Avoiding Common Contract Mistakes

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Discussion Topics

- Introduction
- Forum & Venue Selection Clauses
- Choice & Conflicts of Law Clauses
- Indemnification Clauses
- Limitation of Liability Clauses
- Arbitration Clauses
- Liquidated Damages Clauses
- Attorneys’ Fees Shifting Provisions
- Merger & Integration Clauses
- Jury Waiver Clauses
- Contractual Limitations Periods
- Special Considerations Related to Settlement Agreements
Introduction

- No Such Thing as “the Perfect Agreement”:
  - Agreements must be tailored to the specific situation.
  - No one right way to do it.

- Consider From the Outset:
  - The parties with which you might be in a possible dispute.
  - The subject of a possible dispute.
  - Which state’s law do you want to apply? Is it permissible?
  - What risks exist? How do you allocate that risk?
Forum & Venue Selection Clauses

Generally

- Provision whereby parties agree that any litigation resulting from a contract will be initiated only in a specific forum.
- Example: “The parties hereto consent to the exclusive jurisdiction of the courts of Harris County, Texas.”
- Generally enforceable unless the resisting party can show the forum to be unreasonable under the circumstances.
- Pros and cons of forum selection:
  - You gain agreement up front on a choice of forum.
  - You may lose the right not to be subject to personal jurisdiction in that forum.
  - May encourage settlement if the parties do not want to litigate (or if litigation is difficult) in the selected forum.
- A federal court may enforce a forum selection clause in a variety of ways. See, e.g., Asoma Corp. v. SK Shipping Co., 467 F.3d 817, 822 (2d Cir. 2006) (noting the Supreme Court has not been clear as to the proper mode for forum-selection clause dismissal and listing possible theories (i.e., motion for summary judgment, lack of jurisdiction or forum non conveniens, motion to decline jurisdiction, improper venue)).
Forum & Venue Selection Clauses

Mistakes

- Forum selection does not equal choice of law.
- Carefully consider selecting a governing law that is different from the forum jurisdiction.
- Parties cannot create federal subject matter jurisdiction by contract.
- Parties’ attempt to set venue in a county contrary to mandatory venue statute is unenforceable in Texas.
  - Tex. Civ. Prac. & Rem. Code provides mandatory venue for certain types of actions, including those involving land; libel, slander, or invasion of privacy; and actions to stay a suit or judgment.
Choice & Conflicts of Law Clauses

Generally

- Provision whereby parties agree that the law of a particular jurisdiction will govern disputes arising under the contract.
- The clause may also expressly exclude the application of the conflicts of law provisions of the designated law.
- Example: “This Agreement shall be governed by, and construed in accordance with, the laws of the State of Texas, without regard to principles of conflicts of law thereof.”
- Clauses are generally enforceable, except when the dispute lacks a significant relationship to the chosen jurisdiction or they are violative of public policy.
Choice & Conflicts of Law Clauses

Mistakes

- Choice of law does not equal forum selection.
- Failure to check choice of law statutes in the chosen state and the state that has the most significant contacts for specific requirements or exceptions.
- If the state law does not bear a reasonable relationship to the agreement, the clause may be unenforceable.
- A narrowly drafted provision can result in application only to the construction and interpretation of the contract and not to extra-contractual claims.
- Failure to consider remedies. State law may allow for independent remedies regardless of drafting.
  - Texas law allows recovery for breach of contract and a related tort claim for intentional or negligent misrepresentation in a contract.
  - New York law provides for an independent remedy in tort for parties with a breach of contract claim.
  - Delaware law requires plaintiffs to allege the defendant violated an independent legal duty, apart from the duty imposed by the contract, to assert both a tort and breach of contract claim.
Indemnification Clauses

Generally

- Provision whereby parties may set forth specific indemnities for certain claims or liabilities.
- Example: “The parties hereby agree to indemnify and hold harmless each other from and against all liability, claims, and demands on account of injury to persons arising out of or in any manner connected with the performance of the contract.”

- No exact formula, but the provision must be clear as to the intent of the parties to indemnify and the scope of its coverage.
- The clause generally provides for an obligation to defend.
- Clauses are strictly interpreted and courts generally refuse to broaden or narrow the scope beyond its plain meaning.
- Courts will use general principles of contract construction to resolve ambiguities (general vs. specific provisions, interpret against drafting party, etc.).
Indemnification Clauses

Mistakes

- Courts are unpredictable when construing an indemnification provision that purports to cover “all injuries and damages.”
- Should specifically include all types of damages that are expected to be covered, especially for those that are customarily not covered (e.g. attorneys’ fees).
- Certain types of indemnification may be invalid due to their subject matter (violations of law, negligence, etc.).
- Some states require conspicuous drafting for certain types of indemnification.
- For clauses with duty to defend, the parties should clearly specify when the duty is triggered, who controls the defense, and when and how settlement may be made.
- Indemnification for “loss or damage” vs. indemnification for “liability.”
- Punitive damages might not be recoverable under an indemnification agreement.
Limitation of Liability Clauses

**Generally**

- Provision that allows parties to exclude certain types of damage recoveries under a contract.
- Example: “No party shall, in any event, be liable to any other person for any consequential, incidental, indirect, special, or punitive damages of such other person.”
- Clause may also be drafted to limit or cap certain types of damages.
- Generally disfavored by courts, so language must be clear and unequivocal.
Mistakes

- Failure to specifically identify categories of damages to be excluded.
- Under the UCC, “consequential damages” have been held to include lost revenues and lost profits. Outside of this context, the meaning of the term is less clear.
- Damages resulting from negligence may not cover negligent misrepresentation unless explicitly stated.
Arbitration Clauses

- Does arbitration favor your client?
- If so, how do you get the best clause for your client’s situation?
- Consider the pros and cons of arbitrating your dispute:
  - Pros: generally faster, more confidential, greater finality, neutrality, allows expert analysis of complex issues, no runaway juries.
  - Cons: very limited judicial review, harder to delay, uncertain rules/procedures, discovery may be burdensome, experience of arbitrators varies; potential expense.
How to Get the Best Arbitration Clause

- Many “standard” clauses are incomplete and unclear.
- The clause should be tailored to ensure the features your client needs most. Examples:
  - For speed, select an established organization: AAA, JAMS, ICC. (This administration should force progress on matter.)
  - For fairness, consider three neutrals rather than “I pick” and “you pick” clauses.
  - Consider “injunctive carve outs” (e.g., non-competes).
Arbitration Agreements or Clauses
Drafting Considerations

- Panel size—One arbitrator? Panel of three?
- Who will administer (AAA, ICC, JAMS, etc.).
- Location, language and governing substantive law.
- Special qualifications of the arbitrators.
- Time limits and discovery.
- Pre-hearing briefing.
- Process for resolving pre-hearing disputes.
- Format of the final hearing.
Arbitration Agreements or Clauses
Drafting Considerations

- Post-hearing briefing.
- Timing and form of the award.
- Confidentiality.
- Appeals.
  - In Texas, a motion to confirm, vacate, or modify an arbitration award must be filed in the same county where the agreement requires the arbitration be held. Tex. Civ. Prac. & Rem. Code § 171.096(b).
  - In New York, a motion to confirm, vacate, or modify an arbitration award must be filed in the county specified in the agreement. N.Y. C.P.L.R. § 7502.
  - In Delaware, a motion to confirm, vacate, or modify an arbitration award must be filed in the Chancery Court for the county specified in the agreement. 10 Del. Code § 5702.
  - Under federal law, in the district court for the district in which the award was made. 9 U.S.C. §§ 10-11.
- Costs.
- Consent to entry of judgment to enforce arbitral award.
Breadth of the Arbitration Agreement

- **Scope:**
  - Broad clause—“arising out of or relating to.”
    - Additions for tort claims.
    - Additions for jurisdictional claims.
  - Narrow clause.
    - Excluding specific claims (e.g., “The following matters are specifically excluded from arbitration . . .”).
Terms of an Arbitration Agreement

- Situs of Arbitration (especially crucial for an international arbitration).
  - Why important:
    - Often determines location of some or all hearings.
    - Determines procedural law of arbitration (unless parties provide otherwise).
    - Place of all challenges to award.
  - Things to check:
    - Signatory of New York Convention.
    - Law of situs favors enforcement of arbitral awards.
- Governing Substantive Law.
Terms of an Arbitration Agreement

- **Judicial Review:**
  - Providing for Judicial Review.
    - Not enforceable everywhere (usually not in civil law countries).
    - U.S. courts are split on this issue.
  - Providing for Non-Judicial Review.
    - Included in some arbitral rules (ICC, ICSID).
    - Not advisable outside framework of arbitral institution.
  - The law provides that an arbitrator will hear challenges to the validity of the contract as a whole, while a federal court may hear challenges to the arbitration clause itself. See, *e.g.*, *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1263-64 (9th Cir. 2006).
Terms of an Arbitration Agreement

**Mistakes**

- Failure to provide for a certain language results in the tribunal selecting the language, usually based on the language of the contract.
  - Providing for multiple languages might create practical problems, additional costs.
- Consider whether the subject matter of your contract is arbitrable under law.
  - As previously discussed, it is crucial to include a “carve out clause” to ensure applications for equitable relief can be heard by the court.
  - “Carve outs” also may assuage judicial concerns about interference with the arbitral process.
- Providing for interim or conservatory relief by arbitrators is not necessary if you adopt a fixed set of rules (i.e., AAA, ICC).
Class Arbitration Waivers in Arbitration Agreements

- An arbitration agreement may include a provision prohibiting class resolution of claims.
- The Supreme Court recently spoke on this issue in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).
  - Court held the Federal Arbitration Act preempted California’s judicial law barring the enforcement of class action waivers in consumer contracts.
- Some lower courts have reasoned that *Concepcion* does not deem all class action waiver clauses per se enforceable.
  - See *In re Am. Express Merchants’ Litig.*, 667 F.3d 204 (2d Cir. 2012) (holding class arbitration waiver unenforceable where the cost of plaintiffs individually arbitrating their disputes would be prohibitive).
- The Fifth Circuit recently heard an appeal concerning the National Labor Relations Board’s decision that workers cannot be forced to sign arbitration agreements containing class action waivers.
Liquidated Damages Clauses

Generally

- Allows parties to look to the future, anticipate breach, and agree to settlement in advance.
- Permissible if not unconscionable or contrary to public policy.
- Need not be reciprocal.
- Where agreed sum is *vastly* below actual damages, aggrieved person may be able to void clause and recover actual damages.
Liquidated Damages Clauses

- **Texas**—Clause will be enforced if: (1) the harm caused by the breach is “incapable or difficult of estimation” and (2) the stated amount is a reasonable forecast of compensation. *SP Terrace, L.P. v. Meritage Homes of Tex. LLC*, 334 S.W.3d 275, 287 (Tex. App—Houston [1st Dist.] 2010, no pet.).

- **New York**—The party seeking to invalidate the clause must show: (1) the damages are not a reasonable measure of the actual loss and (2) the actual loss is readily ascertainable. *Zeer v. Azulay*, 860 N.Y.S.2d 527, 531 (N.Y. App. Div. 2008).

- **Delaware**—Provision will not be disturbed where damages are uncertain and the amount agreed upon is reasonable. *Del. Bay Surgical Servs., P.C. v. Swier*, 900 A.2d 646, 651 (Del. 2006).
Liquidated Damages Clauses

Best Practices

- State the rationale or criteria for amount chosen.
- Be as specific as possible.
- Make damages commensurate with injury due to breach.
- Use relevant industry standards, if possible.
- Where breaches have varying importance, make liquidated damages vary with type of breach.
- Need not be monetary damages.
Liquidated Damages Clauses

Mistakes

- Do not offer the aggrieved party an option of either liquidated damages or actual damages.
- Carefully consider the terms of your clause—courts often narrowly interpret and limit such clauses to the types of breaches specified.
- Equitable relief will not be barred unless such bar is explicitly set forth.
Attorneys’ Fees Shifting Provisions

Generally

- Provides that the losing party in a dispute relating to the contract will pay attorneys’ fees of the prevailing party.
  - In Texas, the parties may agree that attorneys’ fees for tort claims are recoverable. See Akin, Gump, Strauss, Hauer & Feld, L.L.P. v. Nat’l Dev. & Research Corp., 299 S.W.3d 106, 120 (Tex. 2009).
- These provisions are generally enforceable.
  - Texas requires any fees recovered to be “reasonable,” as determined by the factors specified in the state’s rules of professional conduct. See Herring v. Bocquet, 21 S.W.3d 367, 368 (Tex. App.—San Antonio 2000, no pet.).
  - New York courts will enforce fee shifting provision “to the extent that the amount [of the fee award] is reasonable or warranted for the services actually rendered.” Yonkers Rib House, Inc. v. 1789 Cent. Park Corp., 880 N.Y.S.2d 148, 149 (N.Y. App. Div. 2009).
Attorneys’ Fees Shifting Provisions

Best Practices

- Carefully draft conditions of recovery—“prevailing party” or “party who recovers damages”?
- Remember fee shifting provisions in consumer contracts may not be enforceable.
- Consider pros and cons before including such a provision.
- Make sure potential damages merit the risk of facing significant fees.
Merger and Integration Clauses

**Generally**

- Merger and integration clauses typically provide that a written instrument embodies the whole agreement between the parties.
- The clause may also specifically disclaim any reliance on oral statements, remarks, or representations extraneous to the contract.
- The goal of such clauses is to preclude judicial inquiry into evidence outside the four corners of the contract when a dispute later arises between the parties or to attempt to bar claims for alleged misrepresentations outside of the contract.
- Texas law on this issue remains somewhat murky for fraudulent inducement claims.
Merger and Integration Clauses

**Generally**

- The parties’ sophistication may determine whether a merger or integration clause is enforceable.
- Merger or integration clauses are more likely to be enforceable when they are tailored to the specific transaction at issue.
Merger and Integration Clauses

**Mistakes**

- **Texas law**—Specific provisions are required to bar extra-contractual claims, including that:
  - The parties disclaim any duties not expressly provided for within the agreement;
  - Breach of contract is the sole and exclusive remedy; and
  - The parties waive and release all tort claims and causes of action that may arise from negotiation, execution, or performance of the agreement.

- **New York law**—A *general* disclaimer is ineffective.
  - A disclaimer most likely satisfies the requisite degree of specificity under New York law when it expressly disclaims reliance on oral representations related to the *subject matter* in controversy.
Merger and Integration Clauses

Mistakes

- Delaware law—Courts will not enforce “boilerplate waivers,” particularly in a contract of adhesion.
  - Clarity, not necessarily specificity, is the guidepost.
- In general, courts place greater emphasis on the sophistication of the parties, the extent of the negotiations, and the clarity of the provision, rather than on the specificity of the waiver (although specificity helps).
Merger and Integration Clauses

**Mistakes**

- In Texas, even with a specific, well-drafted disclaimer, a claim for fraud will still remain actionable unless the clause contains a “clear and unequivocal” intent to disclaim reliance of representations or to waive fraudulent inducement.

- Three Texas Supreme Court decisions on this issue:
Merger and Integration Clauses

- Other non-exclusive factors considered by the court include whether:
  - The terms of the contract were negotiated, rather than boilerplate.
  - The parties discussed the specific disputed topic during negotiations.
  - The complaining party was represented by counsel during negotiations.
  - The parties dealt at arm’s length.
  - The parties were sophisticated.
  - The parties were effecting a “once and for all” settlement of claims.
Jury Waiver Clauses

Generally

- Generally, a jury waiver clause is enforceable unless its challenger can articulate an adequate reason to deny enforcement, such as unconscionability.
- Texas law permits a jury waiver to be extended to other agreements executed at the same time, with the same purpose. See *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 135 (Tex. 2004).
Jury Waiver Clauses

**Generally**

- Consider the pros and cons of waiving the right to a jury:
  - Is the client likely to be a plaintiff or defendant?
  - Where will a case likely be brought?
  - What does the jury pool look like in the potential forum state?
  - Are you more likely to have legal arguments or appeal more to the jurors’ sense of fairness?
Jury Waiver Clauses

Mistakes

- Jury Waiver & Invalidity of Contract:
  - Where a party to the litigation alleges the contract is invalid—for example, due to fraud—jury waiver provision does not bar a jury determination of the contract’s validity.

- Waiver of the Waiver:
  - A party to a contract containing a jury waiver clause may waive protection of that provision by affirmatively demanding a jury trial.
Jury Waiver Clauses

Mistakes

- In Texas, a waiver provision must be “sufficiently conspicuous” to serve as *prima facie* evidence of a knowing and voluntary waiver.
  - This can be accomplished by setting it apart from other text, using a bold heading, all caps, underlining, etc.
  - If no fraud with regard to the waiver is alleged, conspicuous waiver is presumed knowing and voluntary.
- Waiver clause must be drafted clearly and unambiguously.
- A jury waiver will be strictly construed.
Contractual Limitations Periods

- The parties to a transaction may agree to shorten the otherwise applicable limitations period, subject to possible statutory restrictions.
  - For example, in Texas, Civil Practice & Remedies Code §16.070 prohibits shortening a limitations period to less than two years with one narrow exception.
- In general, the shortening of the statute of limitations must be reasonable.
  - Courts will not enforce unreasonably short contractual limitations periods.
  - Shortening the limitations period must not result from fraud, duress, or misrepresentation.
Special Considerations Related to Settlement Agreements

- **Preamble:**
  - Introduces all parties who are bound by the agreement (both signatories and non-signatories).
  - Date—may or may not be defined as the “Effective Date.”

- **Recitals:**
  - Provide brief history of parties’ relationship.
  - Introduce and define past governing agreements.
  - Introduce and define present litigation and related disputes.
  - List third-party intended beneficiaries.
  - Highlight confidential nature of agreement.
  - Highlight disclaimer of liability.
Special Considerations Related to Settlement Agreements

Releases

- Determine type of release—general, mutual, and/or limited.
- If the company is obtaining release, broadly define the “Company.”
  
  “Current and former parent, subsidiary, affiliated and related corporations, firms, associations, partnerships, and entities (collectively, ‘Company Parties’), their successors and assigns, and the current and former owners, shareholders, directors, officers, employees, agents, attorneys, representatives, and insurers of said corporations, firms, associations, partnerships, and entities, and their guardians, successors, assigns, heirs, executors, and administrators, accountants, and counsel (hereinafter collectively referred to as the ‘Releasees’).”
Special Considerations Related to Settlement Agreements

■ Broadly define released claims:
  ■ “Any and all claims, complaints, grievances, liabilities, obligations, promises, agreements, damages, causes of action, rights, debts, demands, controversies, costs, losses, and expenses whatsoever, under any municipal, local, state, or federal law, common or statutory, related to, concerning, or arising out of [broad definition of dispute/relationship].”

■ Include release for violation of specific statutes and common law claims.

■ Broadly define time period, e.g., “from the beginning of the world. . . .”
Special Considerations Related to Settlement Agreements

- Include an acknowledgement of complete satisfaction:
  - "Employee acknowledges that the amount being paid pursuant to Paragraph 7 of this Agreement constitutes complete satisfaction and full compensation for any alleged unpaid overtime, salary, vacation, severance, hours worked, and/or outstanding option grants, and that no other compensation, payments, or benefits are due to Employee by the Company."

Special Considerations Related to Settlement Agreements

- Include release for “known” or “unknown” claims.
  - Specific state statutes may require “magic language” to obtain a release of unknown or other types of claims.
    - Section 1542 of the California Civil Code provides that general releases do not extend to claims “which the creditor does not know or suspect to exist in his favor at the time of executing the release,” which—if known—must have materially affected his settlement.
Special Considerations Related to Settlement Agreements

- Other state or federal statutes may have other requirements for valid release.

  - ADEA/OWBPA (EEOC 1998 Regulations):
    - Waiver must be supported by additional consideration.
    - No waiver of future rights.
    - Must advise of right to consult attorney.
    - Must provide for seven-day revocation period.
    - Must provide specified time for consideration of agreement.
      - 21 days (most separations) or 45 days (early retirement or incentive program offered to group).
Special Considerations Related to Settlement Agreements

Confidentiality

- Cover the negotiations, terms, and the agreement.
- Consider liquidated damages for breach of confidentiality agreement.
- Carve outs: Limit to lawyer, financial/tax advisor, and spouse.
- Recite that confidential nature of settlement was material inducement to settle and that breach will result in irreparable harm.
- Provide that defendants (not parties) may resort to court to enforce (equitable) with no bond.
Special Considerations Related to Settlement Agreements

**Covenant Not to Sue**

- Prevent opposing party from commencing or assisting, directly or indirectly, with any lawsuit, action, claim, arbitration, regulatory action, or other proceeding against released parties.
- Include material inducement language.
- Include carve out for breach of settlement agreement.
- Include carve out for response to regulatory or governmental agency subpoena.
  - Require specified period of notice.