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URBAN LEGENDS IN TECHNOLOGY AND COMPLEX COMMERCIAL CONTRACTS

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CO-PRESENTER

SOMMER COUTU

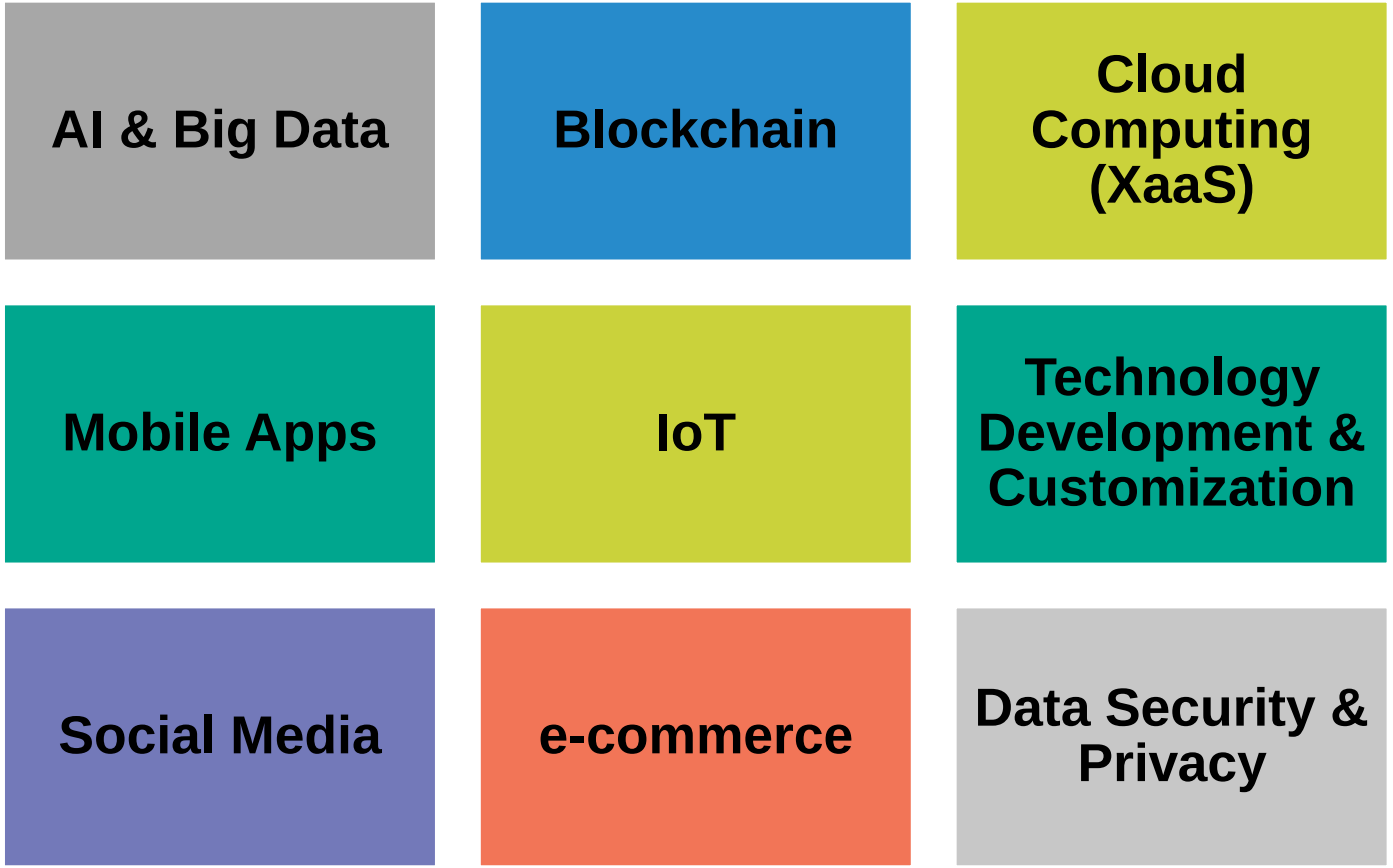
Sommer Coutu is a Vice President of Legal at Dell Technologies, leading the U.S. Technology Transactions team that provides the primary legal and contract support to the North America sales team. Her team negotiates all manner of hardware, complex services, software, licensing and as a service technology contracts with Dell's Enterprise, Commercial and State and Local customers. Sommer has navigated technology negotiations with these customers in a variety of industries globally, with a particular emphasis on the nuances of negotiation through the public procurement process with U.S. State and Local customers. Prior to joining Dell in 2012, Sommer spent nearly ten years litigating business and contract disputes with a focus on trade secret misappropriation and related breach of contract claims.

CO-PRESENTER

SHAWN HELMS

Shawn Helms is a partner and the Co-Head of the Firm's Technology & Outsourcing practice, and is based in the Firm's Dallas office. Shawn has broad experience in the areas of information technology, telecommunications and outsourcing. His practice is focused on complex transactions involving technology and intellectual property, including AI, blockchain, business process and information technology outsourcing (BPO and ITO), licensing, cloud computing and software as a service (SaaS) arrangements, technology maintenance and services, technology development/customization (including iPhone, Android and other mobile device applications and systems), wireless infrastructure, social media issues, strategic alliances, e-commerce, distribution, confidentiality, strategic sourcing and data security/privacy. Shawn is the co-author of a legal treatise on outsourcing law, "Outsourcing: Law and Business" published by Law Journal Press and the book "Technology & Outsourcing published by Bloomberg.

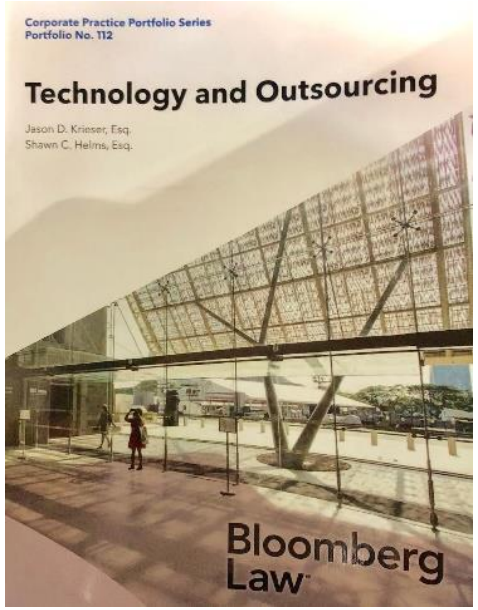
TECHNOLOGY EXPERIENCE

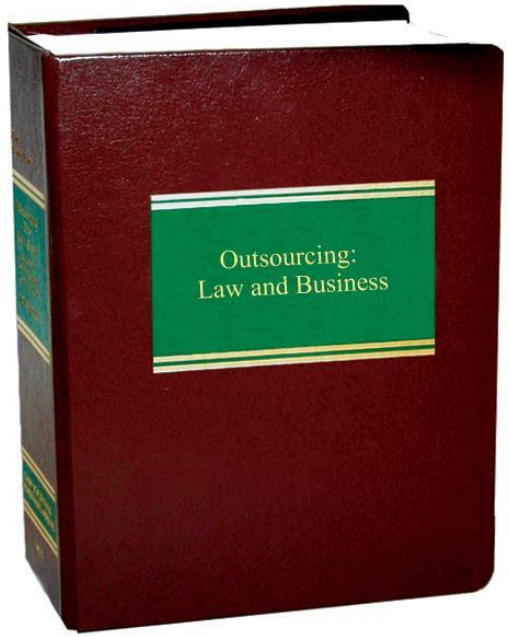


RESEARCH

- Shawn Helms is the co-author of “Technology and Outsourcing” published by Bloomberg in 2018.

- Shawn also authored the market-leading outsourcing legal treatise - “Outsourcing: Law and Business” (outsourcingtreatise.com)





URBAN LEGENDS

Advanced US Contract Law Topics

URBAN LEGEND DEFINED

Noun:

“A story of obscure origin and with little or no supporting evidence that spreads spontaneously in varying forms and is usually incorrect. Sometimes urban legends are not incorrect, but are distorted, exaggerated, or sensationalized over time.”

FAMOUS URBAN LEGENDS

New York City sewer system is infested with deadly alligators.

Walt Disney’s body is cryogenically frozen.

Chewing gum takes 7 years to digest.

URBAN LEGENDS IN US CONTRACT LAW

1. Magic Words
   - Best Efforts vs. Reasonable Efforts
   - Representation vs. Warranty
2. Consequential Damages
3. Words & Digits
4. Indemnity Remedy for Breach of Contract
5. Work for Hire
6. Applying New York Law
7. Force Majeure

MAGIC WORDS?

- Generally an urban legend
- Many examples:
  - Best Efforts vs. Reasonable Efforts
  - Representation vs. Warranty

BEST EFFORTS VS. REASONABLE EFFORTS

Urban Legend:

The term “best efforts” imposes an obligation on a party to use extraordinary efforts to perform a task – doing everything in its power to fulfill the obligation.

Reality:

No meaningful distinction between “best efforts” and any other efforts standard

BEST EFFORTS MYTH EXPLAINED

- Best Efforts vs. Reasonable Efforts
  - Courts equate “best efforts” with “reasonable efforts”
  - UCC reinforces this view
- What is different – best efforts is more than a normal duty of good faith. Farnsworth: “best efforts has diligence as its essence and is more exacting than the usual contractual duty of good faith”.
- One Additional Caveat – Use of “best efforts” and “reasonable efforts” in the same contract.

BEST EFFORTS MYTH EXPLAINED

- Case Law – “best” means “reasonable”
  - The Federal District Court of Kansas said, “best efforts does not mean perfection and expectations are only justifiable **if they are reasonable**.”
  - The Federal District Court for the Southern District of New York declared, “New York courts use the term ‘reasonable efforts’ **interchangeably** with “best efforts.”
  - The Federal District Court for the Western District of Wisconsin said, “the duty to use best efforts requires [a party] to use **reasonable efforts** and due diligence.”
  - The Federal District Court for the District of New Jersey said that the difference between best efforts and reasonable efforts is “**merely an issue of semantics**.”

- UCC §2-306(2) – When explaining the requirement that a seller use best efforts, the UCC official comment calls for the parties to “use a reasonable effort.” This linguistic inconsistency in the UCC has led one Ohio court to say, “[t]he test for best efforts is one of reasonableness.”

REPRESENTATION VS. WARRANTY

Urban Legend:

A party is entitled to different (or additional) legal remedies when a statement is called a “warranty” vs. a “representation”

Reality:

Representations and warranties are “synonyms” or there is, at least, no legal distinction of consequence.

REPRESENTATION VS. WARRANTY MYTH EXPLAINED

- Modern courts and commentators look only to the substantive obligation as described and do not give weight to the label
- Practitioners commonly use “represent and warrant” together, thus the any distinction is blurred
- One Caveat – Consumer protection statutes (e.g., Texas Deceptive Trade Practices Act and California Song-Beverly Consumer Warranty Act) will provide additional remedies for a breach of warranty

CONSEQUENTIAL DAMAGES: ALL-STAR HYPOTHETICAL

The Dallas Mavs' Luka Dončić hired All-Star Lawn Service to provide weekly lawn maintenance. Under the contract between Luka and All-Star, All-Star agreed to perform lawn services each Monday and Luka agreed to pay a $300 weekly fee. When the parties signed the agreement, Luka told All-Star's owner that he would be out of the country during July and August. Luka explained to All-Star's owner he was relying on All-Star's weekly lawn services to avoid HOA penalties for failure to maintain his yard.

All-Star failed to perform maintenance services during the last 3 weeks of July. Luka was fined $200 by his HOA. In addition, Texas Pictures was scheduled to film a scene at his house on July 26th. Because Luka's property was not properly maintained, Texas Pictures was forced to find a new location. Luka lost his $2,000 location fee and was charged an additional $2,000 by Texas Pictures for their additional costs in finding a new location.

ALL-STAR HYPOTHETICAL

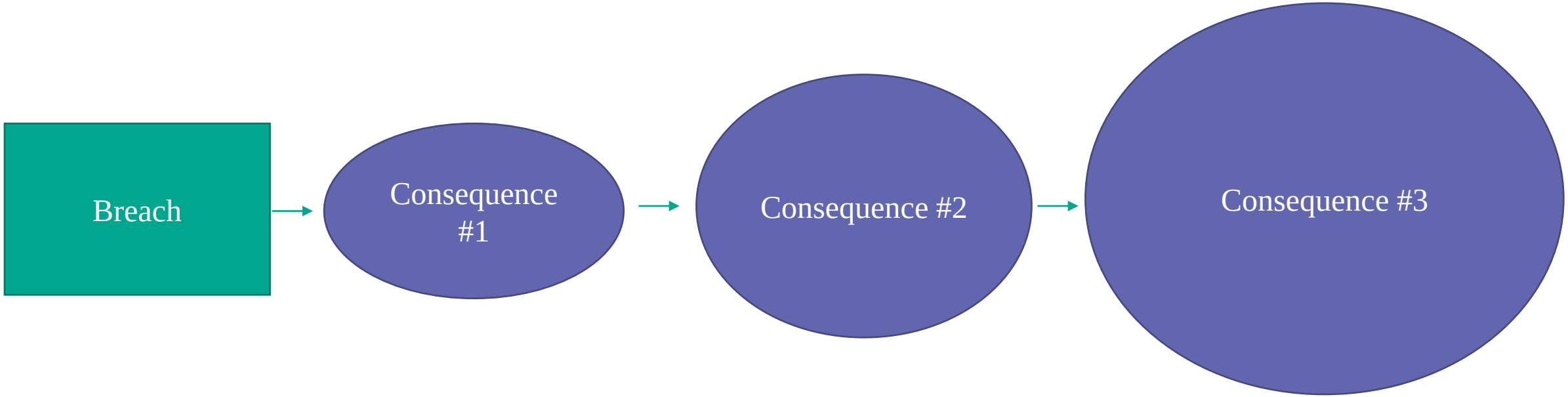
Luka Sues All-Star. Which of the following breach of contract damages are recoverable?

A. $900 lawn fees (for the missed 3 weeks)
B. $200 HOA fine
C. $2,000 lost location fee from Texas Pictures
D. $2,000 for Texas Pictures' additional costs for finding a new location

CONSEQUENTIAL DAMAGES

Urban Legend:

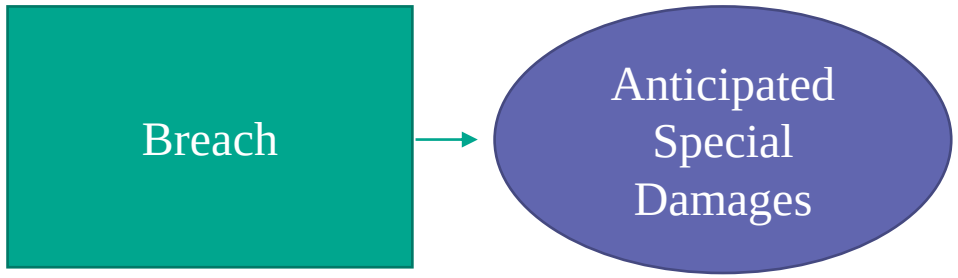
“Consequential Damages” means damages that are very remote or speculative, multiple steps removed from the breach that were not anticipated by the parties.



CONSEQUENTIAL DAMAGES

Reality:

Consequential damages are special damages that do not naturally flow from the breach but are, in fact, damages that the parties anticipated.



CONSEQUENTIAL DAMAGES MYTH EXPLAINED

- Recovery of damages for breach of contract are limited (unlike tort)
- Under *Hadley v. Baxendale* (leading English contract law case from 1854 adopted by U.S. 1894) damages for breach of contract are limited to:
  1. "those losses that would arise normally and naturally as the result of a breach of any similar contract"; and
  2. "any other losses arising from the special circumstances of the non-breaching party to the extent such special circumstances were communicated to the breaching party at the time the contract was made and were, therefore, within the contemplation of the parties as a probably consequence of a breach of contract."
- **The Hadley two prong test defines direct and consequential damages**
- Therefore, "consequential damages" are real losses arising because of the special circumstances of the injured party that were within the contemplation of the parties at the time of the contract.
- Remote damages not contemplated by the parties **are already excluded by contract law** – no need to disclaim these damages.

ALL-STAR HYPOTHETICAL ANSWER

Luka Sues All-Star. Which of the following breach of contract damages are recoverable?

A. **$900 lawn fees (Yes - Direct)**
B. **$200 HOA fine (Yes – Consequential)**
C. $2,000 lost location fee from Texas Pictures
D. $2,000 for Texas Pictures' additional costs for finding a new location

ON A RELATED POINT...

- A typical limitation of consequential damages disclaimer will disclaim a litany of damages (e.g., “consequential, special, punitive, exemplary, indirect, incidental damages and lost profits”)
  - Special damages = consequential damages
  - Punitive damages = tort damages not awarded in contract claims and generally cannot be disclaimed
  - Exemplary damages = punitive damages
  - Indirect damages = not a “damages” terms that has clear meaning under U.S. law. Likely means consequential damages.
  - Incidental damages = specific “inspection, receipt, transportation” expenses under U.C.C. (minor and not always applicable)

WORDS AND DIGITS

Urban Legends:

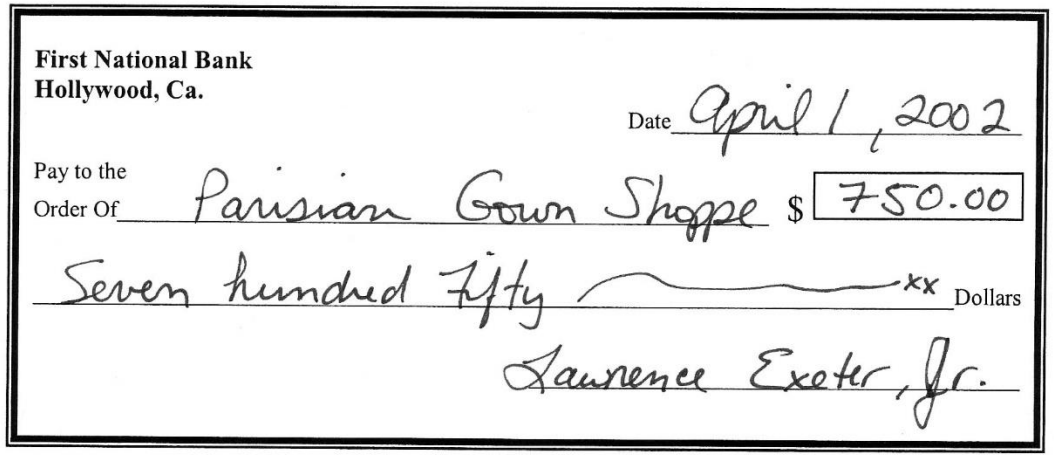
Using words and digits adds clarity to numbers and amounts in contracts and is needed to be legally binding.

Reality:

Using both words and digits is not needed, harder to read and raises some significant risks.

WORDS AND DIGITS MYTH EXPLAINED

- Why?


First National Bank
Hollywood, Ca.

Date April 1, 2002

Pay to the Order Of Parisian Gown Shoppe $ 750.00

Seven hundred fifty xx Dollars

Lawrence Exeter, Jr.

- Writing a phrase with both words and digits is common in contracts "*no later than thirty (30) days after the Closing …*"
- This convention violates a cardinal rule of contract drafting – don't say the same thing twice because there is a chance for ambiguity.

WORDS AND DIGITS MYTH EXPLAINED

- Problem is - our eyes often only see the digits.
- But the court only sees the words.

> The parties to this appeal entered into a residential loan agreement and guaranty for the principal amount of "ONE MILLION SEVEN THOUSAND AND NO/100 ($1,700,000.00) DOLLARS." The loan documentation thus identified the amount of the loan in two different ways, with one number favoring the borrower—one million seven thousand—written out in words and a larger number favoring the bank—$1,700,000—set out in numerals. The bank alleged a default on the loan, and litigation ensued. The parties filed competing motions for summary judgment, and the trial court rendered a final summary judgment in favor of the bank.

Charles R. Tips Family Trust v. PB Commercial LLC, 459 S.W.3d 147 (Tex. App. 2015)

- Words prevailed over the digits. Amazingly – no parol evidence (in Texas case) despite the clear ambiguity.

INDEMNITY FOR BREACH OF CONTRACT

Urban Legend:

There is no usefulness to an indemnity for a matter that is also covered by a warranty (because you have breach of contract claim)

Reality:

An indemnity can offer the beneficiary a broader remedy – particularly for direct (party to party) claims.

INDEMNITY FOR BREACH OF CONTRACT MYTH EXPLAINED

An indemnity can provide a broader remedy because:

- Indemnities are often excluded from the limitation of liability
- Indemnity compensation is likely not limited by normal contract law damage limitations (e.g., remoteness under *Hadley*), and
- there is (arguably) no duty to mitigate.

WORK FOR HIRE

Urban Legend:

If a company is having software or technical documentation developed by an independent contractor it is important to state that the deliverables are “work for hire” under U.S. copyright code

Reality:

“Work for hire” language is ineffective in many technology contracts and may, in fact, be detrimental

WORK FOR HIRE MYTH EXPLAINED

- "Work for hire" is a copyright doctrine that gives an employer ownership of the copyright in works of authorship prepared by an employee or, in limited instances, an independent contractor.
  - Employee – Automatic
  - Independent Contractor – Must meet 3 prongs
    1. *Specially ordered or commissioned.*
    2. *Written contract stating the deliverables are "work for hire."*
    3. *Works must come within 1 of 9 limited categories of works*.

WORK FOR HIRE MYTH EXPLAINED

- 9 categories of works
  - a contribution to **a collective work** (e.g., part of a periodical, anthology, encyclopedia, etc.);
  - a part of a **motion picture** or other audiovisual work;
  - a **translation**;
  - a **supplementary work** (e.g., foreword, illustration, editorial notes, musical arrangement, test answers, bibliography, appendixes, etc.);
  - a **compilation** (an original manner of selecting or arranging preexisting works);
  - an **instructional text**;
  - a **test**;
  - **answer material for a test**; or
  - an **atlas**.
- Business software and technical documentation are not contemplated – (aside from some websites).

APPLYING NEW YORK LAW

Urban Legend:

A party or the transaction must be in New York for New York law to be applied as the governing law of a contract.

Reality:

New York law can be applied when (i) New York has a “reasonable relation” to the parties or the transaction or (ii) almost anytime the transaction is over $250,000.

APPLYING NEW YORK LAW MYTH EXPLAINED

- The application of New York law is popular because it has well developed corporate law and is the venue for many significant business transaction. New York law is the default for many international transactions (i.e., transactions between a US company and a company from another country).
- New York General Obligations Law (Section 5-1401) allows the application of New York for **almost any transaction over $250,000.**
- Excludes “labor” and “personal service” contracts (e.g., staff augmentation)

FORCE MAJEURE

Urban Legend:

Customers should keep out a force majeure provision because it gives the supplier an excuse for non-performance

Reality:

A well drafted force majeure provision can be helpful to the customer

FORCE MAJEURE MYTH EXPLAINED

- Suppliers have common law defenses to non-performance under US law: “impossibility/impracticability” and “frustration of purpose” if certain events or actions occur that are outside the service provider’s control
- These common law defenses can be limited or eliminated by the language of the contract
- A force majeure provision can define the bounds of excusable acts and can give the customer rights if a force majeure event occurs

SOME SOURCES

- **Consequential Damages**
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  - West, “Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic 'Excluded Losses' Provision in Private Company Acquisition Agreements,” 70 Bus. Law. 971 (2015).
- **Best Efforts**
  - Helms, “Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law”
  - Adams, *A Manual of Style for Contract Drafting*, §7.17 - §7.26, American Bar Association (2004)
  - Adams, “Understanding ‘Best Efforts’ and Its Variants (Including Drafting Recommendations),” 50 Prac. Law. 11, 14 (2004).
- **Work for Hire**
  - Toher and Helms, “The ‘Work For Hire’ Doctrine Almost Never Works In Software Development Contracts” The Metropolitan Corporate Counsel, Inc. (June 2008) (http://www.jonesday.com/files/Publication/721eb762-a4df-4dea-aadd-a64170ec1182/Presentation/PublicationAttachment/845f72d6-f806-438c-bddd-acdc85d2eb9f/16-06-10%20Jones%20Toher.pdf)
  - 17 U.S.C. § 101 – definition of “work for hire”
- **Representation vs. Warranty**
  - Peterson, “The Effective Use of Representations and Warranties in Commercial Real Estate Contracts” (July 9, 2001), available at (http://www.acrel.org/Documents/Seminars/a002089.pdf)
  - Adams, “‘Representations and Warranties’ –Once More, With Feeling,” (Sept. 18, 2009), available at (http://www.adamsdrafting.com/2009/09/18/rs-and-ws-once-more-with-feeling/)
- **Applying New York Law**
  - Krieser and Helms, “Outsourcing: Law and Business,” § 11.05[2][b] New York Law Journal (2011).
- **Indemnity for Breach of Contract**
  - Burden, “Contract Indemnities: Indemnities in IT and Outsourcing Contracts,” 22 Computer L. & Security Rep. 68 (2006)
  - De Silva and Golding, “Outsourcing Contracts: Lessons Learned,” 31 Commw. L. Bull. 3, 29 (2005).
- **Force Majeure**
  - Stark, *Negotiating and Drafting Contract Boilerplate*, § 11.01[3] (2003)
  - Restatement (Second) of Contracts, § 261 and § 265
- **Words and Digits**
  - Charles R. Tips Family Trust v. PB Commercial LLC, 459 S.W.3d 147 (Tex. App. 2015)

THANK YOU!
QUESTIONS?

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