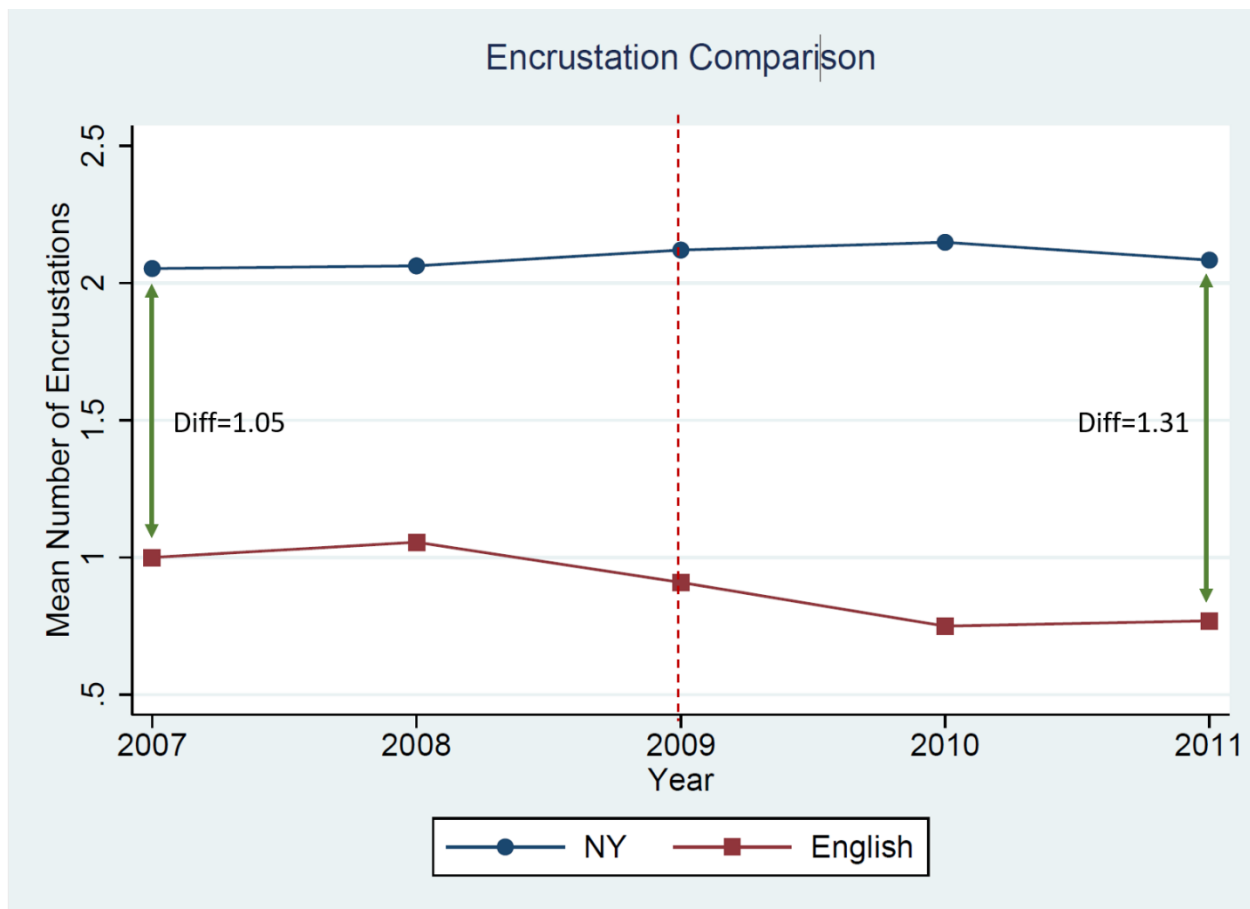


Figure 4

Note from Figure 4 that the number of encrustations on average is higher for NY law compared with English law-governed bonds. The difference between NY Law and English law-governed bonds is 1.05 terms in 2007. This difference increases to 1.31 terms in 2009. Contrary to our conjecture, the increase in the difference is largely driven by a decrease in the number of encrustations for the English-law governed bonds. If anything, the opportunity to re-visit a boilerplate term led to streamlining—a decrease in encrustations in English-law governed bonds.

The comparison in Figure 4 is for the mean number of encrustations for all bonds issued under New York compared with English law by year. The comparison does not control for other

characteristics of the bond issuances, including the identity of the issuers. It is possible that the change in the number of encrustations is driven not by a change in the specific contracting practices of an issuer but instead by a shift in the identity of issuers across time. To assess whether changes in contracting practices differ for specific issuers under NY law and English law, we focus on the two issuers with the largest number of NY law governed bonds (Mexico and Colombia) and the two issuers with the largest number of English law-governed bonds (Sweden and Poland) in our dataset. Figure 5 depicts the mean number of encrustations for each of these four issuers over the period of our dataset.

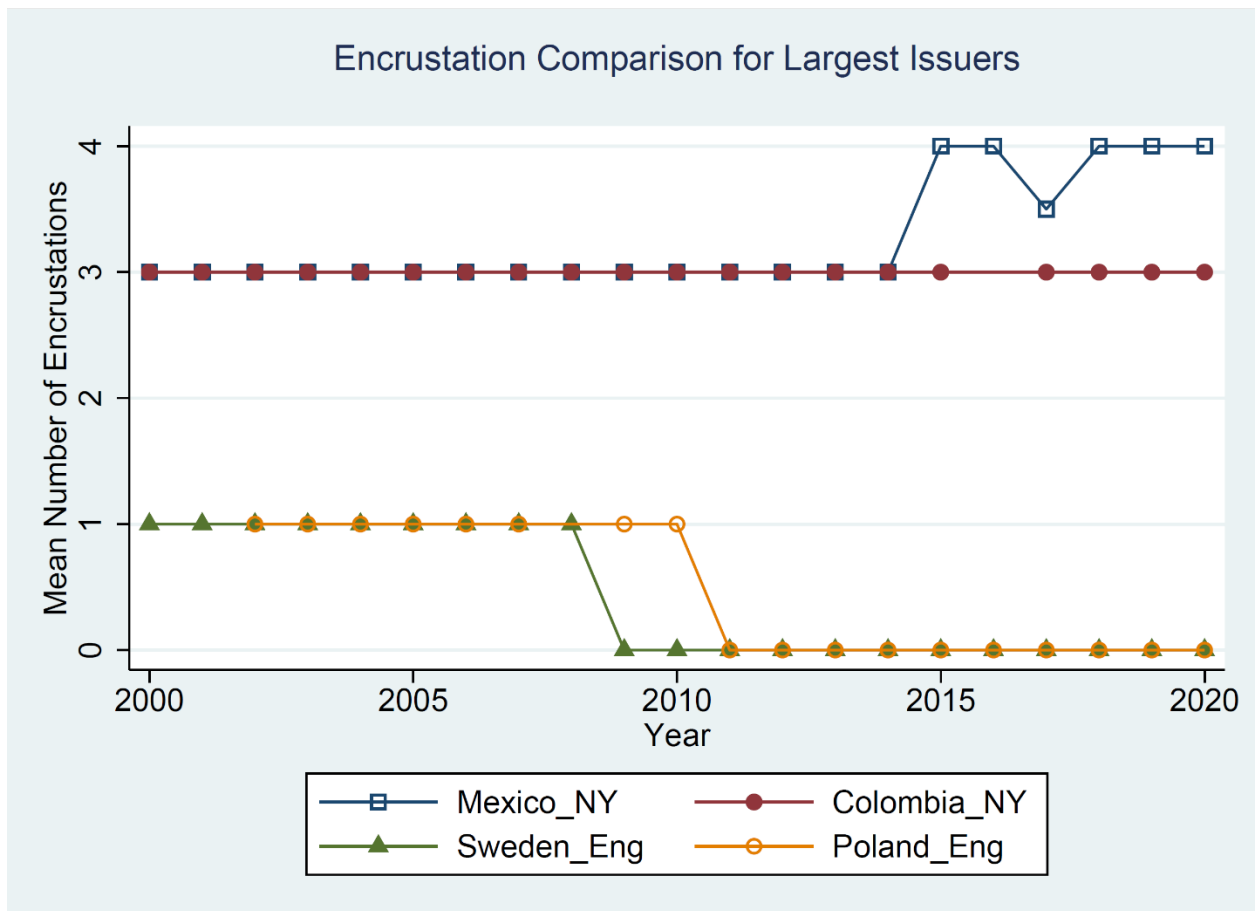


Figure 5

Note from Figure 5 that the two largest NY law-governed bond issuers do not change the number of encrustations around the 2009 non-contractual term shock. This is consistent with such issuers not changing the non-contractual term in response to the shock. Without any active effort to modify the contract term, neither the law firms for Mexico nor Colombia engaged in tinkering and thus the number of encrustations did not change in the immediate years after 2009. Eventually, in 2015, the number of encrustations did increase for Mexico bonds. In contrast, the number of encrustations for Sweden and Poland, the two countries with the largest number of English law governed bonds in our dataset, decreases to zero in the time period immediately around 2009. Contrary to our prediction, the active attention on the part of attorneys for Sweden and Poland on the governing law clause did not result in unrelated tinkering that increased encrustation. Instead, the attention led to a decrease in encrustations unrelated to the non-contractual term. This decrease is consistent with the more centralized and focused contract production process for law firms drafting English law-governed bonds leading to improved contract drafting.

Our analysis assumes a connection between UK law firms and their particular contract drafting processes and English law-governed sovereign bonds and a similar connection between US law firms and New York law-governed sovereign bonds. Not all law firms that draft contracts governed by English law, however, are UK law firms (and same for New York law contracts and US law firms). US law firms in particular, such as Latham & Watkins and Cleary Gottlieb Steen & Hamilton, draft sovereign bond contracts governed by English law. Nonetheless, we conjecture that the contract drafting processes of the UK law firms dominate how contracts are drafted

under English law. Other law firms may draft specific contracts, but they follow the lead set by the UK law firms.

To test this conjecture, we look at the sequence of sovereign bond deals under English law that initially adopted the express version of the non-contractual clause. Linklaters LLP, as underwriter's counsel, was associated with the very first deal using the express non-contractual term in late 2008, involving an issuance by Lithuania. The next four deals under English law that used the express non-contractual term, all in early 2009, had a UK law firm as underwriter's counsel (including in addition to Linklaters LLP, Clifford Chance LLP and Simmons & Simmons) as well as a UK law firm for issuer's counsel if the issuer retained an outside counsel (Allen & Overy). Only in the ninth deal under English law to adopt the express non-contractual term was there a US law firm present: Latham & Watkins (London) LLP for the underwriters and Sidley Austin LLP For the issuer (Macedonia). Notably, while Latham & Watkins is headquartered in the US, the particular branch of Latham & Watkins on the deal was based in London.

IV. Implications

Our goal in this study is not to make claims about whether US or UK law firms are better or worse at contract drafting. That is a question that this narrow study cannot answer. Along those lines, we have four caveats:

- The precipitating events whose effects that we compare in the UK versus the US are different—an EU regulation followed by law firm memos as compared to case law followed by articles by eminent lawyers. It is possible that the reason for our differential effects finding is that the precipitating events were rather different.

- We de-emphasize the relevance of any differences in how courts in England and New York are likely to interpret the contract terms at issue, treating the interpretive regimes as essentially the same. However, it is possible that there are small differences in those interpretive regimes that we are missing that are driving the differences in how lawyers draft.
- It is tempting to conclude from our results that English firms draft better and cleaner contract provisions than their US counterparts. But we know from other work that is not necessarily the case. Within the sovereign debt context itself there are encrustations found primarily in the English law governed clauses and not in their New York counterparts.²³
- Sovereign debt is different from other practice areas. Therefore, extrapolating from drafting differences between UK and US firms in this context to other practice areas may be unjustified.

The point of the caveats is to acknowledge that we are but scratching the surface of the broader topic. Caveats aside, however, our results do suggest that the apparent difference between the relatively coordinated process of contract production followed by UK law firms and the relatively uncoordinated process of producing contracts followed by US law firms has two important effects. First, contracts governed by English law generate a faster response to a legal shock that motivates changes in contractual boilerplate than do contracts governed by New York law. Second, and contrary to our conjecture, the English law-governed contracts

²³ See *Clauses and Controversies*, Episode 34, ft. Lee Buchheit (Apple Podcasts, April 14, 2021) (discussing clauses in the Zambian Eurobonds), at <https://podcasts.apple.com/us/podcast/ep-34-ft-lee-buchheit/id1528208049?i=1000517139058> (last visited, May 6, 2021).

show more evidence of streamlining. The implication here is that when drafting lawyers working in this tradition begin the revision process demanded by legal change, they also remove unnecessary language from the boilerplate term that may have accreted over time. Taken together, this evidence suggests the wisdom of further studies examining how contractual boilerplate is produced. As with any production process, the value of the outputs are likely to be largely determined by the nature of the inputs.