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Boilerplate Clauses in Commercial Contracts: Avoiding Unintended Consequences, Implementing Practical Solutions

Choice of Forum, Choice of Law, Force Majeure, Dispute Resolution, Assignment, and Other Key Clauses

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Boilerplate Clauses in Commercial Contracts

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Introduction

- Draft in understandable language
- Need to understand the underlying law to do a good job drafting
- What is boilerplate?
- Some general rules
- Specific types of clauses
- Supplemental materials

What is boilerplate?

Etymology of the term "boilerplate" in commercial contracts:

- "[R]efer[s] to copy set on printing plates (or molds to make plates) and distributed in that form to newspapers [with the result that] the copy could not be edited." *Black's Law Dictionary* (8th ed. 2004).

Common (mis)perceptions of boilerplate provisions:

- Standard and fungible
- Relatively unimportant and inconsequential
- Parties don't care and don't need to care
- Non-negotiable and immutable

Goals:

- Explain and present examples of a few common boilerplate provisions
- Potential pitfalls associated with careless usage
- Practical tips for avoiding drafting mistakes

Risk Allocation

The essence:

You have many tools to shape accountability and limit risk – learn how to use them and make them work together.

Play the whole chessboard.

Risk Allocation

Remedies

monetary damages

equitable relief

Warranties

Indemnities

Cumulative?

Damages limitations

Right to terminate

Election of remedies

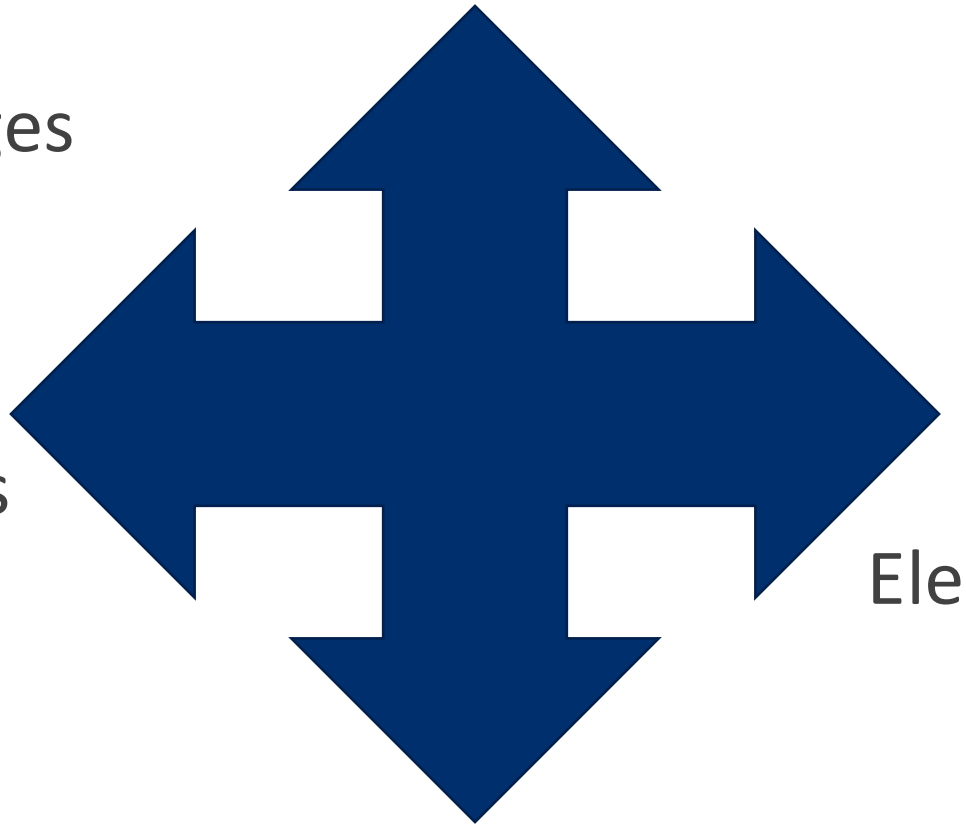
caps, baskets, thresholds?

Risk Allocation

Remedies

monetary damages
equitable relief

Cumulative?
Damages limitations
Right to terminate



Warranties

Indemnities

Election of remedies

caps, baskets, thresholds?

Risk Allocation

Takeaway:

Scrutinize each risk allocation provision. Understand how they affect each other -- draft accordingly.

Ask: Have we safeguarded the ‘benefit of our bargain’? Design solutions to make this happen.

Terminology

- “may”
- “shall”
- “or”
- “relating to” and “arising out of”
- “fraud”
- “assume”
- “a” and “the”
- Singular and plural
- Be careful with grammar
  - Commas
  - Last antecedent rule

ASSIGNMENT PROVISIONS

- An assignment (or more accurately, anti-assignment) provision ordinarily requires the counterparty's consent before a party may assign its rights under the related contract.
- This provision can be important because, generally, unless the contract states otherwise, "all contractual rights may be assigned . . . [and] the right to assign is presumed, based upon principles of unhampered transferability of property rights and of business convenience." (*Flack v. Laster*, 417 A.2d 393, 399 (D.C. 1980))
- An assignment provision might read as follows: "*Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned or delegated by any Party without the prior written consent of the other Party*."
- The following proviso accommodates the eventuality of a future M&A/reorg assignment: "*provided, however, that a Party may (i) assign and delegate this Agreement to any entity that acquires all or substantially all of such Party's assets or its business that is the subject hereof, or (ii) upon written notice to the other Party, assign this Agreement to any entity that is owned by such Party*."
- The following clause excludes any assignment, even, say, by operation of a future M&A/reorg assignment: "*No party may assign or delegate this Agreement or any of the rights, interests or obligations hereunder, voluntarily or involuntarily, whether by change of control, merger, consolidation, dissolution, operation of law, or any other manner.*"

Force Majeure – "All bets are off --"

The essence:

Address with care what happens when your world changes. Protect your company – and think of your counterparty as well. Cover the full sequence of events.

Force Majeure – "All bets are off --"

(a) Definition of a Force Majeure Event. As used in this Agreement, a "Force Majeure Event" means any act or event, whether foreseen or unforeseen, that (i) prevents a party (the "Nonperforming Party"), in whole or in part, from (A) performing its obligations under this Agreement, or (b) satisfying any conditions to the Performing Party's obligations under this Agreement, and (ii) is beyond the reasonable control of and not the fault of the Nonperforming Party, and the Nonperforming Party has been unable to avoid or overcome by the exercise of due diligence.

(b) Acts and Events Deemed to be Force Majeure Events. In furtherance of the definition of Force Majeure Event and not in limitation of that definition, each of the following acts or events is deemed to meet the requirements of section (a) and to be a Force Majeure Event: war, flood, lightening, drought, earthquake, fire, volcanic eruption, landslide, hurricane, cyclone, typhoon, tornado, explosion, civil disturbance, act of God or the public enemy, terrorist act, military action, epidemic, famine or plague, shipwreck, action of a court or public authority, or strike, work-to-rule action, go-slow or similar labor difficulty, each on an industry-wide, region-wide or nationwide basis.

This list of Force Majeure Events is not exhaustive, and the principle of ejusdem generis is not to be applied in determining whether a particular act or event qualifies as a Force Majeure Event under the definition set forth in Section (a) above.

Force Majeure – "All bets are off --"

Conditions to suspension of performance
Notice - reports
Mitigation – diligence
Performing party bears cost? – insurance
Resumption of performance
Dispute resolution
Right to terminate
Exclusive remedy

Force Majeure – "All bets are off --"

"Material Adverse Effect" – any change, event, violation . . that would reasonably be expected to have a material adverse effect . . . changes in general economic conditions . . . materially disproportionate . . . changes in financial markets . . . interest rates . . . materially disproportionate . . . changes in regulatory, legislative or political conditions . . . acts of war . . . errorism . . . earthquakes, hurricanes, tsunami . . . epidemics, pandemics --

Force Majeure – "All bets are off --"

Interim operating covenants – must continue to operate in ordinary course.

"The real question is whether an ordinary course means 'ordinary course' on a clear day or 'ordinary course' based on the hand you're dealt [. . .] If you have flooding, is it the 'ordinary course' of what you do consistent with past practice when you are in a flood, or is it ordinary course on a clear day when there hasn't been any rain? [. . .] Are people doing things that are 'ordinary course' when one is in a pandemic, and is that what the contract contemplates? Or, as the defendant casts it, is this really a clear-day type provision where you have to deliver in the condition that they were when you signed?"

Delaware Vice Chancellor J. Travis noted during a hearing held on May 8, 2020

Force Majeure – "All bets are off --"

Takeaway:

Think comprehensively -- but fairly.

Choice of law and choice of forum

- Choice of law
  - Reasonable relation
  - Fundamental policy issues
  - Scope: torts? Statute of limitations?
- Choice of forum
  - Exclusive?
  - Unreasonable?
  - Personal jurisdiction
  - Does the forum exist?
- Statutes

MERGER

- A merger (a/k/a "entire agreement" or "integration") clause in a contract tells a court to disregard evidence of prior (or contemporaneous) agreements or terms, whether consistent or inconsistent, within the scope of that contract.
- A merger clause could take the following form: *"This Agreement represents the complete agreement of the parties with respect to its subject matter and supersedes any and all prior and contemporaneous agreements with respect to such subject matter."*
- General intent and benefit are, among other things, to prevent a disgruntled party from avoiding obligations by alleging prior (or contemporaneous) agreements conflict with or supersede the written agreement.
- Lurking dangers exist from imprudent use of integration clauses – e.g., incorrectly excluding preexisting agreements.
- Integration clause might "save" specified preexisting agreements as follows:
  - *"This Agreement supersedes all prior and contemporaneous agreements between the parties with respect to its subject matter and constitutes (along with the documents [referred to in this Agreement and] [listed on Exhibit A]) a complete and exclusive statement of the terms of the agreement between the parties with respect to its subject matter."*

Arbitration and Dispute Resolution

The essence:

Avoid dispute vertigo. The one thing certain in litigation is the expense. Look for ways to move on.

Arbitration and Dispute Resolution

. . . Real entrepreneurs don't start lawsuits. And it's not because they don't want their day in court. They know that there are some things more important than being right. Who can afford the legal bills, the time spent, or – most important – the energy required to engage in legal combat. Real entrepreneurs realize that they cannot wait the five, six or even ten years necessary to resolve a dispute. Particularly when the outcome is critical, a speedy settlement may be far more important than smashing your opponent to his knees in a packed courtroom.

In bringing the lawsuit . . . Scully shows us his instincts, and they are all run to the power side of the ledger. It is certainly possible that he was lied to or worse by this former employer. But he is acting as an executive would – not as an entrepreneur. He is looking to outspend and outlast his opponents. If he were an entrepreneur, he'd be looking to outsmart them instead.

*Wall Street Journal (*March 11, 1994)

Arbitration and Dispute Resolution

"De-escalation" clause

Mediation

Arbitration

Arbitration and Dispute Resolution

Agreement to Negotiate. The parties will negotiate in good faith to resolve any controversy or claim arising out of or relating to this Agreement. If either party to this Agreement believes that such a controversy or claim has arisen, that party may give notice to the other party requesting such negotiations. Within twenty (20) days after the date of such notice, each party will submit to the other a written statement setting out (a) such party's position, with a summary of the evidence and arguments supporting its position; and (b) the name of the individual (a member of senior management) who will represent that party in the negotiation. The representatives will meet at a mutually acceptable time and place within thirty (30) days after the date of the initial notice, and thereafter as often as they reasonably deem necessary, to attempt to resolve the dispute.

Arbitration and Dispute Resolution

Scope of Arbitration. Any controversy or claim arising out of or relating to this Agreement is to be resolved by arbitration.

Administration of Arbitration. The arbitration is to be administered by the American Arbitration Association and is to be conducted in accordance with the Commercial Arbitration Rules of the American Arbitration Association.

Appointment of Arbitrators. The arbitration is to be held before a panel of three arbitrators, each of whom must be independent of the parties. No later than 15 days after the arbitration begins, each party shall select an arbitrator begins, each party shall select an arbitrator and request two selected arbitrator to select a third neutral arbitrator. If the two arbitrators fail to select a third neutral arbitrator. If the two arbitrators fail to select a third on or before the tenth day after the second arbitrator was selected, either party is entitled to request the American Arbitration Association to appoint the third neutral arbitrator in accordance with its rules. Before the beginning the hearings each arbitrator must take an oath or provide the undertaking of impartiality and following applicable law.

Arbitration and Dispute Resolution

Scope of Arbitrator's Authority.

Interim Relief. Either party is entitled to seek from any court having competent jurisdiction any interim or provisional relief that is necessary to protect the rights or property of that party. By doing so, that party does not waive any right or remedy under this Agreement. The interim or provisional relief is to remain in effect until [an arbitral tribunal is established] [the arbitration award is rendered or the controversy is resolved].

Punitive Damages. The arbitrators have no authority to award punitive damages or other damages not measured by the prevailing party's actual damages, and may not, in any event, make any ruling, finding or award that does not conform to the provisions of this Agreement.

Arbitration and Dispute Resolution

Time Limitation. Any arbitration proceeding under this Agreement must be commenced no later than one year after the controversy or claim arose. Failure timely to commence an arbitration proceeding constitutes both an absolute bar to the commencement of any arbitration proceedings with respect to the controversy or claim, and a waiver of the controversy or claim.

Choice of Law. The arbitrators are to interpret all controversies and claims arising under or relating to this Agreement in accordance with the laws of _____, without regard to its conflict of laws principles.

Venue. The arbitration is to be conducted in _____

Submission to Jurisdiction. Each party shall submit to any court of competent jurisdiction for purposes of the enforcement of any award, order or judgment. Any award, order or judgement pursuant to arbitration is final and be entered ad enforced in any court of competent jurisdiction.

From Stark, "Negotiating and Drafting Contract Boilerplate" (ALM Publishing)

Arbitration and Dispute Resolution

Takeaway:

The highest value is prevention. Find – if you can – the voice of reason on the other side.

SEVERABILITY

- Generally, a severability clause requires that a contractual provision found to be unenforceable (e.g., vagueness, illegality, etc.) be disregarded, leaving the remainder of contract intact.
- A severability clause might take following form: "*If any provision of this Agreement is held illegal or unenforceable in a judicial proceeding, such provision shall be severed and shall be inoperative, and the remainder of this Agreement shall remain operative and binding on the Parties*."
- "Blue-Pencil" jurisdictions vs. "Rule-of-Reasonableness" jurisdictions vs. "All-or-Nothing" jurisdictions.
  - "*Should any part, term or provision of this Agreement be declared or determined by any court to be illegal or unenforceable, the Parties agree that the court may modify such provision to the extent necessary to make it valid, legal and enforceable.*"
  - "*Upon such a determination that a provision of this Agreement is illegal or unenforceable, the parties shall negotiate in good faith in an effort to agree upon a suitable and equitable substitute provision to effect the original intent of the parties.*"
- Application of a severability provision could produce adverse unintended consequences – e.g., in a scenario in which an overlooked statutory provision renders unenforceable a contractual provision that is economically indispensable to a party.
- Carving out key provisions:
  - "*If any provision of this Agreement is held illegal or unenforceable in a judicial proceeding, such provision shall be severed and shall be inoperative, and, provided that the fundamental terms and conditions of this Agreement (including, without limitation, Section [the inflation adjustment provision] and [add any other indispensable provisions]) remain legal and enforceable, the remainder of this Agreement shall remain operative and binding on the Parties.*"

NO THIRD-PARTY BENEFICIARIES

- Under the common law of contracts in most states, a third party that is not a party to a commercial contract may be entitled to enforce the agreement if it is found that the contracting parties intended to create legally enforceable rights in the third party.
- See generally Restatement of Contracts (Second) § 302 ("*Unless otherwise agreed between the promisor and the promisee, a beneficiary of a promise is an intended beneficiary if …*")
- Nonexistence of third-party beneficiary rights may therefore depend on an express contractual disclaimer of such rights.
- A typical no-third-party-beneficiary provision might read as follows: "*Nothing in this Agreement is intended or shall be construed to give any person, other than the parties hereto, any legal or equitable right, remedy or claim under or in respect of this Agreement.*"
- Blithely including such a no-third-party-beneficiary provision in a contract could negate the parties' contractual intention.
- A more tailored no-third-party-beneficiary provision might read as follows: "*Nothing in this Agreement is intended or shall be construed to give any person, other than the parties hereto, any legal or equitable right, remedy or claim under or in respect of this Agreement; provided; however, that Article IX (Indemnification) is intended to be for the benefit of, and be enforceable by, the Purchaser Indemnitees and the Seller Indemnitees, as applicable*."

SALES

- Warranty disclaimers
- Liability limitations
  - Meaning of “consequential” damages
- Statute of limitations

CONFIDENTIALITY

- A "typical" confidentiality provision in a commercial contract generally has four principal elements:
  - (1) Definition of "confidential information"
    - Counsel should craft the definition of "confidential information" with care to ensure that it is neither too expansive nor too narrow.
  - (2) Prohibition of disclosure
    - Defining universe of recipients, imposing obligations as to nonuse, and prescribing protection of the confidential information.
  - (3) Exclusions from the prohibitions on nondisclosure and nonuse.
  - (4) Duration of relevant covenants and recipient's obligation to destroy or return the confidential information.
- Care should be taken to ensure that the confidentiality obligation is in harmony with the other so-called "boilerplate" provisions of the commercial contract – e.g., conflict between the confidentiality provision and the assignment provision.
  - *"A party that so receives confidential information from the other party may disclose such confidential information to a permitted assignee of such recipient party under Section [assignment provision], provided that such permitted assignee is first informed by such recipient party of the confidential nature of such confidential information and shall have agreed in writing to maintain its confidentiality in accordance with this Section [confidentiality provision]."*
- Ensure that the remedies provision in the contract is compatible with the objectives of the confidentiality provision.
  - *"Each Party acknowledges and agrees that money damages might not be a sufficient remedy for any breach or threatened breach of this Section [X] by [such Party. Accordingly, in addition to all other remedies available at law, the Disclosing Party may seek equitable relief (including injunctive relief) against the Receiving Party and its Representatives to prevent the breach or threatened breach of this Section [X] and to secure its enforcement.]"*

Trademarks, Copyrights, Inventions and Ideas

The essence:

Intellectual property comes in many forms. Each requires special consideration. Know what's called for in each case and take the appropriate protective measures.

Trademarks, Copyrights, Inventions and Ideas

Trademarks

Copyrights

Inventions

Ideas

Trade secrets

Trademarks, Copyrights, Inventions and Ideas

Takeaway:

Know your IP assets and those of your counterparty.

Seek IP expertise. Make the protections fit the property.

Jury trial waiver

- General
- Limits in some states
- Use arbitration or other non-court procedures

FURTHER ASSURANCES

- Seeks to ensure that the parties will cooperate to accomplish whatever routine matters are necessary to effectuate the intent of their contract.
- A simple formulation of this clause might be as follows:
  - *Each party covenants to take all such actions and to execute all such documents as may be desirable to implement the provisions of this Agreement fully and effectively.*
- Expansive and generic formulation could lead to (1) unreasonable "further assurance" requests, or (2) disputes over whether such vague language covers a particular request.
- Consider: (1) qualifying the standard to that which is reasonably necessary or desirable; (2) more detail regarding the nature and categories of further action; and (3) expressly enabling parties to request further assurances from each other.
- A more appropriately detailed provision might be crafted as follows:
  - *Each Party shall, from time to time following the date hereof, upon the request of the other Party, and [without further consideration] [at the sole expense of the other Party], take all such actions and execute all such documents as may be reasonably [necessary/appropriate] to implement the provisions of this Agreement fully and effectively, and as may be reasonably [necessary/appropriate] to carry out the purposes and intent of this Agreement.*

CONCLUSION

Q&A

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