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Drafting Business Contracts: Advice From Litigators to Prevent Ambiguity

Force Majeure, Forum, Choice of Law, Arbitration, Waiver of Jury Trials, Fee Shifting, Indemnity, and Limitation of Liability

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DRAFTING BUSINESS CONTRACTS:

ADVICE FROM LITIGATORS TO
PREVENT AMBIGUITY

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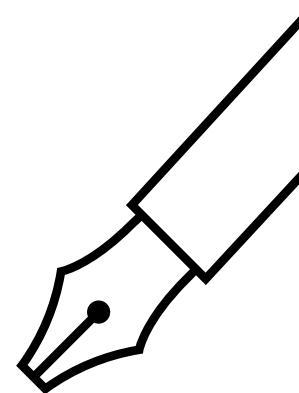
Drafting Business Contracts – Considerations of Potential Disputes:

- ❖ Force Majeure
- ❖ Choice of Forum & Choice of Law
 - ❖ Arbitration
 - ❖ Waiver of Jury Trials
 - ❖ Fee Shifting
 - ❖ Indemnity
 - ❖ Limitation of Liability

Drafting Business Contracts – General Considerations:

➤ The Entire Agreement:

- Integration;
- Incorporation;
- Amendment; and
- Severability



➤ Signed Writing:

- Authorized Signatory; Counterparts; Original Copy
- UCC § 2-201. Formal Requirements; Statute of Frauds

Force Majeure Provisions:

- Excuse non-performance by the parties due to unforeseen outside events that make performance impracticable or impossible
- Force Majeure Events are events beyond the control of the parties which prevents performance under a contract and may excuse nonperformance

(a) acts of God; (b) flood, fire, earthquake or explosion; (c) war, invasion, hostilities (whether war is declared or not), terrorist threats or acts, riot, or other civil unrest; (d) actions, embargoes or blockades in effect on or after the date of this Agreement; (e) action by any Governmental Authority; (f) national or regional emergency; (g) strikes, labor stoppages, or slowdowns or other industrial disturbances.

Force Majeure Provisions (cont'd):

- Force Majeure Provisions are generally narrowly construed
- “A mere increase in expense does not excuse performance under a force majeure provision unless there exists an extreme and unreasonable difficulty, expense, or injury”
- Williston on Contracts § 77:31 (4th ed.)
- **Eiusdem Generis** – when a general phrase follows a list of specifics, the general phrase will be interpreted to include only items of the same type as those listed

Force Majeure Provisions & The Pandemic:

- Relatively few provisions drafted prior to 2020 listed “**pandemics**” or “**epidemics**”
 - “COVID-19, or any of its mutations or other pandemics or epidemics”
- “**Acts of God**” usually interpreted to mean extreme and unpredictable weather events
- “**Government action**”
 - Second Circuit Court of Appeals ruled that the “Covid-19 pandemic and government shutdown orders are exactly the sort of events that fall within the force majeure clause as events ‘beyond the reasonable control’ of either party.”
JN Contemporary Art LLC v. Phillips Auctioneers LLC, 29 F.4th 118 (2d Cir. 2022).



Force Majeure Provisions - Effective Checklist:

- ✓ Does the force majeure provision cover both parties?
 - *i.e. exception for payments?*
- ✓ Scope of Provision? Does it include specific events?
 - *Covid-19 and other Pandemics? Adverse Economic Conditions?*
- ✓ Requirements for Notice? Use of reasonable effort to recommence as soon as possible and/or limit the effect of Force Majeure Event?



Choice of Forum & Choice of Law Provisions:

Choice of Forum:

In this provision, the parties confer personal jurisdiction on the courts of a selected state and agree that the selected forum is the exclusive forum for bringing any claims under (and sometimes, more broadly relating to) the agreement.

Choice of Law:

This provision allows parties to choose the substantive law of an appropriate state to apply to the contract.

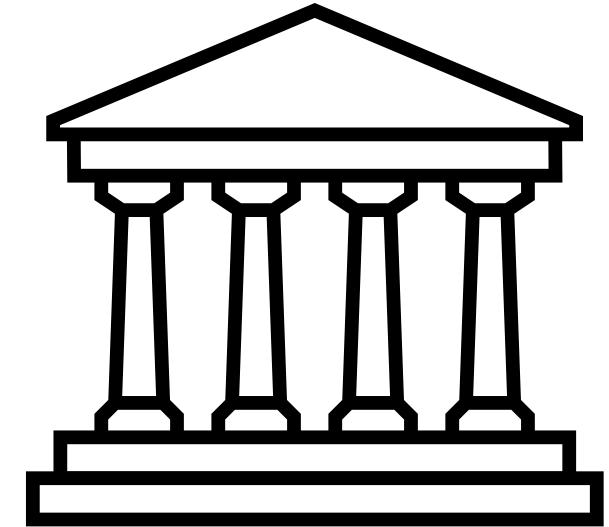
CHOICE OF FORUM PROVISIONS & CHOICE OF LAW PROVISIONS ARE NOT THE SAME

Choice of Forum:

- Most choice of forum provisions are presumptively valid.
 - *Rudman v. Numismatic Guar. Corp. of Am.*, 298 So.3d 1212, 1214 (Fla. 3rd Dist. Ct. App. 2020).
- Three-pronged Test (Generally):
 1. The chosen forum cannot be the result of unequal bargaining power by one of the parties;
 2. Enforcement of the agreement cannot contravene strong public policy enunciated by statute or judicial fiat in the forum where the litigation is required to be pursued or in the excluded forum; and
 3. The provision cannot transfer an essentially local dispute into a foreign forum.

Choice of Law:

- Choice of Law deals more with the substantive law to be applied not the venue of the litigation
- If it is found that the chosen forum's law would contravene a strong public policy of the state of Florida, the choice of law provision will not be enforced
 - State specific considerations.



Choice of Forum & Choice of Law Provisions (cont'd) – Language to Include:

➤ Choice of Forum:

- Mandatory v. Permissive Language
- “Arising out of” v. “Related to”

➤ Choice of Law:

- Conflicts of law principles
- “Law” means any statute, law, ordinance, regulation, rule, code, constitution, treaty, common law, governmental order, or other requirement or rule of law of any Governmental Authority
- “Governmental Authority” means any federal, state, local, or foreign government or political subdivision thereof, or any agency or instrumentality of such government or political subdivision, or any self-regulated organization or other non-governmental regulatory authority or quasi-governmental authority (to the extent that the rules, regulations, or orders of such organization or authority have the force of Law), or any arbitrator, court, or tribunal of competent jurisdiction

Arbitration:

➤ What?

- A method of ADR where a trained, professional, and neutral arbitrator acts as a judge who will render a decision to end your dispute.
- Mandatory v. Voluntary
- Binding v. Non-Binding

➤ Selecting an Arbitrator

- Request American Arbitration Association or JAMs appoint one
- Expert v. Arbitrator

➤ Rules of Arbitration



➤ **But first...Mediation as a prerequisite to Arbitration**

Arbitration (cont'd):

➤ Advantages:

- Faster and Less Expensive than litigation
- Private – No public record
- Control – You can choose the Arbitrator
- Finality – Opinion cannot be appealed
- Limit Discovery

➤ Disadvantages:

- Cannot be appealed
- No automatic right to discovery

Waiver of Jury Trials

- What is it?
 - contracting parties are required to submit disputes to a judge instead of a jury
 - unlike a jury trial, the judge determines all factual issues
- 7th Amendment provides a right to a trial by jury:
 - *In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law*
- Waivers must be knowing and voluntary
- Clause must be conspicuous



Considerations

- Are you likely the plaintiff or defendant?
- Complex or civil rights issues implicated?
 - E.g., employment or trade secrets
- Small party vs. large party?
- Seller likely needing to pursue collection?
- Seller likely needing to defend a technical product, development, design, or service?
- Time a factor? (Consider Covid-19 lessons—bench trials went, jury trials did not)
- Jurisdiction (CA, NC, GA – not enforceable)



Jury Trial Waiver Example

Jury Trial Waiver. THE PARTIES ACKNOWLEDGE THAT THE RIGHT TO TRIAL BY JURY IS A CONSTITUTIONAL RIGHT, BUT ONE THAT MAY BE WAIVED. AFTER CONSULTING (OR HAVING HAD THE OPPORTUNITY TO CONSULT) WITH COUNSEL OF THEIR CHOICE, PURCHASER AND SELLER KNOWINGLY AND VOLUNTARILY, AND FOR THEIR MUTUAL BENEFIT, WAIVE ANY RIGHT TO TRIAL BY JURY IN THE EVENT OF LITIGATION REGARDING THE PERFORMANCE OR ENFORCEMENT OF, OR IN ANY WAY RELATED TO, THIS AGREEMENT.

Fee Shifting Overview

- American Rule = each side bears its own attorneys' fees and costs
- Fee-shifting statutes and rules vary, sometimes requiring the loser in a legal matter to pay for the legal fees and costs of the prevailing party
- Fee-shifting can be awarded based on contractual agreement of the parties
- Rationales for fee shifting
 - Provides a wronged party full compensation for its injuries
 - Deters frivolous lawsuits
 - Encourages settlement



Fee Shifting Drafting Considerations

- Do you need to carve out specific claims?
- Mutual waiver vs. unilateral waiver?
 - Unilateral waivers are enforceable but subject to challenge if one party is sophisticated, not represented by counsel, or is an employee/individual
- Employment Agreements
 - Enforceable, but Arbitration clauses and jury trial waivers invalid where federal civil rights are at issue (*Stutler v. TK Constructors, Inc.*, 6th Cir. 2006)
- Unilateral vs. bilateral
 - In the event of litigation arising from this contract, [Party A] must pay for [Party B's] attorney's fees and costs of litigation
 - If there is litigation between the parties, the prevailing party is entitled to payment of its attorney fees by the non-prevailing party

Additional Considerations

Are you the party with significant resources or limited?

Are you more likely faced with collection risks?

Did you consider interest and timeline for trial?

Have you considered and included in-house counsel fees?

Common Fee Shifting Assumptions and Risks

- Your Assumptions
 - You will be in the “right”
 - The facts will be “clear”
 - No mistakes
 - “one last shot”
 - My counter-party is reasonable
 - Nobody elects litigation
- Assumptions about the Court
 - The Court will understand the industry/terminology/technology
 - The Court won’t be distracted with a busy docket
 - The Court won’t split the baby

Challenges to Enforcement

- Litigation is expensive
- Litigation phases
- Time for award of fees
- Practical realities
- The converse effect of attorney fee provisions
- When the fees and costs exceed the amount in dispute
- The evidentiary hearing

Evidentiary Hearing Considerations

- The court's wide discretion
- The complex commercial matter legal team
- The litigation costs – deposition transcripts, videotaped deposition costs, copies, postage, mileage, meals, travel costs can quickly exceed hundreds of thousands of dollars in a complex commercial dispute
- Reasonable rates in the geographic region
 - Firms often hired outside the geographic location
 - Even firms in geographic locations have a wide range of fees
- Common evidentiary hearing outcomes
- The satellite litigation
- The privilege dispute

Actual vs. Reasonable Attorneys' Fees

- Some courts now consider awarding “actual” attorneys’ fees
- See e.g., *Northridge Livonia, LLC v Burn Fitness-3, LLC*, Oakland County Business Court, Case No. 2020-181630-CB
- Judge Warren held the contract language plainly and unambiguously provides for the recovery of ‘actual attorneys’ fees,’ we must simply enforce the contract language as written.”



Indemnity Provisions

- Nearly every commercial contract contains an indemnification provision
- What is indemnification?
 - An express agreement by one party to compensate the other for agreed expense, costs, or damages
- Can include a duty to defend
 - A duty to defend is broader – covers claims which “may” be ultimately subject to indemnification
 - A duty to defend is triggered by allegations alone (regardless whether they are demonstrably false)
- Indemnification clauses need to be carefully reviewed
 - Often lead to litigation over whether a claim is covered or not
 - Governed by the “true” or “actual” facts, not the allegations alone
- Unilateral or mutual?

Indemnity Considerations

Third-party claims possible, injury to end customers?

Warranty, recall, product-defect, replacement/cover costs?

IP Infringement?

Breach or failure to meet specifications?

Well drafted indemnity clauses can encourage settlement/resolution of costs

Drafting Considerations

- Determine whether provision should cover actual losses, claims and costs or alleged claims
- Determine whether provision should cover alleged wrongdoing or adjudicated wrongdoing
- Determine whether claims of negligence will be included
- Clearly drafting the “trigger” for the claim and the “nexus” of the losses or costs are key
- Specify process for notifying a claim
- Identify required cooperation and access to documents, witnesses, technical assistance, etc.

Buyer-Friendly Indemnity Clause

Seller indemnifies and agrees to hold Buyer harmless from and against any and all claims, demands or actions and costs, liabilities, or losses arising out of (a) any actual or alleged death or injury to any person or damage to any tangible property resulting or claimed to result wholly from (i) any actual or alleged defect in the product, or (ii) any statement or misstatement contained in the documentation and marketing materials provided by Seller; or (b) arising out of any breach of this Agreement by Seller.

Seller-Friendly Indemnity Clause

Indemnification by Seller. Seller shall indemnify and hold harmless Buyer from and against all suits, claims, losses, demands, liabilities, damages, costs and expenses (including costs, and reasonable attorneys' fees) in connection with any suit, demand or action by any third party arising out of or resulting from (a) any breach of this Agreement by Seller or (b) any actual defect in the product or (c) any negligence, or willful misconduct by Seller, except to the extent that any of the foregoing arises out of or results from the breach of this Agreement by Buyer, or the negligence or willful misconduct of Buyer.

Limitation of Liability Provisions

- Primary tool to limit a party's risk in the event of a dispute/issue
 - Most limitation of liability provisions include a waiver of indirect damages, consequential damages (lost profits), and have liability caps
- Can apply to contract as a whole or specific provisions
 - E.g. warranty/recall, failure to meet specification
- The parties have broad flexibility
 - can be limited to specific caps, yearly turnover, multiple of sales, fees paid under the contract, or entire value of contract

Practical Tips and Best Practices

- Develop a contract review checklist
- Designate an internal champion
- Train your sales, purchasing, or commercial officers and explain the common “Red Light” pitfalls:
 - Quantity
 - Price and payment
 - Term and termination
 - Warranty and warranty disclaimer
 - Remedies
 - Indemnity
 - Confidentiality and IP
 - Litigation related (fee shifting, choice of law, forum selection, arbitration, jury trial waiver)

Red Light Examples

- no purchase commitment price (no adjustment mechanisms for raw materials, indexing, changes)
- Payment issues and changes to payment terms
- Termination problems
- Warranty and warranty disclaimer (limitations on express or implied warranties)
- Remedies (limited to repair or replacement only?)
- Indemnity (unclear or narrowly drafted?)
- Confidentiality and IP (what confidentiality obligations or IP rights are you providing?)
- Litigation related (fee shifting, choice of law, forum selection, arbitration, jury trial waiver)

Common Omissions We See In Drafts

- No quantity (UCC 2-201; 2-306)
- No raw material index/adjustment/price flexibility
- Change provision without price adjustment mechanism
- Merger, integration clause, supremacy, competing sets of (different) terms
- Pre-pandemic force majeure clauses
- Overbroad IP clauses
- No confidentiality or rights that you don't have downstream
- No choice of law
- Wrong or impractical forum given subject matter or geography of parties

Seller's Focus for Litigation Risk Management

- Draft broad limitations on warranty and indemnity provisions
- Ensure you are not warranting your good/service beyond the scope of your visibility/responsibility
- Limit warranty costs to repair or replace
- Exclude incidental and consequential damages
- Ensure the force majeure clause is properly broad and has been updated post Covid-19
- Ensure payment terms are clearly defined

Buyer's Focus for Litigation Risk Management

- Ensure the scope of work or goods are clearly defined and all timing deliverables are clearly specified
 - E.g., orders should be binding and cannot be cancelled or modified by seller
- Specify detailed and objective quality, performance, and durability criteria
- Ensure termination provisions are sufficiently detailed to allow you time to find a new source of supply
- Draft broad warranty and indemnity provisions
- Ensure your delivery/service obligations are clear, binding, and are subject to specific performance
- Ensure your forum selection clause is clear and enforceable
- Specify no modifications unless in writing and signed by both parties

Additional Tricks and Traps

- The name swap
 - Watch out for sudden changes to a holding company or an undisclosed subsidiary
- The non-existent or misspelled entity
- The overbroad corporate entities
- Liquidated damages
- Loss of profit, loss of business or other indirect or consequential damages
- Comprehensive master agreement with no “teeth” or mis-matched sub-contracts
- Long-term agreement, with parties of equal bargaining power, but parties failed to remove termination for convenience