Practical Pointers to CYA When Drafting Business Contracts - 3/26/15

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Top Drafting Mistakes

1. Drafting a clause or section from scratch.
2. Inconsistently defining terms and phrases.
3. Leaving out key details.
4. Not spending enough time on key clauses.
5. Not spending enough time proofreading.
6. Executing a draft that is not the “final copy.”
7. The use of “form” contracts.
8. Not investigating and understanding the future business partner and the deal.
9. Failing to follow through to secure contractual rights.
Drafting a Clause or Section From Scratch

Why Re-invent the wheel?

- Need for custom language does not mean lawyers should make up whole clauses and definitions.
- Drafting whole clauses without a reference can lead to inconsistencies, ambiguities, enforceability issues, unreliable/untested language, etc.
- Chances are, the clause you want is out there – it just needs to be tweaked.
- Good sources for business contracts: Westlaw, www.onecle.com,

Example: Bell Atlantic pension plan participants recently sued Verizon claiming that cash payments were too little by half, arguing that a certain multiplier should have been applied twice rather than once. An in-house Verizon lawyer testified that this $1.67 billion drafting snafu resulted from his failure to delete a sentence after inserting the same phrase elsewhere in a contract.
Inconsistently Defining Terms and Phrases

Defining Terms and Phrases in Definitions Section or Within Particular Clauses

• The longer the contract, the better it is to have a separate “definitions” section.
• All terms/phrases with a specific meaning should be capitalized. But capitalization must be consistent throughout the agreement, or else the non-capitalized terms/phrases may be construed as being ambiguous.
Leaving Out Key Details

Parties sometimes wish to omit material information. For instance, contracts involving “consulting services” that do not specify the nature or type of services to be provided. Vague references to the obligations and duties of the parties invites future disputes.

Drafting tips:
• Use recitals to provide context. Recitals are usually not part of the agreement unless they are specifically made part of the agreement. However, if there is an ambiguity in a contract term a court may look to the recitals to determine the intent of the parties, so don’t assume they are meaningless.
• If the contract defines or references periods of time, be sure they are accurate and consistent. The times and dates should be determinable without any doubt, vagueness or ambiguity.
• Conditions precedent. Don’t fail to identify and address essential pre-conditions to the deal.
The Andy Warhol blunder. During his life and with respect to his estate, one of Andy Warhol’s legal advisers was Edward Hayes, a Manhattan lawyer and a former district attorney (and, apparently, the real-life inspiration for the character Tommy Killian in the book Bonfire of the Vanities). One of the assets in the estate was Warhol’s Interview Magazine, with a circulation of 160,000 by the time of Warhol’s death. The estate sold it based on a down-payment with the balance personally guaranteed by the buyer, in a promissory note, payable not to the estate, but to a company called “Andy Warhol Enterprises Inc.” Hayes dissolved the company a week before the promissory note was signed but neglected to ensure that the personal guarantee was made payable to the estate. In the result, it was made payable to an nonexistent company. Hayes said it was just a typing error but the court struck the promissory note which then became unenforceable with the balance owing to the estate, some $7 million, lost.
Not Spending Enough Time On Key Clauses

All to often, boilerplate language is used for what many think of as “standard” provisions. Many times these provisions are included without much thought, yet litigation is often determined on the basis of such boilerplate clauses.

b. Alternative dispute resolution.
c. Integration clauses.
d. Default, opportunity to cure and termination.
e. Indemnification clauses.
f. Duty to defend.
Choice of Law and Venue

Reasons why Every Contract should have Choice of Law and Venue Provisions

- Avoids needless litigation regarding the laws of which states of country apply.
- Avoids removal and motions to transfer.
- Drafter can choose the forum and venue that are best. *(See for example Meras Engineering, Inc. et al. v. CH20, Inc., 2013 WL 146341 (N.D. Cal. 2013).)*
- Sample Provision: This Agreement shall be governed by and construed in accordance with the laws of the State of Nevada. The Parties consent to personal jurisdiction in the State of Nevada and agree that State Court in Las Vegas, Nevada, Eighth Judicial District, is the appropriate forum for any action relating to this Agreement.
Choice of Law & Forum Selection (Cont.)

• To be enforceable under Nevada law, a forum selection clause must have been “freely negotiated” and may not be “unreasonable and unjust.” *Tandy Computer v. Terina’s Pizza*, 105 Nev. 841, 784 P. 2d 7 (1989) (holding a forum selection clause was not binding where it was not negotiated, none of the persons who signed the contract knew of its existence, and enforcement would impose an undue litigation burden upon consumers).

• Do the parties intend the forum selection clause to also encompass tort claims? If so, it should expressly say so or it may not be enforceable. *Tuxedo Intern. Inc. v. Rosenberg*, 251 P. 3d 690 (Nev. 2011).
Arbitration

Issues to Consider in Arbitration Clauses

• To arbitrate or not?
• AAA, JAMS, or other private arbitration.
• Panel or single arbitrator.
• Must arbitrator be an attorney?
• Employee must initial clause.
• Selection of arbitrator, discovery, motions, awards, decisions, confidentiality, fees and costs.
Is it enforceable?

- At least in consumer contracts, under Nevada law “to be enforceable, an arbitration clause must at least be conspicuous and clearly put a purchaser on notice that he or she is waiving important rights under Nevada law.” *DR Horton, Inc. v. Green*, 120 Nev. Adv. Op. 63, 96 P. 3d 1159 (2004).
Integration Clauses


• To be enforceable, it must clearly state that the parties disclaim reliance upon extra-contractual statements.

• Nevada courts will consider integration clauses when ruling on motions to dismiss based on fraudulent or negligent misrepresentations.

Default, Opportunity to Cure, and Termination

• All too often, boilerplate language is used to define what constitutes a default and how (if at all) that default may be cured.

• Avoid using ambiguous terms like “reasonable” and instead include specific terms applicable to this transaction.

• Notice Provisions. The inclusion of the method and place of notice helps to avoid uncertainty. Is a fax copy or email permitted? Must the delivery be in person? What address, phone number or email address will be used? Is first class mail, certified mail, or delivery service appropriate? When does the notice become effective?
Indemnification Clauses

Areas of concern are the specific party being indemnified, as well as the conditions upon which indemnification will arise and the scope of the indemnification. Indemnification can be written narrowly or broadly.

• Unless expressly stated otherwise, it is presumed that an indemnitor will only be liable only were the indemnitee’s injuries were caused by the indemnitor.

• The indemnitor’s liability may be limited through the inclusion of “to the extent caused” contractual limitations. United Rentals Hvy. Techs. v. Wells Cargo, 289 P.3d 221 (Nev. 2012).

Duty to Defend

• This generally means that the defending party will retain its own counsel to represent the party defended.

• Drafting Point: If your client wants to engage its own litigation counsel and control its defense, then consider avoiding “defense” language. At the same time, separately consider the use of indemnification and hold harmless language.
• In litigation, mistakes can be fatal. Lawsuits have been decided based upon errors as to the identification of parties or key terms, as well as failing to eliminate ambiguous terms.

• **Example:** The "Million Dollar Comma" Case

• The famous Canadian case of Rogers and Bell Aliant, also known as the Comma Rule Case, emphasizes the importance of punctuation in terms of contract writing. The contract at issue contained the following clause:

  “This agreement shall be effective from the date it is made and shall continue in force for a period of five (5) years from the date it is made, and thereafter for successive five (5) year terms, unless and until terminated by one year prior notice in writing by either party.”

• Aliant interpreted this as a right to terminate at any time upon one year's notice to Rogers. But Rogers read it as a right to terminate only at the end of the current or a renewed five-year term. The answer depends on whether the phrase, “unless and until terminated by one year prior notice in writing by either party” modifies both preceding clauses, or just the immediately preceding clause.

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Executing a Draft that is not the “Final Copy”

Parties sometimes mistakenly execute a draft that contains redlined edits. This can create ambiguities in future litigation even when the mistake is “corrected” through the execution of a final draft.

Be careful when using “track changes”, and implement a system to ensure that you can easily keep track of what version you sent and to whom.
Track Changes

The Good
• Quick and easy to use.
• Can track changes from one version to the next.
• Can insert comments.
• Multiple authors are assigned different colors.

The Bad
• After several rounds of revisions, the document is difficult to read.

Suggestion
• After a few rounds, circulate a non-marked up copy, and re-start track changes. When the contract is complete, redline the final version and check it against the original and make sure it confirms the parties’ understandings and serves as a safety net before the parties sign.
The Use of “Form” Contracts

This is another common cause of drafting mistakes. Critical information is often omitted, or information or terms from a separate transaction are mistakenly incorporated into the new contract.

**Drafting tips:**

Even for “routine” transactions, have an attorney draft or review the contract before it is executed.

Implement a management system for managing standard forms.
Not Investigating and Understanding the Future Business Partner and the Deal

- Make sure you have a clear understanding of the objectives of the document you are drafting. You cannot draft an effective contract unless you have a clear understanding of the deal.

- Investigate the other party. Consider credit and litigation searches. Knowledge regarding a party's ability to perform and litigious nature is invaluable.

- Fully understand the agreed terms, and anticipate areas of future disputes. Be sure to fully set forth the rights and duties of the parties.
Failing to Follow Through to Secure Contractual Rights

- Secure your rights. For instance, if taking a security interest be sure that steps are taken to attach and perfect that security interest. All too often entities fail to record UCC Financing Statements etc. that are provided for in the contract.

- Be sure that the employees responsible for performance have a copy of the contract, and understand the rights and duties between the parties. Make sure those employees understand the need to report to counsel and/or management when there are issues, and make sure those issues are documented or otherwise memorialized when appropriate.
Other Basic Ambiguities

Conjunctions and Plural Nouns

• Misusing conjunctions and plural nouns can lead to ambiguities (e.g. and, or, every, each and any, plural nouns). Using these terms in contracts raises the question of whether the drafter is referring to an entire group or just a single member of a group.

Omitting Key Details

• Omitting key details can lead to future litigation. For example, contract is for “consulting services.” it is a good idea to attach an annex that lists the specific consulting activities, service levels, and other details. Clients will appreciate the clarity that results from this process, and the contract will better reflect the parties’ bargain.

• Consequences of omitting a “morals clause” – see picture.
Miscellaneous Common Errors

• Failing to really understand terms and conditions.
• Legalese, run-on sentences, passive voice.
• Lack of cohesion (paragraphs do not flow).
• Contract makes various assumptions.
• Lack of proper and/or parallel grammar, punctuation (company is not “they,” past and present tense in same sentence, etc.).
• Vague and ambiguous terms (e.g. “biweekly” could mean twice per week or every other week).
• Write as if a 5th grader would understand.
Typical Mistakes and/or Omissions Cont.

- Failure to specify payment obligations.
- Dispute resolution. Can parties sue or arbitrate immediately, or must they first attempt to resolve in good faith? If the latter, what are the parameters?
- Confidentiality.
- Automatic renewals.
- Attorney’s fees.
- Incorporated documents and exhibits.