

WHAT YOU NEED TO KNOW ABOUT RISK BEFORE YOU SIGN A CONTRACT

Have you ever seen celebrities on television selling contracts with expressions such as “we make the law work for you” or perhaps you may see some legal forms sold at office supply stores. Or perhaps you have seen some compact discs attached to the jackets of some legal contract books. But when you read the fine print in the “Terms of Use” it tells a whole different story. One well known legal form site states:

“At no time do we review your answers for legal sufficiency, draw legal conclusions, provide legal advice or apply the law to the facts of your particular situation. [Our] Services are not substitutes for the advice of an attorney”... Furthermore, the legal information contained on the Site is not legal advice and is not guaranteed to be correct, complete or up-to-date.”

These resources make contracts elliptical – they are silent on key details unique to your matter because they simply do not know precisely your situation. So they leave out key clauses and load up the disclaimer language in fine print. They even make you decide if your situation is too complex – which begs the question of if you knew it was too complex in the first place you would not need their forms.

Please review this overview to get a better understanding of the risk of contracts and then speak with an attorney that can guide you through these risks.

The information in this eBook is not, nor is it intended to be, specific legal advice. You should consult your attorney for individual advice regarding your own situation.

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RISK MANAGEMENT

Problem:

- Many companies have no clear risk governance structure.
 - Risk is siloed or misunderstood.
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Solution:

- Identify major risks [full range of outcomes].
 - Decide which risks you should own or will transfer [e.g. SW Airlines model].
 - Embed risk in all decisions and processes.
 - Align governance & organization around risk.
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Broader Role in Managing your Contracts:

- Help create long-term value.
 - Coordinate strategic plan with agreements.
 - Participate in corporate policies and procedures.
 - Implement risk oversight and compliance.
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ESSENTIAL CONTRACT PARADIGM

Key Contract Clauses:

- Preface and Parties: [intent and privity]
- Definitions
- Subject & Payment: [goods or services]
- Intellectual Property: [ownership, license, confidentiality]
- Performance: [conditions [forfeiture] v. covenants [damages only]
- Representations: [present, fraud - breach relationship]
- Warranties: [future - damage relief]
- Limitation of Liability
- Confidentiality
- Dispute Resolution: [3 types]
- Miscellaneous: [evergreen, merger, survival, parol evidence, non-assignment, set-offs, notice, cumulative remedies, etc.]
- Statement of Work

6 Risk Shifting Devices:

- Indemnification: shifts third party liability.
- Limitation of Liability & Remedies: contains liability.
- Disclaimers: eliminates underlying obligation.
- Conditions: “subject to” or “on the condition that” [trigger specific acts].
- Covenants: promises [redress is damages].
- Waivers: relinquishment of rights.

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WHERE CONFIDENTIALITY ISSUES MAY ARISE

Employment Agreements:

- Transfer of contractual rights.
(e.g. intellectual property of company).
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Independent Contractor Agreements:

- [e.g. federal copyright issues and need to know clauses].
 - Trade Secret interstate differences [governing law clause].
 - Non-disclosure agreements.
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Employee Handbooks:

- What rights are or are not created?
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Policies and Procedures:

- How your company protects its confidential information.

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INDEMNIFICATION ISSUES

4 Types:

- Expressed in Contract
 - Common Law Tort
 - Implied in Contract
 - Statutory Indemnification
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Expressed in Contract:

- Contract clause will be construed “fairly and reasonably”.
 - Intent of the parties important. Should cover reasonable damages.
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Implied in Contract (rare):

- Special Factors: where “intent” inferred from special relationship.
 - Query: Does the implied indemnitor have control over the property or premises and agreed to protect the public from harm?
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Common Law Tort:

- Rest. of Torts (2nd): For example, a retailer may seek indemnification against a manufacturer for defective products.
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Statutory Indemnification:

- Many state statutes provide indemnity for individuals and positions.
 - [E.g. public officials, corporate officers & directors, police officers, etc.]
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INDEMNIFICATION RULES

EXCEPTIONS:

- Sole negligence, Gross negligence, Willful misconduct.
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NOTICE:

- Rule: lack of notice may not preclude right of indemnity.
 - Exception 1: Contract requires notice.
 - Exception 2: Affects amount of award.
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HOLD HARMLESS:

- Problem: Typical license limits indemnification damages to those “finally awarded” so buyer incurs legal costs for “groundless lawsuits”.
 - Solution: Hold harmless clause requires buyer be reimbursed for all damages and expenses (including attorneys fees).
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DEFEND:

- Problem: Buyer may need legal representation up front.
 - Solution: It involves coverage so it is broader than the duty to indemnify (liability).
 - Test: Insurers look at policy and pleadings for coverage.
 - Trigger Date: Usually when notice of claim provided.
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LIMITATION OF LIABILITY CAPS

CAP ON AMOUNT:

- Dollar figure (e.g. “shall be limited to \$200K”).
 - Value of contract (e.g. value of contract or license fee).
 - Certain assets (e.g. assets of partnership not of partner).
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CAP ON TYPE:

- Exclude consequential, special, or punitive damages.
 - Exclude interest or incidental damages (not recovered by buyer).
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CAP ON TIME LIMIT:

- Limit time to file claim (e.g. 1 year).
 - Limit time to mediate (e.g. 45 days).
 - Allow injunction for intellectual property violations (e.g. immediate).
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CAP ON PROCESS:

- negotiate
 - mediate
 - arbitrate
 - litigate
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LIMITATION OF LIABILITY RULES

DISTINCTIONS:

- Limited remedies vs. Limited liability - both contain risk.
 - Limited remedies: focuses on specific relief (e.g. repair or replace).
 - Limited liability: focuses on contracting parties.
 - Indemnification focus is on third parties.
 - Exclusive Remedies. UCC §2-719 allows exclusive remedies.
(If you are a buyer you may want to disallow them.)
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CAPS NOT RECOGNIZED:

- unconscionable [e.g. injury from consumer goods UCC 2-719].
 - unreasonable.
 - fails of its essential purpose (for exclusive remedies).
 - gross negligence or willful misconduct only (some jurisdictions).
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CAPS ON INDEMNIFICATION CLAUSE:

- If indemnification clause not intended to be subject to general limitation of liability clause it should be expressly excepted out.
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LIQUIDATED DAMAGES:

- limited liability - ceiling amount only.
 - liquidated damages - ceiling amount equals floor amount.
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USUAL DAMAGE CLAUSES

Types:

General, Special [Incidental and Consequential] Liquidated, Punitive, and Attorney's Fees.

General:

Occur naturally and ordinarily from breach.

Computation for Goods: UCC 2-706, 708, 709, 712, 713, 714.

Special: [Incidental and Consequential]

- Seller of Goods:
[UCC 2-710] Generally includes any commercially reasonable charges, expenses or commissions with respect to buyers breach and any losses from the requirements and needs buyer had reason to know and not reasonably predictable.
 - Buyer of Goods: [UCC 2-715] Generally includes expenses reasonably incurred from sellers breach plus any losses from buyers needs that seller had reason to know and not reasonably predictable.
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UNUSUAL DAMAGE CLAUSES

Liquidated:

Must be reasonable in light of harm caused and proof of loss difficult (UCC 2-718). Void if unconscionable, a penalty or an adhesion contract.

Punitive:

Breaching party punished. Not allowed in UCC unless specifically in contract.
Only recoverable in some states by statute.
Can be included in contract.

Attorney's Fees:

Governed by state law not UCC. Not recoverable in some states unless per contract or per statute.

Tip:

Generally UCC remedies cumulative unless contract states "sole remedy".

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WARRANTY EXCLUSIONS or MODIFICATIONS

Disclaimer of Express Warranties:

- “Words or conduct” tending to negate or limit.
 - Effective only if consistent with express warranty.
 - Goods subject to Parol Evidence Rules of UCC 2-202.
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Disclaimer of Implied Warranties of Merchantability:

- Must mention “merchantability” (oral or written) and be conspicuous (if in writing).
 - Terms “as is” or “with all faults” or goods examined is acceptable.
Disclaimer of Implied Warranties of Fitness for Particular Purpose.
 - Written (but does NOT need to mention “fitness”) & be conspicuous.
 - “As is” or “with all faults” or goods examined is acceptable.
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Disclaimer of Warranties of Title Against Infringement:

- Words (e.g. seller does not warrant title in the goods) or conduct.
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Exceptions:

- Unconscionability
- Mixed service contracts (disclaimability varies per state).
- Exclusive remedies (e.g. repair or replace) may fail.
- BIG TRAP: “Unless the circumstances indicate otherwise.”

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PAROL EVIDENCE RULE

Parol Evidence Rule:

- Parol [extrinsic] Evidence is substantive law - NOT just a rule of evidence (Rest. of Contracts. §228 & 229).
 - Written terms may NOT be contradicted by evidence of a prior agreement or contemporaneous oral agreement.
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UCC 2-202: Written terms that are a “Final Written Expression”:

- Terms with respect to which confirmatory memoranda of the parties “agree”, or
 - Terms in writing intended as final expression of their agreement.
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Exceptions:

Ambiguous written terms can be explained or supplemented by

- course of performance (this contract)
 - course of dealing (past contracts)
 - usage of trade
 - consistent additional terms [i.e. to show fraud or unconscionability]
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Traps:

- Merger Clause (“complete & exclusive statement”).
- CISG: No parol evidence rule to preclude oral statements.

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DISPUTE RESOLUTION CLAUSES

Mediation:

- Less Expensive
 - May be Confidential
 - Requires good faith
 - Finality problem unless contract makes decision binding
 - Focuses on wants and needs as well as liability
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Arbitration:

- Usually faster than Litigation
 - Limited review (G.L. c. 251 §12)
 - Expertise of panel and informed discovery and hearing issue
 - Appeals allowed
 - Confidential
 - Choice of Act (FAA/AAA/CC).
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Litigation:

- Usually most expensive and slowest procedure.
- Choice of law and forum issues.
- Complex technology issues may be misunderstood.