The TANGO™ Terms

Turn a term sheet into a contract by choosing from these neutral, baseline "ground rules" for business transactions. Drawn from major companies' contract forms; translated from legalese with extensive annotations.

by
D. C. Toedt III
Attorney at law; member of the Texas and California bars
Adjunct professor, University of Houston Law Center
www.OnContracts.com/About

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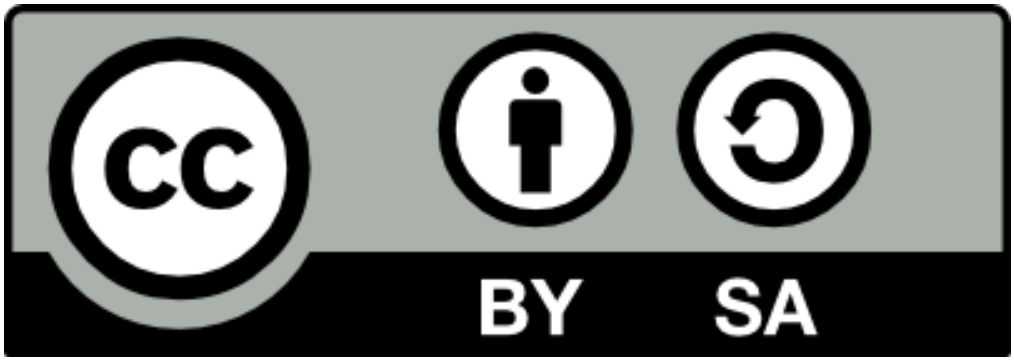

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§ 1 Introduction

CAUTION: Small differences in circumstances can make a big difference in the legal outcome — and so in using the TANGO materials, **YOU AGREE:** (i) that the TANGO materials are offered **AS IS, WITHOUT WARRANTY;** (ii) **that you won't rely** on the TANGO materials as legal advice; and (ii) **that you won't contend** that your use of the TANGO materials establishes or evidences an attorney-client relationship with the author.

§ 1.1 Using the term sheet as a signable agreement

To use the TANGO Terms,[1] *in consultation with your lawyer,* you can create and "sign" a document (a "**Term Sheet**") that does the following: • states the parties' business intentions, in plain English; • says (in effect), "**The TANGO Terms will apply**"; this should automatically adopt certain terms as stated below *(check with your lawyer to be sure that's the case under your local law)*; and • specifies any other agreed provisions, such as optional TANGO provisions. The resulting document is referred to here as "the **AGREEMENT**."

"Signature" for the Term Sheet could be done in a variety of ways, including by email and/or text message agreeing to the terms; see § 132 below. The idea would be for your signed Term Sheet, plus the TANGO Agreement and the relevant options, to form a binding contract between the parties:

Signed Term Sheet + TANGO provisions = "The contract" (the "AGREEMENT")

[1] *Author's note about the TANGO name:* I looked for names that suggested graceful coordinated action, such as in aviation (FORMATION); singing (DUETS); and dancing (FOXTROT). A family friend, hearing the FOXTROT idea, suggested TANGO because of the well-known phrase, *it takes two to tango. (Thanks, Trish!)* It turns out that the TANGO name fits pretty well, because: Tango, the dance, is made up of basic steps that (so I'm told): • can be performed slowly and gracefully by beginners; but also • can be accelerated by experienced performers to add speed, flair, and sophistication.

§ 1.2 Which TANGO terms will apply?

Do you need to read all of the TANGO Terms? No, because only certain terms will apply, depending on what your Term Sheet says, as set forth below.

§ 1.2.1 If the Term Sheet simply "adopts" the TANGO Terms

The quickest and easiest way to use the TANGO Terms is for the Term Sheet to just adopt the TANGO Terms. In that case, the following provisions will apply. *(Parties are always free to agree to deviate from the TANGO Terms, of course.)*

Business Basics Package

General Terms Package

§ 1.2.2 The Business Basics Package

Whenever the Business Basics Package is included in the AGREEMENT, the following TANGO terms will apply:

> Confidential Information Protocol: Each party's information is potentially eligible to be Confidential Information.
>
> Expense Reimbursement Protocol
>
> Interest Charge Protocol
>
> Invoicing Protocol
>
> Issue Escalation Requirement
>
> Lead Representatives Protocol
>
> Letter of Intent Option
>
> Order-Processing Protocol
>
> Payment Terms
>
> Personnel Compensation
>
> Services Protocol

Status Conference Requirement

Taxes Protocol

SECOND: The **General Terms** (**Error! Reference source not found.**), and t he **General Definitions** (**Error! Reference source not found.**) will likewise always apply whenever a Term Sheet adopts the TANGO Terms.

THIRD: Other TANGO terms will not apply unless the Term Sheet clearly says so. A Term Sheet's drafters (and reviewers) can look at the table of contents of this book to see if there are any other options that might be usefully adopted in the Term Sheet.

§ 1.2.3 A hypothetical example of a Term Sheet

§ 1.2.3.1 TERM SHEET

The following TANGO options will apply:

Risk Options:

Consequential Damages Disclaimer

Damages Cap

Implied Warranty Disclaimer

Dispute Options:

Arbitration Protocol – arbitration is to be in New York City

Governing Law Protocol – New York law will apply

§ 1.3 Other matters

§ 1.3.1 What do the checkboxes ☑ and ❑ mean?

a. Checkboxes indicate items for possible discussion by the parties; unless the AGREEMENT clearly states otherwise, terms preceded by a checked checkbox (☑) are part of the AGREEMENT, while terms preceded by a blank checkbox (❑) are not. ¶ In case of doubt: the same is true for any alternatives and options labeled as such.

b. *Special case:* A TANGO provision prefixed with a *blank* checkbox (❑) might include a sub-provision that includes a *checked* checkbox (☑). In that situation, the sub-provision is not part of the AGREEMENT unless its "parent" provision is.

§ 1.3.2 What do cross-references mean?

a. Numbered references with a "Ch." Or "§" prefix refer to the headings of TANGO provisions unless the context indicates otherwise.

b. If one TANGO provision refers to another by name or number (for example in a parenthetical reference), then that other provision is incorporated by reference into the referring provision.

§ 1.3.3 What do brown-colored terms mean?

Terms in brown are variables that the parties might wish to change (by saying so in the Term Sheet).

§ 1.3.4 Which terms will take precedence if there's a conflict?

a. Except as provided in subdivision b, if a Term Sheet adopts a TANGO provision, then that TANGO provision will take precedence in case of a conflict.

b. Exception: The Term Sheet and/or the TANGO provision can make it manifestly clear that a *specific* individual provision in the Term Sheet is to override a *specific* individual Tango provision (for example, if the Term Sheet specifies a different value for a variable provision in brown in a TANGO rider). In that case, the Term Sheet provision will control.

§ 1.3.5 Is the TANGO *commentary* part of the AGREEMENT?

No: The TANGO commentary is for educational purposes[2] and does not form part of the AGREEMENT (unless the Term Sheet says otherwise, of course).

§ 1.3.6 Why the question-and-answer format?

Because people seem to like it, finding the Q&A format easier to understand.[3]

Legalese isn't necessary, as the Supreme Court of Texas scolded the drafter(s) of one contract:

> [The contract] could then have been re-written to say exactly what the parties intend, without resort to industry jargon, outdated legalese, or tenuous assumptions about how judges will interpret industry jargon or outdated legalese.
>
> If you can't understand what your contract means without asking the lawyer who wrote it, you should not be surprised later if judges—who can't just take your lawyer's word for it—also have trouble understanding what it means.

Burlington Resources Oil & Gas Co. LP v. Texas Crude Energy, LLC, 573 S.W.3d 198, 210 n. (Tex. 2019) (cleaned up, extra paragraphing added).

§ 2 Acknowledgements (in a contract)

a. When a party *acknowledges* a stated assertion, it means that the party:

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[2] *Author's note:* One of my principal use cases for the TANGO Terms is as a textbook for the contract-drafting courses I teach as an adjunct professor at the University of Houston Law Center.

[3] *Author's note:* I recast some contract language into Q&A form and showed it to a number of non-lawyers, nearly all of whom were experienced business people. I was surprised that, by and large, these folks significantly preferred the Q&A form over traditional contract language. As an experiment for a client project, I created a contract largely in Q&A form; both the client's CEO and its general counsel specifically said that they liked the Q&A form a lot.

1. commits, with binding effect, not to contest the truth of the assertion; and

2. waives any requirement that another party bear a burden of proof of the truth of the assertion.

b. In case of doubt, an acknowledgement in this sense does not require the certification of a notary public or other official.

COMMENTARY

An acknowledgement is tantamount to an admission under the (U.S.) Federal Rules of Civil Procedure. It would therefore make sense for a party to be able to withdraw or amend an acknowledgement in generally the same manner as withdrawing or amending an admission under Fed. R. Civ. P. 36(b).

Apropos of this subject, California Evidence Code § 622 provides: "The facts recited in a written instrument **are conclusively presumed to be true** as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration."

An acknowledgement, used in this sense, is not the same as an acknowledgement before a notary public or other officer; the latter is discussed just below.

PRO TIP: Don't be obnoxious in drafting acknowledgements. Some inexperienced drafters include statements in which another party "acknowledges" a supposed fact that would be against that party's interest. Here's an example sometimes seen in confidentiality agreements: "*Receiving Party acknowledges that Disclosing Party would be irreparably harmed by a breach or threatened breach of Receiving Party's confidentiality obligations under this Agreement*." (The drafter's intent here is presumably for the Receiving Party to waive the Disclosing Party's burden of proof in seeking a preliminary injunction or comparable relief.) Most Receiving-Party counsel would reflexively: (i) delete this acknowledgement entirely, or (ii) change "*would* be …" to "*could* be irreparably harmed."

§ 3 Acknowledgements (notary public) (commentary)

[TO DO: Examples of statutory notary certificates from various jurisdictions]

§ 3.1 "Notarizing" a document with an acknowledgement certificate

(This section discusses the certificate of acknowledgement by a notary public or other authorized official; that's a different type of certificate than a "jurat," which is tantamount to an oath sworn by the signer — the notary or other official certifies that the signer of the document appeared personally [or, in some jurisdictions, remotely by live audio and video call] and declared, under penalty of perjury, that the document's contents were true.)

A document such as a deed to real property might include, after the signature blocks, a space for a notary to sign a certificate that the signer appeared before the notary, presented sufficient identification, and acknowledged that the signer indeed signed the document. In many jurisdictions, the notary's signed certificate and official seal serve as legally-acceptable evidence that the document isn't a forgery — that is, that the document is authentic. (This is sometimes referred to as making the document *self-authenticating* or *self-proving*.)

The law likely *requires* a notary's certificate of acknowledgement if the document is to be recorded in the public records so as to put the public on notice of the document's contents. Let's illustrate the process with a hypothetical example.

Suppose that "Alice" is selling her house. To do so, she will ordinarily sign a deed and give it to "Bob," the buyer.

- Bob will normally want to take (or send) the deed to the appropriate government office to have the deed officially recorded. That way, under state law, the world will be on notice that *Bob* now owns Alice's house.
- But how can a later reader know for sure that the signature on the deed is in fact Alice's signature, not a forgery?

The answer is that under the laws of most states, for Alice's deed to Bob even to be *eligible* for recording in the official records, the deed must include an

acknowledgement certificate, signed by a notary public or other authorized official. The notary's certificate must state that Alice:

- personally appeared before the notary (usually on a stated date);
- produced sufficient identification to prove that she was indeed Alice; and
- acknowledged to the notary that she had signed the deed.

If Alice signed the deed in a special capacity (e.g., as trustee of a trust or executor of her father's estate), then the notary's certificate will usually say that, too.

Once Alice has done this, the notary will sign the certificate and imprint a seal on the deed. The notary might do this with a handheld "scruncher" that embosses the paper of the deed, or instead with an ink stamp (this depends on the jurisdiction).

Typically, the notary is also required to make an entry in a journal to serve as a permanent record.

This acknowledgement procedure allows the civil servants who must record Alice's deed to look at the deed and have at least some confidence that the signature on it isn't a forgery.

Incidentally, state law usually determines just what wording must appear in an acknowledgement.

In some jurisdictions, Alice is not required to actually sign the deed in the presence of the notary; she need only acknowledge to the notary that yes, she signed the deed.

See generally Acknowledgements and Jurats (NationalNotary.org).

§ 3.2 Non-notary officials might also be authorized to certify signature authenticity

By statute, certain officials other than notaries public *(note the plural form)* are authorized to certify the authenticity of signatures in certain circumstances. *See, e.g.*, TEX. CIV. PRAC. & REM. CODE § 121.001, which gives the power to certify signature acknowledgements to the following (among others):

- district-court and county-court clerks; and
- in certain cases, commissioned officers of the U.S. armed forces.

§ 3.3 A notary public shouldn't (or can't) certify a signature if s/he has a conflict of interest

See generally, e.g., American Society of Notaries, Conflicts of Interest (2008).

See also TEX. CIV. PRAC. & REM. CODE § 121.002: That statute specifically allows a corporate employee (who is a notary public) to certify the acknowledgement of a signature on a document in which the corporation has an interest unless the employee is a shareholder who owns more than a specified percentage of the stock.

§ 3.4 CAUTION: A flawed signature-acknowledgement certificate can lead to serious problems in court

Parties will want to double-check that the notary "does the needful" (it's an archaic expression, but I like it) to comply with any statutory requirements. In a New York case, a married couple's prenuptial agreement was voided because the notary certificate for the husband's signature didn't recite that the notary had confirmed his identity. *See* Galetta v. Galetta, 21 N.Y.3d 186, 191-92, 991 N.E.2d 684, 969 N.Y.S.2d 826 (2013) (affirming summary judgment that prenup was invalid). It was undisputed that the couple's signatures on the agreement were authentic, and there was no accusation of fraud or duress. *See id.*, 21 N.Y.3d at 189-90. Even so, said the state's highest court, the notarization requirement was important because it "necessarily imposes on the signer a measure of deliberation in the act of executing the document." *Id.* at 191-92.

§ 3.5 A lawyer who certifies a client's signature acknowledgement might have to testify about it

In many states it's easy to become a notary public. Some lawyers themselves become notaries so that they can certify the authenticity of clients' signatures on wills, deeds, and the like. But that might lead to a lawyer's being called someday to testify in court about a signed document, for example about how the lawyer confirmed the signer's identity. That could pose two problems for the lawyer:

- The lawyer might not get paid for spending the time needed to prepare for and deliver the testimony (both in court and in deposition); and
- The lawyer might also be disqualified from being able to represent the client whose signature was certified. *See, e.g.*, TEX. CIV. PRAC. & REM.

CODE § 121.001; TEX. DISCIPL. R. PROF. CONDUCT § 3.08 ("Lawyer as Witness"). (As a practical matter, though, disqualification might not be too much of an issue, because the lawyer might already have to testify by virtue of having participated in the events leading up to the signing of the notarized document.)

§ 3.6 Study exercises: Notary-public acknowledgements

FACTS: Your client, Landlord, has negotiated a five-year commercial lease agreement for one of its office buildings. The tenant's lawyer wants the signers to have their signatures notarized. Landlord agrees to have the signatures notarized. ASSUME: All events take place in Texas and are subject to Texas law.

QUESTION: Why might the tenant's lawyer want the lease agreement to be notarized? Would that be in your client Landlord's best interest? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* J. Allen Smith & Michael R. Steinmark, Tenants' Rights Under Unrecorded Leases, at http://goo.gl/S2prC (2010); Tex. Prop. Code §§ 12.001, 13.001, 13.002.

QUESTION: If the notary public can't find her notary seal, may she sign the notary certificate and skip applying the seal? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. GOV. CODE § 406.013; TEX. CIV. PRAC. & REM. CODE § 121.004.

QUESTION: What must the notary public do *before* signing the notary certificate to confirm that the signers are who they claim to be? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. CIV. PRAC. & REM. CODE § 121.005(a).

QUESTION: Must the notary's certificate say anything in particular about the identity of the signer? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. CIV. PRAC. & REM. CODE § 121.005(b).

QUESTION: What must the notary do *after* notarizing the signature(s)? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. CIV. PRAC. & REM. CODE § 121.012; TEX. GOV. CODE § 406.014.

QUESTION: If no notary is around, can *you* notarize the signatures as an attorney? *Should* you? Explain, citing relevant statutory- and regulatory provisions, including the relevant subdivision(s) if any. *Suggested reading:*

TEX. CIV. PRAC. & REM. CODE § 121.001; TEX. DISCIPL. R. PROF. CONDUCT § 3.08 ("Lawyer as Witness").

QUESTION: Surprise! The person who will sign the lease for the tenant has gone on a business trip to Kuwait and will FAX her signed signature page to you. Can your secretary, who is here in Houston and is a notary public, notarize that signature page? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. CIV. PRAC. & REM. CODE § 121.004(a).

QUESTION: Another document in the transaction must be signed and notarized by an individual who's in California. Is anything special required for the notary certificate? What downside risk does the notary have if the notary is asked to sign the certificate in the absence of the individual who's going to sign the document? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* CAL. CIV. CODE § 1189(a).

QUESTION: Who in Kuwait could "notarize" the signature? Explain, citing relevant statutory provisions, including the relevant subdivision(s) if any. *Suggested reading:* TEX. CIV. PRAC. & REM. CODE § 121.001.

§ 4 Affiliate Definition

§ 4.1 What persons and organizations count as *affiliates*?

a. Two persons A and B are *affiliates* (or *affiliated*) if any of the following is true:

1. B "controls" A, as defined below; or
2. A controls B; or
3. B and A are each under common control of a third person.

b. Two persons A and B may also be *affiliates* if the AGREEMENT specifically says so.

COMMENTARY

Subdivision a: This definition of *affiliate* is adapted from (a portion of) the regulatory definition promulgated by the U.S. Securities and Exchange Commission ("SEC") in Rule 405, 17 C.F.R. § 230.405, which is also found in other sources. *See, e.g.*, UBS Securities LLC v. Red Zone LLC, 77 A.D.3d

575, 578 (N.Y. App. Div. 1st Dept. 2010) (quoting BLACK'S LAW DICTIONARY and citing New York and Delaware statutes).

Subdivision b: This provision allows drafters to expand the definition of *affiliate* in a controlled way. By designating specific affiliate groups, drafters can expand the definition of *affiliate* on a case-by-case basis as needed. This can be useful because voting control might not capture all of the individuals and/or organizations that a party wants to name as affiliates. ¶ If it's not possible to determine in advance who all the named affiliate groups will be, the parties could consider: • letting one party unilaterally name additional affiliates with the other party's consent, not to be unreasonably withheld; and/or • designating specific "open enrollment" periods in which affiliates can be named.

§ 4.2 What counts as *control* for purposes of defining *affiliate*?

a. If B is a corporation or other organization, then A *controls* B if A has the power to vote at least 50% of the voting power entitled to vote for members of the organization's board of directors, or equivalent body in a non-corporate organization.

b. In addition, A controls B if A has the power — by contract — to direct B's management and policies relating to their agreement.

c. Control for this purpose can be direct, or it can be indirect through one or more intermediaries.

COMMENTARY

Subdivision a: A minimum voting percentage of 50% seems to be pretty typical. Drafters, however, should think about *why* they're defining the term *affiliate*, because the answer might warrant changing the percentage. For other possible definitions of *voting control,* see § 4.3.3.

Subdivision b: This part of the definition of *control* does not subscribe to the notion that affiliate status can arise through non-contractual forms of "management power" — even though that concept can be found in from U.S. securities regulations such as SEC Rule 405, 17 C.F.R. § 230.405 — because the vagueness of the quoted term could lead to expensive litigation, as discussed at § 4.3.2.. magic influence, because

§ 4.3 Affiliate status — additional commentary

§ 4.3.1 Businesses sometimes want "affiliates" to have contract rights

Affiliate status can be important in a contract because the contract might give rights to — and/or purport to impose obligations on — the "affiliates" of one or both of the parties.

For example, a software license agreement might grant the right to use the software not only to the named licensee company, but also to affiliates of the licensee company. Such an agreement will almost certainly impose corresponding obligations on any affiliate that exercises the right to use the software.

Or, **a customer will sometimes want its non-owned "affiliated" companies to be allowed to take advantage of the contract terms** that the customer negotiates with a supplier.

A supplier, though, might not be enthused about an expansive definition of *affiliate*. **The supplier will often <u>not</u> want to limit its own freedom** to negotiate more-favorable terms with the customer's affiliates.

§ 4.3.2 Expansively defining "control" could lead to trouble.

Some contracts categorically define "control," for purposes of determining affiliate status, as including management control *by any means*. Such a vague definition could eventually lead to major disputes.

Consider the Offshore Drilling Co. case: **the parties in the lawsuit hotly disputed who had had "control" of a vessel destroyed by fire, and thus which party or parties should be liable for damages**. The specific facts and outcome of the case aren't important here — what matters is that the parties almost-certainly had to spend a lot of time and money fact-intensive litigation over the *control* issue. *See* Offshore Drilling Co. v. Gulf Copper & Mfg. Corp., 604 F.3d 221 (5th Cir. 2010) (affirming summary judgment in relevant part). That's the last thing parties to a contract should want.

And in the UBS v. Red Zone case, the UBS investment bank and Red Zone LLC, a private equity firm (whose managing member was Dan Snyder, owner of the Washington Redskins) entered into a contract which stated, in part, that Red Zone would pay UBS a $10 million fee if Red Zone succeeded in acquiring — or in acquiring "control" of — the amusement-park company Six Flags.

Apparently Red Zone never did acquire more than 50% of Six Flags's stock, but because of other circumstances the appellate court held that "Red Zone clearly controlled Six Flags once its insiders and nominees constituted the majority of the board and took over the company's management." UBS Securities LLC v. Red Zone LLC, 77 A.D.3d 575, 578, 910 N.Y.S.2d 55 (N.Y. App. Div. 1st Dept. 2010) (reversing denial of UBS's motion for summary judgment).

Epilogue: After losing its case with UBS, Red Zone successfully sued its law firm for malpractice in drafting the contract in question; Red Zone was awarded a $17.2 million judgment. *See* Red Zone LLC v. Cadwalader, Wickersham & Taft LLP, 45 Misc.3d 672, 994 N.Y.S.2d 764 (N.Y. Sup. Ct. 2013), *aff'd*, 2014 NY Slip Op 4570, 118 A.D.3d 581 988 N.Y.S.2d 588 (App. Div. 1st Dept. 2014).

§ 4.3.3 Other definitions of *voting control*

Some drafters might want voting control also to arise from one or more of the following:

1. a legally enforceable right to select a majority of the members of the organization's board of directors or other body having comparable authority — note that this alternative does **not** say that control exists merely because a person has a **veto** over the selection of a majority of the members of the organization's board;

2. a legally enforceable right, held by a specific class of shares or of comparable voting interests in the organization, to approve a particular type of decision by the organization; or

3. a legally enforceable requirement that a relevant type of transaction or decision, by the organization, must be approved by a vote of a supermajority of the organization's board of directors, shareholders, outstanding shares, members, etc. (The required supermajority might be two-thirds, or three-fourths, or 80%, etc.)

§ 4.3.4 Pro tip: Plan for changes in affiliate status

Contract drafters and reviewers should plan for changes in affiliate status, in case one or more of the following things happens:

- A party acquires a new affiliate, e.g., because its parent company makes an acquisition;

- Two companies cease to be affiliates of one another, e.g., because one of them is sold off or taken private;
- A third party – perhaps an unwanted competitor – becomes an affiliate of "the other side."

§ 4.3.5 The *timing* of affiliate status can be important

In some circumstances, affiliate status might exist at some times and not exist at others. That could be material to a dispute. Compare, for example:

"Absent explicit language demonstrating the parties' intent to bind future affiliates of the contracting parties, the term 'affiliate' includes only those affiliates in existence at the time that the contract was executed." Ellington v. EMI Music Inc., 24 N.Y.3d 239, 246, 21 N.E.3d 1000, 997 N.Y.S.2d 339, 2014 NY Slip Op 07197 (affirming dismissal of complaint).

In GTE Wireless, Inc. v. Cellexis Intern., Inc., 341 F.3d 1 (1st Cir. 2003), the appeals court held that Cellexis breached a settlement agreement not to sue GTE or its affiliates when it sued a company that, at the time of the settlement agreement, had not been a GTE affiliate, but that later became an affiliate. Reversing a summary judgment, the appeals court reasoned that the contract language as a whole clearly contemplated that future affiliates would be shielded by the covenant not to sue. *See id.* at 5.

§ 5 Amendments & Waivers Protocol

§ 5.1 Amendments and waivers *of what* are of concern here?

This section applies to amendments and waivers: (i) of the AGREEMENT, and (ii) of any related document, unless the AGREEMENT clearly and specifically states otherwise.

§ 5.2 Amendments and waivers must be in writing — why?

Amendments and waivers must be in writing:

1. To mitigate the problem of faulty memories (and "he said, she said" disputes), any such amendment or waiver must be in a signed writing.

2. To reduce the risk that an amendment or waiver might be inadvertently overlooked in a document, any amendment or waiver must be clearly and conspicuously labeled as such.

COMMENTARY

The "clearly and conspicuously labeled" requirement has in mind that a party might bury an amendment or waiver in some otherwise-innocuous communication. (See also § 121 on conspicuousness.) See generally, e.g., Linda R. Stahl, Beware the Boilerplate: Waiver Provisions (Andrews Kurth Jan. 14, 2013) (citing Texas cases about conspicuousness).

CAUTION: **A court might not enforce a contractual requirement that amendments and waivers must be in writing.** Under a century-old New York precedent (which this author refers to as the "**Cardozo Rule**," after the judge who announced it), parties are free to orally waive such a requirement and then do as they please, subject to the statute of frauds. See Beatty v Guggenheim Exploration Co., 225 N.Y. 380, 387-88 (1919) (Cardozo, J.), *quoted in* Israel v. Chabra, 12 N.Y.3d 158, 163-64 (2009).

The issue isn't free from doubt, however, because:

- Other court decisions have upheld amendment-in-writing and waiver-in-writing requirements; see, e.g., DeValk Lincoln Mercury, Inc. v. Ford Motor Co., 811 F.2d 326, 334 & n.2 (7th Cir. 1987), where the court, looking to Michigan precedents, upheld a summary judgment giving effect to an "anti-waiver" clause in Ford's dealership agreement.

- The United Kingdom's Supreme Court expressly rejected the Cardozo Rule, concluding that "the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation." Rock Advert. Ltd v MWB Bus. Exch. Ctrs. Ltd, [2018] UKSC 24 ¶ 10.

- A statute might expressly validate such provisions, such as the New York law referred to in § 5.6 as well as UCC 2-209(2) for amendments to agreements for the sale of goods.

§ 5.3 *Which party* must sign an amendment or a waiver?

a. *Amendments:* An amendment must be signed ☑ by each party ❑ by at least the party against which enforcement of the amendment is sought.

b. *Waivers*: Only the waiving party need sign a waiver.

COMMENTARY

Subdivision a: In the author's view, it's better to require *all* parties to sign *amendments*, to keep the parties talking and thus help reduce the chances of later disputes generally.

Note that the (U.S.) Uniform Commercial Code's statute of frauds provision requires only that a contract be signed "by the party against whom enforcement is sought …." UCC § 2-201.

§ 5.4 *Who* must sign an amendment or waiver on behalf of a party?

☑ An amendment or waiver may be signed by any authorized representative of the signing party.

❑ An amendment or waiver must be signed by an officer of the signing party at the level of vice-president or higher (or equivalent for organizations not having vice-presidents).

COMMENTARY

A party might want to use the stricter alternative so as to preclude the other party from relying on "apparent authority" of other would-be signers.

§ 5.5 How broadly will a waiver extend?

To reduce the chance that a party might try to take "unfair" advantage (however that might be defined) of a waiver by another party of a term- or breach of the AGREEMENT:

a. Any such waiver will be a one-time thing unless the waiving party clearly says otherwise in writing.

b. The waiver is not to be deemed a waiver of any other term or breach at any time.

c. A party will not be precluded from requiring strict performance or exercising any right or remedy solely because on one or more past occasions it did not do .

d. IF: A tribunal holds that, notwithstanding this Protocol, a party, at a given moment in time, waived its right to enforce one or more terms of the AGREEMENT by not doing so. THEN: That non-enforcement is not be deemed a waiver by that party of its right to enforce any term at any other time.

COMMENTARY

> *But see:* The Connecticut supreme court once noted that " a party to an executory bilateral contract waives a material breach by the other party if he continues the business relationship, and accepts future performance without some warning that the contract is at an end." RBC Nice Bearings, Inc. v. SKF USA, Inc., 318 Conn. 737, 123 A.3d 417, 425 (2015) (citations omitted).
>
> To like effect is Inferno Rest. & Pizzeria, Inc. v SW Michaels Pizzeria, Inc., 2019 NY Slip Op 50995, 64 Misc. 3d 1203 (N.Y. Sup. Ct. Jun. 13, 2019) (party waived its right to terminate) (citing cases).

§ 5.6 What law governs amendments and waivers?

To reduce uncertainty about how this Protocol might be interpreted by courts and other tribunals, the parties desire that this Protocol be governed by and enforced in accordance with New York's General Obligations Law 15-301(1); in that statutory provision, the term "change" is to be deemed to encompass both amendments and waivers.

COMMENTARY

> New York's General Obligations Law 15-301(1) provides that "[a] written agreement ... which contains a provision to the effect that it cannot be changed orally, cannot be changed by an executory agreement unless such executory agreement is in writing and signed by the party against whom enforcement of the change is sought or by his agent."

It might seem strange to specify a choice of law to govern a specific provision in the contract. But it's not unheard of; for example, in the 1988 update to the Restatement (Second) of Conflicts of Laws, comment i to 187 states in part that "the parties may choose to have different issues involving their contract governed by the local law of different states," *citing* Kronovet v. Lipchin, 288 Md. 30, 415 A.2d 1096 (1980).

§ 5.7 What if a tribunal holds that *oral* amendments and waivers are allowable anyway?

a. The parties recognize that under some past precedent, a court or other tribunal of competent jurisdiction might hold that the applicable law allows *oral* amendments and/or waivers despite the requirements of this Protocol.

b. In that situation, to reduce the risk of after-the-fact surprise, the parties agree that in any case where a party is claiming that an *oral* amendment or waiver ("modification") was made:

1. Clear and convincing evidence must indicate that each alleged oral modification was agreed to by all parties that might be adversely affected by the change.

2. Such evidence must include (without limitation) reasonable corroboration of any self-interested statements, for example, self-interested witness testimony.

3. If asked, the party asserting any oral modification must promptly provide all evidence referred to in subdivisions a and b (where such evidence is in the possession, custody, or control of that party) to all other parties referred to in subdivision b.

COMMENTARY

It's a real possibility that a court might disregard a contractual requirement that amendments and waivers must be in writing; this is discussed in more detail above.

Subdivision b.1: Concerning the clear-and-convincing-evidence requirement, see the commentary at **Error! Reference source not found.**.

Subdivision b.2 The corroboration requirement seeks to reduce the risk of fraud or faulty memory; it borrows from (U.S.) patent law, which requires that an inventor who claims an invention date earlier than the filing date of her patent application must corroborate that claim, for example, with a signed- and witnessed laboratory notebook, and may not rely solely on his- or her oral testimony alone.

§ 6 And/or

a. When the term *and/or* is used in a list, such as "A, B, C, and/or D," it refers to one or more (or, some or all) of the listed items, not to just one of them.

b. As a hypothetical example, consider the following sentence: *The parties expect to meet on Tuesday, Wednesday, and/or Thursday*. This means that the parties expect to meet on one or more of those days, not on one and only one of them.

COMMENTARY

The term *and/or* is equivalent to the inclusive or (as opposed to the exclusive or, which is expressed mathematically as XOR). Some people scorn the term *and/or*, but it can be quite useful. For example, one appellate judge excoriated the use of *and/or* as "indolent." That judge — evidently not a slave to brevity — proclaimed that instead a drafter "could express a series of items as, *A, B, C, and D together, or any combination together, or any one of them alone*." *See* Carley Foundry, Inc. v. CBIZ BVKT, LLC, No. 62-CV-08-9791, final paragraph (Minn. Ct. App., Apr. 6, 2010) (italics added). Um, sure, your honor.

Granted, it's possible to use *and/or* inappropriately. See, e.g., the examples collected by Wayne Scheiss, director of the legal-writing program at the University of Texas School of Law, in In the Land of Andorians (Jan. 2013). But let's face it: Trying to ban *and/or* might be an exercise in frustration, because many drafters will use the term anyway. And properly used, the term *and/or* can be a serviceable shorthand expression. So the better practice might well be just to define the term — as here — and be done with it.

Ken Adams, author of A Manual of Style for Contract Drafting, helpfully suggests that, when dealing with a list of three or more items, use "one or more of A, B, and C." That might well work in many cases. *See* Kenneth A.

Adams, "A, B, and/or C", Dec. 2, 2012, at http://goo.gl/m9U3p (adamsdrafting.com).

§ 7 Apparent authority (commentary)

"Apparent authority" is a legal doctrine:

- Suppose hypothetically that Party A's actions made it reasonable for others to assume that an individual "Alice" had authority to bind Party A (for example, by allowing Alice to use a title with terms such as "manager" or "executive").
- And suppose also that Alice, purportedly on behalf of Party A, signed a contract with Party B.

In that situation, Party A might be bound by the signed contract, even if in fact Party A had directed Alice not to sign it.

§ 8 Arbitration Protocol

§ 8.1 When does this Protocol apply?

This Protocol applies whenever the AGREEMENT provides that disputes are to be arbitrated.

§ 8.2 What disputes are to be arbitrated?

All disputes arising out of or relating to the AGREEMENT or any transaction or relationship resulting from it — including without limitation claims arising by statute or common law — must be arbitrated in accordance with this Protocol.

COMMENTARY

CAUTION**: Some disputes might not be arbitrable because of statutory restrictions**; see § 8.9.2 and § 8.9.3 for additional discussion.

This arbitration provision is broad in scope so as to try to avoid expensive piecemeal proceedings. As one experienced arbitrator points out: "It makes no sense to limit the arbitrator's purview to *contract* claims,

allowing related tort and statutory claims to be litigated in court on a parallel track." Gary McGowan, 12 Ways to Achieve Efficiency and Speed in Arbitration, Corporate Counsel (2013) (emphasis added). ¶ According to the Fourth Circuit, however, just that sort of piecemeal litigation was mandated by the specific arbitration provision in a franchise agreement, despite the resulting inefficiency. *See* Chorley Enterprises, Inc., v. Dickey's Barbecue Restaurants, Inc., 807 F. 3d 553, 558 (4th Cir. 2015) (reversing district court ruling that all claims must be litigated).

The phrase *any transaction or relationship* is informed in part by an arbitration provision seen in cases decided by the Fifth and Eleventh Circuits respectively. The provision in question stated that "[a]ll disputes, claims, or controversies arising from or relating to the Agreement or the relationships which result from the Agreement… shall be resolved by binding arbitration." *See* Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008) (reversing denial of motion to compel arbitration), *citing* Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005) (same).

Statute-based claims can be arbitrated in the U.S., but only if the parties so agree. For example: • An employer tried to force an employment-discrimination case to be heard in arbitration under the employer's collective-bargaining agreement ("CBA") with a union. The employer managed to convince the district court to rule in its favor. But the Fifth Circuit disagreed; the appeals court said that the arbitration provision in the CBA didn't cover discrimination claims because the provision didn't include a clear and unmistakable statement that statutory claims were to be arbitrated. *See* Ibarra v. United Parcel Service, 695 F.3d 354, 356 (5th Cir. 2012) (reviewing Supreme Court cases; vacating and remanding summary judgment in favor of employer). • In contrast, another employer's collective-bargaining agreement *did* include what the [U.S.] Supreme Court described as "a provision … that clearly and unmistakably requires union members to arbitrate claims arising under the Age Discrimination in Employment Act of 1967 (ADEA)"; the Court held that *that* arbitration provision *was* enforceable. *See* 14 Penn Plaza LLC v. Pyett, 556 U.S. 249 (2009) (reversing court of appeals; citation omitted).

§ 8.3 What arbitration rules will govern?

a. All arbitration proceedings are to be governed by the Commercial Arbitration Rules of the American Arbitration Association as in effect at the time of the demand for arbitration.

b. In case of doubt: The arbitration rules are agreed to as a choice of rules and not of forum.

COMMENTARY

Subdivision a: **Many arbitration rules are sufficiently well-developed that they could be thought of as the arbitral version of the Federal Rules of Civil Procedure:** Once you agree to such rules, you've agreed, in great detail, how any arbitration proceeding would be conducted. Drafters have considerable choice in their selection of arbitration rules, such as, for example: • The Commercial Arbitration Rules of the American Arbitration Association seem to be a typical "default" standard in the U.S. The AAA also has expedited rules that can be used if desired, as well as rules for appeal of arbitration awards to an appellate panel of arbitrators. *(Disclosure: The author is a member of the AAA's commercial arbitration panel.)* • The International Arbitration Rules of the International Centre for Dispute Resolution ("ICDR"), which has published its International Arbitration Rules, are said to be based on the UNCITRAL Rules (mentioned below) but with administration features included. For a discussion of the 2014 revisions to the ICDR rules, see Eduardo R. Guzman and Joseph M. Kelleher, International Centre for Dispute Resolution ("ICDR") Revised Rules Came Into Effect on June 1, 2014. • The LCIA Arbitration Rules of the London Court of International Arbitration (LCIA) are popular in international arbitrations. • The ICC arbitration rules of the International Chamber of Commerce (ICC) are believed to be among the most popular world-wide, in part because the arbitration award prepared by the Arbitral Tribunal will be scrutinized, before being released to the parties, by the ICC's International Court of Arbitration. Others, though, believe that these putative benefits must be weighed against the likely cost of an ICC arbitration; see, e.g., Latham & Watkins, Guide to International Arbitration, ch. IV. • The UNCITRAL arbitration rules do not provide for administration; to some, the absence of administration would be a serious deficiency. • The World Intellectual Property Organization (WIPO) has published arbitration rules and expedited arbitration rules. • The JAMS Streamlined Arbitration Rules have been praised by some arbitrators as effective; JAMS also has a set of international arbitration rules. • The International

Institute for Conflict Prevention and Resolution (CPR) rules are favored by some. ¶ For a detailed comparison of arbitration rules in the U.S. (AAA, JAMS, and CPR), see Liz Kramer, ArbitrationNation Roadmap: When Should You Choose JAMS, AAA or CPR Rules? For international arbitration, see this October 2014 chart (CorporateCounsel.com), by Kiera Gans and Amy Billing, of selected key aspects of different rules.

Subdivision b: **The phrase "choice of rules and not of forum" is designed to forestall the strange result that occurred in the Second Circuit's 1995 Salomon securities class-action case.** There, the arbitration agreement stated that the rules of the New York Stock Exchange (NYSE) would control. Those rules provided for arbitration proceedings to be heard by the NYSE. In that case, however, the NYSE declined to accept the case for hearing — and the court held that this action by the NYSE negated the parties' agreement to arbitrate. See, for example: • In re Salomon Inc. Shareholders' Derivative Lit., 68 F.3d 554 (2d Cir. 1995); • Inetianbor v. CashCall, Inc.,768 F.3d 1346 (11th Cir. 2014) (affirming denial of motion to compel arbitration); • Grant v. Magnolia Manor-Greenwood, Inc., 383 S.C. 125, 678 S.E.2d 435 (2009) (citing *Salomon* in affirming denial of motion to compel arbitration); • PoolRe Ins. Corp. v. Organizational Strategies, Inc., 783 F.3d 256 (5th Cir. 2015) (affirming vacatur of arbitration award and denial of motion to compel second phase of arbitration) (citing cases). ¶ **Other courts, however, have reached what seems to be the opposite result**, namely that the unavailability of the designated arbitral body will not negate the agreement to arbitrate unless that designation was material to the agreement. *See, e.g.*: • Ferrini v. Cambece, No. 2:12-cv-01954 (E.D. Cal. June 3, 2013) (magistrate judge's recommendation that motion to compel arbitration be granted) (citing cases); • GAR Energy & Assoc., Inc. v. Ivanhoe Energy Inc., No. 1:11-CV-00907 (E.D. Cal. Dec. 23, 2011) (magistrate judge's recommendation that motion to compel arbitration be granted; the record contained no indication that the parties regarded the agreement's selection of a now-defunct arbitration association as significant) (citing cases), recommendation adopted in full, Jan. 19, 2012; • Nachmani v by Design, LLC, 901 N.Y.S.2d 838, 74 A.D.3d 478 (App. Div. 2010) (affirming order compelling arbitration *not* administered by AAA and staying arbitration that *was* to be administered by AAA; agreement to AAA rules was a choice of rules and not of an administrator).

§ 8.4 What law is to govern the arbitration proceedings?

All arbitration proceedings are to be governed by the (U.S.) Federal Arbitration Act.

COMMENTARY

The arbitral law could be, for example: • the (U.S.) Federal Arbitration Act; • the (UK) Arbitration Act 1996; the relevant U.S. state arbitration act (see this list); • some other jurisdiction's law.

An ordinary choice of law clause might not apply in arbitration. In a U.S. Supreme Court case, a securities firm's customer agreement stated that New York law applied, and also required arbitration of disputes. And New York law stated that arbitrators could not award punitive damages. But an arbitrator *in Illinois* awarded punitive damages anyway, as permitted by the agreed arbitration rules. The Court held that the parties' choice of New York law did not preclude the award of punitive damages, because "the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other." Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 63-64 (1995).

The choice of arbitral law might make a difference, for example if the parties were to choose the Federal Arbitration Act (FAA) instead of state arbitration law. For example, the choice of law might affect the standard of review on appeal, because the arbitration laws in California, New York, and Texas (for example) allow broader appellate review than does the Federal Arbitration Act. *See* County of Nassau v. Chase, 402 Fed. Appx. 540 (2d Cir. 2010) (comparing New York and federal arbitration statutes in affirming district court's granting of motion to confirm arbitration award) (non-precedential); *see also* Cindy G. Buys, The Arbitrators' Duty to Respect the Parties' Choice of Law in Commercial Arbitration, 79 St. John's L. Rev. 59 (2005). (See also the notes to XXX.)

CAUTION: The Fifth Circuit has held that the Federal Arbitration Act applies "absent clear and unambiguous contractual language to the contrary" in which the contract "*expressly* references state arbitration law." BNSF R.R. Co. v. Alston Transp., Inc., 777 F.3d 785, 790-92 (5th Cir. 2015) (vacating district court's vacatur of arbitration award and remanding with instructions to reinstate award) (cleaned up; emphasis by the court, extensive citations omitted).

§ 8.5 How many arbitrators are to hear a dispute?

The arbitration is to be heard by an arbitral tribunal consisting of a single individual:

1. having the qualifications (if any) specified in the AGREEMENT and the arbitration rules, and
2. selected in accordance with the arbitration rules or, failing that, as provided by law.

COMMENTARY

At least in theory, three arbitrators are more likely than a single arbitrator to consider everything that needs to be considered and not overlook significant issues or evidence. It's also possible that a reviewing court might be more inclined to confirm an arbitration award rendered by three arbitrators instead of just one. ¶ But **folk wisdom among litigators and arbitrators is that *three* arbitrators are likely to increase both delay and expense.** Contract negotiators therefore might want to specify appointing a single arbitrator in cases of comparatively low value, perhaps using three arbitrators for "big" cases. ¶ Under Rule R-16 of the AAA's Commercial Arbitration Rules, the AAA can in its discretion decide to appoint three arbitrators, but otherwise a single arbitrator is used unless the arbitration agreement specifies otherwise.

Arbitrator qualifications are worth some thought; some contracts specify different arbitrator qualifications for different types of dispute. One such case involved the sale of certain oil and gas properties for $1.75 billion. The contract called: • for title disputes to be arbitrated by consultants familiar with the energy industry; and • for accounting disputes to be arbitrated by an accounting referee. *See* BP America Production Co. v. Chesapeake Exploration LLC, 747 F.3d 1253, 1256 (10th Cir. 2014) (affirming a variety of orders by the district court).

Subdivision 2: *"As provided by law" as a fallback selection method:* As a fallback, this provision states that the Arbitral Tribunal is to be selected "as provided by law" if for some reason the agreed selection method were to fail. This is to avoid having a court refuse to compel arbitration in such a circumstance — that's the subject of a circuit split among U.S. federal courts, as discussed in Moss v. First Premier Bank, 835 F.3d 260, 266-67 (2d Cir. 2016) (affirming district court's refusal to compel consumer-provider arbitration on grounds that the designated arbitration forum had ceased accepting cases of that kind).

§ 8.6 Where will the arbitration hearing be conducted?

The arbitration hearing is to be conducted in a location to be determined in accordance with the arbitral rules.

COMMENTARY

The choice of arbitral location — sometimes referred to as the "seat" of the arbitration — can have significant procedural implications, such as in determining the arbitral law that will govern the arbitration proceedings themselves. (The arbitration *rules* might well specify the arbitral location to be applied in the absence of the parties' agreement otherwise.) EXAMPLE: Suppose that the parties' agreement specifies that the arbitral location will be (say) London, but the agreement does not specify an arbitral law. In that case, *procedurally* the arbitration proceedings might well be governed by English *arbitration* law — even if the agreement's governing-law specified another law to govern the interpretation and enforcement of the parties' agreement. See, e.g., Zurich American Insurance Co. v. Team Tankers A.S., 811 F.3d 584, 588-89 (2d Cir. 2016) (affirming confirmation of arbitral award).

§ 8.7 Who is to administer the arbitration?

a. Any arbitration is to be administered by the American Arbitration Association.

b. If the designated administrator declines or is unable to serve and the parties do not agree on another administrator, then the arbitral tribunal is to administer the arbitration.

COMMENTARY

Subdivision a: **Many practitioners (the author included) prefer "administered" arbitration, as opposed to "ad hoc" arbitration** in which the arbitration is administered by the arbitral tribunal and the parties themselves. Among the reasons for preferring administered arbitration:

- Administration chores such as scheduling, invoicing, etc., are unavoidable in arbitration, and it's usually more cost-effective to have those chores handled by the AAA, JAMS, LCIA, ICC, or other arbitral institution, than it would be to pay the arbitrator's hourly rate.

- An experienced arbitrator notes that "AAA's vetting process formalizes disclosures of potential conflicts/biases and thus minimizes the likelihood of a flawed proceeding" that could result in the award being vacated, which would waste a great deal of time and money. Gary McGowan, 12 Ways to Achieve Efficiency and Speed in Arbitration, Corporate Counsel (Apr. 22, 2013). Another commentator says that "the conventional wisdom is that it is easier to enforce an award given by an arbitral institution than one given by an ad hoc arbitrator." Eric S. Sherby, A Checklist for Drafting an International Arbitration Clause (Sept. 10, 2010).

Subdivision b: The "declines or is unable to serve" language is a fallback provision, intended to preserve the parties' agreement to arbitrate from possible invalidation in case for some reason the designated arbitration administrator declines to serve (as has happened in some employment- and consumer-related arbitrations) or even no longer exists.

Disclosure: The author is an arbitrator on the AAA's commercial panel.

§ 8.8 What language is to be used for the arbitration?

Except to the extent that the parties clearly agree otherwise, the English language as spoken in the United States of America is to be used for:

1. all notices in any arbitration proceedings;
2. all written and oral communications in such proceedings; and
3. any award.

COMMENTARY

CAUTION: An agreement involving multi-national parties should be very clear about the language of arbitration. Failure to do so could lead to nasty surprises.

Which language? In transnational contracts, the parties might well choose English, the global *lingua franca*, as the arbitral language. BUT: **Drafters might also wish to consider the language of where the arbitration award might someday need to be enforced or challenged**, with an eye to reducing the expense (and time delay) of providing a translation — which might be necessary under Article IV.2 of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).

Subdivision 1: **The language of arbitration notices might turn out to be important**, as a U.S. retailer learned in its dealings with a Chinese manufacturer in CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016). In that case, a Chinese manufacturer of solar-panel products entered into a co-branding agreement with a U.S. retailer. The two companies got into a dispute; a Chinese arbitration institution sent the U.S. retailer a notice of arbitration — which was written in Chinese, and so the U.S. retailer did not realize what the notice was. A Chinese arbitral tribunal awarded the Chinese manufacturer more than USD $1 million; the U.S. retailer was able to have the award set aside by a U.S. court, but at the cost of much expense and angst, which might have been at least partly avoided if the notice of arbitration had been in English.

§ 8.9 Additional notes

§ 8.9.1 Some key takeaways about arbitration

Arbitration is binding; *mediation* generally is nonbinding.

A three-arbitrator panel is often *more* than three times as costly as using a single arbitrator.

Arbitration proceedings can be kept confidential if the parties so agree.

The American Arbitration Association's Commercial Arbitration Rules are quite workable, although there are other arbitration providers with their own rules. (Disclosure: The author serves as an arbitrator on AAA's commercial panel.)

An arbitrator might have the power to decide a case as she sees fit, in accordance with her own notions of fairness, without staying within the strict bounds of the contract or the law, unless the contract or the arbitration rules say otherwise. (The legalese names for this concept are *amiable compositeur* and *ex aequo et bono*.)

Arbitration is especially popular in international contracts, because, by treaty, enforcement of foreign arbitration awards is very often easier than enforcement of foreign court judgments.

In international contracts, the *language* of the arbitration should be specified, including the language for any notices. Otherwise, a party might receive a notice of an arbitration claim in, say, Chinese — precisely that happened

in CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016).

§ 8.9.2 Some arbitration provisions might be unenforceable under U.S. federal law

Not all arbitration provisions will be readily enforced by U.S. courts. For example:

• Drafters working in the financial-services arena should check the Dodd-Frank Act's prohibition of mandatory arbitration of Sarbanes-Oxley Act "whistleblower" claims. *See generally, e.g.*, Federal Courts Split on Whether Dodd-Frank's Bar on Arbitration of Whistleblower Retaliation Claims Under Sarbanes-Oxley Is Retroactive (Oct. 9, 2012) (sutherland.com).

• In the Truth in Lending regulations, Regulation Z now prohibits pre-dispute arbitration clauses in mortgages secured by dwellings. *See* 12 C.F.R. § 1026.36(h).

• Government contractors and subcontractors should check restrictions on arbitration clauses in employment agreements relating to certain government contracts. *See* Frank Murray, Assessing the Franken Amendment (Feb. 16, 2011).

• Moreover, in July 2014, President Obama signed an executive order stating that in federal-government contracts for more than $1 million, "contractors *[must]* agree that the decision to arbitrate claims arising under Title VII of the Civil Rights Act of 1964 or any tort related to or arising out of sexual assault or harassment may only be made with the voluntary consent of employees or independent contractors after such disputes arise"; the order includes a flowdown requirement for subcontracts for more than $1 million.

(The executive order sets out exceptions for (i) the acquisition of commercial items or commercially available off-the-shelf items; (ii) collective bargaining agreements; and (iii) some but not all arbitration agreements that were in place before the employer placed its bid for the government contract in question.)

• Federal law provides that in franchise agreements between automobile manufacturers and their dealers, pre-dispute arbitration agreements are unenforceable. *See* 15 U.S.C. § 1226(a)(2).

• The regulations implementing the Military Lending Act render unenforceable *any* agreement to arbitrate consumer credit disputes between lenders and active-duty military personnel or their eligible dependents; the regulations do not distinguish between pre-dispute and post-dispute

agreements to arbitrate, even though the statute appears to make just such a distinction. *See* 10 U.S.C. § 987(e)(3), implemented in 32 C.F.R. § 232.9(d).

• Federal regulations governing livestock and poultry production require that certain contracts mandating the use of arbitration must include, on the signature page, a specifically-worded notice, in conspicuous bold-faced type, allowing the producer or grower to decline arbitration; in addition the Secretary of Agriculture apparently has the power to review arbitration agreements to determine "whether the arbitration process provided in a production contract provides a meaningful opportunity for the poultry grower, livestock producer, or swine production contract grower to participate fully in the arbitration process." *See* 9 C.F.R. § 201.218.

§ 8.9.3 U.S. state statutes might purport to invalidate or restrict certain arbitration agreements (but might be preempted by federal law)

State laws in the U.S. have not always been friendly to non-judicial arbitration. But any time a question of state-law unenforceability arises concerning arbitration, the reader should consider the possible preemptive effect of the Federal Arbitration Act. *See generally, e.g.*, Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 687-688 (1996), where:

The case involved an arbitration provision in the franchise agreement for Subway sandwich shops.

A Montana statute required a specific notice to be included on the first page of any contract containing an arbitration provision, otherwise the arbitration provision would be unenforceable.

Reversing the Montana supreme court, the Supreme Court held that under the federal Act, state courts "may not … invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Id.* at 687 (emphasis in original).

More recently, in California the Legislature passed, but the governor vetoed, AB 465, which would have clamped down severely on arbitration provisions in employment agreements. Governor Brown's veto message explained that, among other things, he wanted to see the outcome of some pending U.S. Supreme Court cases. (For a pre-veto discussion of the bill and its implications for employers, see Fenwick Employment Brief, Sept. 2015.) At this writing, the California legislature is trying again with AB 51.

§ 8.9.4 Be sure arbitration-agreement *signatures* can be satisfactorily proved

It behooves a party wanting arbitration to make sure a /complete/ signed copy of the arbitration agreement is available in the record. Otherwise, a party opposing arbitration might well deny having signed the arbitration agreement. *See, e.g.*, Ashburn v. AIG Financial Advisors, Inc., 234 Cal. App.4th 79 (2015) (reversing grant of motion to compel arbitration and remanding for evidentiary hearing); Ruiz v. Moss Bros. Auto Group, Inc., 181 Cal. Rptr.3d 781, 232 Cal. App.4th 836, 844-45 (2014) (affirming denial of motion to compel arbitration, but offering suggestions on how to prove up electronic signatures to arbitration agreement).

§ 8.9.5 Employers: Be sure your arbitration policy is actually binding

Here's a drafting lesson from a California court of appeal: An employer's arbitration provisions was set forth in its employee handbook — but the handbook stated in part, "[T]his handbook is not intended to be a contract (express or implied), nor is it intended to otherwise create any legally enforceable obligations on the part of the Company or its employees." The court affirmed a trial court's refusal to compel arbitration. Esparza v. Sand & Sea, Inc., 2 Cal. App. 5th 781, 783, 206 Cal. Rptr. 3d 474 (2016).

§ 8.9.6 Be very clear that arbitration is mandatory, not optional

Feel-good language making it seem that arbitration is optional can kill an arbitration provision. Consider, for example, the arbitration "agreement" that stated: "Arbitration: If the dispute is not resolved through mediation, the parties may submit the controversy or claim to Arbitration. *If the parties agree to arbitration*, the following will apply: …." Quam Construction Co. v. City of Redfield, 770 F.3d 706, 708 (8th Cir. 2014). Not surprisingly, both the trial court and appellate court concluded that under this clause, arbitration was not required and that the appellant's motion to compel arbitration must be denied.

§ 8.9.7 A badly drafted *forum selection* provision might kill an arbitration provision

It's not unheard of for (thoughtless) contract drafters to include both (i) an arbitration provision and (ii) a forum-selection provision requiring all disputes to be litigated in a specified court. That might well cause a court to refuse to

enforce the arbitration provision. For more details, see the commentary to the Forum Selection provision (§ 58).

§ 8.9.8 A broad arbitration provision coupled with a narrow choice of law provision could spell trouble

See § 66.5.7 for an example of how a broad arbitration provision and a narrow choice-of-law provision helped lead to a treble-damage award of $48 million against an investment-advisory firm.

§ 8.9.9 A one-way arbitration clause might be vulnerable to challenge for unconscionability and/or lack of mutuality

A drafter might be tempted to craft a provision requiring arbitration if a particular party requests it, but requiring court litigation otherwise. Such a provision might be held unenforceable for unconscionability. See, for example:

- Armendariz v. Foundation Health Psychcare, Inc., 24 Cal. 4th 83, 6 P.3d 669, 775, part II-D-2 (2000), where the California supreme court reversed the court of appeals and upheld the trial court's denial of an employer's motion to compel arbitration of employees' claims; and
- Eaton v. CMH Homes, Inc., 461 S.W.3d 426 (Mo. 2015) (en banc), where the Missouri supreme court reversed the trial court's refusal to compel arbitration, but also "clarifie[d] that a lack of mutuality of the obligation to arbitrate is one of the relevant factors a court will consider, along with the other terms of the contract, in determining whether the agreement to arbitrate otherwise is unconscionable."

In a puzzling 2014 Arkansas case — decided by a 4-3 majority — a cell-phone carrier's consumer contract included an arbitration provision. The contract also said that if *the carrier* failed to enforce any right or remedy, that failure would not constitute a waiver on the carrier's part: "If we do not enforce any right or remedy available under the Agreement, that failure is not a waiver." a majority of the Arkansas supreme court held that this rendered the *arbitration* provision void for lack of mutuality. *See*Alltel Corp. v. Rosenow, 2014 Ark. 375. (The dissent in that case arguably has the stronger position.)

§ 8.9.10 **Some parties fear that arbitrators might "go rogue"**

Parties considering agreeing to arbitration sometimes fear that an arbitrator might "go rogue," imposing an award that no one could have foreseen, acting on his or her own individual sense of justice. Depending on the applicable law and the arbitration rules, that might not be an unwarranted concern.

For example, **some critics thought the arbitrators ran amok in a software-copyright dispute between competitors IBM and Fujitsu.** In that case, the arbitrators ultimately ordered IBM to provide its operating-system source code and other secret information to Fujitsu; they ordered Fujitsu to pay significant money to IBM. See David E. Sanger, Fight Ends For I.B.M. And Fujitsu, NY Times, Sept. 16, 1987. For more background on the dispute, see a student note from the 1980s by Anita Stork (now a prominent antitrust litigator), The Use of Arbitration in Copyright Disputes: IBM v. Fujitsu, 3 BERKELEY TECH. L.J. 241 (1988).

As another example, in a 2014 case, Minnesota's supreme court upheld a $600 million arbitration award that in essence was a punitive sanction against a party for fabricating evidence. *See* Seagate Technology, LLC v. Western Digital Corp., 854 N.W.2d 750 (Minn. 2014). The court quoted one of its earlier holdings, that "Where the arbitrators are not restricted by the submission to decide according to principles of law, they may make an award according to their own notion of justice without regard to the law." *Id.* at 764.

Uniform standards in this area don't exist; in some jurisdictions, and under some arbitral rules:

> ... absent provision in the arbitration clause itself, **an arbitrator is not bound by principles of substantive law or by rules of evidence. He may do justice as he sees it**, applying his own sense of law and equity to the facts as he finds them to be and making an award reflecting the spirit rather than the letter of the agreement, even though the award exceeds the remedy requested by the parties.
>
> **His award will not be vacated even though** the court concludes that his interpretation of the agreement misconstrues or disregards its plain meaning or misapplies substantive rules of law, unless it is violative of a strong public policy, or is totally irrational, or exceeds a specifically enumerated limitation on his power.

> Nor will an arbitration award be vacated on the mere **possibility** that it violates an express limitation on the arbitrator's power.

Silverman v. Benmor Coats, Inc., 61 N.Y.2d 299, 300, 308-09, 473 N.Y.S.2d 774, 461 N.E.2d 1261 (1984) (affirming confirmation of arbitration award) (extra paragraphing added, citations and internal quotation marks omitted), *cited in* County of Nassau v. Chase, No. 09-3643-cv (2d Cir. Oct. 4, 2010) (summary order affirming district court's refusal to vacate award; internal quotation marks omitted) *and* Advanced Aerofoil Technologies, AG v. Todaro, No. 13 Civ. 7181 (RWS) (S.D.N.Y. Apr. 15, 2014) (confirming arbitration award); *see also, e.g.*, LG Electronics, Inc. v. Interdigital Communications, Inc., No. 9747-VCL, part II-B, esp. text accompanying n.4 et seq. (Del. Ch. Aug. 20, 2014) (extensively-annotated discussion).

And Rule 47 of the AAA's Commercial Arbitration Rules expressly authorizes the arbitrator to "grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties ...."

On the other hand:

- In some jurisdictions it's the other way around. That is, an arbitrator is not permitted to act as amiable compositeur or ex aequo et bono unless the arbitration agreement expressly says so;
- Likewise, Article 21.3 of the ICC Rules of Arbitration require agreement of the parties as a prerequisite to the arbitrator's deciding as *amiable compositeur* or *ex aequo et bono*; ditto Article 33.2 of the UNCITRAL Arbitration Rules and Article 59(a) of the WIPO Arbitration Rules.

See also the respective articles on "Ex aequo et bono" by McGill University and Wikipedia.

§ 8.9.11 Judicial reference as an alternative to arbitration (California)

As an alternative to arbitration, drafters of contracts that would be litigated in California can consider including a provision requiring disputes to be heard in a bench trial to a judicial referee, instead of to a judge, under sections 638 through 645.1 of the California Code of Civil Procedure. *See generally* What You Need To Know About Judicial Reference (Sidley.com 2014).

§ 9 Article- and section references

a. This Article applies unless otherwise clear from the context.

b. A reference to an Article is to a top-level numbered entry in these TANGO Terms; the term "this Article" refers to the top-level numbered entry containing the referring text (in this case, § 9).

c. References to numbered sections (for example, § 9) are to the correspondingly numbered sections in the TANGO Terms, which could be an Article.

d. References to "this section" are to be interpreted as dictated by the context.

§ 10 As-Is Definition

a. The term "as is" (as well as variations such as "as is, where is, with all faults") operates as a disclaimer of all *performance* and *noninfringement* warranties.

b. The disclaimer referred to in subdivision a extends, without limitation, to any implied warranties of merchantability or fitness for a particular purpose that might otherwise apply.

c. Any *express* warranties of performance in the AGREEMENT are not affected by an as-is disclaimer. EXAMPLE: "Provider warrants that the widgets will do X, Y, and Z, but the widgets are otherwise provided AS IS." In this example, the as-is disclaimer at the end does not affect the warranty in the first part of the sentence.

d. The term "as is" (or variations thereof) does not itself disclaim any implied warranties of title.

COMMENTARY

> This as-is definition is modeled on § 2-316 of the (U.S.) Uniform Commercial Code, which covers disclaimer of implied warranties in sales of goods. It's included here in case the UCC doesn't apply (for example, if this Agreement is not for the sale of goods or if the transaction is governed by a law that doesn't include some version of the UCC). ¶ One common formulation for disclaiming warranties is "AS IS, *[and sometimes:*

WHERE IS,] WITH ALL FAULTS," in all-cap, bold-faced type, or other conspicuous manner. ¶ CAUTION: Check for any applicable legal requirement of "conspicuousness" for warranty disclaimers.

Subdivision c: This language is modeled on UCC § 2-312 (disclaimer of warranty of title must be expressly stated). From a business perspective this makes sense; for example**, if Alice sells Bob a car on an as-is basis, Bob still should be entitled to expect that Alice actually owns the ca**r (i.e., that he's not buying stolen property).

§ 11 Assignment Consent

§ 11.1 How does this Article apply?

Each party (each, an "**Assigning Party**") must obtain the consent of each other party (each, a "**Reviewing Party**") before assigning the AGREEMENT.

COMMENTARY

In the U.S., a party to most types of contract (but not all types) may assign the contract to a third party without the consent of the other party — but that is not universally the case: Sometimes *the law* requires consent to assignment, and sometimes *a contract itself* will require such consent. For more background information, see the additional commentary to this Article.

Strategically, assignment consent is often an important negotiation topic. It's worth taking the time to read the additional commentary.

§ 11.2 What factors must a Reviewing Party consider?

In deciding whether to grant its consent to a proposed assignment, a Reviewing Party is to give due consideration to whatever evidence that the Assigning Party timely presents to the Reviewing Party concerning the relevant qualifications, capabilities, and financial position of the proposed assignee.

COMMENTARY

The idea for this provision is adapted from a Taco Bell franchise agreement, quoted in Robert E. Scott and George G. Triantis, Anticipating

Litigation in Contract Design, 115 YALE L.J. 814, 872-73, text accompanying n.178 (2006), archived at https://perma.cc/R46W-H5JA.

§ 11.3 Must consent to assignment not be unreasonably withheld?

☑ The Reviewing Party may grant or withhold consent to assignment of the AGREEMENT in the Reviewing Party's sole discretion.

❑ The Reviewing Party must not unreasonably withhold, delay, or condition its consent to an assignment of the parties' agreement.

❑ IF: The Reviewing Party unreasonably withholds, delays, or conditions its consent to a proposed assignment; THEN: The Reviewing Party is to be deemed as having given its consent, effective on the date that the Reviewing Party received the request for consent. ☑ But such deemed consent will not affect any other remedy for the unreasonable withholding that might be available to the Assigning Party (for example, the right to recover monetary damages).

❑ Any withholding, delay, or conditioning of the Reviewing Party's consent to assignment is presumed to be done in good faith.

COMMENTARY

Even if the agreement is silent as to unreasonable withholding of assignment consent, the law might have something to say about it, as explained in § 11.11.13

CAUTION: It could be dangerous for a prospective assigning party to ask for a prohibition of unreasonable withholding of consent: If the reviewing party refused to agree to the prohibition, then the refusal might well be interpreted as establishing that consent could be withheld in the reviewing party's sole discretion.

The first alternative provision above is adapted from a suggestion by Ric Gruder; it's included to dissuade a Reviewing Party from rolling the dice and refusing consent in order to extract concessions.

§ 11.4 Is consent required for a sale of the Assigning Party's business assets?

☑ An Assigning Party need not obtain the Reviewing Party's consent to an assignment of the AGREEMENT if the assignment is in connection with a sale or other transfer of substantially all of the assets of the Assigning Party's business ☑ to which the AGREEMENT relates.

❑ Yes, an assignment of the AGREEMENT in conjunction with a sale of assets requires consent to the same extent as any other assignment.

COMMENTARY

> This exception is stated as a standard part of this Requirement because it's likely to be extremely important to a party that might later want to sell a line of business or a product line, or to spin off an unincorporated division.

§ 11.5 Does a pledge of rights under the AGREEMENT require consent?

☑ No:

a. An Assigning Party need not obtain the Reviewing Party's consent to a "**Pledge**," namely (i) an assignment- or pledge of a right under the AGREEMENT, and/or (ii) a grant of a security interest in any such right, as stated in more detail below.

b. This exception, however, does not apply to a Pledge: (i) that purports to delegate any material obligation of the Assigning Party under the AGREEMENT, or (ii) that has such an effect as a matter of law.

c. When this exception does apply, it applies regardless whether the Pledge in question is absolute or collateral.

❑ Yes: An assignment- or pledge of a right under the AGREEMENT, and/or grant of a security interest in any such right, requires consent to the same extent as would other assignments of the AGREEMENT.

COMMENTARY

When an agreement requires consent to assignment of the agreement, **a prospective assigning party will often insist on an exception for pledges of rights** under the agreement, e.g., a pledge to a bank of the pledging party's right to payment. See generally, e.g., section 4.5 of the introductory report to the 2016 Model Intellectual Property Security Agreement, prepared by a task force of the American Bar Association's Section of Business Law.

Even without an explicit carve-out for pledges, courts have distinguished between assigning an *agreement* in its entirety and assigning certain *rights and benefits* under the agreement. See, e.g., Bioscience West, Inc. v. Gulfstream Prop. & Cas. Ins. Co., 185 So.3d 638 (Fla. App. 2016), where the court held that an insurance policy holder had not assigned the insurance policy *per se* (which would have violated an assignment-consent requirement in the policy), but instead had merely assigned the right to payment for a particular loss that had occurred. *See id.* at 640-42.

CAUTION: An *arbitration* provision might not be binding on the recipient of a pledge if the recipient does not agree to arbitration. See, e.g., Lachmar v. Trunkline LNG Co., 753 F.2d 8, 9-10 (2d Cir. 1985) (following New York law).

§ 11.6 Is assignment without consent a *material* breach

☑ Yes: Any assignment of the AGREEMENT without a consent required by the AGREEMENT is a material breach of the AGREEMENT.

❑ Not necessarily: Assignment without a required consent is a material breach only if it would otherwise qualify as such under applicable law.

COMMENTARY

The default selection here supposes that if a party felt that an assignment-consent requirement was important enough to include in an agreement, then the requirement likely qualifies as a "material" term, and therefore failure to obtain consent would be a material breach.

Why would it matter whether A's assignment of the agreement without B's consent would be a material breach? Consider the business context:

- **Suspension of performance:** A's material breach would normally justify B's suspension of B's own performance and perhaps even termination of the agreement. That prospect might give B considerable

leverage to demand money or other concessions from A and/or from A's would-be assignee.

- **Greener pastures:** A's material breach might also provide B with a pretext to scrap B's contractual commitments to A and take up instead with another, more-lucrative counterparty. Such a desire seems to have been at work in Hess Energy Inc. v. Lightning Oil Co., 276 F.3d 646, 649-51 (4th Cir. 2002).

- **"Own goal" if not actually a material breach?** Suppose that there's no material-breach clause in the assignment-consent provision. In that case, a court might hold that A's assignment without consent was a breach but not a material one. If B *did* give notice of termination for (supposed) material breach, then B's termination might itself constitute an "own goal" breach of the contract — but by B, not by A. This happened, for example, in Hess Energy, 276 F.3d at 651; Automated Solutions Corp. v. Paragon Data Sys., Inc., 2006 Ohio 3492, 167 Ohio App.3d 685 (2006). Such an own-goal could be costly: See Southland Metals, Inc. v. American Castings, LLC, 800 F.3d 452 (8th Cir. 2015), in which a party that terminated a contract for breach was held liable for $3.8 million in damages because the terminating party had not allowed the other party to try to cure the breach, as required by the contract's termination provision.

§ 11.7 What effect would an assignment have on future consents?

a. If a *Reviewing* Party assigns the AGREEMENT (or another party succeeds to the Reviewing Party's rights), then that assignee (or successor) has the sole right to grant consent to an assignment, to the exclusion of the former Reviewing Party.

b. An assignee of or successor to an *Assigning* Party must obtain consent to an assignment the same extent as then-former Assigning Party.

§ 11.8 ❑ Assignment by operation of law requires consent

(a) The term "Operation-of-Law Transaction" refers to a merger, consolidation, amalgamation, or other similar transaction or series of transactions involving the Assigning Party in which the Assigning Party is not the surviving entity, regardless whether an assignment is deemed to occur by operation of law.

(b) An Operation-of-Law Transaction requires consent to the same extent, if any, as would an assignment by the Assigning Party outside of such a transaction.

COMMENTARY

This option could be dangerous for a prospective assigning party, as discussed in § 11.11.5.

§ 11.9 ❑ Assignment without consent is void

An assignment of the AGREEMENT is void if it is made without a consent required by that agreement or by law.

COMMENTARY

A court applying the so-called 'classical approach' might hold that an assignment was void if made without a required consent. *See, e.g.*, Condo v. Connors, 266 P.3d 1110, 1117-18 (Colo. 2011).

In contrast, a court applying the so-called "modern approach" (or one of its variants) might hold that such an unconsented assignment was a *breach* of the contract, for which damages might be available, but that the assignment per se was not *void* unless the contract said so, perhaps with requisite "magic words." *See id.* at 1119; *cf.* David Caron Chrysler Motors, LLC v. Goodhall's, Inc., 43 A.3d 164, 170-72 (Conn. 2012) (reviewing case law from numerous jurisdictions).

§ 11.10 ❑ Assignment can be grounds for "insecurity"

a. A non-assigning party may treat any assignment that delegates the assigning party's performance obligations without the non-assigning party's consent as creating reasonable grounds for insecurity.

b. In any such case, without prejudice to the non-assigning party's rights against the assigning party:

1. The non-assigning party may, by notice in accordance with the AGREEMENT, demand assurance of due performance, from one or more of the non-assigning party and the assignee, that is commercially reasonable under the circumstances of the particular case.

2. Until the non-assigning party receives such assurance, the non-assigning party may, if commercially reasonable to do so, suspend any performance under the AGREEMENT for which it has not already received the agreed return.

3. Failure by the assignee and the assigning party to provide such assurance, within a reasonable time (not to exceed 30 days) after the effective date of the notice, is a repudiation of the AGREEMENT.

COMMENTARY

The [U.S.] Uniform Commercial Code has a provision similar to this clause, namely UCC § 2-210(5) (which applies by its terms only to sales of goods). It states that "[t]he other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee" under UCC § 2-609. Under the latter UCC section, the non-assigning party may suspend its performance (if commercially reasonable) and eventually treat the agreement as repudiated if the assignee does not provide adequate assurances.

§ 11.11 Additional commentary¶

§ 11.11.1 Background: To promote economic efficiency, most contracts can be freely assigned

Normally, in U.S. law, most contracts (but not all) can be freely "assigned," that is, transferred to a third party, with the assigning party's duties delegated to the third party, without the consent of the other party.

Economic efficiency underlies the policy rationale behind the free assignability of contracts: If B can carry out A's obligations under a contract at lower cost than A could do so, then it might well make economic sense for A to sell the contract to B. This concept is seen in the routine buying and selling of standard contracts for future deliveries of commodities (natural gas, wheat, whatever). See generally Futures contract (Wikipedia.com).

To illustrate, imagine these hypothetical facts:

1. Supplier A and Customer have a contract for Supplier A to deliver a hill of beans to Customer's back yard.

2. Supplier A discovers that another supplier, Supplier B, has a bean farm that's closer to Customer's house; Supplier B could deliver the beans to Customer's house with lower transportation costs.

3. Supplier B is willing to buy Customer's bean-delivery contract from Supplier A; that way, both suppliers can make some money from the contract, and Supplier A can use his own resources to pursue other business.

4. Customer, the buyer of the beans, doesn't care which supplier delivers the hill of beans, as long as *someone* makes it happen.

Supplier A's transfer of "the Customer contract" to Supplier B is referred to as an *assignment* of the contract. In the U.S. and similar legal systems, the law usually favors such assignments, because they promote economic efficiency, which is (usually) regarded as a Good Thing. As a result, Supplier A is normally free to assign the Customer contract to Supplier B, which also entails delegating Supplier A's contractual duties to Supplier B. This is more than a little bit like subcontracting. The major difference is that:

5. If Supplier A were to *subcontract* to Supplier B, then Supplier B would deal with Supplier A, and Supplier A would deal with Customer.

6. On the other hand, with an *assignment* of the contract, Supplier B would take over dealing directly with Customer — but either way, Supplier A would still be liable to Customer for any damage she suffered if Supplier B didn't deliver the hill of beans as promised.

An excellent general resource on this subject is Tina L. Stark, Assignment and Delegation, which is Chapter 3 of her book Negotiating and Drafting Contract Boilerplate (2003). Disclosure: Professor Stark is a friend and mentor of the author.

§ 11.11.2 Some special types of contract can't be assigned without consent

But now imagine these hypothetical facts:

- Justin is a teenaged singer who has posted a lot of homemade music videos to YouTube. As a result, he has become wildly popular with 'tween girls all over the world.

- Justin has a longstanding contract with Connie; the contract calls for him to do a birthday show for Connie's twelve-year old daughter and her friends.

- Then Justin gets a huge career break: The Why, a legendary rock group from the Sixties, want Justin to open for them in their reunion tour. Unfortunately, for Justin to open for The Why, he would have to miss Connie's daughter's birthday party.
- Justin comes up with a solution: His long-time friend, Sam, who is trying to break into the business, should sing at Connie's party instead, so that Justin can open for The Why.
- In that situation, though, a reasonable person likely would think that Sam was not an acceptable substitute for Justin at Connie's daughter's birthday party.
- Consequently, U.S. law probably would not allow Justin to delegate his birthday-party performance to Sam unless Connie consented to it.

§ 11.11.3

And intellectual-property licenses generally can't be assigned without the licensor's consent *(read)*

Another example: Under U.S. law, licenses of intellectual property are an exception to the general rule of assignability — an IP licensee may not assign its license rights, nor delegate its license obligations, without the licensor's consent, even when the license agreement is silent on the subject. *See, e.g.*:

- Trademark licenses: In re XMH Corp., 647 F.3d 690 (7th Cir. 2011) (Posner, J.)
- Copyright licenses: Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009)
- Patent licenses: Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002)

The non-assignability of IP licenses is a good deal for IP owners and can put IP licensees in something of a bind. EXAMPLE: Imagine that you're a customer that will be taking a license to intellectual property, for example computer software, from a supplier. In the U.S., you can't assign the license without the supplier's consent — and the supplier might want to be the sole source of licenses, so that no one else can make money selling licenses.

For real-world examples of a software vendor controlling the supply of its software licenses in this way, see, for example:

• Vernor v. Autodesk, Inc., 621 F.3d 1102 (9th Cir. 2010) (vacating summary judgment granting declaratory judgment). In that case, Vernor bought used

copies of Autodesk's AutoCAD software from Autodesk's direct customers and then resold those copies on eBay. The appeals court held that Autodesk did not *sell* copies of its software, but *licensed* them, and therefore Vernor's actions were prohibited by copyright law, because the first-sale doctrine did not apply.

• In Adobe Systems Inc. v. Hoops Enterprise LLC, No. C 10 2769 (N.D. Cal. Feb. 1, 2012), the court granted partial summary judgment dismissing the defendants' counterclaim of copyright misuse; the Ninth Circuit affirmed. Adobe Systems Inc. v. Kornrumpf, No. 12-16616 (9th Cir. Jun. 2, 2014) (unpublished).

Optional additional reading: For further discussion of the assignability of IP licenses, see this article, posted on the Web site of the Licensing Executives Society, by Finnegan Henderson attorneys John Paul, Brian Kacedon, and Douglas W. Meier.

§ 11.11.4 Some government contracts, *by law*, cannot be assigned by the contractor

As an example of statutory restrictions on assignment, a New York statute provides that, whenever a company enters into a contract with a state agency, the company cannot assign the contract without the agency's consent; if the contractor fails to obtain the consent, the agency "shall revoke and annul such contract," and the contractor forfeits all payments except that needed to pay its employees. *See* N.Y. State Fin. L. art. 9, 138.

The non-assignability of state contracts in New York gives the state agency considerable leverage — which New York state agencies apparently can be quite unabashed about wielding, as seen in the Dubai deal discussed at § 11.11.8.

§ 11.11.5 Would a *merger* require consent as an "assignment" of a contract?

The law seems to vary as to whether a merger or similar transaction effects an assignment of contracts by operation of law.

• In one case, the Delaware chancery court ruled, on summary judgment, that "mergers do not result in an assignment by operation of law of assets *that began* as property of the surviving entity *and continued to be such* after the merger." Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH 62 A.3d 62 (Del. Ch. 2013) (partially granting motion for summary judgment) (emphasis added).

• A California federal court, reviewing case law, noted the existence of variations in different states' laws on this point. The court held that the law governing the license agreement would control. *See* Netbula, Llc v. BindView Development Corp., 516 F. Supp.2d 1137, 1148-50 (N.D. Cal. 2007), where the court granted the defendants' motion for summary judgment dismissing the plaintiff's claim of copyright infringement. (Disclosure: The author was vice president and general counsel of the defendant BindView during most of the relevant events and was a deposition witness in the lawsuit.)

See generally a state-by-state survey by Jolisa Dobbs of the Thompson Knight law firm at http://goo.gl/Sd1wz3.

§ 11.11.6 Would a stock sale alone effect an assignment — and require consent?

A Seventh Circuit opinion followed what seems to be the general (U.S.) rule that a mere change of control of a licensee corporation, through a transfer of the corporation's stock to a new owner, does not constitute an "assignment" of the license that would require consent of the licensor (assuming, that is, that the licensee remained a separately functioning corporation). *See* VDF Futureceuticals, Inc. v. Stiefel Labs., Inc., 792 F.3d 842, 846 (7th Cir. 2015) (Posner, J.), *quoting* Kenneth Ayotte & Henry Hansmann, Legal Entities as Transferable Bundles of Contracts, 111 MICH. L. REV. 715, 724 (2013), *and* Elaine D. Ziff, The Effect of Corporate Acquisitions on the Target Company's License Rights, 57 BUS. LAWYER 767, 789 (2002).

§ 11.11.7 *Why* might a party want to restrict the other party's right to assign?

In some situations, even though the law would normally allow assignment of a contract, one party to the contract might want its opposite number *not* to be free to assign it. Contracts often include language to this effect. Such language can be great for a party that has the right to consent to another party's assignment — and very not-great for a party that must *obtain* consent to such an assignment.

For example: You're a supplier. You're talking to a potential customer about a contract to sell them your stuff. The customer will often want you to agree not to assign the contract to anyone without their consent. The customer's rationale is basically this: *We don't care if assignability is good for commerce in general:* **We** *want to decide who we do business with.* (Yes, grammatically this gets the *who-whom* bit wrong.)

And customers sometime demand assignment-consent restrictions "Just Because." They're especially likely to do so if they went to some trouble picking out a supplier, for example by going through a request for proposal (RFP) process.

§ 11.11.8 Business danger # 1: De facto control of assigning party's destiny

In a *long-term* contractual relationship, **a party's desire to restrict assignment can be strategically dangerous for the other party:**

- Large-scale asset transfers are used for many strategic business transactions, such as sales of factories and other facilities; sales of product lines; and spin-offs of divisions.
- Importantly, key contracts are often among the assets transferred in such transactions; for example, in 2017 BP entered into an agreement to acquire existing- and new biomethane production sites from Clean Energy Fuels — and under the asset purchase agreement, the purchased assets included "all Contracts which *[sic: that]* are primarily related to the Business …."

If a contract's assignment-consent requirement applied even in a transaction such as this, it would effectively give the non-assigning party a veto over the transaction — and multiple counterparties might have such veto power.

EXAMPLE (**STUDY**): In one high-profile, politically-sensitive case involving a Dubai company, the Port of New York and New Jersey was able to … extract **a $10 million consent fee — plus a commitment to invest $40 million** in improvements to terminal operations — in return for consent to an assignment of a lease agreement, as reported in the New York Times.

EXAMPLE *(skim)*: A woman dying of cancer arranged to leave her ownership interest in a real-estate investment to a trust for the benefit of her long-time companion. A court held that this was ineffective because of an anti-assignment clause in the investment contract documents. *See* Lee Graham Shopping Center, LLC v. Estate of Diane Z. Kirsch, 777 F.3d 678 (4th Cir. 2015) (affirming summary judgment).

§ 11.11.9 Business danger # 2: Burden of obtaining consents *(skim)*

Obtaining assignment consents could be burdensome: In one case involving assignment consents, the assigning party wanted to sell a product line but had to seek consent from some 25 different companies. At a minimum, this would

be time-consuming and could easily delay closing the deal**; at worst, 25 different companies could each try to extract a price for their consent** — possibly with each successive company demanding more than the previous one. *See* MDS (Canada) Inc. v. Rad Source Tech., Inc., 720 F.3d 833, 850 (11th Cir. 2013) (affirming district court's judgment in part and certifying question of sublicense-as-assignment to Florida supreme court), *certified question answered in part*, No. SC13-1215 (Fla. July 10, 2014).

§ 11.11.10 Business danger # 3: Blowing up a potential transaction

In an especially bad case, **the delay required to obtain consents to assignment** might result in blowing up the prospective transaction that would have involved the assignments in question.

§ 11.11.11 Legal danger: Loss of valuable, paid-for rights

Valuable rights under a contract might disappear if a party were to assign the contract without a required consent. Consider the following examples:

• The Oregon supreme court ruled, in effect, that **a bank materially breached a lease when it merged with its own wholly-owned subsidiary** — in effect, causing an assignment of the lease — without first obtaining the landlord's consent as required by the lease. *See* Pacific First Bank v. New Morgan Park Corp., 876 P.2d 761 (Ore. 1994) (reversing trial-court judgment). That ruling presumably gave the landlord the right to demand whatever it wanted from the bank to cure the breach — at least if the bank wanted to continue to occupy the leased premises.

• In Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009), a software supplier successfully sued a customer that had done a corporate reorganization — and, in effect, **forced the customer to re-buy the customer's software license after the customer did a corporate reorganization**, just because technically a different corporate subsidiary was using the software than before.

(Author's note: The Cincom case strikes me as shortsighted behavior on the part of the software vendor — it's hard to imagine that the customer was ever again willing to buy anything else from that vendor.)

• In a 2011 Delaware case, one party had agreed to indemnify another — and the agreement prohibited assignment. The court held that the contract language was ambiguous about whether the indemnity right was passed on to

a successor company in an unauthorized merger. ClubCorp, Inc. v. Pinehurst, LLC, C.A. No. 5120-VCP, slip op. at 6 (Del. Ch. Nov. 15, 2011) (Parsons, V.C.) (denying motion for summary judgment).

§ 11.11.12 Exception to consent requirement: "Strategic" asset dispositions

Suppose that Alice and Bob are negotiating a contract between them. It'd be fairly standard for Bob to want to be able to assign the contract *without* Alice's consent if Bob were to do an asset disposition such as the sale of an unincorporated division or a specific product line.

• As discussed above, this could be crucial to Bob's company if the company wanted to retain control over its own strategic destiny.

• It also could keep Bob's assignee ("Betty") from having to re-buy and pay again for an IP license that the assigning party already paid for once, as happened in the Cincom case discussed above.

In their contract negotiation, Bob might argue for one or more consent carve-outs along the following lines:

We need to keep control of our strategic destiny. If we ever wanted to sell a product line or a division (or even the whole company) in an asset sale, we'd need to be able to assign this agreement as part of the deal. We don't want to have to worry about whether somebody at your company was going to get greedy and try to hold us up for a consent fee.

Alice, though, might respond in the negotiation with something like this:

What if you decided to sell a product line or a division to one of our competitors? We need to retain control over that possibility. The only way for us to do that is to retain the absolute right to consent to any assignment you might make.

The negotiation of that point might come down to a question of bargaining power and skill.

(It might not be necessary to give a party an absolute veto over an asset-transaction assignment; instead, the prospective assigning party might consider agreeing not to assign its assets without first consulting with the non-assigning party.)

§ 11.11.13 Should unreasonable withholding of consent be prohibited?

Applicable law might — or might not — require consent to assignment not to be unreasonably withheld. Here are a few examples; drafters should check the applicable law in their cases.

• Cal. Civ. Code § 1995.260 imposes an implied requirement of no unreasonable withholding of consent to transfer of a lease if the lease is silent about the standard for withholding consent. One court held that a provision allowing withholding of consent "for any reason or no reason" did not trigger the implied requirement and thus was not to be construed as including an unreasonably withheld standard. Nevada Atlantic Corp. v. Wrec Lido Venture, LLC, No. G039825 (Cal. App. Dec. 8, 2008) (unpublished; reversing trial-court judgment that withholding of consent was unreasonable).

• In contrast, the Texas supreme court held that, when an oil-and-gas contract required consent to assignment but was silent about the standard for withholding consent, the reviewing party's right to refuse consent was unrestricted. Barrow-Shaver Resources Co. v Carrizo Oil & Gas, Inc., No. 17-0332, slip op. at 16 (Tex. June 28, 2019) (affirming court of appeals' reversal of trial-court judgment on jury verdict).

• The Alabama supreme court held that when contract in suit specifically gave a party the right, *in its sole discretion*, to consent to any proposed assignment or sublease, that trumped a case-law rule that a refusal to consent is to be judged by a reasonableness standard under an implied covenant of good faith." Shoney's LLC v. MAC East, LLC, 27 So.3d 1216, 1220-21 (Ala. 2009) (on certification by Eleventh Circuit).

• A lease prohibited the tenant from assigning the lease, including by operation of law, without the landlord's consent. The lease also stated that the landlord would not unreasonably withhold its consent to an assignment of the lease *to a subtenant that met certain qualifications*. Notably, though, the lease agreement did not include a similar statement for *other* assignments. The Oregon supreme court held that ordinarily, the state's law would have required the landlord to act in good faith in deciding whether or not to consent to an assignment. But, the court said, the parties had implicitly agreed otherwise; therefore, the landlord did *not* have such a duty of good faith. Pacific First Bank v. New Morgan Park Corp., 876 P.2d 761 (Or. 1994) (affirming court of appeals decision on different grounds; reversing trial-court declaration that bank-tenant had not *materially* breached lease agreement).

In a factually-messy Eleventh Circuit case, the court upheld a trial court's finding that the owner of a patent, which had exclusively licensed the patent to another party, had not acted unreasonably when it refused consent to an

assignment by the licensee to a party that wanted to acquire the licensee's relevant product line. MDS (Canada) Inc. v. Rad Source Tech., Inc., 720 F.3d 833, 850 (11th Cir. July 1, 2013) (affirming district court's judgment in part).

§ 12 Associated Individuals Definition

The term *Associated Individual*, as to an organization, refers to any individual who, at the time in question, falls into one or more of the following categories:

1. an employee of the organization;
2. an officer or director of the organization, if it is a corporation;
3. a holder of a comparable position, if the organization is of another type (for example, a limited liability company); and
4. any other individuals expressly specified in the AGREEMENT, if any.

COMMENTARY

This defined term can be used in extending a contract's limitations of liability to specified individuals. That can be useful if an aggrieved plaintiff were to sue, not just the company that is another party to the contract, but also various individuals associated with that company. This might occur: • if the plaintiff felt that the defendant company had few assets that could be seized to satisfy a judgment, but that the individual co-defendants personally owned substantial assets; and/or • if the plaintiff wanted to put pressure on the company to settle the case, as seems to have happened in the bitter *Oracle v. Oregon* lawsuit, where various Oracle managers and executives were individually named as co-defendants in a multi-million lawsuit over a failed software development project. (The case was later settled, with Oracle agreeing to pay $25 million in cash and to provide technology worth another $75 million.)

Subdivision b.2 recognizes that *with the benefit of hindsight*, a motivated opposing counsel and expert witness can almost always find *something* that the a party conceivably could have done, but in fact didn't do, to achieve the stated objective.

§ 13 Attorney Fees Protocol

§ 13.1 ☑ The prevailing party is entitled to recover its attorney fees, etc.

a. In any litigation, arbitration, or other action arising out of or relating to the AGREEMENT or any transaction or relationship resulting from it, the prevailing party(if any), will be entitled to recover its Dispute Expenses from the other party, in addition to any other relief that may be granted.

b. All provisions of the AGREEMENT relating to the recovery of attorney fees and other Dispute Expenses will survive each of the following:

1. any termination, expiration, or other coming to an end of the AGREEMENT; and
2. the entry of a judgment, arbitration award, or other decision in a contested proceeding — for the avoidance of doubt, however, this Protocol is not to be considered to have merged into that decision.

COMMENTARY

> While this provision uses the term *Dispute Expenses*, the concept is often stated as *attorneys' fees* or *attorney's fees*. Legal-language maven Bryan Garner suggests using the singular *attorney fees*.

§ 13.2 ❑ Each party is to pay its own attorney fees, etc.

In any litigation, arbitration, or other action arising out of or relating to the AGREEMENT or any transaction or relationship resulting from it, each party is to bear its own Dispute Expenses.

COMMENTARY

> This is an alternative to the prevailing-party language above; it conforms to the "American Rule" discussed in the additional commentary.

§ 13.3 ❑ Attorney Fees in Motion Practice Option

§ 13.3.1 Why are the parties agreeing to this Option?

The parties are agreeing to this Option to provide an incentive for the parties to amicably resolve any subsidiary- or ancillary dispute that is brought before a tribunal (each, a **Motion**).

§ 13.3.2 What happens if a party loses a Motion?

a. The prevailing party in a Motion will be entitled to recover its Dispute Expenses for the Motion unless the tribunal, for good cause, rules otherwise.

b. A tribunal's decision not to award Dispute Expenses under this section is final and non-appealable.

§ 13.3.3 Can the losing party recover its expenses later?

a. Motion-related Dispute Expense recoveries may not be recaptured as part of a later recovery of Dispute Expenses for the overall action.
EXAMPLE:

1. Suppose that a party ("Alice") recovers Dispute Expenses from another party ("Bob") in connection with a Motion in an action because Alice was the prevailing party in the Motion.
2. But suppose also that *Bob* later prevails in the overall action and thus becomes entitled to recover Dispute Expenses from *Alice*, either by agreement or by law.
3. In that case, Bob is not entitled to a refund of the Dispute Expenses that Alice recovered from him in connection with the Motion.

COMMENTARY

Subdivision b: Much of the expense of litigation (and, to a lesser extent, of arbitration) comes from pre-trial motion practice. This drop-in provision tries to provide an incentive for the parties to avoid such motion practice —

with subdivision c likewise trying to avoid "satellite litigation" over attorney-fee demands in motion practice.

§ 13.4 ❑ Attorney Fees for Serious Accusations Option

COMMENTARY

This Option is intended to discourage parties and their trial counsel from making baseless accusations in the hope of prejudicing the jury, judge, or arbitrator and/or of gaining settlement leverage, for reasons discussed in the additional commentary.

The concept underlying this Option was inspired by a remark many years ago by the author's then-law partner (and longtime mentor), über-patent-litigator John F. Lynch. At that time, accused patent infringers would routinely accuse patent owners and their patent attorneys of what was then referred to as "fraud on the Patent Office," which is now known as inequitable conduct before the U.S. Patent and Trademark Office. John mused that perhaps there should be a rule — paraphrased from memory here: *If Lawyer A accuses Lawyer B of fraud on the Patent Office,* then perhaps *at the end of the case, one of the two lawyers should be suspended from practice.* This provision doesn't (and can't) go quite that far; it does, though, give parties an incentive to be cautious about making a Serious Accusation.

§ 13.4.1 What does "Serious Accusation" mean?

This Option will be relevant if a party makes a "**Serious Accusation**," namely an assertion: • by one or more individuals and/or organizations (each, an "**accuser**"), • before any tribunal, • in a claim or defense to a claim, • that one or more other individuals and/or organizations (each, an "**accused**") had engaged or is engaged in one or more of the following:

1. conduct punishable as a felony;
2. fraud;
3. breach of fiduciary duty;
4. gross negligence;

5. willful misconduct; and

6. any other particular Serious Accusations expressly agreed to in writing by the parties, if any — for the avoidance of doubt, it is immaterial if one or more such other particular Serious Accusations is also in another category listed above.

§ 13.4.2 **This Option takes effect in case of an unproved Serious Accusation**

a. This Option will take effect in any case, regardless of any other outcome in the case, in which:

1. an accuser makes a Serious Accusation; but

2. in the final judgment in litigation or final arbitration award, as the case may be, the tribunal does not find that the accuser proved the Serious Accusation by the quantum of proof required by law, or if greater, the quantum of proof required by the AGREEMENT.

b. The accuser in such a case is referred to below as an "**unsuccessful accuser**."

§ 13.4.3 **An unsuccessful accuser must pay the accused's Dispute Expenses**

An unsuccessful accuser must reimburse the accused for all of the accused's Dispute Expenses incurred in the entire case (not merely in defending against the Serious Accusation), unless the tribunal determines otherwise for good reason supported by clear and convincing evidence.

§ 13.4.4 **An unsuccessful accuser may not recover its own Dispute Expenses**

An unsuccessful accuser s not entitled to recover any of its attorney fees or other expenses or costs of the litigation or arbitration, and hereby **WAIVES** any such recovery, regardless whether such recovery would otherwise be available under the AGREEMENT or applicable law.

§ 13.4.5 An unsuccessful accuser must also pay liquidated damages

An unsuccessful accuser must pay the accused USD $10,000 as liquidated damages to compensate the accused for the additional expense, burden, and inconvenience of defending against all of the one or more Serious Accusations in the case, over and above the accused's Dispute Expenses.

§ 13.4.6 Severability

The parties intend for any and all parts of this Option to be severable from the AGREEMENT if found to be unenforceable for any reason.

§ 13.5 ❑ ADR Non-Participation Attorney Fee Option

§ 13.5.1 Why are the parties agreeing to this Option?

a. The parties wish to create incentives to comply with any applicable dispute-resolution provision(s) in the AGREEMENT (each, a **Dispute-Resolution Provision**) in the following categories.

1. arbitration;
2. early neutral evaluation;
3. economical litigation agreement;
4. escalation of disputes;
5. forum selection;
6. jury-trial waiver;
7. mediation;
8. minitrial to management;
9. service of process by courier.

b. The parties agree that such provisions, when part of the AGREEMENT, hold out the possibility of promoting amicable settlement of any disputes that might arise between the parties, or at least of helping reduce the expense and burden of such disputes.

COMMENTARY

This Option is modeled on a *mediation* provision in a standard California residential real-estate purchase agreement, which has been enforced at least twice by courts. See generally:

- Cullen v. Corwin, 206 Cal. App. 4th 1074, 142 Cal. Rptr. 3d 419 (2012) (reversing award of attorney fees to prevailing *defendant*, on grounds that the defendant had refused to participate in mediation as required by contract); and
- Lange v. Schilling, 163 Cal. App. 4th 1412 (2008) (reversing award of attorney fees to prevailing *plaintiff*). *Cf. also* Thompson v. Cloud, 764 F.3d 82 (1st Cir. 2014), where the court denied the winning party's request for attorney fees under an analogous clause, on grounds that the winning party never *asked* for mediation and thus the losing party didn't refuse to mediate. *See id.* at 92.

§ 13.5.2 **If this Option applies, what effect will it have?**

a. This Option will apply if a party (the "**Non-Participating Party**") does any of the following:

1. fails, upon written request by another party, to participate in dispute-resolution efforts or proceedings required by a Dispute-Resolution Provision; or
2. challenges the enforceability of a Dispute Resolution Provision.

b. If this Option applies, then no Non-Participating Party will be entitled to recover Dispute Expenses, and each Non-Participating Party **WAIVES** any claim to such recovery, even if that Non-Participating Party:

1. would otherwise have been entitled to such a recovery, whether under the AGREEMENT or under applicable law; and/or
2. prevails in the dispute in question or in the challenge against validity or enforceability of the Dispute-Resolution Provision in question.

c. In case of doubt: This Option does not limit any other party's right to relief, if any, in respect of an action or omission by the Non-Participating Party.

COMMENTARY

The use of bold-faced type for the waiver language is for conspicuousness.

§ 13.6 Additional commentary

§ 13.6.1 Legal background: The "American rule" vs. "loser pays"

§ 14

The general rule in the U.S., sometimes known as the "American rule," is that each party must pay its own attorney fees. *See, e.g.*, Zurich American Insurance Co. v. Team Tankers A.S., 811 F.3d 584, 590 (2d Cir. 2016) (reversing award of attorney fees; discussing American Rule), *citing* Baker Botts LLP v. ASARCO LLC, 576 US ___, 135 S. Ct. 2158 (2015).

Some, though, view a prevailing-party allocation of attorney fees as fundamentally more fair: If you lose a case, presumably you were responsible for the case having to be litigated, so you should pay the attorney fees and expenses that you forced the prevailing party to spend.

(The prevailing-party rule is sometimes called the "loser pays" rule, or the "everywhere but America" rule.)

Complicating the picture: Big companies sometimes regard litigation expenses as a cost of doing business. Once in a while, a big company might try to use its superior financial strength to bully a weaker counterparty. Smaller companies can try to offset that advantage by negotiating a prevailing-party clause.

Of course, a prevailing-party clause raises the stakes for a smaller litigant as well: If the smaller litigant were to lose the case, then the smaller litigant would be liable for the bigger litigant's attorney fees; those fees will often have been billed by a big, *expensive* law firm.

§ 14.1.1 What constitutes a prevailing party?

Some courts have held that, if the putatively winning side is not the "prevailing party" if it did not receive any monetary damages or equitable relief. *See, e.g.*, Intercontinental Group Partnership v. KB Home Lone Star LP, 295 S.W.3d 650 (Tex. 2009) (5-4 reversal of $66,000 attorney fees award to plaintiff that had received a zero-dollar damages award and no declaratory or other equitable relief).

Some commentators have suggested that drafters should specify what they mean by "prevailing party," but my guess is that most will not want to do so.

§ 14.1.2 The "Texas rule": Only a successful contract *enforcer* can recover fees — and then only from an individual or corporation

If a party negotiating a contract thinks it might be more likely to be the defendant in a dispute than the plaintiff, it might want to affirmatively include a "pay your own lawyer" provision in the contract such as in § 13.2 above.

In Texas, absent an agreement otherwise, a party that successfully enforces a claim against *an individual or corporation* on an oral or written contract — but *not* a party that successfully *defends* against an enforcement action — is entitled to recover attorney fees. See Tex. Civ. Prac. & Rem. Code § 38.001.

Courts have held that under section 38.001, attorney fees are recoverable *only* from an individual or corporation. *See* Hoffman v. L&M Arts, No. 3:10-CV-0953-D, slip op. at part III (N.D. Tex. Mar. 6, 2015) (citing cases) (subsequent history omitted). In 2015, a bill to change that died in committee in the Texas Legislature. *See* Tate Hemingson, Recovery of attorney fees under Civil Practice & Remedies Code Section 38.001(Strasburger.com 2015).

§ 14.1.3 The California rule: It's *all* "prevailing party"

California Civil Code § 1717 provides, in essence, that any one-way attorney fees provision (as is sometimes seen in consumer-facing contract forms) is to be treated as a prevailing-party provision, and states that attorney fees under the section cannot be waived.

§ 14.1.4 Other possible attorney-fee provisions

Drafters could consider redefining the term *Recovering Party* as one of the following:

- any party that succeeds in enforcing one or more rights under the Agreement;
- a specified party if it is the prevailing party (but not the other party even if it prevails);
- neither party — that is, each party will bear its own attorney fees and expenses.

§ 14.1.5 Attorney fees in arbitration awards

In an arbitration proceeding, applicable law might override the parties' agreement that attorney fees can, or cannot, be awarded. *See* Recovery of Attorney Fees in International Arbitration: the Dueling "English" and "American" Rules, by John L. Gardiner & Timothy G. Nelson of Skadden Arps, available at http://goo.gl/jsjy4 (accessed Jan. 30, 2010).

§ 14.1.6 One-sided attorney-fee clauses might well be enforced

Some contracts contain unilateral attorneys' fee clauses; for example, a real-estate lease agreement might state that the *landlord* can recover its attorney fees if it has to sue the tenant, while remaining silent as to whether the *tenant* can ever recover its attorney fees. (Under the 'American rule,' that would normally mean that the tenant could not recover, even if it were the prevailing party in a suit brought by the landlord — except in California, as noted above.)

Such unilateral clauses might well be enforceable. *See, e.g.*, Allied Indus. Scrap, Inc., v. OmniSource Corp., 776 F.3d 452 (6th Cir. 2015) (reversing district court's denial of attorney fees), *discussing* Wilborn v. Bank One Corp., 906 N.E.2d 396 (Ohio 2009) (affirming dismissal of borrowers' lawsuit against lenders claiming that unilateral attorneys' fee clause in residential mortgage loan agreement form was void as contrary to public policy).

§ 14.1.7 Serious Accusation attorney-fee awards

Many litigators like to load up their pleadings with accusations of fraud, gross negligence, bad faith, breach of fiduciary duty, and the like, whether or not such accusations are warranted by the facts. For an example of such a loaded-up case, see Falco v. Farmers Ins. Gp., 795 F.3d 8643 (8th Cir. 2015), in which the appeals court affirmed summary judgment in favor of defendants, including dismissal of the plaintiff's claim that the defendants had supposedly breached a fiduciary duty.

The strategic thinking among plaintiffs often seems to be something like this: *We might as well go ahead and make these accusations — there's no downside to us for doing so, and the jury might believe the accusations. That will raise the stakes for the other side; this in turn will give us more leverage to force the other side to settle the case on* our *terms.*

Such strategic thinking can work out very well for the claimant (sometimes spectacularly so, as discussed elsewhere in this work). Unfortunately, even

when utterly baseless, Serious Accusations can pose major problems for their targets. Such accusations: • can unfairly influence jurors; • in themselves can damage a defendant's reputation — because the press and other third parties can tend to think, *where there's smoke, there's fire* — even if the defendant is ultimately vindicated; • are almost always expensive and time-consuming both to prosecute and to defend against, because wide-ranging discovery and expert testimony will usually ensue; and • can be tough to get rid of quickly, either on the pleadings or on summary judgment, because judges and arbitrators will often find that a full trial (usually a jury trial in the U.S.) or arbitration is required to decide the truth of the matter.

With these factors in mind, the expense-shifting and liquidated-damages features of the Serious Accusations option are intended to encourage parties to think long and hard before making Serious Accusations, by giving a prospective accuser a significant financial downside if it proceeds to make such an accusation but then fails to prove it.

§ 15 Audit Rights Protocol

§ 15.1 Audit basics

§ 15.1.1 Definitions

a. "**Auditable Records**" refers to records sufficient to document each of the following, as applicable,

1. labor performed and billed under the AGREEMENT;
2. materials and other items billed under the AGREEMENT;
3. ❑ compliance with specific requirements of the AGREEMENT; and
4. any other matters as to which, under the AGREEMENT, the Auditing Party has the right to audit records.

b. "**Auditing Party**" refers to a specified party that has the right to cause Auditable Records to be audited under the AGREEMENT.

c. "**Permissible Auditors**" refers to:

1. any Big Four accounting firm;

2. ☑ any other independent accounting firm that regularly audits books and records of the Recordkeeping Party; and

3. any other auditor proposed in writing by the Auditing Party to which the Recordkeeping Party does not reasonably object.

d. "**Recordkeeping Party**" refers to any party that, under the AGREEMENT, is required to keep records that come within the definition of Auditable Records.

COMMENTARY

This language is set up in generic terms with a view to having this provision be serviceable even if a drafter doesn't fill in deal-specific details.

Subdivision a.1 allows generic compliance audits — but that might be controversial, especially in the case of highly-sensitive information.

Subdivision b.2: Contract-negotiation consultant and author John Tracy suggests (in a LinkedIn discussion thread) that an auditing party should consider agreeing in advance that, if it wishes to audit the recordkeeping parties books and records, **the auditing party will engage the outside CPA firm that regularly audits the recordkeeping party's books anyway**. John says that this should reduce the cost of the audit and assuage the recordkeeping party's concerns about audit confidentiality; he also says that "the independent CPA will act independently rather than risk the loss of their license and accreditation and get sued for malpractice."

§ 15.1.2 **What audits may the Auditing Party have done?**

The Auditing Party may cause one or more audits of Auditable Records to be conducted, in accordance with this Article, by one or more Permissible Auditors.

COMMENTARY

In some cases involving multiple parties to a contract, a recordkeeping party might want to define *Auditing Party* to include only selected other parties.

The "cause" language has in mind that:

- An auditing party might not want to bear the expense of having an outside auditor do the job, and instead might prefer to send in one of its own employees to "look at the books";
- On the other hand, a recordkeeping party might not want the auditing party's own personnel crawling around in the recordkeeping party's records, but it might be OK with having an outside accountant (or other independent professional) do so.

A recordkeeping party might want the absolute right to veto the auditing party's choice of auditors, instead of having the right to give reasonable consent. On the other hand, the auditing party might not trust the recordkeeping party to be reasonable in exercising that veto, and it could be concerned that a dispute over that issue would be time-consuming and expensive. This provision represents a compromise.

An auditing party might want to add that consent is deemed given if the recordkeeping party doesn't object in writing within X days after receiving or refusing the auditing party's written proposal of an auditor.

§ 15.1.3 How much advance notice is required for an audit?

The Auditing Party must give the Recordkeeping Party at least ten business days' advance written notice of any proposed audit except for good reason.

COMMENTARY

Normally, both parties will benefit if the recordkeeping party has a reasonable time to collect its records, remedy any deficiencies, etc., before the auditor(s) get there. On the other hand, if the auditing party suspects cheating or other malfeasance, a surprise audit might be in order.

§ 15.1.4 What access must the Recordkeeping Party provide to the auditors?

The Recordkeeping Party must:

1. provide the auditor(s) with access to the Auditable Records to the extent reasonably necessary for the audit; and
2. make the Recordkeeping Party's relevant personnel reasonably available to the auditor(s), and direct them to answer reasonable

questions from the auditor(s), except as otherwise provided in the AGREEMENT.

COMMENTARY

A party agreeing to an audit clause might want to restrict the auditor's access to the facilities, computers, etc., of the party being audited. For example:

• Software vendors often include audit provisions in their license agreements, to allow a vendor to audit a customer's use of the software to confirm that all such use is appropriately licensed (and paid for). A software vendor's audit clause might allow the vendor to access the customer's computer systems, but the customer might not want this, especially if the customer is in a sensitive industry such as finance or health care.

• A possible compromise might be to allow a third-party auditor to have limited access to computer systems, etc., under a strict confidentiality agreement.

(Hat tip: Christopher Barnett, Top Three Revisions To Request In Software License Audit Clauses (ScottAndScottLLP.com 2015).)

Subdivision 2: Audits sometimes happen after business relationships start to turn sour. In situations like that, it's not unheard of for recordkeeping parties' personnel to be uncooperative. So, it can help to lay out ground rules for what might otherwise be an unfriendly episode.

§ 15.1.5 **What facilities must be provided to the auditors?**

IF: An audit is to be conducted at one or more sites controlled by the Recordkeeping Party; THEN: The Recordkeeping Party is to cause the audit site(s) to be furnished with appropriate facilities of the type customarily used by knowledge-based professionals, including without limitation furniture; lighting; air conditioning; electrical power; and Internet access.

COMMENTARY

In an unfriendly audit, an uncooperative recordkeeping party might try to make the auditors work in a closet, an unairconditioned warehouse, or worse.

§ 15.1.6 In what form are Auditable Records to be provided?

The Recordkeeping Party will make Auditable Records available to the auditor(s) in the form, electronic or otherwise, in which those records are kept in the ordinary course of business.

COMMENTARY

An auditing party probably would not want a recordkeeping party to just print out its electronic records on paper and deliver them to the auditors; in all likelihood, that would significantly increase the cost of the audit. *See* Ryan C. Hubbs, The Importance of Auditing In An Anti-Fraud World — Designing, Interpreting, And Executing Right to Audit Clauses For Fraud Examiners, at 4 (Assoc. of Certified Fraud Examiners 2012).

§ 15.1.7 Where are audits to take place?

Unless otherwise agreed, each audit is to be conducted:

1. at the location or locations where the Auditable Records are kept in the ordinary course of business the records; and/or
2. at the Recordkeeping Party's option, at one or more other reasonable places designated in advance by the Recordkeeping Party in consultation with the Auditing Party.

COMMENTARY

This provision reminds drafters that in an unfriendly audit, the recordkeeping party might try to demand that auditable records be produced for audit at a location not desired by the auditing party, or vice versa.

In some contracts it might be desirable for the audit provision to specify either (1) an agreed location for audits, or (2) if a specific location can't be satisfactorily determined in advance, an agreed *procedure* for determining the location if the parties are unable to agree on one. (This is an example of the truth that if parties can't agree in advance on an outcome – possibly because one or more of them simply doesn't know what outcome they want – then perhaps they *can* agree on a process for determining the outcome when the circumstances arise.)

§ 15.1.8 When are audits to take place?

Unless otherwise agreed, each audit is to take place at one or more reasonable times designated in advance by the Recordkeeping Party in consultation with the Auditing Party.

COMMENTARY

In some situations, a recordkeeping party might find it more convenient for audits to take place outside of business hours — for example, if a retail store's landlord has the right to audit the store's books (for determining percentage rent owed), then the store owner might prefer for the audit to occur when customers aren't in the store.

§ 15.1.9 Is any information "off limits" to the auditors?

Unless the AGREEMENT expressly states otherwise, the Auditing Party's right to audit Auditable Records does not extend to any of the following:

1. information that, under applicable law, would be immune from discovery in litigation, for example on grounds of attorney-client privilege, work-product immunity, or any other privilege;
2. trade secrets and other confidential information relating to formulae and/or processes; and
3. clearly unrelated or -irrelevant information.

COMMENTARY

This clause excludes from auditing any information that is subject to the attorney-client privilege and any other applicable privilege. That's because in the case of the attorney-client privilege, disclosure of privileged information to outsiders likely would waive the privilege in many jurisdictions and thus make the privileged information available for discovery by others, including third parties. (A recordkeeping party might also want to specify other particular audit exclusions.)

Subdivision 2 might be open to dispute, but at least it gives the Recordkeeping Party ammunition with which to oppose an unreasonable "fishing expedition" by the Auditing Party.

§ 15.1.10 How often may audits be conducted?

Except for good reason, the Recordkeeping Party need not permit audits more often than:

1. once per 12-month period; and
2. once per period audited .

COMMENTARY

An audit might end up being at least somewhat burdensome and disruptive to the recordkeeping party; most recordkeeping parties will want to limit the auditing party's ability to initiate audits. See also • the definition of good reason; and • the option requiring the Auditing Party to reimburse the Recordkeeping Party's expenses.

§ 15.1.11 Is there a deadline for *requesting* an audit?

a. Except for good reason, the deadline for the Auditing Party to request an audit for any given Auditable Record is the later of:

1. the end of any legally enforceable record retention period for that Auditable Record, if any; and
2. three years after the end of the calendar quarter in which the substantive content of that Auditable Record was most-recently revised.

b. For the avoidance of doubt, subdivision a does not in itself require the Recordkeeping Party to maintain Auditable Records for any period of time, but only states a deadline for the audit request.

COMMENTARY

An audit request should be timely; otherwise, a creative counsel might try to argue that the party had the right to conduct an audit even when, for example, the underlying agreement had expired or been terminated. A would-be auditing party tried unsuccessfully to make such an argument in New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015) (affirming district court's judgment after bench trial).

At some point, the recordkeeping party might want to be able to get rid of its records; also, it won't want to have to support an audit of (say) 20 years of past records.

§ 15.1.12 Is there a deadline for *completing* an audit?

Except for good reason, the deadline for the auditor(s) to complete a given audit is three months after the effective date of the Auditing Party's advance written notice of the audit.

COMMENTARY

Three months should normally be more than enough time for an auditor to complete a reasonable audit unless one or another party is unreasonable about scheduling, access, etc.

§ 15.2 What confidentiality obligations apply to audits?

a. Absent consent of the Recordkeeping Party, the Auditing Party:

1. may not use any nonpublic information that is learned or derived in the course of any such audit, except to the extent necessary to protect the Auditing Party's rights and/or for the Auditing Party's performance of its obligations under the AGREEMENT;

2. may not disclose any such information to third parties except in response to compulsory legal process, after first: (A) advising the Recordkeeping Party of such process (where not prohibited by law); and (B) providing reasonable cooperation in any efforts by the Recordkeeping Party to preserve the confidentiality of such information.

b. The Auditing Party must enter into binding written agreements with its auditors requiring them to comply with the audit-confidentiality requirements of the AGREEMENT.

COMMENTARY

This provision includes what amounts to a nondisclosure agreement ("NDA") in miniature. For especially sensitive matters, the parties might wish to negotiate a separate NDA for the auditor(s) to sign — perhapsusing the Confidential Information Protocol.

§ 15.2.2 May auditor(s) retain copies of Auditable Records?

☑ Yes: Auditor(s) may make and keep copies of audited Auditable Records, so long as the auditor(s):

1. comply with the audit-confidentiality requirements of the AGREEMENT; and
2. return or destroy the copies, in accordance with the auditor's regular, commercially reasonable policies and processes, within a reasonable time after the end of the last period for which Auditable Records are required to be maintained under the AGREEMENT or by law.

❑ No: Auditor(s) must not retain any copies of Auditable Records once the audit is completed.

COMMENTARY

An auditing party's auditors might well find it burdensome (and therefore more expensive for the auditing party) to be precluded from making copies of the recordkeeping party's records.

Outside auditors might insist on being able to take copies with them to file as part of their work papers.

In some circumstances, the recordkeeping party might want to negotiate for limits on the types of records that the auditor(s) are allowed to copy and take away.

§ 15.3 Audit reports

§ 15.3.1 Must auditor(s) limit what is reported to the Auditing Party?

☑ The auditor(s) may provide the Auditing Party with a reasonable summary and detail of the audit findings.

❑ The auditor(s) must agree in writing (and must provide a copy of the agreement directly to the Recordkeeping Party):

1. to disclose to the Auditing Party only whether a reportable discrepancy was revealed by the audit, and if so, the size and general nature of the discrepancy; and

2. that the Recordkeeping Party is a third-party beneficiary of that written agreement.

COMMENTARY

A Recordkeeping Party might want this if it is concerned that the auditor(s) might need to delve into confidential information that the Recordkeeping Party doesn't want to be provided to the Auditing Party.

§ 15.3.2 Is the *Recordkeeping* Party entitled to a copy of the audit report?

☑ If requested by the Recordkeeping Party, the Auditing Party will direct the auditor(s) to provide the Recordkeeping Party, at the Auditing Party's expense, a complete and accurate copy of any audit report.

❑ The Auditing Party may, in its sole discretion, provide the Recordkeeping Party with a copy of some or all of the audit report.

COMMENTARY

The Recordkeeping Party might not care about getting a copy of an audit report if the report says, basically, *everything's cool here*. But if the Recordkeeping Party will have to come up with extra money, or is accused of a material breach, it likely will indeed want to get a copy of the audit report.

The Auditing Party might object to providing the Recordkeeping Party with a copy of the audit report. But face it: If the dispute goes to litigation or even arbitration, the odds are high that the Auditing Party's lawyers will be able to get a copy of the audit report as part of the discovery process (for example, by issuing a subpoena to the auditors).

§ 15.4 Audit adjustments, interest, and expense-shifting

§ 15.4.1 What post-audit adjustments are to be made?

IF: An audit reveals the apparent existence of a billing- or payment discrepancy such as (for example) over- or underbilling or over- or underpayment; THEN: The party benefiting from that discrepancy is to promptly take such action as may be necessary to remedy ("true-up")

the discrepancy, including, for example, refunding an overpayment or paying a shortfall, as the case may be.

COMMENTARY

This is practically a universal feature of audit provisions.

§ 15.4.2 **Must interest be paid on adjustments?**

a. This section applies if, after an audit, a party must pay a shortfall or refund an overpayment due to an error by that party or for which that party is otherwise responsible.

b. The party referred to in subdivision a must also pay interest on the shortfall or refund at 1.5% simple interest per month or the maximum rate permitted by law, whichever is less.

c. The TANGO interest-charges protocol (including but not limited to its usury-savings provisions) will apply to any such interest payment.

COMMENTARY

Drafters should be *very* careful about usury laws, which can have teeth, as discussed in interest charges.

If an agreement also is going to provide for charging interest on past-due amounts *apart* from an audit provision, then that interest provision probably should be separate from the audit provision. In the 2014 *Cellport* case, a contract drafter's failure to keep the two provisions separate resulted in a contract plaintiff's winning its case but receiving a much-lower interest rate than was called for by the contract. *See* Cellport Sys., Inc. v. Peiker Acustic GmbH & Co., KG, 762 F.3d 1016, 1028-29 (10th Cir. 2014).

§ 15.4.3 **Who must pay for the audit?**

a. The Recordkeeping Party must reimburse the Auditing Party for reasonable outside auditors' fees and -expenses if (i) the audit reveals the existence of one or more of the following items and (ii) under the AGREEMENT the Recordkeeping Party is responsible for the item(s):

1. a discrepancy in billing or payment, for the period being audited, that: (A) is equal to or greater than 5%; and (B) was caused by an error made by, or imputable to, the Recordkeeping Party; and (C) favors the Recordkeeping Party; and/or

2. an uncured material breach of the AGREEMENT, and/or

3. fraud.

b. Otherwise, the Auditing Party is responsible for all costs of an audit.

COMMENTARY

Subdivision a.1: The discrepancy revealed by the audit must exceed the stated threshold percentage *for the period being audited*. That will help to avoid unfair expense shifting if, say, a discrepancy for a single month was discovered in an audit of five years' worth of records. In that kind of situation, the Recordkeeping Party arguably shouldn't have to foot the bill for the entire five-year audit; on the other hand, neither should the Recordkeeping Party necessarily escape the consequences of the ten-percent discrepancy in that one month. The language of this provision represents a compromise position.

Subdivision a.1: The threshold for shifting audit expenses might well be negotiable, often falling in the range between 3% and 7% for royalty-payment discrepancies and perhaps around 0.5% for billing discrepancies in services.

Subdivision a.2: Consider also whether the *auditing* party should be required to pay the *recordkeeping* party's audit expenses, discussed below.

§ 15.4.4 **Who will pay for the *Recordkeeping* Party's audit expenses?**

☑ The Recordkeeping Party is responsible for its own expenses incurred in connection with any audit.

❑ IF: For a particular audit, the Recordkeeping Party is not required to reimburse the Auditing Party's expenses of the audit; THEN:
The *Auditing* Party is to reimburse the Recordkeeping Party (and the Recordkeeping Party's subcontractors, if applicable) for reasonable expenses actually incurred in connection with the audit, such as (for example) reasonable fees and expenses for an auditor engaged by the Recordkeeping Party to monitor the audit.

COMMENTARY

An article by two construction lawyers points out that "audit provisions rarely address the apportionment of *the costs incurred by the Contractor or its subcontractors* in facilitating the audit, managing the audit, reviewing and responding to the audit results, and other related activities *if the audit fails to demonstrate significant overbilling* by the Contractor." Albert Bates, Jr. and Amy Joseph Coles, Audit Provisions in Private Construction Contracts …, 6 J. AM. COLL. CONSTR. LAWYERS 111, 132 (2012) (emphasis added).

§ 15.4.5

❑ Limitation of Remedies for Audit Discrepancies

IF: In respect of any invoicing- or payment discrepancy revealed by an audit, the Recordkeeping Party complies with the obligations of this Protocol within 30 days after receiving notice of the discrepancy and a copy of the audit report; THEN: The Recordkeeping Party will have no further obligation or liability for that discrepancy or the actions or omissions that caused it.

COMMENTARY

An auditing party might object to this provision if it wanted to be free also (i) to terminate the Agreement if the discrepancy were material, and/or (ii) to demand a greater measure of damages for the discrepancy if that were available by law (such as indirect damages resulting from copyright infringement).

As a contrary example, though: A software customer might want this provision as a shield against an aggressive software licensor in case an audit by the licensor revealed that the customer was making more use of the software than it had paid for. See, e.g., Christopher Barnett, Top Three Revisions To Request In Software License Audit Clauses (ScottAndScottLLP.com 2015). (Software licensors might well be willing to go along with such a limitation of liability — but possibly with the proviso that any catch-up license purchases would be at full retail price, regardless of any negotiated discount; otherwise the customer would have an incentive to roll the dice and cheat on obtaining licenses.)

§ 15.5 Other audit provisions

§ 15.5.1 What constitutes "good reason"?

For purposes of the audit provisions of the Agreement, **good reason**, whether or not capitalized, includes, without limitation, any one or more of the following:

1. significant lack of cooperation, by the Recordkeeping Party, in an audit under the Agreement; and
2. the discovery of substantial evidence of fraud, or of material breach of the Agreement, by or attributable to the Recordkeeping Party.

COMMENTARY

Either of the two listed items might well warrant setting aside the usual agreed limitations on advance notice, deadlines, etc.

§ 15.5.2 Will audit provisions survive termination?

The AGREEMENT's audit provisions will survive any termination or expiration of the AGREEMENT (but will also remain subject to all deadlines and other limitations stated in the Agreement).

COMMENTARY

Not specifying that audit rights survive termination of the Agreement might result in the audit right ending when the Agreement does. That happened in New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015) (affirming district court's judgment after bench trial).

§ 15.5.3 ❑ Flowdown Requirement for Audit Provisions

a. The Recordkeeping Party is to include, in each subcontract under the Agreement, if any, provisions for the benefit of the Auditing Party as a third-party beneficiary, as follows:

1. a requirement that the subcontractor permit audits by the Auditing Party in accordance with the audit provisions of the Agreement; and

2. an authorization for the subcontractor to deal directly with the Auditing Party and its auditor(s) in connection with any such audit.

b. In case of doubt, subdivision a neither authorizes nor prohibits the Recordkeeping Party's use of subcontractors under the Agreement.

COMMENTARY

Flowdown requirements are often found in government contracts.

§ 15.6 Additional commentary

§ 15.6.1 A real-world example *(skim)*

The nuclear Navy, in which the author served, has a saying: You get what you inspect, not what you expect. This saying can be equally true in the world of contract relationships: Mistakes can happen — and sometimes, so can creative accounting, stonewalling, and even outright fraud. Here's a real-world situation in which an audit provision in a contract came in handy for the would-be auditing party:

• A Saudi company signed a consignment agreement with a Florida company. Under that agreement, the Florida company would sell what was expected to be around $500 million worth of aircraft parts.

• The parties apparently didn't have any procedure in place for confirming just what parts the Saudi company had shipped to the Florida company to be sold off. (The court's opinion suggests that the Florida company might have used "creative" accounting techniques in that regard.)

• The Saudi company tried to get discovery to find out just how much the Florida company had really sold. The Florida company evidently stonewalled on producing its records.

• The district court refused to order an accounting — this, even though the parties' contract included an audit provision. The appellate court reversed and remanded, stating that the district court abused its discretion by refusing to order an accounting. *See* Zaki Kulaibee Establishment v. McFliker, 771 F.3d 1301 (11th Cir. 2014).

§ 15.6.2 Some things an audit might uncover *(skim)*

One fraud examiner asserts that "entities often implicitly trust vendors. but just as good fences make good neighbors, vendor audits produce good relationships." Craig L. Greene, Audit Those Vendors (2003). Greene lists a number of things that fraud examiners watch for, including, for example:

- fictitious "shell entities" that submit faked invoices for payment;
- cheating on:
    - shipments of goods (e.g., by short-shipping goods or sending the wrong ones) or
    - performance of services (e.g., by performing unnecessary services or by invoicing for services not performed);
- billing at higher-than-agreed prices;
- kickbacks and other forms of corruption;

and others. *See id.*

§ 16 Best Efforts Definition

§ 16.1 What does "best efforts" mean?

a. The term *best efforts* refers to the diligent making of reasonable efforts to achieve a stated objective.

b. In case of doubt, a party obligated to use best efforts need not:

1. take any unreasonable action;
2. take every conceivable reasonable action to achieve the stated objective; nor

3. materially harm its own lawful interests.

COMMENTARY

Subdivision a: The "diligent" term comes from RESTATEMENT (SECOND) OF AGENCY § 13, comment a (1957), *quoted in* T.S.I. Holdings v. Jenkins, 924 P.2d 1239, 1250, 260 Kan. 703, 720 (1996), *quoted in* Corporate Lodging Consultants, Inc. v. Bombardier Aerospace Corp., No. 6:03-cv-01467-WEB, slip op. at 9 (D. Kan. May 11, 2005).

Subdivision b attempts to reconcile the divergent holdings of some courts, as discussed below.

§ 16.2 Additional commentary

Best-efforts clauses can be (quite) problematic, because different courts have expressed very-different views as to what level of effort the term requires (see the additional commentary below). Even so, many business people *like* best-efforts provisions, and so contracts often contain them. It therefore can be a good idea to *define* "best efforts" to reduce at least some of the attendant legal uncertainty. **(W.I.D.D.: When In Doubt, Define!)**

§ 16.2.1 Why do some contracts include best-efforts terms?

Best-efforts obligations are especially common when one party grants another party *exclusive* rights, for example exclusive distribution rights or an exclusive license under a patent, trademark, or copyright. This was the case in Kevin M. Ehringer Enterpr., Inc., v. McData Serv. Corp., 646 F.3d 321 (5th Cir. 2011), where the appeals court reversed judgment on a jury's verdict that the defendant had not intended to perform its best-efforts obligation.

§ 16.2.2 A sports analogy to best efforts: Bring your "A" game

To many business people, it may seem self-evident that when a contract uses the term *best efforts*, it calls for "something more" than mere *reasonable efforts* — otherwise, why bother even saying *best efforts*? That is, *reasonable efforts* will cover a range of possibilities, while *best efforts* refers to somewhere near the top of that range.

To many business people: • "C" is a passing grade in (U.S.) schools, and is equivalent to reasonable efforts. • In contrast, *best efforts* means an "A" effort — or in sports slang, *bring your "A" game, buddy, not your "C" game*.

§ 16.2.3 Another analogy: Best speed

Here's another analogy: On major U.S. highways, the speed-limit signs often include both maximum *and* minimum speeds of (say) 60 mph and 45 mph. Those two speeds establish the upper- and lower bounds of reasonableness.

Now, suppose that a trucking company were to agree that its driver would use her "best efforts" to drive a shipment of goods from Point A to Point B on such a highway, where drivers must drive between 45 mph and 60 mph. In good weather with light traffic and a smoothly running truck, driving at 45 mph might qualify as *reasonable* efforts, but not as *best* efforts.

§ 16.2.4 Possible variation: "All reasonable efforts" instead of "best efforts"

A drafter could specify that best efforts requires the diligent making of **all** reasonable efforts. Reportedly, that's a common formulation in the UK; see Shawn C. Helms, David Harding, and John R. Phillips, Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law (JonesDay.com 2007).

A drafter could also add the phrase, leaving no stone unturned in seeking to achieve the stated objective. This language is from an opinion by the supreme court of British Columbia. See Atmospheric Diving Systems Inc. v. International Hard Suits Inc., 89 B.C.L.R. (2d) 356 (1994). The author has not been able to find the full text of this opinion freely available online. It's extensively excerpted by Ken Adams in his posting "Best Efforts" Under Canadian Law. (Warning: The present author strongly disagrees with Ken's view that "best efforts" means simply "reasonable efforts.")

§ 16.2.5 CAUTION: Best efforts might mean different things to different courts

Depending on the jurisdiction, a court might not share the view of *best efforts* just described. As one court explained, "[c]ontracting parties ordinarily use best efforts language when they are uncertain about what can be achieved, given their limited resources." *See* CKB & Assoc., Inc. v. Moore McCormack Petroleum, Inc., 809 S.W.2d 577, 581-82 (Tex. App. – Dallas 1990) (affirming

summary judgment that defendant had failed to use its best efforts; "[a]s a matter of law, no efforts cannot be best efforts")

• Some — but not all — U.S. courts have seemingly equated *best efforts* with mere *reasonable efforts*, contrary to what business people are likely to think they're getting in a best-efforts clause.

As one 2005 review of case law puts it, "For years U.S. courts have used the phrases 'reasonable efforts' and 'best efforts' interchangeably within and between opinions. Where only one of the terms is used, the best-efforts obligation frequently appears indistinguishable from a reasonable-efforts obligation. Some recent cases have gone so far as to equate best efforts and reasonable efforts." *See* Scott-Macon Securities, Inc. v. Zoltek Cos., Nos. 04 Civ. 2124 (MBM), 04 Civ. 4896 (MBM), part II-C (S.D.N.Y. May 11, 2005) (citing cases).

(Some of those cases, though, might be interpreted more narrowly as holding merely that a best-efforts obligation does not require the obligated party to make *unreasonable* efforts, while still requiring diligence in the making of *reasonable* efforts.)

• Fortunately, still other U.S. courts seem to have recognized that *best efforts* means something more than merely *reasonable efforts*.

For example, in the Tigg Corp. v. Dow Corning Corp. case, the Third Circuit held that, at least where the contract involved an exclusive-dealing arrangement, "[t]he obligation of best efforts forces the buyer/reseller to consider the best interests of the seller and itself as if they were one firm." the appellate court affirmed a trial court's judgment, based on a jury verdict, holding Dow Corning liable for breaching a best-efforts obligation in an exclusive-dealing agreement. The appellate court agreed with Dow Corning, however, that the trial court had erred in entering judgment on the amount of monetary damages Dow Corning should pay, and remanded the case for a new trial on that issue. Tigg Corp. v. Dow Corning Corp., 962 F.2d 1119 (3d Cir. 1992).

Likewise, in Macksey v. Egan, a Massachusetts appeals court construed the term *best efforts* "in the natural sense of the words as requiring that the party put its muscles to work to perform with full energy and fairness the relevant express promises and reasonable implications therefrom." Macksey v. Egan, 36 Mass. App. Ct. 463, 472, 633 N.E.2d 408 (1994) (reversing judgment on jury verdict that defendant had breached best-efforts obligation; extensive citations omitted).

• Some UK and Canadian courts have defined the standard of performance for *best efforts* as, in essence, *all reasonable efforts*. For a survey of such cases, see Shawn C. Helms, David Harding, and John R. Phillips, Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law, July 2007.

For example, in its *Atmospheric Diving Systems* opinion (1994), the supreme court of British Columbia held that *best efforts* requires "taking, in good faith, all reasonable steps to achieve the objective, carrying the process to its logical conclusion and leaving no stone unturned. … doing everything known to be usual, necessary and proper for ensuring the success of the endeavour."

Similarly, in Australia, the term *best endeavours* seems to be treated as synonymous with *all reasonable endeavours*; in its *Hospital Products* opinion (1984), that country's highest court held that "an obligation to use 'best endeavours' does not require the person who undertakes the obligation to go beyond the bounds of reason; he is required to do all he reasonably can in the circumstances to achieve the contractual object, but no more … [A] person who had given such an undertaking … in effect promised to do all he reasonably could …." Hospital Prods. Ltd v. United States Surgical Corp., 1984 HCA 64, 156 CLR 41, paras. 24, 25.

Adding to the difficulty, some U.S. courts have held that the term *best efforts* is too vague to be enforceable *unless* the parties agree to some sort of objective standard of performance, "some kind of goal or guideline against which best efforts may be measured," in a case quoted by the court in the Kevin Ehringer Enterprises case.

One court held that "as promptly as practicable" and "in the most expeditious manner possible" were sufficient to meet that requirement. *See* Herrmann Holdings Ltd. v. Lucent Technologies Inc., 302 F.3d 552, 559-61 (5th Cir. 2002) (reversing dismissal under Rule 12(b)(6); citing cases).

With all of this in mind, the definition of *best efforts* in this clause attempts to draw at least a somewhat-bright line that provides an objective standard of performance (albeit one that might require a trial to determine whether it had been met).

[TO DO: Look up California law – all efforts even if bankruptcy? https://www.linkedin.com/grp/post/4036673-6027114806685810691]

§ 16.2.6 "Best efforts" might be held to be unenforceably vague

According to some U.S. courts, the term *best efforts* is too vague to be enforceable *unless* the parties agree to some sort of objective standard of performance. In one case, the Fifth Circuit, quoting a Texas appellate court, held that under state law, "to be enforceable, a best efforts contract must set some kind of goal or guideline against which best efforts may be measured." Kevin M. Ehringer Enterprises v. McData Serv. Corp., 646 F.3d 321, 326 (5th Cir. 2011) (emphasis added, citation omitted).

§ 16.2.7 "Every effort" clauses and the like are often interpreted similarly

"When confronted with idiosyncratic contractual language expressing sentiments akin to doing all that one can or 'all that is necessary' to complete a task, Texas courts often interpret such language as requiring 'best efforts'–an expression with a more clearly established meaning and history." Hoffman v. L & M Arts, 774 F. Supp. 2d 826, 833 (N.D. Tex. 2011) (citing cases).

"[C]ourts and arbitrators interpreting similar phrases *[the phrase in question was 'every effort']* have determined, like the district court here, that they impose an obligation to make all reasonable efforts to reach the identified end." Aeronautical Indus. Dist. Lodge 91 v. United Tech. Corp.., 230 F.3d 569, 578 (2d Cir. 2000) (citations omitted).

§ 16.2.8 *Asking for* a best-efforts commitment can make business sense

Sure, there's some legal uncertainty associated with a best-efforts commitment. But from a business perspective it can make good sense to ask the other side for such a commitment anyway: a party that makes a best-efforts commitment — to the extent that it later thinks about that commitment at all — will at least be aware that it might well have to make more than just routine, day-to-day, "reasonable" efforts. That alone might be worthwhile to the party asking for the commitment.

§ 16.2.9 CAUTION: *Agreeing to* a best-efforts commitment might lead to trouble

If you commit to a best-efforts obligation, and the other side later accuses you of breaching that obligation, and you can't settle the dispute, then you're likely

to have to try the case instead of being able to get rid of it on summary judgment. That's because:

- No matter what you do, if a problem arises, the other side's lawyers, with 20-20 hindsight, will argue that there were X number of things that you supposedly *could* have done to achieve the agreed goal.
- You're unlikely to be able to get *summary* judgment that you didn't breach the best-efforts obligation. Instead, you're likely to have to go to the trouble and expense of a full trial or arbitration hearing. The judge or arbitrator might well say that the question involves disputed issues of material fact. Those issues will have to be resolved by witness testimony and cross-examination about such things as industry practices; then-existing conditions; etc. According to the rules of procedure in many jurisdictions, that will require a trial and will not be able to be done in a summary proceeding. Your motion for summary judgment is therefore likely to be denied.
- The tribunal, after hearing the evidence, may find that in fact you did not use your best efforts. If that happens, you're going to have a very hard time convincing an appeals court to overturn that finding.

§ 16.2.10 Best-efforts takeaways

Drafters should try very hard to be as precise as possible in specifying just what goal the best efforts are to be directed to achieving.

And obligated parties should think long and hard before agreeing to a best-efforts obligation, because in the long run it could prove to be burdensome and expensive.

§ 16.2.11 Optional reading about best efforts

- Brian D. Hershberg and Alex J. Speyer, Contractual Standards: Distinctions without a Difference?, https://goo.gl/iWCTfN (MayerBrown.com) (archive: https://goo.gl/GVhBjQ [archive.org]) (accessed Aug. 22, 2018).
- John Pavolotsky, Best efforts clauses – what buyers expect versus how suppliers respond (IACCM.com 2015).

- Shawn C. Helms, David Harding, and John R. Phillips, Best Efforts and Endeavours – Case Analysis and Practical Guidance Under U.S. and U.K. Law (JonesDay.com 2007).
- Jonathan Pink, Making the Best of a Best Efforts Clause (Blogspot.com 2008).
- Janet T. Erskine, Best Efforts versus Reasonable Efforts: Canada and Australia (McCarthy.ca 2007).
- Rob Park, Putting the "Best" in Best Efforts, 73 U. CHI. L. REV. 705 (2006).
- Aaron Singer, What do "Best Efforts" and "Reasonable Commercial Efforts" mean? (BCRElinks.com 2003).

§ 17 Binding Agreement

To help forestall hindsight claims that a party supposedly didn't understand the AGREEMENT when it agreed to it, each party acknowledges that:

1. it has read and understood the AGREEMENT;
2. it agrees to be bound by the AGREEMENT — except for provisions, if any, that are clearly identified as nonbinding; and
3. the AGREEMENT will also bind each party's heirs, legal representatives, successors, and permitted assigns, if any.

COMMENTARY

> The AGREEMENT's terms might include some specified nonbinding provisions, for example if the parties' agreement is a letter of intent (concerning which, see generally **Error! Reference source not found.**).

§ 18 Blue-Pencil Request

IF: A tribunal of competent jurisdiction holds that a provision of the AGREEMENT is invalid, void, unenforceable, or otherwise defective; THEN: The parties' intent is as follows:

a. All other provisions of the AGREEMENT are to remain enforceable;

b. The holding of defectiveness is to apply:

1. only in the jurisdiction of the tribunal issuing the holding; and

2. only for so long as the holding remains in effect; and

c. The tribunal is respectfully requested to reform the defective provision, if practicable, to the minimum extent necessary to cure the defect while still given effect to the intent of the defective provision.

COMMENTARY

CAUTION: This "blue-pencil" request — seen most often in connection with overly-restrictive noncompetition covenants— could in theory lead to unpredictable results; moreover, some courts refuse to engage in blue-penciling even when requested by the parties. See generally Kenneth J. Vanko, A Quick State-By-State Guide on the Blue-Pencil Rule, archived at https://perma.cc/CMF7-LHJB.

For commentary about a UK supreme court decision addressing blue-penciling, see Seyfarth Shaw LLP, First UK Supreme Court Decision on Restrictive Covenants for 100 years (JDSupra 2019), *discussing* Tillman v. Egon Zehnder Ltd., [2019] UKSC 32 at ¶¶ 54 et seq.

§ 19 Board of Directors Definition

The term *board of directors* refers to the principal governing body of an organization, such as (without limitation) the board of directors of an American corporation.

COMMENTARY

This is a convenience definition, allowing drafters to refer generically to a "board of directors" without having to spell out different variations for, e.g., limited liability companies, foreign organizations, and the like.

§ 20 Business Day Definition

The term *business day* refers to a day other than a Saturday; a Sunday; or a holiday on which banks in New York City are generally closed.

(See also the definition of *day*, below.)

COMMENTARY

> For time periods greater than five- or ten business days, it might be simpler to use the term *calendar day*(and indeed for all time periods), so as not to have to figure out what counts as a business day, especially if different jurisdictions are involved. *See* a 2015 LinkedIn discussion on that subject (membership required).

§ 21 Calendar Year Definition

a. The term *calendar year* refers to a year according to the Gregorian calendar, beginning at the beginning of January 1 and ending at the end of the following December 31.

b. An *interval* of a calendar year, specified as beginning at any time on a particular date or as following a particular date, ends at exactly 12:00:00 midnight at the *beginning* of the same date one year afterwards. EXAMPLE: A period of one calendar year following January 2, 20x5 ends at 12:00:00 midnight at the *beginning* of January 2, 20x6.

COMMENTARY

> Many parties entering into contracts, even in non-Western countries, will likely operate on the West's conventional Gregorian calendar, but that might not be the case in, e.g., Muslim countries. See generally the blog post and comments at Ken Adams's post, Referring to the Gregorian calendar? (Nov. 14, 2013).
>
> Note the use of "12:00:00 midnight *at the beginning* of the same date …" to remove ambiguity about whether a calendar-year interval ends at the beginning- or end of the anniversary date.

§ 22 Certify Definition

When a party "certifies" an assertion (in a "certification" or "certificate"), the certifying party is declaring:

1. that the assertion is true;

2. that, within a reasonable time before certifying the assertion, the certifying party made a reasonable investigation to confirm that the assertion was true;

3. that the certifying party intends for the other party to rely on the certification; and

4. that it is reasonable for the other party to rely on the certification for purposes relating to the AGREEMENT.

§ 23 Claim Definition

a. The term claim refers to any request or demand for damages or other relief by an individual or organization (including without limitation a governmental entity).

b. A claim might be set forth:

1. in a written communication such as, for example, a letter or email; and/or

2. in a filing with (or submission to) a tribunal of competent jurisdiction.

COMMENTARY

This definition of *claim* draws on ideas set out in an article by D. Hull Youngblood, Jr. and Peter N. Flocos, Drafting And Enforcing Complex Indemnification Provisions, THE PRACTICAL LAWYER, Aug. 2010, p. 21, at 27.

When appropriate, drafters should consider specifying *written* claims, to avoid putting a hair trigger on provisions that depend on claims being made, e.g., claim-defense requirements.

§ 24 Clear and Convincing Evidence Definition

For an asserted fact to be proved by *clear and convincing evidence*, the evidence must be sufficient to produce, in the mind of the factfinder, an abiding conviction that the assertion's truth is highly probable.

COMMENTARY

This definition restates, in somewhat-plainer language, the standard set out by the Supreme Court of the United States. *See* Colorado v. New Mexico, 467 U.S. 310, 316 (1984) (original proceeding); *see also* Ninth Circuit Model Jury Instructions 1.7 (quoting *Colorado*).

Contracts sometimes require facts to be established by clear and convincing evidence. For example, an indemnification agreement between a company (DAOU Systems) and its officers states that: "… it shall in any event be presumed that Indemnitee has at all times acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Company. *Anyone seeking to overcome this presumption shall have the burden of proof and the burden of persuasion by clear and convincing evidence.*" Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 YALE L.J. 814, 867 (2006) (footnote 166 omitted, emphasis by the authors), archived at http://perma.cc/R46W-H5JA.

§ 25 Code of Conduct Modification

§ 25.1 When would this Modification apply?

This Modification applies if the AGREEMENT requires one or more parties (each, an "**Obligated Party**") to abide by a code of conduct specified by a party.

COMMENTARY

CAUTION: A customer with bargaining power will sometimes demand that its suppliers agree to comply with the customer's sometimes-lengthy code of conduct. That can be a real challenge for a supplier:

- If the supplier has numerous customers, it can be a significant operational burden for the supplier to have to try to manage compliance with X different codes of conduct.
- It's a non-trivial cost for a supplier just to have to *read* a given customer's code of conduct.

- In the author's experience, customers often just want the ability, in case of a code-of-conduct violation by a supplier, to be able to say publicly, "We terminated our contract with that supplier."
- As will be seen below, this Protocol therefore sets up such termination as a (usually) exclusive remedy for breach of the code of conduct.

§ 25.2 What would happen if an Obligated Party were to violate the code of conduct?

IF: An Obligated Party violates the specified code of conduct; THEN: Except as otherwise provided in this Modification, the other party's **EXCLUSIVE REMEDY** will be — in the other party's sole discretion — to terminate the AGREEMENT by giving notice of termination to the breaching party.

§ 25.3 What if the violation is also a separate breach?

This Modification will not preclude a party from seeking remedies for an Obligated Party's violation of a code of conduct that would breach the AGREEMENT even in the absence of a commitment to abide by the code of conduct.

§ 26 Commercially Reasonable Definition

a. *(Defining the term by example:)* The term *commercially reasonable efforts* refers to those efforts that prudent people, experienced in the relevant business, would generally regard as sufficient, in the relevant circumstances, to constitute reasonable efforts.

b. In case of doubt: If the AGREEMENT requires a party to make commercially reasonable efforts to do something (referred to as "X"), then the party:

1. need not actually succeed in accomplishing X;
2. need not make all reasonable efforts to accomplish X; and
3. may take its own business interests into account.

COMMENTARY

Many business people are drawn to the term *commercially reasonable*, which can speed up contract negotiations, but the vagueness of the term poses a risk of disagreement later. See the extended commentary at § 26.2.1.

Subdivision a: A prudence standard played a role in defining *commercially reasonable efforts* in a major lawsuit between the (U.S.) state of Indiana and IBM Corporation, as discussed in the extended commentary at § 26.2.4.

Subdivision b.1: A court might interpret a commercially reasonable-efforts obligation as requiring a party *actually to do X*; see the extended commentary at § 26.2.2

Subdivision b.2: Business people Clients be taken aback to learn that, absent an agreed definition, the term *commercially reasonable efforts* might require the making of **all** reasonable efforts; see the extended commentary at § 26.2.2.

Subdivision b.3: A California federal district court, reviewing (sparse) precedent, held that a party obligated to use commercially reasonable efforts could permissibly take into account its own business interests. See Citri-Lite Co. v. Cott Beverages, Inc., No. 1:07-cv-01075, slip op. at 45 (E.D. Cal. Sept. 30, 2011) (findings of fact and conclusions of law; citing cases), *aff'd*, No. 11-17609 (9th Cir. Nov. 21, 2013) (unpublished).

§ 26.2 Additional commentary

§ 26.2.1 Why business people sometimes use the term

Commercially reasonable is a "let's kick the can down the road" term, as in, *we'll deal with this later*. The term is often used in routine contracts in lieu of stating more precise standards of performance, especially for matters for which the parties are confident they can amicably resolve any disputes that might arise. Many business people are drawn to such clauses, which can speed up contract negotiations, even though the vagueness of the term poses a risk of disagreement later.

Clients, though, can sometimes be overconfident in their expectation that "we'll just work it out later if the issue ever comes up." They can lose sight of the fact that the congenial individuals who negotiated the contract might not be in the

same jobs later. Hindsight disagreements about what's required to be "commercially reasonable" have sometimes led to litigation, as discussed below.

§ 26.2.2 Left undefined, "commercially reasonable efforts" might mean *all* reasonable efforts

Clients might be taken aback to learn that, absent an agreed definition, the term *commercially reasonable efforts* might require the making of **all** reasonable efforts: In a 2017 opinion, the Delaware supreme court held that the term *commercially reasonable efforts* required taking "all reasonable steps" to achieve the stated objective. Williams Companies, Inc. v. Energy Transfer Equity, L.P., 159 A.3d 264, 272-73 (Del. 2017) (affirming that party had not breached its efforts obligation).

(This, even though the contract elsewhere used the term *reasonable best efforts*; the principle of expressio unius, exclusio alterius might have suggested that the two terms were intended to have different meanings. *See id.* at 267.)

In a dissent on other grounds, Chief Justice Strine opined that *commercially reasonable efforts* is "a comparatively strong" commitment, one that is only "slightly more limited" than best efforts. *Id.* at 276 & n.45 (Strine, C.J., dissenting) (citation omitted).

§ 26.2.3 Balancing the interests

A California federal district court, reviewing (sparse) precedent, held that a party obligated to use commercially reasonable efforts could permissibly take into account its own business interests:

> Defendant correctly points out that the limited case law regarding the meaning of "commercially reasonable efforts" is consistent with the principle that commercial practices by themselves provide too narrow a definition and that the performing party may consider its own economic business interests in rendering performance.

Citri-Lite Co. v. Cott Beverages, Inc., No. 1:07-cv-01075, slip op. at 45 (E.D. Cal. Sept. 30, 2011) (findings of fact and conclusions of law; citing cases), *aff'd*, No. 11-17609 (9th Cir. Nov. 21, 2013) (unpublished). (Hat tip: Dallas attorney Gary Powell.)

A tangentially related issue arose in a 2014 English case stemming from the financial crisis of 2008: There, Barclays Bank had the right to consent to a particular type of financial transaction, but it was obligated to grant or withhold such consent in a commercially reasonable manner. The England and Wales Court of Appeals rejected Unicredit's argument that this meant that Barclays was required to take *Unicredit's* interests into account, not merely Barclays's own interests. Barclays Bank PLC v. Unicredit Bank AG, [2014] EWCA Civ 302, ¶ 16 (affirming trial-court ruling).

§ 26.2.4 A court might apply a "prudence" standard

In a major lawsuit between the (U.S.) state of Indiana and IBM, the contract in question took a stricter view of *commercially reasonable efforts*. That contract defined the term as "taking commercially reasonable steps *[circularity, anyone?]* and performing in such a manner as a well managed entity would undertake with respect to a matter in which it was acting in a *determined, prudent*, businesslike and reasonable manner to achieve a particular result." Indiana v. IBM Corp., 4 N.E.3d 696, 716 n.12 (Ind. App. 2014) (reversing trial court in pertinent part) (emphasis added, citation to trial record omitted), *affirmed*, 51 N.E.3d 150 (Ind. 2016), *after remand*, 112 N.E.3d 1088 (Ind. App. 2018) (affirming in part, reversing in part, trial court's recalculation of damages), *affirmed in pertinent part,* No. 19S-PL-19 (Ind. June 26, 2019).

In that case, the contract in suit called for IBM to overhaul Indiana's computer system for managing its welfare program; the project ended up being in essence a train wreck, after which the parties sued each other. The trial court rendered judgment for IBM, but a state appellate court reversed in part and remanded, holding that while IBM was entitled to be paid for its work, that payment would be subject to offset (determined on remand), on grounds that IBM had materially breached the contract.

§ 26.2.5 Commercial reasonableness might be proved up indirectly

A party seeking to prove (or disprove) commercial reasonableness of a transaction, contract term, decision, etc., might want to focus on the process by which the transaction, etc., came into being. "Where two sophisticated businesses reach a hard-fought agreement through lengthy negotiations, it is difficult to conclude that any negotiated term placed in their contract is commercially unreasonable." West Texas Transmission, LP v. Enron Corp., 907 F.2d 1554, 1563 (5th Cir. 1990) (affirming district court's refusal to grant specific performance of right of first refusal) (extensive citations omitted).

§ 26.2.6 Specific cases [updated occasionally]

In a lawsuit over a merger agreement, Delaware's chancery court ruled that an obligation to use commercially reasonable efforts to close the merger by a certain date — pending regulatory approval — did not require a party to warn the other party that it intended to walk away from the deal if the regulatory approval had not been received by that date. See Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc., No. 2018-0927-SG (Del. Ch. Mar. 14, 2019).

§ 27 Confidential Information Protocol

§ 27.1 Definition of Confidential Information

§ 27.1.1 Which party's information is potentially protectable?

Unless the AGREEMENT clearly specifies otherwise:

a. Each party is a "**Disclosing Party**" whose Confidential Information (defined below) is protectable.

b. Any party accessing Confidential Information under the AGREEMENT is referred to as a "**Receiving Party**."

COMMENTARY

A confidentiality agreement protecting each party's information will often be a better idea than a one-way agreement, as discussed in more detail in § 27.7.2. (Keep in mind, however, that a nominally-two-way agreement can still be drafted to favor the role that the drafting party expects to play.)

CAUTION: Drafters representing *disclosing* parties should be sure that each prospective *receiving* party is a signatory to the confidentiality obligations, because the disclosing party might not have any recourse against a non-signatory. This happened in Knight Capital Partners Corp. v. Henkel AG, No. 18-2189 (6th Cir. Jul. 16, 2019), *affirming in pertinent part* No. 16-12022 (E.D. Mich. Oct. 11, 2018) (granting defendant's motion for summary judgment).

§ 27.1.2 What types of information are eligible to be considered Confidential Information?

a. Any otherwise-eligible information disclosed by a Disclosing Party to a Receiving Party under the AGREEMENT is referred to as "**Confidential Information**."

b. All types of information are potentially eligible for protection as Confidential Information, so long as the information is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

c. The term *Confidential Information* likewise encompasses the following, prepared by (or for, or on behalf of) the Receiving Party, when they contain Confidential Information: Analyses; compilations; forecasts; interpretations; notes; reports; studies; summaries; and similar materials.

COMMENTARY

Subdivision b: The language, "the subject of efforts reasonable under the circumstances," is adapted from the Uniform Trade Secrets Act; see, e.g., Cal. Civ. Code § 3426.1(d)(2); Tex. Civ. Practice & Rem. Code § 134A.002(6)(B).

Subdivision b: Some drafters like to go into even more detail in stating that Confidential Information includes various specific categories of information. It's a judgment call whether the benefit of doing so would outweigh the time burden (and the opportunities for mistakes) of adding yet-more verbiage that the parties must review.

Subdivision b: For some confidentiality agreements, drafters might want to consider limiting the categories of potentially protectable information.

Subdivision c: This is a typical requirement in confidentiality agreements.

§ 27.1.3 What about a special "secret sauce" compilation of nonconfidential information?

In case of doubt: Confidential Information can include, without limitation, "secret sauce" confidential selections and/or combinations of specific items of *nonconfidential* information.

COMMENTARY

It's well-established in U.S. law that when a party makes a specific, "secret sauce" selection or combination of one or more particular items of nonconfidential information, the selection or combination itself can qualify as Confidential Information, even if the individual items of information are not themselves confidential. (Think of Kentucky Fried Chicken's "secret blend of 11 herbs and spices.") See, e.g., • AirFacts, Inc. v. de Amezaga, 909 F.3d 84, 88-89, 96-97 (4th Cir. 2018) (proprietary flowcharts showing public information in a useful form); • Tewari De-Ox Systems, Inc., v. Mountain States/Rosen, L.L.C., 637 F.3d 604, 613-14 (5th Cir. 2010) (commonly-known information about meat packing; citing cases); • Hertz v. Luzenac Group, 576 F.3d 1103, 1110 (10th Cir. 2009) (process for producing vinyl silane-coated talc); • Integrated Cash Mgmt. Servs., Inc. v. Digital Transactions, Inc., 920 F.2d 171, 174 (2d Cir. 1990) ("winning combination" of generic software programs).

§ 27.1.4 **Is third-party information protectable?**

Yes:

a. Third-party information in the possession of a Disclosing Party is considered to be Confidential Information if the information is otherwise eligible — but subject, however, to the Disclosing Party's obligations in subdivision c.

b. *Disclosing Party representation:* By providing the information to the Receiving Party, the Disclosing Party represents and warrants to the Receiving Party that the Disclosing Party is authorized to make the third-party information available to the Receiving Party.

c. *Disclosing Party indemnity obligation:* By providing the information to the Receiving Party, the Disclosing Party agrees to defend and indemnify (§ 53) the Receiving Party and its Protected Group (§ 116) against any claim, by the third party, that the Disclosing Party allegedly was not authorized to make the third party's information available to the Receiving Party.

COMMENTARY

Thought experiment: Suppose that a disclosing party ("Alice") furnishes a receiving party ("Bob") with confidential information that belongs to a third party ("Carol"), which Carol previously provided to Alice under a

separate confidentiality agreement. In that situation, Bob should keep in mind that if Alice *wasn't* authorized to share Carol's information with Bob, then Carol might not sue just Alice for breach of their agreement: She might also sue Bob, as well, for tortious interference with the Alice-Carol agreement. Obviously, Bob doesn't want to find himself in that situation.

Subdivision b puts the disclosure of third-party information into the category of representations, with its own set of potentially-grave legal consequences for the Disclosing Party if it acts negligently, recklessly, or fraudulently in making the disclosure.

Subdivision c: As with any defense- and indemnity obligation, **the receiving party should consider whether the disclosing party has the financial wherewithal** to meet the obligation — and whether to seek a further contractual commitment to maintain appropriate insurance coverage. [TO DO: LINK]

§ 27.1.5 ☑ Information marked "confidential" is presumed to be so

a. Confidential Information need not be marked as such unless the AGREEMENT clearly states otherwise (see the Marking Requirement Option in § 27.1.6).

b. Information that is marked as confidential, in a manner that reasonably calls attention to the claim of confidentiality, is to be rebuttably presumed to be Confidential Information.

COMMENTARY

This section represents a compromise between a receiving party's attitude ("Hey, if you forget to mark your information, it's fair game for me to use or disclose as I please; too bad!") versus a disclosing party's desire not to have to bother marking its information. See also the optional § 27.1.6 (marking requirement for Confidential Information).

§ 27.1.6 ❑ Marking Requirement Option

This Option applies only if the AGREEMENT clearly so states.

a. *Requirement:* Except as provided below, information of a Disclosing Party is not eligible to be Confidential Information unless it is disclosed in a tangible form that prominently marked as such with a visible confidentiality legend.

b. *Catch-up marking:* IF: The information is not marked in accordance with subdivision a at the time of initial disclosure; THEN:

1. The Disclosing Party must clearly advise the Receiving Party, at the time of the initial disclosure, that the information is confidential; and

2. The Disclosing Party must provide the Receiving Party with a follow-up written disclosure or summary of the information — which must be marked as confidential — within ten business days after an initial unmarked disclosure; and

c. *Notice of catch-up marking:* The Disclosing Party must give the Receiving Party notice of the follow-up written disclosure as a reminder of the confidential nature of the information.

d. *Marking exception for internal files*: Information need not be marked as confidential if the information is provided to the Receiving Party solely by giving the Receiving Party access to the Disclosing Party's internal files without permission to make notes or copies.

e. ❑ *Marking exception for clearly confidential information:* Information need not be marked as confidential if the information would be recognized, by a reasonable person familiar with the type of information in question, as clearly being Confidential Information.

COMMENTARY

See the extended discussion of confidential information marking at § 27.7.4.

CAUTION: **Imposing a marking requirement might be unrealistic**, because disclosing parties often simply forget to mark their confidential information. See Larry Schroepfer, Nondisclosure Agreements: To Mark, or not to Mark?, at https://perma.cc/6HXL-KP6D (2016). An English licensing lawyer adds: "[P]eople very rarely comply with the marking requirement; they are therefore shooting themselves in the foot by accepting such a requirement." Mark Anderson (in a comment to the above).

CAUTION: **Agreeing to a marking requirement, but then not complying with it, can be fatal to a claim of confidentiality,** as discussed at § 27.7.4.3 and § 27.7.4.4.

Subdivision b.2: The catch-up marking option is pretty standard in confidentiality agreements when marking is required — but (to reiterate) agreeing to a marking requirement, and then failing to comply with it, can be fatal to the Disclosing Party's rights, as discussed in more detail at § 27.7.4.

Subdivision c: If a Disclosing Party were to make an initial unmarked disclosure but then later do catch-up marking, the Receiving Party likely would want a formal written reminder that the information is confidential. Sending the notice would help document the fact that the Disclosing Party did in fact do catch-up marking; the Disclosing Party might later be grateful that it had left a paper trail on that point.

Subdivision d: This exception recognizes that It might well be burdensome for a disclosing party to have to go through its internal files to ensure that all confidential information was marked, on pain of losing confidentiality protection.

Subdivision e: Disclosing parties often prefer this approach to marking, because it relieves them of any *obligation* to mark.

§ 27.2 Exclusions from Confidential Information status

§ 27.2.1 What information is ineligible to be Confidential Information?

Three categories of information are excluded from Confidential Information status, as follows.

a. Confidential Information does not include **"generally available"** information; the emphasized term refers to information that is shown to be or to have become — without breach of the AGREEMENT — in one or both of the following categories:

1. generally known to people within the circles that normally deal with the kind of information in question, and/or
2. readily accessible or -ascertainable to such people without using unlawful means;

b. Confidential Information does not include information that is "**independently possessed**" by the Receiving Party; the quoted term refers

to information that is shown — with reasonable corroboration of testimony by interested witnesses — to be in any of the following subcategories:

1. the Receiving Party **already knew** the information when the Disclosing Party provided it;

2. a **third party** made the information available to the Receiving Party without violating an obligation of confidence to the Disclosing Party; and/or

3. the information was **developed independently** by the Receiving Party, that is, without using information of the Disclosing Party that was not itself excluded from the definition of Confidential Information; and

c. Confidential Information does not include information that is **disclosed by** the Disclosing Party (or with its permission) to one or more third parties **without restrictions** comparable to those of the AGREEMENT.

COMMENTARY

CAUTION: Applicable law might impose confidentiality restrictions on information (for example, personal health information or export-controls information) even if the information came within one of the exclusions in this section.

Some wordier confidentiality provisions list five specific exclusion categories; this section combines those into three broader categories.

Subdivision a: **This "generally available" exclusion is a standard feature of confidentiality agreements (and the law).** Its specific language is a mash-up of the definitions in: • the UK's 2018 draft regulations implementing the EU Trade Secrets Directive (2016/943); see UK IP Office, Consultation on draft regulations concerning trade secrets at 19 (2018), archived at https://perma.cc/PHT8-DQFJ; and • section 1(4)(i) of the U.S. Uniform Trade Secret Act, https://perma.cc/XK9G-CLJA at 5.

Generally available information includes, for example, information that can be found: • in a published book; • on a Web site; • in a magazine, journal, or other publication; • in an issued patent or a published patent application. (These aren't the only possibilities.)

If information is generally available, but others don't know that a Disclosing Party is using it, then *the fact of the Disclosing Party's use* of

the information could separately qualify as Confidential Information, even though the information being used is itself generally available. [TO DO: Find case citation]

Subdivision a.2: The "without using *unlawful* means" provision is intended to be more definitive than "without using *improper* means," because the latter term can give rise to disputes. In an old case, the Fifth Circuit held that when aerial photographers — hired by an unknown party — had flown in circles above an unfinished chemical plant and taken photographs, that constituted trade-secret misappropriation under Texas law. See E. I. duPont deNemours & Co. v. Christopher, 431 F.2d 1012, 1015 (5th Cir. 1970) (affirming photographers' denial of motion to dismiss).

Subdivision b **Concerning the corroboration requirement, a disclosing party will sometimes propose an even-stiffer obligation,** namely requiring the receiving party to prove any exclusion from confidentiality with *documentary evidence*. As a compromise, this section borrows the corroboration requirement from (U.S.) patent to help guard against the possibility that witnesses might "describe [their] actions in an unjustifiably self-serving manner .... The purpose of corroboration [is] to prevent fraud, by providing independent confirmation of the [witness's] testimony." Sandt Technology, Ltd. v. Resco Metal & Plastics Corp., 264 F.3d 1344, 1350 (Fed. Cir. 2001) (cleaned up); see also the additional discussion at § 35.

Subdivision b.2: If a third party has the information in question, and isn't obligated to keep the information secret, then it's tough for the Disclosing Party to argue that the information really is the confidential information of the Disclosing Party.

Subdivision b.3: CAUTION: As a practical matter, **an accused misappropriator of confidential information might have a hard time convincing a judge or jury that it independently developed the allegedly-misappropriated information on its own**, unless the defendant had made "clean room" efforts to wall off the independent developers from anyone who had had access to the confidential information. For an example, see Celeritas Technologies Ltd. v. Rockwell Int'l, Inc., 150 F.3d 1354 (1998), where a federal-court jury in Los Angeles awarded a startup company more than $57 million because the jury found that Rockwell had breached a confidentiality agreement; the jury rejected Rockwell's assertion that its engineers had independently developed the technology in question after those same engineers had been exposed to the startup company's information. (Disclosure: The author was part of Rockwell's trial team in that case.)

On a tangential note: An Oregon court held that a departed employee could misappropriate the former employer's confidential customer information merely by remembering it. See Pelican Bay Forest Products, Inc. v. W. Timber Products, Inc., 297 Or. App. 417 (2019) (reversing and remanding summary judgment in favor of former employee and his new employer).

Subdivision c: A disclosing party might try to omit this exclusion, but in such a case the receiving party would probably push back, on theory that if you [the disclosing party] allow others to use its information without legal restriction, then I get to do the same thing. • Moreover, it's unclear what the legal effect of omitting this exclusion would be, because by law (at least in the U.S.), such a disclosure of information to a third party without confidentiality restrictions would have the effect of killing any trade-secret rights the discloser might have had in the information, as discussed in § 27.7.5.

§ 27.2.2 What effect does a subpoena, etc., have?

Confidential Information does not lose its status as such merely because the information becomes the subject of a subpoena, search warrant, etc.; that possibility is addressed at § 27.4.7 (compulsory legal demands).

COMMENTARY

It would be undesirable to totally strip away trade-secret protection from otherwise-confidential information solely because it has been requested under subpoena, etc., because it might well be possible to get a court order limiting what the requester was allowed to do with the information. See the discussion at § 27.4.7 (compulsory legal demands).

§ 27.3 Confidentiality Obligations

§ 27.3.1 What must a Receiving Party do with Confidential Information?

a. A Receiving Party must take appropriate measures to safeguard Confidential Information; those measures must be, at a minimum:

1. not less than whatever reasonable people in business, in comparable circumstances, would do; and

2. not less than the protective measures that the Receiving Party uses to safeguard its own confidential information of comparable value.

b. ❑ The Receiving Party must keep all Confidential Information segregated from other information, so as to facilitate any necessary return or destruction of the Confidential Information.

COMMENTARY

This section represents a typical formulation of the secrecy measures required of a Receiving Party. In many situations, these "standard" precautions are likely to satisfy the disclosing party's desires, but for some types of Confidential Information, a disclosing party might want to insist on special precautions — especially in the era of criminal hackers, and even state actors, breaking into insufficiently-secure computer systems and stealing valuable information, such as happened to Sony Pictures Entertainment, allegedly at the hands of North Korea, and to Home Depot, which booked a charge of $161 million after a 2014 theft of customers' credit-card data

If a Disclosing Party were to fail to require the Receiving Party to take reasonable secrecy precautions to protect Confidential Information — including restricting disclosure of the information by the Receiving Party — **that failure could jeopardize or even destroy the Disclosing Party's legal rights** in the information. See § 27.7.5 for real-world examples.

Subdivision b: See also the return-or-destruction provisions in § 27.4.14. This requirement could well be unduly burdensome; on the other hand, a segregation requirement might have been useful in S.W. Energy Prod. Co. v. Berry-Helfand, 491 S.W.3d 699 (Tex. 2016). In that case, an independent oil-and-gas reservoir engineer disclosed trade-secret information to a production company under a nondisclosure agreement; when the relationship waned, the engineer asked for the information to be returned, but that proved problematic, as one individual ended up retaining some of the information in his files. *See id.* at 708. (The jury awarded more than $11 million in damages, but the state supreme court held that the expert testimony did not support the entire amount of the award and so remanded for a new trial. *See id.* at 721.)

§ 27.3.2 What must a Receiving Party not do with Confidential Information?

a. A Receiving Party must not take any of the following actions without the Disclosing Party's clear, prior, written consent (in the AGREEMENT or otherwise):

1. disclose or use Confidential Information;

2. copy, duplicate, create excerpts of, or make audio- or visual recordings of Confidential Information.

b. A Receiving Party must not take any action with Confidential Information that would violate applicable law.

§ 27.3.3 Must a Receiving Party help out against misappropriators?

Yes:

a. IF: A Receiving Party suspects someone is disclosing or using Confidential Information without the relevant Disclosing Party's permission; THEN: The Receiving Party must promptly report its suspicions to the Disclosing Party.

b. If the Disclosing Party so requests, the Receiving Party must — at the Disclosing Party's expense — provide reasonable cooperation with the Disclosing Party and/or its legal counsel in investigating and/or taking legal action against possible misappropriation. (NOTE: This subdivision b applies whether or not the possible misappropriation was something that the Receiving Party had reported to the Disclosing Party.)

c. The Receiving Party's cooperation obligation includes, without limitation, providing the Disclosing Party with any evidence that reasonably requested by the Disclosing Party and/or the Disclosing Party's counsel concerning the possible misappropriation.

§ 27.3.4 Are these confidentiality obligations "fiduciary" in nature?

No — just because the Receiving Party is agreeing to preserve Confidential Information in confidence, that does not mean:

1. that the Receiving Party is a fiduciary of the Disclosing Party, nor

2. that the parties have entered into a "confidential relationship," which has significantly different connotations than an agreement to preserve information in confidence.

COMMENTARY

A receiving party likely would not want to take on the higher burden of entering into a fiduciary relationship with the disclosing party. ¶ Opinions seem to vary as to whether the term *fiduciary relationship* and *confidential relationship* are synonyms; the answer might depend on the jurisdiction. *See* John A. Day, Difference Between Fiduciary Relationships and Confidential Relationships (JohnDayLegal.com) (citing Tennessee cases).

§ 27.3.5 How long will these confidentiality obligations remain in effect?

The confidentiality obligations of this Protocol will continue to apply to particular Confidential Information for as long as the information does not come within one or more of the exclusion categories in this Protocol.

COMMENTARY

A *receiving* party might want confidentiality obligations to expire at a time certain, e.g., X years after the effective date of the parties' agreement. A *disclosing* party might be OK with that if the information in question is likely to have lost its value by then — but the disclosing party might balk if the information was a valuable trade secret that could provide a competitive advantage for years to come.

§ 27.3.6 Will the Receiving Party be free to do what it wants after that?

Not necessarily: Termination or expiration of the Confidential Information obligations of the AGREEMENT:

1. will not waive or otherwise affect the Disclosing Party's ability to enforce its other intellectual-property rights (for example, copyrights and patents) against the Receiving Party except to the

extent, if any, that the parties expressly agree otherwise in writing; and

2. will not affect any obligation of confidentiality imposed by law.

§ 27.4 Uses and disclosures of Confidential Information

§ 27.4.1 What <u>may</u> the Receiving Party do with Confidential Information?

During the term of the AGREEMENT, a Receiving Party may use Confidential Information only to the extent reasonably necessary for one or more of the following purposes:

1. performing the Receiving Party's obligations, and/or exercising the Receiving Party's rights, under the AGREEMENT;
2. assessing whether to enter into another agreement with the Disclosing Party; and
3. any other particular authorized uses expressly agreed to in writing by the parties.

COMMENTARY

Many confidential-information clause templates don't specify any preauthorized uses or disclosures of Confidential Information; typically, the parties end up reinventing the wheel by negotiating some fairly standard categories of authorized use. To save that time and effort, this provision simply goes ahead and pre-authorizes some of those particular categories of use and disclosures.

If this Confidential Information Module is part of a larger agreement that addresses subjects beyond confidentiality, then conceivably the Disclosing Party might want to cut off the Receiving Party's right to use and disclose Confidential Information before the end of the term of that agreement.

A receiving party might want to state explicitly that that certain specific uses are pre-authorized.

CAUTION: Some receiving parties ask for "residuals" clauses that state, in effect, that the receiving party will not be liable for use of confidential information that receiving-party personnel retain in their unaided

memory. This could be dangerous for the disclosing party; see **Error! Reference source not found.**.

§ 27.4.2 To whom may the Receiving Party disclose Confidential Information?

a. The disclosure authorizations of this section apply only to the extent that disclosure is not prohibited by applicable law such as (for example) export-control law, privacy law, etc.

b. The Receiving Party may disclose Confidential Information:

1. to anyone approved in writing by an authorized representative of the Disclosing Party;
2. to the Receiving Party's outside legal counsel and outside accountants who have a binding legal obligation to preserve the Confidential Information in confidence; and
3. as stated in § 27.4.7 (subpoenas, etc.) and § 27.4.4 (disclosures to law enforcement, etc.).

c. In addition, during the term of the AGREEMENT, the Receiving Party may disclose Confidential Information to the Receiving Party's employees, officers, and directors who have a legitimate "need to know" in connection with an authorized use of the information.

COMMENTARY

CAUTION**: Privacy- or export-control laws might prohibit some disclosures regardless whether the disclosures are authorized by the AGREEMENT.**

Drafters should consider the extent — if any — to which the Receiving Party's contractors, affiliates, etc., should also be permitted to receive Confidential Information. This will be especially true if the Receiving Party's workforce includes so-called leased employees or other individuals working long-term in independent-contractor status.

§ 27.4.3 How are subpoenas, etc. to be handled?

a. IF: A Receiving Party is served with a subpoena, a search warrant, or other compulsory legal demand for information initiated by

a governmental authority or another party acting under such authority; THEN: The Receiving Party may disclose Confidential Information as required by the compulsory demand; BUT:

1. The Receiving Party must promptly check with the Disclosing Party before it discloses the demanded Confidential Information, unless such checking is prohibited by law.

2. The Receiving Party must cooperate with the Disclosing Party — at the Disclosing Party's expense — if it seeks legal protection for the information.

3. The Receiving Party must disclose only so much information as is specifically required by the demand.

b. In case of doubt, this section does not allow the Receiving Party to disclose Confidential Information in situations where disclosure requirement would be triggered by action or omission on the part of the Receiving Party itself — for example, a filing under the securities laws would not qualify under this section. (On that subject, see § 27.4.14.)

COMMENTARY

Note that this section is phrased as an authorized disclosure and not as stating that the issuance of a subpoena, etc., immediately excludes the requested information from Confidential-Information status (which would be both a terrible idea and usually unnecessary).

Subdivision b: For a case in which the securities-law-filing issue was litigated, see Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072 (Del. Ch.), aff'd, 45 A.3d 148 (Del. 2012) (en banc). There, the court held that Martin Marietta had breached a non-disclosure agreement by including Vulcan's confidential information in an SEC filing about Martin Marietta's proposed takeover of Vulcan.

§ 27.4.4

Some disclosures to law enforcement, legislators, etc., are not prohibited

Nothing in the AGREEMENT is intended to prohibit disclosure of Confidential Information to law enforcement, congressional investigators, attorneys, etc., as follows:

1. to the extent necessary to report possible violations of law or regulation to a federal, state, or local government authority that has jurisdiction over such violations;

2. to an attorney to the extent necessary for the purpose of reporting or investigating a suspected violation of law;

3. in a filing under seal in a complaint or other document filed in a lawsuit or other proceeding;

4. to an attorney representing the Receiving Party for use in the court proceedings of a lawsuit alleging that the Disclosing Party or its affiliate retaliated against the Receiving Party for reporting a suspected violation of law — as long as any document containing the Confidential Information is filed in court only under seal AND the Receiving Party does not otherwise disclose the Confidential Information except under a court order; and

5. to the minimum extent affirmatively authorized by law or regulation, for example the (U.S.) National Labor Relations Act or other applicable labor- or employment law.

COMMENTARY

This section is informed by the fact that American law limits the ability of individuals and companies to restrict disclosure of confidential information where the restriction would contravene public policy — for example, the (U.S.) Defend Trade Secrets Act, enacted in 2016 and codified at 18 U.S.C. § 1833 et seq.

Subdivision 5 reflects the position taken by the (U.S.) National Labor Relations Board about employees' discussions of wages and working conditions; see generally, e.g., Nat'l Labor Rel. Bd. v. Long Island Assoc. for AIDS Care, 870 F.3d 82, 88-89 (2d Cir 2017) (affirming NLRB ruling). NOTE: More recently, Trump-administration appointees to the NLRB appear to be willing to revisit employer-employee confidentiality

agreements, at least in the context of settlement- and separation agreements. See, e.g., Stephen M. Swirsky, NLRB Board Members Signal Intention to Reconsider Board Law on Confidentiality of Settlement Agreements and to Modify the Board's Blocking Charge "Rule" (NatLawReview.com Jan. 5, 2018).

§ 27.4.5 May the Receiving Party disclose Confidential Information to contractors?

See § 27.4.2.

§ 27.4.6 What specific instructions must be given to individual recipients?

a. This section applies if specifically requested in advance by the Disclosing Party as to any particular item(s) of Confidential Information and/or any particular individual recipient(s).

b. Before the Receiving Party discloses the item(s) of Confidential Information in question to such a recipient, the Receiving Party must first take reasonable steps to cause the recipient to be specifically instructed or -reminded that he or she has a duty to abide by the confidentiality obligations of the AGREEMENT.

COMMENTARY

This section reflects an extra precaution that some disclosing parties like to require of receiving parties.

Subdivision a makes the compliance burden more manageable by requiring the Receiving Party to take steps, but only if requested by the Disclosing Party.

§ 27.4.7 ❑ Recipients' confidentiality agreements must be provided upon request

a. Upon request by the Disclosing Party, the Receiving Party will provide the Disclosing Party with a copy of the written confidentiality agreement between the Receiving Party and each individual or organization to which the Receiving Party provides Confidential Information.

b. Such copies may be redacted, if so desired by the Receiving Party, to prevent disclosure to the Disclosing Party of confidential information of the Receiving Party.

COMMENTARY

This requirement might be burdensome for the receiving party, but in some situations the disclosing party might have a legitimate need for it.

§ 27.4.8 May a Receiving Party confirm guesses about Confidential Information?

No — if a third party asks a Receiving Party to confirm the third party's guess about Confidential Information, the Receiving Party must not say or do anything that would confirm that the guess is right or wrong.

COMMENTARY

This section could come into play if a receiving party were questioned by a journalist — or by a competitor or the disclosing party.

§ 27.4.9 What copies of Confidential Information may be made?

The Receiving Party may make (or have made) copies of Confidential Information as reasonably necessary for uses and disclosures authorized by this Plan.

§ 27.4.10 May the Receiving Party rely on Confidential Information?

The Receiving Party is not entitled to rely, and agrees not to rely, on Confidential Information for any purpose, EXCEPT to the extent (if any) expressly stated otherwise in the AGREEMENT.

COMMENTARY

This section is included to try to head off fraudulent-inducement claims by the Receiving Party, as discussed in more detail in the commentary to the Reliance Disclaimer (§ 20).

Some language in this provision is in bold-faced type to make it conspicuous (about which more, see **Error! Reference source not found.**).

§ 27.4.11 ALERT: Export-controlled information is subject to special rules

If particular Confidential Information is subject to applicable export-control laws, then the Receiving Party must comply with those laws. For example, without the proper license or license exception —

a. The Receiving Party must not send or take Confidential Information to another country — that might include even taking a phone, laptop, or other device to another country.

b. The Receiving Party must not disclose Confidential Information to anyone who is a citizen of a country subject to export-controls restrictions such as embargoes and/or sanctions.

COMMENTARY

If someone needs a better reason to comply with this section than just liability for breach of contract, consider this: **Violating the export-control laws could land the violator in prison.** This actually happened, for example, to a 71-year old emeritus professor at the University of Tennessee who was sentenced to four years in prison for disclosing export-controlled information to two of his graduate students, who were from Iran and China respectively. (The reported facts seem to have been somewhat egregious.)

§ 27.4.12 ALERT: Personal information might be protected by law

The Receiving Party must comply with applicable law (if any) concerning personal information.

COMMENTARY

Disclosing- and receiving parties will want to check out privacy laws concerning (without limitation): • protected health information, for example under the U.S. Health Insurance Portability and Accountability Act of 1996 ("HIPAA"); • personal financial information, for example under the Gramm-Leach-Bliley Act; • the EU's General Data Protection

Regulation (GDPR); and • American state laws concerning user privacy such as the recently-enacted California Consumer Privacy Act (CCPA).

§ 27.4.13 **❑ Disclosure in a secure data room is permitted**

a. The Receiving Party may, without the Disclosing Party's consent, disclose Confidential Information to a prospective acquirer of:

1. substantially all shares (or equivalent ownership interest under applicable law) of the Receiving Party itself; or

2. substantially all of the assets of the Receiving Party's business specifically associated with the AGREEMENT.

b. Any such prospective recipient of Confidential Information must agree in writing to abide by the Receiving Party's obligations in the AGREEMENT relating to Confidential Information.

c. Any such disclosure must be done in one or more secure physical data rooms or via a secure online data room.

d. The Receiving Party must not allow the recipient to keep copies of Confidential Information without the Disclosing Party's prior written consent.

COMMENTARY

In merger-and-acquisition activity, a company that will be acquired will generally "open the kimono" to the potential acquiring company, very often by allowing the acquiring company to access electronic documents in a secure data room. ¶ This specific provision was inspired by a blog posting by English lawyer Mark Anderson. See generally the Wikipedia article Data room.

§ 27.4.14 **❑ Disclosure in public filings is permitted (with restrictions)**

The Receiving Party may include Confidential Information in a submission to a regulatory agency or other governmental body, if all of the following conditions are met:

1. the inclusion must be compelled by law, to the same extent as if the inclusion were compelled by law in response to a subpoena or other compulsory legal demand (§ 27.4.7);

2. the Receiving Party must first consult with the Disclosing Party a sufficient time in advance to give the Disclosing Party a reasonable opportunity to seek a protective order or other relief;

3. the Receiving Party must disclose only so much Confidential Information as is required to comply with the law; and

4. the Receiving Party must provide reasonable cooperation with any efforts by the Disclosing Party to limit the disclosure, and/or to obtain legal protection for the information to be disclosed, in the same manner as if the proposed disclosure were in response to a compulsory legal demand.

COMMENTARY

A Receiving Party that is publicly traded (or wants to be) might feel it must disclose Confidential Information in its public filings. **Such disclosure, though, can destroy the confidentiality status of the information.** *See generally, e.g.*, Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1011-12, esp. text accompanying n.15 (1984) (noting that Environmental Protection Agency's disclosure of Monsanto's pesticide test data would destroy Monsanto's trade-secret rights in the data).

This basic issue arose in Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1147 (Del. Ch. 2012), *aff'd*, 45 A. 3d 148 (Del. 2012) (en banc): In that case, Martin Marietta was held to have breached a confidentiality agreement by including confidential information of Vulcan Materials in a public filing with the Securities and Exchange Commission.

§ 27.5 Return or destruction of Confidential Information

§ 27.5.1 When must Confidential Information be returned or destroyed?

If the Disclosing Party so requests in writing, the Receiving Party must turn over to the Disclosing Party all hard copies and other tangible embodiments of Confidential Information in the Receiving Party's possession, custody, or control — EXCEPT:

1. as otherwise provided in this Option; and/or

2. as necessary for § 27.4.4 (disclosure to law enforcement, etc.); § 27.5.4 (emails and electronic files); and/or § 27.5.6b (archival copies).

COMMENTARY

CAUTION: **An obligation to return or destroy Confidential Information might not be practical** if (for example) Confidential Information is embodied in a deliverable (for example, custom-developed computer software, or a physical object) that the receiving party will have the right to keep on using; this might be the case in a services agreement.

CAUTION: Unfortunately, sometimes parties forget about return-or-destruction obligations. A *disclosing* party will want to follow up to be sure that the return-or-destruction requirement is actually complied with; if it were to fail to do so, a receiving party (or a third party) could try to use that as evidence that the disclosing party did not take reasonable precautions to preserve the secrecy of its confidential information. Likewise, if the receiving party were to forget to comply with its return-or-destruction obligations, then the disclosing party might use that fact to bash the receiving party in front of a judge or jury.

SUGGESTION: For easier Receiving-Party compliance with this section, drafters could consider the segregation-requirement option of § 27.3.1b — or a Receiving Party could elect to segregate Confidential Information on its own initiative, even without a specific contractual requirement.

§ 27.5.2

May the Receiving Party just *destroy* the Confidential Information instead?

a. The Receiving Party may destroy its copies of Confidential Information instead of returning them ❑ but only if the Disclosing Party approves in writing.

b. The required destruction would include deleting Confidential Information from phones, tablets, personal computers, etc., except as provided below.

COMMENTARY

Subdivision a: The (optional) requirement of obtaining Disclosing-Party consent for destruction has in mind the situation in which the Disclosing Party doesn't itself have a copy of Confidential Information to be

destroyed. That might occur if, say, (i) a contractor had developed particular information that, under the parties' agreement, was the property of the customer, but (ii) the contractor hadn't yet provided any copies of the information to the customer.

§ 27.5.3 What if the Receiving Party is an employee of the Disclosing Party?

a. IF: The Receiving Party is a Disclosing-Party employee; THEN: The employee must not retain copies of Confidential Information except solely for the purpose of imminently disclosing that specific information to law enforcement authorities, etc., under § 27.4.4.

b. The employee's confidentiality obligations will continue unabated as to all such retained copies (if any).

c. The employee must return or destroy all other copies of Confidential Information.

d. For this purpose, the term "employee" includes, without limitation, a contractor who is in an employee-like status with the Disclosing Party.

§ 27.5.4 Must even email attachments, etc., be purged?

The Receiving Party need not return or destroy electronic copies of Confidential Information to the extent that it would be unduly burdensome or costly to do so; examples would be Confidential Information in email attachments and system-backup media.

COMMENTARY

A receiving party might find it to be tremendously burdensome — and expensive — to try to return or destroy all copies of a disclosing party's confidential information, even those in emails, backup systems, etc.

§ 27.5.5 What is the status of remaining copies (if any)?

The confidentiality obligations of the AGREEMENT will continue in effect by their terms for all copies of Confidential Information that are not returned or destroyed (including without limitation archive copies retained under the Archive Copies Protocol, below).

§ 27.5.6 How will the Disclosing Party know that Confidential Information has been returned or destroyed?

a. IF: The Disclosing Party so requests in writing within a reasonable time after the return-or-destruction of the AGREEMENT become applicable; THEN: The Receiving Party will promptly provide the Disclosing Party with a written certificate of its compliance with those provisions.

b. The certificate must:

1. be signed by an officer of the party or other individual authorized to bind the party;

2. note any known compliance exceptions; and

3. for each exception, note whether and how the exception is authorized by the AGREEMENT (unless prohibited by applicable law, for example because the Receiving Party is cooperating with law-enforcement authorities).

COMMENTARY

Requiring the Receiving Party to *certify* its compliance with the return-or-destruction requirements would:

- make "obligation management" easier for the Disclosing Party;
- give the Receiving Party an incentive to do a good job in complying with the return-or-destruction requirement;
- help the parties identify specific areas that might need attention before a dispute arose, and thus possibly help to avoid the dispute in the first place; and
- provide the Disclosing Party with "they lied!" ammunition in case it turned out that some specimens of Confidential Information were not returned or destroyed.

§ 27.5.7 What "archive" (or "archival") copies may be retained?

A Receiving Party may indefinitely retain — in confidence — archive copies of Confidential Information, including a reasonable number of backup copies.

COMMENTARY

> Confidentiality agreements will often allow receiving parties to retain archive copies of confidential information. Doing so can be highly useful if, for example, the parties were to later get into a dispute about just what a disclosing party did or did not actually disclose. This is especially true in the case of confidentiality agreements entered into in connection with merger- or asset-purchase agreements.

§ 27.5.8 How must archive copies be stored?

a. The Receiving Party must maintain all archive copies in accordance with commercially reasonable security standards.

b. As an example (and without limitation), subdivision a could be satisfied by maintaining the archive copies in the custody of a reputable commercial records-storage organization that is contractually obligated to maintain the copies in confidence.

§ 27.5.9 How may the Receiving Party use archive copies?

The Receiving Party may not use archive copies except for the following:

1. helping to ascertain and confirm the Receiving Party's compliance with its continuing confidentiality obligations;
2. documenting the parties' interactions in connection with the AGREEMENT;
3. any other purpose agreed to in writing by the Disclosing Party; and
4. reasonable testing of the accuracy of the archive copies.

§ 27.5.10 Who must keep custody of archive copies?

a. An archive-copy custodian may be, but need not be, "independent" in the sense used of independent accountants.

b. The Receiving Party's outside counsel and its independent accountants (if any, and without limitation) are considered independent for purposes of archival-copy custody.

COMMENTARY

The term *independent* is generally well understood by corporate lawyers. If the archive custodian(s) does not need to be "independent" (a term well-understood by corporate lawyers), then the custodian(s) might be, for example, the receiving party's IT staff. Alternatively, a disclosing party might want the archive custodian(s) to be limited to the Receiving Party's outside counsel

The phrase *outside counsel only* is generally well understood by lawyers who work in litigation. See, for example, paragraph 11© of the protective order entered in an antitrust case brought by the [U.S.] Department of Justice.

§ 27.5.11 Who may access archival copies?

The Receiving Party must take prudent measures to ensure that Confidential Information contained in archive copies is not made accessible to Receiving-Party personnel, *other than* as follows:

1. to those of the Receiving Party's personnel who maintain the archive copies, if applicable;
2. with the Disclosing Party's prior written consent; or
3. as directed (or permitted) by a tribunal having jurisdiction.

COMMENTARY

The "prudent measures" requirement in the preamble of this section is a tightening up of the "commercially reasonable measures" standard used in, e.g., section 9 of the Mutual Non-Disclosure Agreement between large software companies Sybase and SAP (https://goo.gl/MwkmNa). (Sybase was acquired by SAP in 2010.)

§ 27.6 Other confidentiality provisions

§ 27.6.1 ❑ Compliance-Inspection Option

This Option applies only if the AGREEMENT clearly so states.

a. At any time that the Receiving Party has Confidential Information in its possession, the Disclosing Party may cause reasonable inspections of

the Receiving Party's relevant properties and premises to be conducted to confirm compliance with the Receiving Party's confidentiality obligations under the AGREEMENT.

b. ☑ Any such inspection must be upon reasonable written notice.

c. In case of doubt: The right of inspection of this Option extends, by way of illustrative example and not of limitation, to any or all hard-copy and electronic records of any kind in the possession, custody, or control of the Receiving Party.

COMMENTARY

> **Receiving parties are highly likely to balk** at this Option; in some cases, though, a disclosing party might feel it was necessary.

§ 27.6.2

❑ Receiving-Party Expanded Liability Option

This Option applies only if the AGREEMENT clearly so states.

a. *Applicability:* This Protocol concerns "**Receiving-Party Uses or Disclosures**," namely uses and/or disclosures of Confidential Information that take place: by; on behalf of; or with the permission of, the Receiving Party.

b. *Background (1):* The parties wish to plan for the possibility that one or more Receiving-Party Uses or Disclosures might result in one or more of the following being experienced by: (i) the Disclosing Party and/or (ii) a member of the Disclosing Party's Protected Group:

1. a claim by a third party; and/or

2. loss or expense arising from violation of law.

c. *Indemnity obligation:* The Receiving Party will defend and indemnify the Disclosing Party and its Protected Group against any of the events referred to in subdivisions b.1 and b.2.

d. *Background (2):* The parties also wish to play for the possibility that a third party (referred to as the Recipient) might — legitimately or otherwise — obtain or otherwise access Confidential Information in question as a result of the Recipient's relationship with the Receiving Party.

e. *Vicarious liability:* IF: The Recipient uses, discloses, and/or copies such Confidential Information in a manner not permitted by the AGREEMENT; THEN: The Receiving Party will be liable to the Disclosing Party for any resulting harm to the Disclosing Party or its interests, to the same extent as if the damage had been caused by use, disclosure, or copying of the Confidential Information by the Receiving Party.

f. For this purpose, the term *Recipient* includes, without limitation, any employee of the Receiving Party.

COMMENTARY

A disclosing party will sometimes ask a receiving party to be liable (or, "be responsible") for any misappropriation of Confidential Information by the receiving party's employees, contractors, etc. This is an example of the "one throat to choke" principle. (OK, OK, that's an outdated expression; it's still useful.)

If a receiving party objects to this provision, the objection might trigger questions from the disclosing party about the receiving party's intentions (or competence).

§ 27.6.3

❑ General-Experience Option

This Protocol's restrictions on the Receiving Party's use of Confidential Information do not limit the ability of the Receiving Party's personnel to utilize their general knowledge, skills, and experience in the general field of Confidential Information, even if those things were improved by the personnel's exposure to Confidential Information.

COMMENTARY

The above language is adapted from section 3 of an AT&T nondisclosure agreement(archived at http://perma.cc/G974-2ZH5): "… and the use by a party's employees of improved general knowledge, skills, and experience in the field of the other party's proprietary information is not a breach of this Agreement." CAUTION: This language could be dangerous to a disclosing party because of the difficulty of determining when it did or didn't apply.

§ 27.6.4

❑ Residuals Usage Option

a. The term *Residuals* refers to ideas, concepts, know-how, techniques, and similar information that may be retained in the unaided memory of the Receiving Party's personnel who did not intentionally memorize the information for that purpose.

b. The Receiving Party may use Residuals as it sees fit without obligation to the Disclosing Party — this subdivision, however, does not negate any restriction of the AGREEMENT on the Receiving Party's disclosure of Confidential Information to third parties.

c. For the avoidance of doubt, any use of Residuals by the Receiving Party will be subject to any applicable patent rights, copyrights, trademark rights, or other intellectual-property rights owned or assertable by the Disclosing Party.

COMMENTARY

A disclosing party likely will push back strongly against any request for this provision. In practice, the provision can amount to a blank check for the receiving party and its people to do whatever they want with the disclosing party's confidential information.

Some receiving parties (*cough*, Microsoft) have tried to include provisions granting them "residual rights" along the following lines:

> a. The parties' agreement's restrictions on use of Confidential Information do not limit a Receiving Party's ability to use "Residuals," as defined in subdivision b.
>
> b. The term "***Residuals***" refers to ideas, concepts, know-how, techniques, and similar information, derived from Confidential Information, that is retained in the unaided memory of a Receiving Party's personnel who did not intentionally memorize the information for that purpose.
>
> c. Subdivision a above is not to be interpreted as granting the Receiving Party any license under any patent, copyright, or other intellectual-property right owned or otherwise assertable by the disclosing party.

The danger is that granting residuals rights of this kind could later result in he-said-she-said disputes about whether the receiving party's personnel were in fact relying on their unaided memories — and that same

uncertainty might well tempt the receiving party to treat this language as a get-out-of-jail-free card to do whatever it wanted with the disclosing party's confidential information.

If pressured to agree to this provision, a disclosing party might try to exclude particular receiving-party personnel or departments from being able to exercise residual rights.

Additional reading (optional for students):

- Larry Schroepfer, Residuals: License to Steal? (2016)
- Tom Reaume, This Residuals Clause Left a Bad Residue (2011);
- Scott M. Kline and Matthew C. Floyd, Managing Confidential Relationships in Intellectual Property Transactions: Use Restrictions, Residual Knowledge Clauses, and Trade Secrets, 25 Rev. Litig. 311, 315 et seq. (2006);
- Brian R. Suffredini, Negotiating Residual Information Provisions in IT and Business Process Outsourcing Transactions (2004).
- Michael D. Scott, Scott on Information Technology Law § 6.25[D] (accessed Nov. 26, 2010)
- Brian R. Suffredini, Negotiating Residual Information Provisions in IT and Business Process Outsourcing Transactions (2004)

§ 27.6.5 Will these confidentiality provisions expire with the AGREEMENT?

No: The confidentiality obligations of the AGREEMENT will survive any termination or expiration of that agreement; this will be true no matter what other provision(s) of that agreement (if any) deal with the survival of that agreement's terms.

§ 27.7 Additional commentary

§ 27.7.1 Why do parties enter into confidentiality agreements — and why does the law enforce such agreements?

It's quite common for parties to enter into a confidentiality agreement as a prelude to negotiation of another agreement such as a sale- or license agreement or a merger- or acquisition agreement.

It's also quite common for other types of agreement to include confidentiality provisions, for example services agreements; license agreements; and employment agreements.

One [U.S.] state supreme court summarized the public-policy basis for enforcing confidentiality agreements:

> The basic logic of the common law of trade secrets recognizes that **private parties invest extensive sums of money in certain information that loses its value when published to the world at large.**
>
> Based on this logic, trade secret law creates a property right defined by **the extent to which the owner of the secret protects his interest from disclosure to others**.
>
> In doing so, *[trade secret law]* allows the trade secret owner to reap the fruits of its labor ….
>
> Trade secret law promotes the **sharing** of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it. *[Quoting Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 493 (1974).]*

DVD Copy Control Assn., Inc. v. Bunner, 31 Cal. 4th 864, 880, 75 P.3d 1 (2003) (reversing court of appeal, and holding that preliminary injunction against Web site operator, prohibiting disclosure of trade secrets, did not violate the First Amendment) (citations omitted, extra paragraphing added), *as excerpted by* Altavion, Inc. v. Konica Minolta Sys. Lab. Inc., 226 Cal. App. 4th 26, 34 (2014) (affirming judgment of trade-secret misappropriation) (alteration marks edited, emphasis added).

The law protects just about any information that is kept confidential and provides a competitive advantage. This prerequisite generally comes from the definition of "trade secret," as found either in the relevant statute — which in the U.S. will typically be a variation of the Uniform Trade Secrets Act — or section 757 of the Restatement of Torts. As summarized by the Seventh Circuit:

> Illinois courts frequently refer to six common law factors (which are derived from § 757 of the Restatement (First) of Torts) in determining whether a trade secret exists:
>
> (1) the extent to which the information is known outside of the plaintiff's business;
>
> (2) the extent to which the information is known by employees and others involved in the plaintiff's business;
>
> (3) the extent of measures taken by the plaintiff to guard the secrecy of the information;
>
> (4) the value of the information to the plaintiff's business and to its competitors;
>
> (5) the amount of time, effort and money expended by the plaintiff in developing the information; and
>
> (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.

Learning Curve Toys, Inc. v. PlayWood Toys, Inc., 342 F.3d 714, 722 (7th Cir. 2003).

§ 27.7.2 *Two-way* confidentiality agreements are *usually* a better idea

The term *Disclosing Party* implicitly defines whose Confidential Information will be protected. One of the first issues the parties likely will confront is whether the agreement should protect just one party's Confidential Information, or that of each party.

In many cases, a two-way confidentiality agreement that protects each party's Confidential Information will:

- get to signature more quickly;
- be safer for both sides; and

- reduce the chance of future embarrassment for the drafter(s).

§ 27.7.2.1 A two-way confidentiality agreement will usually be signed sooner

A confidentiality agreement protecting just one party's information will usually take longer to negotiate. That's because a confidentiality agreement will (usually) be more balanced — and therefore quicker to negotiate and easier to work with — if its provisions will apply equally to the confidential information of each party, not just one party.

- If only one party will be disclosing confidential information, and that disclosing party is doing the drafting, then the confidentiality provision might contain burdensome requirements that the receiving party would have to review carefully.

- Conversely, if the receiving party is doing the drafting, then the disclosing party would have to review the confidentiality provisions carefully to make sure it contained sufficient protection for Confidential Information

In contrast, a two-way provision is likely to be more balanced — it's a variation of the "I cut, you choose" principle — because each negotiator keeps in mind that today's disclosing party might be tomorrow's receiving party or vice versa.

(Beware, though: even if an agreement is nominally a two-way agreement, it still can be drafted so as subtly to favor the drafter's client.)

§ 27.7.2.2 A two-way confidentiality agreement will usually be safer

A two-way agreement can avoid the danger of future, "afterthought" confidential disclosures *by the receiving party*. With a one-way agreement, only the (original) disclosing party's information is protected, and so any disclosures by the receiving party might be completely unprotected, resulting in the receiving party's losing its trade-secret rights in its information.

That's just what happened to the plaintiff in Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant). There, the plaintiff's confidentiality agreement with the defendant protected only the defendant's information. Consequently, said the court, the plaintiff's afterthought disclosures of its own confidential information were unprotected.

§ 27.7.2.3 A two-way agreement might help avoid future embarrassment

Suppose that Alice and Bob enter into a confidentiality agreement that protects only Alice's information. Also suppose that the agreement's terms were strongly biased in favor of Alice.

But now suppose that, at a later date, the parties decide that they also needed to protect *Bob's* confidential information as well, so that Bob can disclose it to Alice.

In that case, with the shoe on the other foot, Alice might not want to live with the obligations that she previously made Bob accept. As a result, whoever negotiated the (one-way) confidentiality agreement for Alice might find himself in a doubly embarrassing position:

- First, Alice's negotiator would be (i) asking Bob to review and sign a new confidentiality agreement, which would cause delay; and (ii) probably having to explain to both Alice and Bob why Alice isn't willing to live with the same terms that she previously asked Bob to agree to.
- Second, Alice might ask pointedly of her negotiator, Why didn't you do this right the first time, instead of wasting everybody's time?

So it's often a good idea to insist that any confidentiality provisions be two-way in their effect from the start, protecting the confidential information of both parties.

§ 27.7.3 How much secrecy is needed?

§ 27.7.3.1 Fort-Knox security measures aren't necessary (usually)

Some people mistakenly think that legal protection won't be available for confidential information unless every possible security measure is taken. That's not how the law works. It's not mandatory to keep confidential information locked up in Fort Knox-like secrecy; in many circumstances, less-strict security measures may well suffice. *See, e.g.*, Learning Curve Toys, Inc. v. PlayWood Toys, Inc., *supra* (reversing judgment as a matter of law and remanding with instructions to reinstate jury verdict of misappropriation; applying Illinois law).

As one court remarked:

> … there always are more security precautions that can be taken. **Just because there is something else that**

> **Luzenac could have done does not mean that their efforts were unreasonable under the circumstances.** In light of undisputed precautions that Luzenac took, we do not think that the record demonstrates beyond dispute that Luzenac's measures to protect the secrecy of 604AV were merely "superficial." … Whether these precautions were, in fact, reasonable, will have to be decided by a jury.

Hertz v. Luzenac Group, 576 F.3d 1103, 1113 (10th Cir. 2009) (citations omitted).

§ 27.7.3.2 But *some* secrecy efforts are virtually mandatory

Still, the disclosing party will have to show that it made at least *some* efforts to keep the information confidential — obviously "more is better," but more is also more costly.

Failure on this point can be fatal to a trade-secret claim: In one case, the Seventh Circuit noted pointedly that the party asserting misappropriation had made no effort to preserve the so-called trade secrets in confidence. *See* Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant; applying Illinois law).

§ 27.7.4 Marking requirements: More background

§ 27.7.4.1 Purpose of marking requirements

The basic objectives of the marking requirement are usually:

- to alert the receiving party's personnel that particular information is subject to confidentiality obligations;
- conversely, to let the receiving party's personnel know what particular information is *not* subject to confidentiality obligations and therefore may be used freely; and
- perhaps most importantly (at least from a litigation perspective), to help courts and arbitrators sift through claims that particular information was or was not subject to confidentiality obligations.

§ 27.7.4.2 Courts pay attention to the absence of marking

In assessing whether a disclosing party in fact maintained particular information in confidence, a court very likely will give significant weight to

whether the disclosing party caused the information to be marked as confidential.

In the Seventh Circuit's *Fail-Safe* case, the court pointedly noted that the plaintiff had not marked its information as confidential; the court affirmed the district court's summary judgment dismissing the plaintiff's claim of misappropriation. *See* Fail-Safe, LLC v. A.O. Smith Corp. 674 F.3d 889, 893-94 (7th Cir. 2012) (applying Illinois law).

To like effect was another Seventh Circuit case, nClosures, Inc. v. Block & Co., 770 F.3d 598, 600 (7th Cir. 2014), where the court affirmed a summary judgment that "no reasonable jury could find that nClosures took reasonable steps to keep its proprietary information confidential," and therefore the confidentiality agreement between the parties was unenforceable.

§ 27.7.4.3 Failure to mark, when required by contract, can be fatal

A disclosing party's failure to mark its confidential information as such *when required by a confidentiality agreement* or nondisclosure agreement ("NDA") can be fatal to a claim of misappropriation of trade secrets or misappropriation of confidential information.

For example, in *Convolve v. Compaq*, the computer manufacturer Compaq (now part of Hewlett-Packard) defeated a claim of misappropriation of trade secrets concerning hard-disk technology because the owner of the putative trade-secret information did not follow up its oral disclosures with written summaries as required by the parties' non-disclosure agreement. *See* Convolve, Inc. v. Compaq Computer Corp., No. 2012-1074, slip op. at 14, 21 (Fed. Cir. Jul. 1, 2013) (affirming summary judgment in pertinent part; non-precedential).

As another example, see, *Hoover Panel Systems Inc. v. Hat Contract Inc.*, from the U.S. District Court for the Northern District of Texas (citation unavailable at this writing), discussed in Steven E. Jedlinski, Summary Judgment of No Misappropriation Due to Failure to Follow Confidentiality Marking Requirements (HKLaw.com 2019).

§ 27.7.4.4 Forgetting "catch up" marking can also be fatal — or not …

In the *Convolve v. Compaq* case discussed above, Convolve had disclosed some of its confidential information orally to Compaq, but it didn't follow up those oral disclosures with written summaries, which was required by the parties' non-disclosure agreement. *See* Convolve, Inc. v. Compaq Computer Corp., No. 2012-1074, slip op. at 14, 21 (Fed. Cir. July 1, 2013) (affirming summary judgment in pertinent part; non-precedential).

On the other hand, a jury and judge might look past a failure to mark

§ 27.7.4.5 Caution: Some information might be confidential by law even without marking

Applicable law might independently impose a confidentiality obligation benefiting third parties, regardless of marking. For example, the U.S. Health Insurance Portability and Accountability Act(HIPAA) imposes such obligations in respect of patients' protected health information.

§ 27.7.4.6 Should marking be required even for in-place access?

A slightly tricky situation is when a receiving party's people are allowed to look at a disclosing party's internal files but not to make notes, take away copies, etc. In such a situation, it might well be burdensome for the disclosing party to have to go each of the files to ensure that all confidential information is marked, on pain of losing confidentiality protection. There might also later be a he-said, she-said proof problem if a dispute were to arise about whether particular information had in fact been marked.

§ 27.7.4.7 Examples of marking requirements

The following agreements include marking requirements for confidential information, several of which contain catch-up marking provisions:

- Dow Chemical Master Collaboration Agreement § 1.4—the on-line version appears to be an incomplete provision, and the marking requirement applies to information first disclosed in a non-written form.
- Ford Global Services Agreement § 8.1(b) and (d), with a catch-up marking provision in § 8.1(c).

§ 27.7.5 Not requiring secrecy precautions can kill trade-secret rights

A disclosing party should *always* insist on imposing confidentiality obligations on a receiving party; otherwise, a court is likely to hold that the disclosing party had failed to make reasonable efforts to protect its confidential information. See, e.g.:

Gal-Or v. United States, No. 09-869C (Ct. Fed. Cl. Nov. 21, 2013) (dismissing plaintiff's trade-secret claims): "[I]nstances in which Mr. Gal-Or took proactive steps to protect the confidentiality of his trade secrets are simply *overwhelmed [emphasis in original]* by the number of times he did not. … In sum, because Mr. Gal-Or disclosed trade secrets to others, *who were under no obligation to*

protect the confidentiality of the information, Mr. Gal-Or lost any property interest he may have held." *[Emphasis added.]*

Southwest Stainless, LP v. Sappington, 582 F.3d 1176, 1189-90 (10th Cir. 2009) (reversing judgment of misappropriation of trade secrets): A supplier gave specific price-quote information to a customer without any sort of confidentiality obligation; that defeated the supplier's claim of trade-secret misappropriation against a former employee.

Lockheed Martin Corp. v. L-3 Comm. Integrated Sys. L.P., No. 1:05-CV-902-CAP (N.D. Ga. March 31, 2010) (granting L-3's motion for new trial): The court set aside a $37 million damages verdict for trade-secret misappropriation in favor of Lockheed after it came to light that Lockheed had disclosed the trade secrets in question to a competitor without restrictions. The case later settled; *see, e.g.*, R. Robin McDonald, Discovery Failure Sinks Lockheed's $37 Million Win, Apr. 6, 2010; *see also* R. Robin McDonald, Lockheed and L-3 settle five-year battle, Nov. 29, 2010. For a more-detailed discussion of the specifics of the lawsuit, see this blog entry of Apr. 6, 2010 by "Todd" (Todd Harris?) at the Womble Carlyle trade secrets blog.

E.I. DuPont De Nemours & Co. v. Kolon Industries, Inc. 748 F.3d 16 (4th Cir. 2014): A jury found South Korea-based Kolon Industries liable for misappropriating DuPont's trade-secret information in DuPont's Kevlar® production process. The jury awarded DuPont nearly $1 billion in damages, and the trial judge enjoined Kolon from producing Kevlar-type fiber for 20 years.During the trial, Kolon had argued that DuPont, in earlier litigation with its then-primary competitor, had supposedly failed to keep the information confidential. The trial judge, though, did not allow Kolon to put on evidence of this. Kolon had better luck with this argument on appeal: The appellate court reluctantly vacated the jury verdict and ordered a new trial. (The appellate court also ordered that a different district judge be assigned to hear the case.) The civil case later settled on undisclosed terms; this was in conjunction with Kolon's guilty plea in a related criminal case, where Kolon agreed to pay a $360 million penalty. *See* Andrew Zajac, Kolon Guilty in Kevlar Secrets Case, Settles with DuPont (Bloomberg.com Apr. 30, 2015).

Events Media Network, Inc. v. The Weather Channel Interactive, Inc., No. 13-03 (D.N.J. Feb. 3, 2015): Events Media Network ("EMNI") was in the business of collecting, reviewing, and compiling detailed information about various local and national events and attractions. EMNI licensed the information to other companies, including The Weather Channel ("TWC"). EMNI made its information available on its Web site; it claimed that technical restrictions precluded anyone from accessing all of the information. TWC's license

agreement with EMNI allowed TWC to use the EMNI information in TWC's own Web properties. The parties allowed the license agreement to expire.

EMNI claimed that TWC continued using the EMNI information after expiration, and that this allegedly constituted misappropriation of EMNI's trade secrets and breach of contract. TWC moved for summary judgment dismissing EMNI's trade-secret claim, on grounds that the information in question wasn't preserved in confidence and therefore could not be the subject of a trade-secret misappropriation claim.

The district court granted that part of TWC's summary-judgment motion — the court said that under the license agreement, "**EMNI was not attempting to protect the Information from public disclosure, but increase its dissemination**, giving TWC broad discretion over how and where it would use the Information publicly to achieve this end." *Id.*, slip op. at 16 (emphasis added).

§ 27.7.6 How long should confidentiality obligations last?

Disclosing parties will normally be reluctant to agree to a fixed confidentiality period. That's because doing so can result in destruction of the disclosing party's trade-secret rights in its confidential information after the end of the confidentiality period.

Receiving parties, of course, generally prefer to have fixed expiration dates for confidentiality obligations.

§ 27.7.6.1 Negotiation arguments for having confidentiality obligations expire

Whether confidentiality obligations should ever expire might depend on the circumstances:

- Some types of confidential information will have a limited useful life, e.g., future plans. Such information might reasonably have its protection limited to X months or years.
- Other types of confidential information might have essentially-unlimited useful life — for example (putatively), the recipe for making Coca-Cola® syrup.

A receiving party might want an expiration date for confidentiality obligations as a safe harbor. After X years have gone by, it might well take time and energy for the receiving party to figure out (1) which information of the disclosing party is still confidential, and (2) whether the receiving party might be using or disclosing confidential information in violation of the NDA. The receiving

party likely would prefer instead to have a bright-line "sunset," after which the receiving party can do whatever it wants without having to incur the burden of analyzing the facts and circumstances.

A disclosing party *might* regard an expiration date for confidentiality obligations as acceptable, depending largely on:

1. how sensitive the information is, in the disclosing party's eyes, and
2. how long it will be until the confidentiality obligations expire.

For example: Suppose that:

- the confidential information relates to the design of a product manufactured and sold by the disclosing party, and
- the disclosing party knows that, in two years, it will be discontinuing the product and will no longer care about the product-design information.

In that situation, the disclosing party might be willing to have the receiving party's confidentiality obligations expire in three or four years. That would provide the receiving party with a bright-line sunset date as well as providing the disclosing party with a year or two of safety margin.

§ 27.7.6.2 Danger of letting confidentiality obligations expire

If the receiving party's confidentiality obligations are allowed to expire, the disclosing party might thereafter find it difficult — or, more likely, impossible — to convince a court to enforce any trade-secret rights in the relevant information. [CITATION NEEDED]

§ 27.7.6.3 Possible expiration dates for confidentiality obligations

The parties could specify that the Receiving Party's confidentiality obligations will expire X months or years after:

- the date that all copies of the information are returned or destroyed;
- the effective date of the AGREEMENT;
- the effective date of termination or expiration of the AGREEMENT.

§ 27.7.7 Confidentiality agreements ("NDAs") and potential investors

Potential investors in a company might be reluctant to sign a nondisclosure agreement ("NDA"). Venture capitalists in particular often flatly refuse to do so. With folks like that, you basically have to take your chances that they won't "steal" your idea.

As a practical matter, going *without* an NDA *with venture capitalists* might not be a bad bet, because:

- You can try to be very, very selective about what you disclose without an NDA, so that you're not giving away the "secret sauce" of your idea.
- Investors and others generally do have one or two other things on their minds. They generally see lots of entrepreneurs who are convinced they've got a world-beating idea. You'll probably be lucky to get these investors to pay attention for two minutes. Ask yourself how likely it is that they'll want to take your idea and spend time and money building a business around it without you.
- Contracts aren't the only thing that discourage bad behavior. If an investor stole someone's idea, and if word got around, then that investor might later find it hard to get other people to talk to him.
- You have to decide what risks you want to take. Your business might fail because an investor steals your idea and beats you to market. Or it might fail because you can't raise the money you need to get started.

It's sort of like having to take a trip across the country. You have to decide whether to fly or drive. Sure, there's a risk you could die in a plane crash flying from one side of the country to the other. But if you were to drive the same route, your risk of dying in a car crash has been estimated as being something like 65 times greater than flying.

As the old saying goes, you pays your money and you takes your choice.

§ 27.7.8 Caution: NDAs and prospective BigCo partners / acquirers

It's not unheard of for a big company to approach a small company about being "partners," perhaps hinting that the big company might want to acquire the small company. In that situation, the small company should be alert to the possibility that the big company might be trying to get a free look at the small company's confidential information. See, e.g., this story told by an anonymous commenter on Hacker News.

An NDA can come in very handy in such situations. *Enforcing* an NDA can take a lot of time and money, especially if the big company is convinced (or convinces itself) that it hasn't done anything wrong. But a jury might well punish a big company that it found breached a secrecy agreement. See, e.g., Celeritas Technologies Ltd. v. Rockwell Int'l, Inc., 150 F.3d 1354 (1998), where a federal-court jury in Los Angeles awarded a startup company more than $57 million because the jury found that Rockwell had breached an NDA. (Disclosure: The author was part of Rockwell's trial team in that case.)

§ 27.7.9 Review questions *(for students)*

§ 27.7.9.1 FACTS:

You represent Seller, Inc., which is considering signing a confidentiality agreement ("NDA," or nondisclosure agreement) with a potential customer, Buyer, Inc.

The NDA says:

The Receiving Party acknowledges that the Confidential Information is proprietary to the Disclosing Party, has been developed and obtained through great efforts by the Disclosing Party and that Disclosing Party regards all of its Confidential Information as trade secrets.

QUESTION 1: Are you OK with this?

MORE FACTS: The NDA contains blanks to be filled in for who will be the "Disclosing Party" and who will be the "Recipient."

QUESTION 2: What should be filled in?

QUESTION 3: Should the NDA include a time limit for when disclosure can be made in confidence? Why or why not?

MORE FACTS: The NDA includes a number of exclusions from the definition of *Confidential Information*. One of those exclusions is that information subject to a third-party subpoena is not considered Confidential Information.

QUESTION 4: Would you object to this? Why?

QUESTION 5: What would be a better alternative?

MORE FACTS: The NDA states:

> The Receiving Party acknowledges that any breach or threatened breach of this Agreement by the Receiving Party would result in irreparable harm to the Disclosing Party,

> entitling the Disclosing Party to temporary and permanent injunctive relief against the breach; the Receiving Party waives any requirement that the Disclosing Party post a bond.

You remember seeing this sort of clause in a lot of NDAs.

QUESTION 6: From Seller's perspective, do you see any problem with this clause? *[Hint: Look for "bond" in the Equitable Relief provisions.]*

§ 28 Confidentiality of Dealings Requirement

a. All nonpublic information about the fact, and the terms, of the parties' dealings under the AGREEMENT must be preserved in confidence (as defined below) by the specified party (each party if not otherwise specified).

b. For this purpose, "preserved in strict confidence" means not disclosing (or confirming) the fact or terms of the parties' dealings to any third party, nor to any of the obligated party's officers, directors, employees, and agents, except on a need-to-know basis.

c. The confidentiality obligation of this Protocol: ☑ does not expire ❑ expires at exactly 12 midnight at the end of *[FILL IN DATE]*.

§ 28.2 Commentary

Parties often want the mere fact that they are in discussions to remain confidential, let alone the details of their business dealings. That can present some tricky issues, though, especially in an employment-related agreement, as discussed in more detail below.

For example, in a sales agreement:

• The vendor might want for the pricing and terms of the agreement to be kept confidential. Otherwise, a buyer for a future prospective customer might say, "I know you gave our competitor a 30% discount, and I want to show my boss that I can get a better deal than our competitor did, so you need to give *me* a 35% discount if you want my business."

• Conversely, the customer might not want others to know who its suppliers are, possibly because the customer doesn't want its competitors trying to use the same suppliers.

Likewise, parties to "strategic" contracts such as merger and acquisition agreements very often want their discussions to be confidential. If the word leaks out that a company is interested in being acquired, that could send its stock price down.

Tangentially: Agreements to settle disputes sometimes require that the settlement terms be kept confidential. /*See, e.g.*, Caudill v. Keller Williams Realty, Inc.., 828 F.3d 575 (7th Cir. 2016) (Posner, J.) (affirming district-court holding that settlement agreement's liquidated-damages provision, calling for $20 million payment for breach of agreement's confidentiality requirement, was unreasonable).

§ 28.2.1 Confidentiality of parties' *dealings*, not of their *relationship*

Drafters should be careful to make it clear that the parties' *dealings* are confidential, not their *relationship*. If it were otherwise — that is, if an agreement said that the parties' *relationship* was confidential — then the confidentiality provision might be (mis)interpreted as a declaration of a "confidential relationship"; that in turn might imply unwanted fiduciary obligations.

§ 28.2.2 Confidential-dealings clauses have been enforced

Clauses requiring parties' contract terms to be kept confidential have been enforced. For example, in 2013 the Delaware chancery court held that a party materially breached an agreement by publicly disclosing the agreement's terms in violation of a confidentiality clause, thereby justifying other party's termination of agreement. /See/ eCommerce Indus., Inc. v. MWA Intelligence, Inc., No. 7471-VCP, part II-A, text accompanying notes 117 et seq. (Del. Ch. Oct. 4, 2013).

§ 28.2.3 But a confidential-dealings clause might not be "material"

In a different case, the Supreme Court of Delaware held that in a patent license agreement, a provision requiring the terms of the license to be kept confidential was /not/ material, because the gravamen of the contract was the patent license, not the confidentiality provision; as a result, when the licensee publicly disclosed the royalty terms, the patent owner was not entitled to terminate the license agreement for material breach (see § 4.76). Qualcomm Inc. v. Texas Instr. Inc., 875 A.2d 626, 628 (Del. 2005) (affirming holding of chancery court).

§ 29 Beware of confidential-*dealings* clauses in employment agreements

In employment agreements, confidentiality provisions sometimes require the employee to keep confidential all information about salary, bonus, and other compensation. The NLRB and some courts have taken the position that such a requirement violates Section 7 of the National Labor Relations Act, as explained in this Baker Hostetler memo. (See also the discussion of how the [U.S.] Securities and Exchange Commission has taken a similar view about employees' reporting possible criminal violations to government authorities.)

§ 30 Consequential Damages Exclusion

COMMENTARY

CAUTION: Drafters should consider instead simply establishing some kind of damages cap, as discussed in the Damages Cap entry. That's because, as discussed below, it can be tricky to determine just what damages incurred by a party are "consequential" and thus would be excluded.

§ 30.1 What *are* "consequential damages"?

The term "**consequential damages**" (whether or not capitalized) refers to **uncommon harm**, namely: at the time that the parties entered into the AGREEMENT, reasonable people, experienced in the type of business contemplated by the AGREEMENT, would not have expected such harm to result routinely, in the usual course of things, from the event (or series of events) that produced the harm.

COMMENTARY

This language essentially paraphrases the crux of the *Hadley* rule.

Reminder: It's black-letter law that damages cannot be recovered in any case for *unforeseeable* harm.

Subdivision 2: This definition follows the landmark English case of Hadley v. Baxendale, [1854] EWHC Exch J70 (the "corn mill crankshaft

case"), and its progeny, as explained in detail in the additional commentary to this section.

CAUTION: Drafters should keep in mind that, as Ken Adams points out, "courts are prone to holding that elements of damages that the seller might have intended to exclude are in fact direct rather than consequential." Adams cites a UK case, GB Gas Holdings Ltd. v Accenture (UK) Ltd., [2010] EWCA 912 at paragraphs 66-69, affirming [2009] EWHC 2734 (Comm), in which certain specific claims for damages were held (as a preliminary matter, before trial) not to be categorically excluded from recovery by the contract's exclusion of indirect and consequential damages.

Practice note: Some drafters like to enumerate specific categories of risk for which damages cannot be recovered, hoping to improve the odds that a court will enforce the enumeration in a manner congenial to them. The following categories have been harvested from various agreement forms but should be reviewed carefully, as some could be a bad idea: • breach of statutory duty; • business interruption; • diminution of value — but in a purchase of goods (or other asset), this might well be one of the principal measures of damages; see Thomas H. Warren, W. Jason Allman, & Andrew D. Morris, Top Ten Consequential Damages Waiver Language Provisions to Consider (ACC.com 2012), archived at https://perma.cc/AE4M-ZLKW; • loss of business or of business opportunity; • loss of competitive advantage; • loss of data; • loss of privacy; • loss of confidentiality — this would normally be a really bad idea, at least from the perspective of a party disclosing confidential information; • loss of goodwill; • loss of investment; • loss of product; • loss of production; • loss of profits from collateral business arrangements; • loss of cost savings; • loss of use; • loss of revenue. ¶ For a summary of cases in U.S., English, and Australian courts addressing such "laundry lists," see Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic "Excluded Losses" Provision in Private Company Acquisition Agreements, 987-91 (Weil.com 2015), archived at http://perma.cc/D2HC-Z5XD.

§ 30.2 What does this Exclusion do?

a. No party will be entitled to recover damages for uncommon harm (defined above) from any other party, and no such other party will attempt to do so.

b. This Exclusion, however, does not limit recovery of lost profits from the specific transaction(s) contemplated by the AGREEMENT.

COMMENTARY

Subdivision a: The "no other party will attempt to recover …" phrase is intended to make it a separate breach of the AGREEMENT for a party to try to set aside a consequential-damages exclusion.

Subdivision b follows New York law as stated in Biotronik A.G. v. Conor Medsystems Ireland, Ltd., 22 N.Y.3d 799, 11 N.E.3d 676, 988 N.Y.S.2d 527 (2014), where that state's highest court held that, on the specific facts of the case, "lost profits were the direct and probable result of a breach of this Agreement *and thus constitute general damages*" (emphasis added, citations omitted), and thus were not barred by a limitation-of-liability clause. *Accord*, Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc., 487 F.3d 89, 109-110 (2d Cir. 2007); Atos IT Solutions and Services GMBH v Sapient Canada Inc., 2018 ONCA 374 ¶ 72.

CAUTION: A federal district court held that a particular clause excluding all lost profits meant that a party could recover no damages for breach — and this, said the court, meant that under *Wisconsin* law, the agreement's limited remedy (i) failed of its essential purpose and (ii) was unconscionable; thus, under UCC § 2-719, all UCC remedies were available, including lost profits as consequential damages. On appeal, the Seventh Circuit agreed, even though the majority of states had since shifted to the opposite view, on grounds that to change Wisconsin law was not a matter within the purview of federal courts. See Sanchelima Int'l, Inc. v. Walker Stainless Equipment Co., 920 F.3d 1141 (7th Cir. 2019) (with extensive citations).

§ 30.3 Does it matter what the liable party knew, when?

This Exclusion applies even if the liable party was advised (or had other reason to know) of the possibility, or even the probability, of the uncommon harm (defined above) in question.

COMMENTARY

This language "writes around" part of the *Hadley* rule. The *business* idea is that **as a matter of agreed allocation of risk** — and to try to avoid after-the-fact disputes about what both parties did or did not contemplate — the breaching party will not be liable for damages for

uncommon harm, period; this will be true even if the breaching party had been advised that the uncommon harm might occur, or even that it probably *would* occur, in case of breach.

The party at risk of suffering the uncommon harm is free to try to bargain for the future breaching party to accept more of the risk associated with the uncommon harm — although that might affect the economics of the transaction. This would work in much the same way that **an overnight delivery service will typically limit its liability for loss or damage unless the sender declares a higher value for the package,** in which case the delivery service will usually charge a higher price.

§ 30.4 What other terms apply to this Exclusion?

The Limitation of Liability General Terms are incorporated by reference into this Exclusion.

§ 30.5 Additional commentary

§ 30.5.1 *Hadley v. Baxendale*

As every first-year law student learns (in the U.S. at least), consequential damages are usually defined with reference to the landmark English case of Hadley v. Baxendale, [1854] EWHC Exch J70. In *Hadley*:

A corn mill used a crankshaft to turn a grinding wheel. The crankshaft broke, and the mill owners didn't have a spare, so they engaged a transportation company to take the broken crankshaft to a manufacturer, which would use the broken crankshaft as a template to make a new one. **Without a crankshaft, the corn mill was out of commission**.

The transportation company screwed up and didn't deliver the broken crankshaft to the manufacturer when promised, so the corn mill was out of commission for longer than anticipated. **The mill owners sued the transportation company for the profits they lost during the mill's *extra* down time**.

The court held that the mill owners could not recover the lost profits from the mill's extra down time, because:

- that type of damage from the transportation company's breach — i.e., the mill owners' loss of profits from an out-of-commission corn mill —

was **not something that would have been expected to occur in the usual course**; *and*

- in the particular circumstances of the case, the transportation company had **no reason to think** that its breach would cause such harm; for example, the transportation company had no reason to know that (because the mill owners didn't have a spare crankshaft on hand) the broken crankshaft had put the corn mill out of commission.

The *Hadley* rule diverges from tort law's "eggshell skull" rule, under which a defendant is liable for the plaintiff's "unforeseeable and uncommon reactions to the defendant's negligent or intentional tort." Eggshell Skull Rule, at https://www.law.cornell.edu/wex/eggshell_skull_rule; see generally, e.g., Vosburg v. Putney, 80 Wis. 523, 50 N.W. 403 (1891); Thomas J. Miles, Posner on Economic Loss in Tort: EVRA Corp v. Swiss Bank, 74 U. CHI. L. REV. 1813, 1813 n.1 (2007), archived at https://perma.cc/EV2G-BETQ (explaining eggshell-skull rule).

The following quote from the *Hadley* opinion is instructive and worth a careful reading:

> Now we think the proper rule in such a case as the present is this:-- Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising[:]
>
> [i] naturally, i.e., **according to the usual course of things**, from such breach of contract itself, or
>
> [ii] such as may reasonably be supposed to have been in the contemplation of **both** parties, **at the time they made the contract,** as the **probable** result of the breach of it.
>
> Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to *both* parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be **the amount of injury which would ordinarily follow** from a breach of contract **under these special circumstances so known and communicated.**

> But, on the other hand, if these special circumstances were **wholly unknown** to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise *generally*, and *in the great multitude of cases not affected by any special circumstances*, from such a breach of contract.
>
> For, had the special circumstances been known, **the parties might have specially provided for the breach of contract by special terms** as to the damages in that case; and of this advantage it would be very unjust to deprive them.

(Emphasis extra paragraphing, and bracketed numerals added.)

Now as a hypothetical situation, let's suppose that the mill owners, in negotiating their contract with the transportation company, had included language along the following lines: *Our corn mill is out of commission, and we're losing money every day, so it's important that you get the replacement crankshaft back to us when you promised.* In that situation, the *Hadley* court might well have allowed the mill owners to recover their lost profits, because the transportation company clearly had reason to know of the mill owners' special vulnerability to a breach.

So let's change the hypothetical facts again: Suppose that the mill owners hadn't been quite so explicit in their warning to the transportation company, but the court found that the transportation company still had reason to know about the mill owners' plight. In that situation, the *Hadley* court might also have allowed the mill owners to recover their lost profits.

§ 30.5.2 *Hadley* is still followed

The principles announced in *Hadley v. Baxendale* are still followed. For example, in New York, as announced by the state's highest court:

> … the party breaching the contract is liable for those risks foreseen **or which should have been foreseen** at the time the contract was made. It is not necessary for the breaching party to have foreseen the breach itself or the particular way the loss occurred, rather, it is only necessary that loss from a breach is [i] foreseeable *and* [ii] **probable**.

> To determine whether consequential damages were reasonably contemplated by the parties, courts must look to the nature, purpose and particular circumstances of the contract known by the parties as well as **what liability the defendant fairly may be supposed to have assumed consciously**, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.
>
> Of course, proof of consequential damages cannot be speculative or conjectural.

Bi-Econ. Mkt., Inc. v. Harleysville Ins. Co., 10 N.Y.3d 187, 193, 886 N.E.2d 127 (2008) (cleaned up; citations omitted, emphasis, extra paragraphing, and bracketed romanettes added); see also Kreg Therapeutics, Inc. v. VitalGo, Inc., No. 17-3005, slip op. at 20-21, part II.B.3 (7th Cir. Mar. 14, 2019), citing *Bi-Econ. Mkt.*; PNC Bank, Nat. Ass'n v. Wolters Kluwer Financial Servs. Inc., 73 F. Supp. 3d 358, 370 (S.D.N.Y. 2014) (following New York law).

For a somewhat-stricter definition, see El Paso Marketing, L.P. v. Wolf Hollow I, L.P., 383 S.W.3d 138, 144 (Tex. 2012), where the court (quoting from an earlier opinion) said that:

> Direct damages are the *necessary and usual* result of the defendant's wrongful act; they flow naturally *and necessarily* from the wrong.
>
> Consequential damages, on the other hand, result naturally, *but not necessarily*.

(Cleaned up, emphasis and extra paragraphing added.)

§ 30.5.3 A consequential-damages award could be ruinous

An award of consequential damages can be sizeable, as noted practitioner-commentator Glenn D. West observes:

> In 1984, an Atlantic City casino entered into a contract with a construction manager respecting the casino's renovation. **The construction manager was to be paid a $600,000 fee** for its construction management services. In breach of the agreement, completion of construction was delayed by several months. As a result, the casino was unable to open on time and [it] **lost profits, ultimately determined by an arbitration panel to be in the**

> **amount of $14,500,000.** *There was no consequential damages waiver in the contract at issue in this case.*

Glenn D. West, Consequential Damages Redux …, 70 BUS. LAWYER 971, 984 (Weil.com 2015) (footnote omitted, emphasis added), archived at http://perma.cc/D2HC-Z5XD.

In an example from Down Under, a Dr. Kitchen, an opthmalmologist, wrongfully terminated his service agreement with an eye clinic. The service agreement did not include an exclusion of consequential damages. **The Supreme Court of Queensland held him held liable for the clinic's lost profits and other amounts, in the total sum of nearly AUD $11 million**. *See* Vision Eye Institute Ltd v Kitchen, [2015] QSC 66, *discussed in* Jodie Burger and Viva Paxton, Australia: A stitch in time saves nine: How excluding consequential loss could save you millions (Mondaq.com 2015).

§ 30.5.4 A consequential-damages *disclaimer* should make *Hadley* irrelevant

In our *Hadley* hypothetical above, let's suppose that the transportation company's contract form had expressly excluded liability for consequential damages. In that situation, at least under U.S. law (and assuming no factors such unconscionability), *it would have been irrelevant if the transportation company knew or had reason to know of the mill owners' plight*, because the transportation company would not have been liable for consequential damages anyway.

A consequential-damages disclaimer usefully simplifies litigation and settlement discussions concerning the breach of contract. To paraphrase one of the author's former students on a different subject, "*that's a conversation we don't want to have*."

§ 30.5.5 The Fourth Circuit lectures negotiators of consequential-damages exclusions

If a customer agrees to an exclusion of consequential damages protecting a supplier, the customer might find that courts are unsympathetic that the customer wasn't made whole by what it was able to recover from the supplier. To borrow a line from the movie *The Princess Bride*, the Fourth Circuit 'splained things in a case where a fumigation service provider had caused millions of dollars of damage to its customer's facility, but a consequential-

damages exclusion in the contract spared the fumigator from having to pay for the damage:

> Companies faced with consequential damages limitations in contracts have two ways to protect themselves. First, they may purchase outside insurance to cover the consequential risks of a contractual breach, and **second, they may attempt to bargain for greater protection against breach** from their contractual partner. Severn *[the fumigation customer]* apparently did take the former precaution — it has recovered over $19 million in insurance proceeds from a company whose own business involves the contractual allocation of risk. But it did not take the latter [precaution], and there is no inequity in our declining to rewrite its contractual bargain now.

Severn Peanut Co. v. Industrial Fumigant Co., 807 F.3d 88, 92 (4th Cir. 2015) (emphasis added). The appellate court affirmed summary judgment in favor of the fumigator.

§ 30.5.6 For simplicity: Consider some kind of damages cap instead?

Excluding consequential damages creates the risk of future disputes about what specific damages are excluded. Parties should consider instead simply imposing a cap on recoverable damages — either a cap on overall damages or a cap on consequential damages. For more details, see the Damages Cap entry.

§ 30.5.7 Further reading on consequential damagers *(optional)*

Bi-Econ. Mkt., Inc. v. Harleysville Ins. Co., 10 N.Y.3d 187, 193, 886 N.E.2d 127 (2008).

Kreg Therapeutics, Inc. v. VitalGo, Inc., No. 17-3005, slip op. at 20-21, part II.B.3 (7th Cir. Mar. 14, 2019), *citing Bi-Econ. Mkt.*

PNC Bank, Nat. Ass'n v. Wolters Kluwer Financial Servs. Inc., 73 F. Supp. 3d 358, 370 (S.D.N.Y. 2014) (following New York law).

RESTATEMENT (SECOND) OF CONTRACTS § 351, "Unforeseeability And Related Limitations On Damages," comment b.

Thomas J. Miles, Posner on Economic Loss in Tort: EVRA Corp v. Swiss Bank, 74 U. CHI. L. REV. 1813 (2007), archived at https://perma.cc/EV2G-BETQ, in

which the now-dean of the University of Chicago's law school examines *Hadley*'s principles in a tort-related context.

Thomas H. Warren, W. Jason Allman & Andrew D. Morris, Top Ten Consequential Damages Waiver Language Provisions to Consider (2012).

Glenn D. West, Consequential Damages Redux, *supra*, 70 BUS. L. at 992.

§ 31 Conspicuousness Definition

§ 31.1 What does "conspicuous" mean?

a. A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it.

b. If a party was represented by counsel in entering into the AGREEMENT, then any term in the AGREEMENT that is not obscured (see also the Redlining Representation) is deemed conspicuous *as to that party*.

COMMENTARY

> In some jurisdictions, certain types of clauses might not be enforceable unless they are "conspicuous." For clauses in this category, courts typically want extra assurance that the signers knowingly and voluntarily assented to the relevant terms and conditions.
>
> (Spoiler alert: A long provision in all-capital letters ("all-caps") won't necessarily be deemed conspicuous; it's just less readable.)
>
> This definition of *conspicuous* is based on the definition in section 1-201(10) of the [U.S.] Uniform Commercial Code.
>
> Subdivision b cuts the Gordian knot: If a party is represented by counsel, then that party should not be heard to complain about a supposed lack of conspicuousness unless the provision in question was somehow obscured.

§ 31.2 Does conspicuousness require all-caps?

No — and in fact all-caps provisions are discouraged except for terms of just a few words.

COMMENTARY

The Ninth Circuit noted acerbically:

> **Lawyers who think their caps lock keys are instant "make conspicuous" buttons are deluded.** In determining whether a term is conspicuous, we look at more than formatting. A term that appears in capitals can still be inconspicuous if it is hidden on the back of a contract in small type. Terms that are in capitals but also appear in hard-to-read type may flunk the conspicuousness test. **A sentence in capitals, buried deep within a long paragraph in capitals will probably not be deemed conspicuous.** Formatting does matter, but conspicuousness ultimately turns on the likelihood that a reasonable person would actually see a term in an agreement. Thus, it is entirely possible for text to be conspicuous without being in capitals.

In re Bassett, 285 F.3d 882, 886 (9th Cir. 2002) (emphasis added, citations omitted). To like effect is a Georgia supreme court opinion:

> No one should make the mistake of thinking, however, that capitalization always and necessarily renders the capitalized language conspicuous and prominent. In this case, **the entirety of the fine print appears in capital letters, all in a relatively small font**, rendering it difficult for the author of this opinion, among others, to read it. Moreover, **the capitalized disclaimers are mixed with a hodgepodge** of other seemingly unrelated, boilerplate contractual provisions — provisions about, for instance, a daily storage fee and a restocking charge for returned vehicles — **all of which are capitalized** and in the same small font.

Raysoni v. Payless Auto Deals, LLC, 296 Ga. 156, 766 S.E.2d 24, 27 n.5 (2014).

The drafting tips here, of course, are:

- Be judicious about what you put in all-caps.
- Don't use too small a font for language that is to be conspicuous.

CAUTION: Conceivably a relevant statute might *require* certain contract terms to be in all-caps; this is especially likely to be true in the case of consumer-protection legislation.

§ 31.3 Additional commentary

§ 31.3.1 In judging conspicuousness, courts tend to focus on "fair notice"

In a non-UCC context, the Supreme Court of Texas held that — with a possibly-significant exception — an indemnity provision protecting the indemnitee from its own negligence must be sufficiently conspicuous to provide "fair notice." The supreme court adopted the conspicuousness test stated in the UCC, quoted above; the court explained:

> This standard for conspicuousness in Code cases is familiar to the courts of this state and conforms to our objectives of commercial certainty and uniformity. **We thus adopt the standard for conspicuousness contained in the Code** for indemnity agreements and releases like those in this case that relieve a party in advance of responsibility for its own negligence.
>
> *When a reasonable person against whom a clause is to operate ought to have noticed it, the clause is conspicuous.*
>
> For example, language in capital headings, language in contrasting type or color, *and language in an extremely short document*, such as a telegram, is conspicuous.

Dresser Indus., Inc. v. Page Petroleum, Inc., 853 S.W.2d 505, 508-09 (Tex. 1993) (citations omitted, emphasis and extra paragraphing added).

The *Dresser* court also pointed out that **the fair-notice requirement did not apply to settlement releases**: "Today's opinion applies the fair notice requirements to indemnity agreements and releases only when such exculpatory agreements are utilized to relieve a party of liability for its own negligence *in advance*." *Id.*, 853 S.W.2d at 508 n.1 (emphasis added).

§ 31.3.2 Fair notice will often depend on the circumstances

What counts as "conspicuous" will sometimes depend on the circumstances. In still another express-negligence case, the Texas supreme court said that the indemnity provision in question did indeed provide fair notice because:

> The entire contract between Enserch and Christie consists of one page; the indemnity language is on the front side of the contract and is not hidden under a separate heading. The exculpatory language and the indemnity language, although contained in separate sentences, appear together in the same paragraph and the indemnity language is not surrounded by completely unrelated terms. Consequently, the indemnity language is sufficiently conspicuous to afford "fair notice" of its existence.

Enserch Corp. v. Parker, 794 S.W.2d 2, 8-9 (Tex. 1990).

A federal judge held that a contract's waiver of the right to jury trial was sufficiently conspicuous when it was "in plain language, written in an identical font size as the rest of the MLA, and was in a short document between two sophisticated parties," in "a complex business transaction in which neither side had a significant bargaining power advantage over the other." BMC Software, Inc. v. IBM Corp., No. H-17-2254, slip op. at 8, 9, part III-C (S.D. Tex. Jan. 25, 2019) (adopting magistrate judge's order granting IBM's motion to strike BMC's jury demand).

§ 31.3.3 Actual knowledge – when proved – might substitute for conspicuousness

Texas's *Dresser* court noted an exception to the conspicuousness requirement: "The fair notice requirements are not applicable when **the indemnitee establishes that the indemnitor possessed actual notice or knowledge** of the indemnity agreement." *Id.*, 853 S.W.2d at 508 n.2 (emphasis added, citation omitted).

Note especially the emphasized portion of the above quotation, which implies that the burden of proof of actual notice or knowledge is on the party claiming indemnification from its own negligence.

In contrast, a federal district judge in Houston granted Enron's motion to dismiss Hewitt Associates' claim for indemnity, on grounds that the contract in question did not comply with the conspicuousness requirement of the "express negligence" rule (which requires obligations to indemnify someone

against their own negligence to be both express and conspicuous). The judge surveyed prior cases in which actual knowledge (of an indemnity clause) had been sufficiently established, including by ways such as:

- evidence of specific negotiation, such as prior drafts;
- through prior dealings of the parties, for example, evidence of similar contracts over a number of years with a similar provision;
- proof that the provision had been brought to the affected party's attention, e.g., by a prior claim.

See Enron Corp. Sav. Plan v. Hewitt Associates, LLC, 611 F. Supp. 2d 654, 673-75 (S.D. Tex. 2008) (Harmon, J.).

§ 31.3.4 Guidance from the SEC *(skim)*

The Security and Exchange Commission's Plain English Handbook (at 43) points out that:

> … **All uppercase sentences usually bring the reader to a standstill** because the shapes of words disappear, causing the reader to slow down and study each letter. Ironically, readers tend to skip sentences written in all uppercase.
>
> To highlight information and maintain readability, use a different size or weight of your typeface. Try using **extra white space, bold type, shading, rules, boxes, or sidebars in the margins** to make information stand out. …
>
> Whatever method you choose to highlight information, **use it consistently** throughout your document so your readers can recognize how you flag important information.

(Emphasis and extra paragraphing added.)

The Handbook gives a "before" example:

> THE SECURITIES AND EXCHANGE COMMISSION HAS NOT APPROVED OR DISAPPROVED THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

It suggests replacing the all-caps with italics …

> *The Securities and Exchange Commission has not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.*

… or with bold-faced type:

> **The Securities and Exchange Commission has not approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

§ 31.3.5 Further reading

See Linda R. Stahl, Beware the Boilerplate: Waiver Provisions (Andrews Kurth Jan. 14, 2013) (citing Texas cases).

§ 32 Consumer Price Index Definition

Unless the AGREEMENT states otherwise, "CPI" and "Consumer Price Index" refers to the Consumer Price Index – All Urban Consumers ("CPI-U"), as published from time to time by U.S. Bureau of Labor Statistics.

§ 32.1 Commentary

§ 32.1.1 Business context

CPI clauses are sometimes included in contracts for ongoing sales or goods or services. Such contracts will typically lock in the agreed pricing for a specified number of years, subject to periodic increases by X% per year (let's say) or by the corresponding increase in CPI, whichever is greater (or sometimes, whichever is *less*).

Depending on the industry, CPI-U might or might not be the best specific index for estimating how much a provider's costs have increased. this is explained in the FAQ page of the Bureau of Labor Statistics (accessed Aug. 16, 2012).

§ 32.1.2 Caution: "The lesser of CPI or X%" could be dangerous

Prohibiting a provider from increasing its pricing by more than the increase in CPI or X percent per year, whichever is *less*, would force the provider to 'eat' any increases in its own costs that exceeded the increase in the particular index chosen.

§ 32.1.3 Consider: What if CPI goes down?

A drafter might want to specify whether agreed pricing, rent, etc., can ever *decrease* as a result of changes in CPI.

§ 32.1.4 Consider: Are pricing increases to be compounded?

If price increases are limited to adjusting for increases in CPI over a baseline figure, that will automatically take care of compounding. But if the permissible price increase is "the change in CPI or X%, whichever is greater," then the X% might end up being compounded over time, so that the X% increase in Year One would itself be increased by another X% in Year Two. [NEED EXAMPLE]

§ 32.1.5 Additional reading (optional)

- Malik Crawford and Kenneth J. Stewart, Writing an escalation clause using the Consumer Price Index (BLS Nov. 2012)
- Bureau of Labor Statistics, Frequently Asked Questions (FAQs)

§ 33 *Contra Proferentem* Disclaimer

The parties do not desire for the *contra proferentem* ("against the offeror") principle of contract interpretation to be given effect in interpreting the AGREEMENT; each party therefore **WAIVES** any argument to that effect.

§ 33.1 Commentary

§ 33.1.1 Overview

The *contra proferentem* principle of contract interpretation holds that **if** an ambiguity in particular language cannot be resolved by other conventional

means, then the ambiguity should be resolved against the party that drafted the ambiguous language and thus is "to blame" for the problem.

(If a contract provision is not ambiguous, then *contra proferentem* won't come into play in the first place.)

The (U.S.) Supreme Court explained the concept of *contra proferentem*: "Respondents drafted an ambiguous document, and they cannot now claim the benefit of the doubt. The reason for this rule is to protect the party who did not choose the language from an unintended or unfair result." Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62-63 (1995) (reversing 7th Circuit) (citations and footnotes omitted).

The *contra proferentem* principle gives drafters a powerful incentive to draft clearly: As between the drafter of ambiguous language, on the one hand, and the "innocent" other party, it's the drafter that must bear the consequences of the ambiguity.

For additional information, see generally:

- the Wikipedia article Contra proferentem;
- Michelle E. Boardman, *Contra Proferentem*: The Allure of Ambiguous Boilerplate, 104 MICH. L. REV. 1105 (2006) (hat tip: Anna Sharova in a LinkedIn group discussion (group membership required).

§ 33.1.2 Caution: Disclaiming *contra proferentem* could cause problems

Suppose that (1) a contract states that *contra proferentem* is not to be applied, but in a dispute, (2) a court or arbitrator concludes that an ambiguity in a contract could not otherwise be resolved. The results in that situation might be unpredictable:

- The tribunal might disregard the *contra proferentem* prohibition and apply the principle to resolve the ambiguity; or
- The tribunal might rule that the ambiguous provision could not be enforced — which in some circumstaces might jeopardize the enforceability of the entire contract.

(Hat tip: Jonathan Ely, in a comment in a LinkedIn group discussion (group membership required).)

§ 33.1.3 Arguing *contra proferentem* might be a tough sell

In Song v. Iatarola, 83 N.E.3d 80, (Ind. App. 2017), one party to a contract lost a case because of the way the court interpreted a particular provision in the contract. On appeal, the losing party claimed that the provision should have been interpreted against the winning party because the winning party supposedly "wrote" the provision.

The record, though, contained evidence that, while the winning party had *typed* the provision into the Word document, the parties had *jointly drafted* the actual wording of the provision. That sank the losing party's argument; the appellate court held that:

> During the summary judgment stage and in their appeal, the Iatarolas failed to establish that no genuine issue of material fact existed about whether Song *independently* drafted the addendum such that its interpretation should be construed against him. Rather, the evidence outlined above indicates that *it was the Iatarolas who wanted the addendum drafted, and that both parties contributed to its preparation*.

Id., 83 N.E.3d at 81 (on rehearing; emphasis added).

§ 33.2 Question bank

FACTS:

- You represent Buyer in negotiating a long-term master purchase agreement with Seller.
- You draft a price-increase clause that limits Seller's permissible price increases to no more than the increase in CPI (and no more than once a year as well).
- A year later, Seller says it is increasing its price by the percentage stated in a particular CPI published by the U.S. Government for the specific industry in which Seller and Buyer operate. You hadn't known there even was such a thing.
- Your client Buyer angrily tells you that Seller's price increase must be limited to the (much-lower) increase in the "regular" CPI, namely CPI-U, US City Average, All Items, 1982–1984=100.

QUESTION: On these facts, how might a court rule on Buyer's claim that Seller's price increases must be limited to the increase in CPI-U and not to the increase in the special CPI?[4]

§ 34 Copies of Agreement

To reduce the cost of litigation and other proceedings: In any action or other context of any kind, photocopies and electronic images of the AGREEMENT may be used as originals in the same manner as provided in Rule 1003 of the U.S. Federal Rules of Evidence.

COMMENTARY

> In the (U.S.) Federal Rules of Evidence, Rule 1003 provides that in federal-court litigation, "[a] duplicate is admissible to the same extent as the original unless a genuine question is raised about the original's authenticity or the circumstances make it unfair to admit the duplicate."

§ 35 Corroboration requirements (commentary)

Some *TANGO* provisions borrow a corroboration requirement from U.S. patent law. Under that law, if an inventor claims an invention date earlier than the filing date of her patent application, she must corroborate that claim, for example, with a signed- and witnessed laboratory notebook, and cannot rely solely on her testimony alone.

The corroboration requirement helps to guard against the possibility that witnesses might "**describe [their] actions in an unjustifiably self-serving manner** …. The purpose of corroboration [is] to prevent fraud, by providing independent confirmation of the [witness's] testimony." Sandt Technology, Ltd. v. Resco Metal & Plastics Corp., 264 F.3d 1344, 1350 (Fed. Cir. 2001) (affirming relevant part of summary judgment; as a matter of law, inventor provided sufficient corroboration of date of invention) (cleaned up; emphasis added).

[4] Chances are that the court would rule in favor of Seller, because you (on behalf of Buyer) drafted the price-increase provision.

As the U.S. Supreme Court once explained:

> This corroboration requirement for testimony by an interested party is based on the sometimes-unreliable nature of oral testimony, due to the forgetfulness of witnesses, their liability to mistakes, their proneness to recollect things as the party calling them would have them recollect them, aside from the temptation to actual perjury.

Washburn & Moen Mfg. Co. v. Beat 'Em All Barbed-Wire Co., 143 U.S. 275, 284 (1892), *quoted in* TransWeb LLC v. 3M Innovative Properties Co., 812 F.3d 1295, 1301 (Fed. Cir. 2016) (cleaned up).

Corroboration cases are governed by a rule of reason; not every detail need be "independently and conclusively supported by corroborating evidence," *TransWeb*, 812 F.3d at 1302 (internal quotation marks and citation omitted); "there are no hard and fast rules as to what constitutes sufficient corroboration, and each case must be decided on its own facts." *Id.*

§ 36 Counsel Consultation Acknowledgement

a. The parties agree to this section to help forestall hindsight claims that a party should supposedly be excused from its obligations, or that the party is supposedly entitled to greater rights, under the AGREEMENT, because the party purportedly did not understand the implications of entering into that agreement.

b. Each party acknowledges the following:

1. The acknowledging party had the *opportunity* to consult counsel of its choice in deciding whether to enter into the AGREEMENT on the terms stated in it;

2. If the acknowledging party did not consult counsel, it made an informed decision not to do so;

3. In case of doubt: The acknowledging party is not relying on advice from legal counsel for any other party in deciding whether to enter into the AGREEMENT; and

4. Each party other than the acknowledging party is relying on the acknowledgements in this section.

COMMENTARY

Subdivision b.1 — "acknowledges": See the Acknowledgements entry.

The acknowledgements in this section are mainly "litigation insurance," intended to try to foreclose an aggressive trial counsel from arguing the contrary.

Subdivision b.2 says that the parties *have had the opportunity* to consult counsel. It does not say that the parties *have been* represented, because one or both parties might not have been represented.

Subdivision b.2 refers to consultation with counsel when the parties were *entering into* their agreement, not to when they were *negotiating* this Agreement (because there might not have been any negotiation).

Subdivision b.2: The idea for this subdivision came from a services-contract form used by a large company in the oil and gas industry.

Subdivision b.3: This language can provide protection for the parties' attorneys against later claims, by a disgruntled counterparty, to the effect of, *I thought you were* my *lawyer; you had a conflict of interest and didn't disclose it.* (In malpractice lawsuits against attorneys, a standard tactic by plaintiffs' lawyers is to claim that the attorney accused of malpractice had an undisclosed conflict of interest — and that's a claim that's easy for nonlawyer jurors to understand, akin to *They lied!*)

§ 37 Damages Cap

§ 37.1 When does this damages cap apply?

This damages cap applies if the AGREEMENT states, in substance, that a party's liability for damages is limited to either (i) a specified amount, or (ii) an amount that can be computed.

§ 37.2 What is the amount of the damages cap?

a. If the AGREEMENT includes a damages cap but does not specify an amount, then the liability of either party is limited to 2X on a 12-month lookback (see the definition below).

b. The following hypothetical examples are provided to illustrate the meanings of the terms used above:

1. **ABC's liability for breach is capped at 2X:** This means that ABC will not be liable for more than two times the amount paid or payable to ABC.

2. **ABC's liability for breach is capped at 3X on a 12-month lookback:** This means that ABC will not be liable for more than three times the amount that it was paid (or was owed) in the 12-month period just before the date that any claimant against ABC knew or reasonably should have known of the circumstances giving rise to the claim.

§ 37.3 What *types* of damages are limited by the damages cap?

Unless the AGREEMENT clearly states otherwise, the damages cap applies to all damages and other monetary recover that: ☑ arise out of breach ☑ relate to breach, of the AGREEMENT.

COMMENTARY

> The term "relating to" is considered broader than "arising out of"; this means that a relating-to damages cap would potentially limit the recovery for more categories of claim than would an "arising out of" damages cap.

§ 37.4 Does the damages cap cover other monetary awards too?

☑ Yes: The damages cap limits the aggregate monetary amount recoverable (including but not limited to attorney fees and -expenses) in respect of the same claim or group of claims.

❑ No: A party that is liable for capped damages can still be liable for other monetary amounts — for example, attorney fees and -expenses — when allowed by the AGREEMENT and/or by applicable law.

§ 37.5 What other terms apply to the damages cap?

The Limitation of Liability General Terms are incorporated by reference into this article.

§ 37.6 Additional commentary

Consider the cases below:

- From USA Today: "Southwest [Airlines] said in a statement that it suspended operations for about 50 minutes early Friday to 'ensure performance' of software systems that were upgraded overnight. The matter didn't cause any flight cancellations, spokeswoman Michelle Agnew said, but early morning flights on the East Coast were delayed by an average of 40 minutes."
- From KHOU.com: "Hill's Pet Nutrition is facing three class action lawsuits after reports of pet deaths after eating dog food with elevated levels of vitamin D. ... [The company] said it learned of the problem through a complaint. It said a supplier error was to blame for the elevated vitamin D."
- From a corporate press release: A Taiwan company, TSMC, manufactures computer chips. It recently learned that "a batch of photoresist *[a light-sensitive material used in 'etching' circuits onto chips]* from a chemical supplier contained a specific component which *[sic]* was abnormally treated, creating a foreign polymer in the photoresist." BOTTOM LINE: "This incident is expected to reduce Q1 revenue by about US$550 million ...."

Now imagine that you were the supplier that provided the software to Southwest Airlines, or the ingredients to Hill's Pet Nutrition, or the photoresist to the chip manufacturer.

How would you like to have to litigate which damages were "direct" and which were "consequential"?

The better approach: Consider instead trying to negotiating a damages cap, to cut the Gordian knot — or to be like Indiana Jones.

§ 38 Day Definition

a. The term *day* refers to a calendar day.

b. A period of X days begins on the specified date and ends at exactly 12 midnight (UTC if not otherwise specified) at the end of the day X days later. EXAMPLE: If a five-day period begins on January 1, it ends at exactly 12 midnight at the end of January 6.

COMMENTARY

Subdivision b is included for certainty.

UTC is the standard abbreviation for Coordinated Universal Time (basically, Greenwich Mean Time); the specific abbreviation reflects a compromise between English- and French-speakers at the International Telecommunication Union and the International Astronomical Union. See https://en.wikipedia.org/wiki/Coordinated_Universal_Time

§ 39 Deadline Definition

IF: The AGREEMENT states a deadline date marking the end of a specified period, but does not clearly indicate a time at which the period ends;
THEN: The period ends at exactly 12 midnight, in the time zone where the relevant actor (or action to be taken) is (or is to be) located, at the end of the indicated date.

COMMENTARY

This definition simply provides a benchmark reference point; using this definition, drafters can precisely specify deadlines as desired.

§ 40 Deceptive-Practices Prohibition

In its dealings relating to the AGREEMENT, each party will:

1. refrain from engaging in any deceptive, misleading, or unethical practice; and
2. ☑ defend and indemnify each other party against any third-party claim arising out of any alleged such practice.

COMMENTARY

Provisions like this are sometimes seen in contracts where, say, a manufacturer's reputation might be adversely affected by deceptive conduct on the party of a reseller.

§ 41 Deliveries

COMMENTARY

This Article is adapted from various purchase order forms.

§ 41.1 What delivery commitment does Supplier make?

☑ Supplier: ☑ will cause delivery ❑ will endeavor to cause delivery of ordered deliverables, in the quantities, and on the schedule, (i) as specified in the accepted order or (ii) as otherwise agreed in writing.

❑ Delivery times are approximate.

§ 41.2 What packaging requirements must be met?

Supplier will cause all deliverables specified in an accepted order to be properly packaged, including conformance to:

1. any requirements of law; and
2. any specific packaging instructions stated in the accepted order.

§ 41.3 Are country-of-origin markings required on goods?

When required by law or specified in an accepted order, Supplier will cause ordered deliverables (and/or their containers, if applicable) to be accurately marked with their country of manufacture.

§ 41.4 ❑ Time is of the essence for accepted orders

COMMENTARY

> When a contract states that time is of the essence, it generally means that if a party misses a deadline, then the other party will have the right to cancel the contract. But a court might look past a time-of-the-essence clause if it appears that it was included as a mere "stock phrase" as opposed to being genuinely negotiated and agreed to. See generally RESTATEMENT OF CONTRACTS § 242, comment d.

§ 41.5 ❑ May Supplier make substitutions for deliverables?

❑ Supplier may not substitute different deliverables for those specified in an accepted order without Customer's prior written consent.

❑ Supplier may make substitutions for deliverables specified in an accepted order as follows:

a. The substituted deliverables must meet any functional specifications stated in the order for the ordered deliverables.

b. Supplier must advise Customer of the substitution no later than the scheduled time for delivery.

c. Customer may reject the substituted deliverables on or before 14 days after delivery.

§ 41.6 ❑ How will Supplier handle shortages of deliverables?

IF: Supplier runs short of ordered deliverables, for whatever reason or reasons; THEN: Supplier may do some or all of the following: (1) allocate its production as it deems appropriate; (2) delay or stop shipments; (3) send partial shipments with prior notice.

COMMENTARY

> This no-liability provision is a barebones, one-sided force majeure provision.

Supplier and Customer might want to give more thought to this particular "what-if?" scenario; see generally the Force Majeure Protocol.

§ 41.7 Order number is required on shipping documents

IF: Customer provides an identifier for an accepted order that is recognizable as such (for example, a purchase-order number); THEN: Supplier is to cause that identifier to be included on shipping labels, shipping documents, and order-related correspondence.

§ 41.8 Consolidation of shipping documents is encouraged

Supplier is encouraged to consolidate shipping documents wherever practicable.

§ 41.9 Prudent, lawful shipping practices are required

Supplier will see to it that all shipments of deliverables under an accepted order are made in a prudent manner, including without limitation compliance with all applicable laws. (See also the above requirements in this Article concerning packaging.)

§ 41.10 Supplier is responsible for environmental damage

As between Supplier and Customer, Supplier is responsible for any and all environmental damage arising from ordered deliverables to Customer until Customer receives the deliverables.

§ 41.11 ☑ Delivery to Customer-designated third party

a. Customer may designate, in writing, a third party to which deliverables are to be shipped.

b. Supplier will cause deliverables to be shipped to any such third party, absent reasonable objection by Supplier.

COMMENTARY

Supplier might have legitimate reasons for not wanting to ship ordered goods to particular third parties. For example, a third party might be a competitor of Supplier, or the third party might be on a bar list of some kind, e.g., under the export-control laws.

§ 41.12 When will ownership and risk of loss transfer?

Unless otherwise agreed in writing, title and risk of loss for deliverables will pass per INCOTERMS 2010 EXW (Ex Works) Supplier's facility.

COMMENTARY

Drafters should usually try to take advantage of the INCOTERMS three-letter options, which spell out things such as responsibility for freight charges, insurance, and export- and customs clearance, as well as the passage of title and risk of loss. See

§ 41.13 ❑ What if delivery is to be to a stocking point?

IF: The relevant order specifies that ordered deliverables are to be delivered to a warehouse (or other stocking point) until needed by and released to Customer; THEN: Both title and risk of loss for the ordered deliverables will pass to Customer only when they are released for final delivery to Customer.

COMMENTARY

Just-in-time delivery of parts is sometimes used by manufacturers to minimize the amount of their capital that is tied up in inventory. Such a manufacturer might require a supplier to deliver parts and other components — still owned by the supplier, and thus tying up the supplier's capital —until needed by the manufacturer. See generally, e.g., Everything you need to know about Just in Time inventory management (tradegecko.com), archived at https://perma.cc/L7Y9-DDSM.

§ 41.14 ❑ Written advice of shipment is required (with details)

a. This section applies if Customer so requests in the AGREEMENT and/or in a particular accepted order.

b. Seller will advise Customer in writing when the order has been shipped.

c. Seller's written advice of shipment is to include any specific details reasonably requested by Customer, such as tracking information for the shipment.

§ 41.15 ❑ Shipping documents are to be sent for release of goods

If an order so specifies: Promptly after Supplier delivers ordered deliverables to a carrier for shipment to Customer, Supplier will send Customer any documents necessary for Customer to cause the deliverables to be released to Customer or Customer's designee.

COMMENTARY

> In some international shipments, deliverables might be delivered to the custody of customs officials, and Customer might need to present certain documents to have the deliverables released.

§ 41.16 ❑ Prompt alerting (by Supplier) about likely delay is required

a. Supplier is to promptly advise Customer, preferably in writing, if a reasonable person would conclude that a delivery is likely not to meet the schedule specified in the relevant order.

b. In case of doubt: Supplier's advising Customer of a possible delay, in itself, will not affect any right or remedy Customer might have for an actual delay.

§ 41.17 ❑ Prompt alerting (by Customer) about delivery problems is required

Customer will promptly advise Supplier, in writing of any mismatch between the type, quantity, and price of deliverables specified in an accepted order and the deliverables actually delivered.

§ 41.18 ❑ Are partial- and/or early deliveries permitted?

❑ Supplier may, in its sole discretion:

1. ship partial deliveries of ordered deliverables; and
2. deliver ordered goods in advance of the delivery schedule specified in the order.

❑ Customer may, in its sole discretion, reject any delivery that is incomplete or that is not delivered on the date specified in the order; if Customer does so, that will not affect any right or remedy Customer might have arising from the delivery failure.

COMMENTARY

> Supplier might want to be able to ship things as they're finished, without waiting for the order to be completed; on the other hand, Customer might want deliveries to be all-or-nothing, so that Customer's people won't have to spend time dealing with deliveries that don't conform exactly to the Order.

§ 41.19 ❑ Customer may store rejected deliverables at Seller's expense

a. Customer may direct that rejected deliverables be returned to Supplier (at whatever address Supplier specifies) at Supplier's sole expense.

b. Customer may store rejected deliverables, at Supplier's risk, pending Customer's receipt of Supplier's return shipping instructions.

c. Supplier is to pay, or reimburse Customer for, all charges for storage, insurance, and return shipping of rejected deliverables.

§ 41.20 ❑ Customer may sell or dispose of "orphaned" deliverables

a. This section applies if:

1. Customer rejects one or more deliverables as authorized by the AGREEMENT, but
2. Supplier does not provide Customer with pre-paid return shipping instructions within a reasonable time.

b. Customer may, in its sole discretion:

1. destroy some or all of the rejected deliverable(s);
2. sell some or all of the rejected deliverable(s), at a commercially reasonable public- or private sale;
3. otherwise dispose of some or all of the rejected deliverables.

c. If Customer sells some or all of the rejected deliverables, it will apply any proceeds in the following order:

1. expenses of the sale;
2. storage charges;
3. any other amounts due to Customer from Supplier;
4. payment of any remaining balance to Supplier.

§ 41.21 ❑ No Supplier liability for delivery failure

Supplier will not be liable for any failure to deliver all or any part of an order.

COMMENTARY

This is likely to get pushback from customers.

§ 41.22 ❑ Supplier may store deliverables until Customer is ready for delivery

a. This section applies if, through no fault of Supplier or its contractors, Customer is not ready to receive some or all deliverables under an accepted order on the schedule specified in the order.

b. Supplier may cause the relevant deliverables to be stored at a site reasonably selected by Supplier. Such a site might be under the control of Supplier or a third party (such as, for example, a freight forwarder).

c. Both title and risk of loss for stored deliverables will immediately pass to Customer (if that has not happened already).

d. Supplier may deem its delivery of the relevant deliverables to be complete once put into storage (and thus Supplier may invoice Customer for any remaining amount due).

e. Customer will reimburse Supplier for all expenses incurred by Supplier in connection with putting the relevant deliverables into storage, per the Expense Reimbursement article.

f. When Customer is able to accept delivery of the stored deliverables, Supplier will arrange for delivery — but Supplier need not do so if any of Supplier's invoice(s) relating to the order in question is past due.

COMMENTARY

> This optional section draws on ideas seen in § 4.4 of the GE Terms of Sale, cited in § 162.1.

§ 42 Discretion Definition

a. *Basic definition:* Unless the AGREEMENT specifies otherwise, *discretion* refers to reasonable discretion as defined in subdivision c.

b. *Sole discretion:* If the AGREEMENT provides that a party may act in its "sole discretion" (or "unfettered" or "absolute" discretion or similar terms), it means that the party may act:

1. as that party sees fit, with regard solely to its own interests as it then perceives those interests,

2. as long as the action or inaction is not shown — by clear and convincing evidence — to be arbitrary, capricious, or irrational,

and the party is to be conclusively deemed to have satisfied any applicable standard of good faith.

c. *Reasonable discretion:* If the AGREEMENT provides that a party may act in its "reasonable discretion," then that party:

1. must act (i) reasonably, and (ii) in good faith; and

2. is to be presumed to have complied with subdivision c.1 unless shown otherwise by clear and convincing evidence.

d. *Action or inaction:* For purposes of these definitions, not acting is considered an action.

COMMENTARY

Subdivision b: If an agreement gives a party *sole*, *absolute*, and/or *unfettered* discretion as to a particular matter, then the party's exercise of that discretion should be largely unreviewable; the party should normally be deemed to have satisfied any applicable standard of reasonableness and/or good faith.

In the UK, there is case law indicating that discretion must be exercised in good faith and not arbitrarily, capriciously, or irrationally. See Barry Donnelly and Jonathan Pratt, Are you obliged to act reasonably?, in the In-House Lawyer [UK], June 2013, at 20 (archive: https://perma.cc/H9HW-7KDA).

And in some U.S. jurisdictions, a party's discretion might be constrained by an implied obligation of reasonableness, or perhaps of good faith. See, e.g., Han v. United Continental Holdings, Inc., 762 F.3d 598 (7th Cir. 2014) (applying Illinois law).

Unlike the UK cases, this definition does not impose a good-faith requirement on exercises of *sole* discretion, because doing so can complicate litigation.

Subdivision c: This language borrows the idea of a presumption of proper action from the business-judgment rule that is applied to directors of a corporation, albeit without the other duties that bind directors, most notably the duties of loyalty and care. See generally, e.g., Lindsay C.

Llewellyn, Breaking Down the Business Judgment Rule (Winston.com 2013), archived at https://perma.cc/TR7G-CNU8.

§ 43 Disparagement Prohibition

a. Each party (each, an "**Obligated Party**") will refrain from disparaging the other party, and/or the products or services of that other party, to any third party.

b. In case of doubt, for this purpose the term "third party" does not include the other party's affiliates, nor the officers, employees, distributors, resellers, and agents of the other party or any of its affiliates.

COMMENTARY

Manufacturers sometimes ask for disparagement prohibitions in their distribution- or reseller agreements, with the idea that they can prohibit their distributors and resellers from making negative comments to end-customers. Distributors and resellers, however, might well object to this statement, wanting to preserve their freedom to say whatever they please to their own customers.

Some jurisdictions might limit a party's ability to enforce a non-disparagement provision; for example, in 2014, California enacted Cal. Civ. Code 1670.8 prohibiting such provisions in consumer contracts, with civil penalties for violation.

A disparagement prohibition could lead to bad publicity, as discussed in the Review Restrictions entry.

Parties wanting a provision like this should consider the so-called "Streisand effect," which is named for the legendary singer-actress: When word got out that she was trying to suppress unauthorized photos of her residence, the resulting viral Internet publicity resulted in the photos being distributed even more widely — thus defeating her purpose.

The litigation privilege might trump a non-disparagement provision; see, for example, the decision of Maryland's highest court in O'Brien & Gere Engineers, Inc. v. City of Salisbury, 135 A.3d 473, 447 Md. 394 (2016).

§ 44 Dispute Expense Definition

"**Dispute Expense**" refers to one or more of the following when incurred (for example) in a trial or arbitration hearing; an appeal at any level; or other contested proceeding in the action:

1. reasonable fees billed by (or by one or more firms for the services of) attorneys; law clerks, paralegals, and other persons not admitted to the bar but performing services under the supervision of an attorney; and expert witnesses;

2. reasonable expenses actually incurred by individuals and/or firms referred to in subdivision 1 in connection with the proceeding, such as (for example) printing, photocopying, duplicating, and shipping;

3. the costs of the litigation, arbitration, or other proceeding, such as for example costs of court; administration fees charged by an arbitration provider; and arbitrator fees and expenses; and

4. costs, fees, and other expenses incurred in enforcing a right to recover Dispute Expenses.

COMMENTARY

The text of this provision is informed in part by the attorneys-fees clause in the contract in suit in Seaport Village Ltd. v. Seaport Village Operating Co., No. 8841-VCL (Del. Ch. Sept. 24, 2014) (letter opinion awarding attorney fees).

Subdivision 4: Note that any attorney fees, etc., incurred in enforcing the right to attorney fees are themselves recoverable.

§ 45 Effective Date Definition

The effective date of the AGREEMENT is the last date signed as written in the signature blocks.

COMMENTARY

In most contracts, the preamble states the effective date; strictly speaking, that's usually unnecessary unless the contract is to be effective as of

a specific date (and not before or after), but **many drafters like to include the effective date anyway**.

To state the effective date, **the author prefers the "last date signed" approach** that's used in the following example:

> THIS AGREEMENT ("**Agreement**") is between ABC Corporation *[state of incorporation and address for notice omitted]* and XYZ LLC *[ditto]*. This Agreement is effective the last date written on the signature page.

Here's a different version of the last-date-signed approach:

> THIS AGREEMENT is made, effective the last date signed as written below, between ….

In reviewing others' contract drafts, you're likely to see some less-good possibilities, such as writing a specific date into the preamble. The problem is that **the stated date might turn out to be inaccurate,** depending on when the parties actually signed the contract — and more than one corporate executive has gone to prison for doing so.

On the other hand, **it might be just fine to state that a contract is effective as of a different date.**

• EXAMPLE: Alice discloses confidential information to Bob after Bob first orally agrees to keep the information confidential; they agree to have the lawyers put together a written confidentiality agreement. That written agreement might state that it is effective as of the date of Alice's oral disclosure. The following might work if it's for non-deceptive purposes:

> This Agreement is entered into, effective December 31, 20XX, by ….

(Alice and Bob would not want to backdate their actual signatures, though.)

§ 46 Employees' Labor-Law Rights

a. The parties agree to this section to help forestall later claims of the kind referred to below.

b. In case of doubt: Nothing in the AGREEMENT is intended to restrict a party's ability to exercise any legally protected and non-waivable right:

1. to engage in collective action, for example under the U.S. National Labor Relations Act ("NLRA"); or

2. to file a charge or other claim with a governmental authority, for example the U.S. National Labor Relations Board ("NLRB") or the U.S. Equal Employment Opportunity Commission ("EEOC").

c. This section, however, also is not to be asserted as establishing, evidencing, or asserting:

1. that an employment relationship exists between the parties; nor

2. that the NLRA or other legislation applies; nor

3. that the NLRB or EEOC has jurisdiction.

COMMENTARY

Subdivision b is informed by attempts on the part of the EEOC and NLRB to invalidate certain kinds of agreements between companies and their employees. See, e.g., Hunton & Williams LLP, NLRB Strikes Down Employee Conduct Rules and Non-Disclosure Agreement … (2014); Kerry Notestine, Terri Solomon, and Dan Thieme, EEOC Lawsuit Against CVS Pharmacy Challenging Severance Agreements Dismissed (2014). One such case was decided *against* the NLRB in Murphy Oil USA, Inc. v. NLRB, 808 F.3d 1013 (5th Cir. Oct. 26, 2015), *aff'd sub nom.* Epic Systems Corp. v. Lewis, _ U.S. _, 136 S. Ct. 1612 (2018), in which Murphy Oil's employees were required to sign an arbitration agreement that prohibited "class action" arbitrations. The NRLB ruled that this constituted an unfair labor practice, but the Fifth Circuit disagreed, and the Supreme Court affirmed holding that the Federal Arbitration Act trumped section 7 of the National Labor Relations Act.

§ 47 Ending Time Definition

a. If the AGREEMENT states that a time period, a right, an obligation, etc., ends or expires on a specified day but does not clearly indicate the *time* of day, then the end or expiration is exactly 12 midnight at the end of the specified date.

b. If not otherwise specified in the AGREEMENT, the time zone to be used is the time zone where the relevant actor, or the action to be taken, is located (or, if applicable, is required to be located) at that time.

COMMENTARY

Another time-zone possibility would be to use Coordinated Universal Time, which is basically Greenwich Mean Time with a few technical differences; see generally the Wikipedia article Universal Time.

§ 48 Entire Agreement

§ 48.1 Why is this Article included?

This Article is intended to forestall later claims that one or more other documents (and/or oral terms) are supposedly part of the AGREEMENT.

§ 48.2 What constitutes "the AGREEMENT"?

Each party will treat the following, and no more, as "the AGREEMENT":

1. the Term Sheet;
2. any exhibits, schedules, appendixes, statements of work, etc., that are attached to the Term Sheet;
3. any TANGO provisions adopted by the Term Sheet; and
4. any materials adopted or otherwise clearly incorporated by reference into one or more of the materials listed in subdivisions 1 through 3 above, if any.

COMMENTARY

Some entire-agreement provisions state that the agreement is the parties' entire agreement "concerning the subject matter hereof"; drafters should keep in mind that the exact boundary of that subject matter might later be disputed.

EXAMPLE: In a California case, parties to various contracts agreed to terminate those contracts. The termination agreement stated that it was

the parties' entire agreement concerning "the subject matter hereof." The appeals court held that this termination language did *not* have the effect of terminating the *arbitration* agreement that was set forth in some of the contracts. See Oxford Prep. Academy v. Edlighten Learning Solutions, No. G055685, slip op. (Cal. App. Apr. 22, 2019) (reversing denial of motion to compel arbitration).

§ 48.3 To what extent are the parties' prior discussions still relevant?

The AGREEMENT merges and supersedes any and all oral- and/or written discussions or negotiations; comments; remarks; and interim- or partial commitments; concerning the subject matter of the AGREEMENT.

COMMENTARY

This section reminds the parties that whatever they might have *thought* they agreed to before will be of no moment once they sign (or otherwise assent to) the parties' agreement.

§ 48.4 What if a party later issues a purchase order, etc., with other terms?

a. This section applies if, in connection with the AGREEMENT or a transaction under the AGREEMENT:

1. a party sends another party, directly or indirectly, an additional document such as a purchase order, an order confirmation, a bill of sale, an invoice, etc., and

2. that additional document contains terms ("**Modifying Terms**"), over and above specific transaction details (such as quantity, price, delivery date, and the like), that would add to or vary the terms of the AGREEMENT;

b. The Modifying Terms will be of no effect — even if one or more parties takes action consistent with those terms — unless they meet the requirements to amend or waive the AGREEMENT.

COMMENTARY

Even when parties have agreed in writing about the terms on which they do business, their procurement- or sales people might reflexively issue purchase orders, sales confirmations, and similar documents. Such party-issued documents typically include terms and conditions that might be significantly different than what the parties agreed to (read: heavily biased in favor of the issuing party). When party-issued documents are "in play" in connection with an Order, it can sometimes lead to disputes about which terms and conditions are to control. This section tries to forestall such disputes.

Subdivision a.1: Concerning the "directly or indirectly" term: To keep its internal costs down, a large customer might insist on doing business with smaller vendors only via a reseller (or another intermediary). When the buyer wants to buy something from such a vendor, the buyer will issue a purchase order *to the reseller*, which in turn will issue a purchase order to the vendor; likewise, the vendor might issue an order confirmation to the reseller, which passes it on to the customer.

Subdivision b: CAUTION: Allowing Modifying Terms to take precedence would give a party a blank check to "re-trade the deal" by including Modifying Terms in a purchase order, an order confirmation, an invoice, etc.

Subdivision b ("action consistent …"): A party might claim that another party had *implicitly* accepted Modifying Terms by taking action that conformed to some of the Modifying Terms — in fact, some customers' purchase-order forms state that the supplier is deemed to have accepted the purchase-order terms if the supplier starts work in any manner; see, e.g., section 1 of the Honeywell PO and section 1 of the Cisco PO, each cited in § 162.1.

§ 49 Equitable Relief Stipulation

§ 49.1 Definitions

a. For purposes of this Stipulation:

1. "**Injunctive relief**" (whether or not capitalized) refers, without limitation, to an order (by any tribunal) directing specific perform-

ance; temporary restraining orders; temporary- and permanent injunctions; and similar relief.

2. "**Claimant**" refers to any signatory party seeking injunctive relief against any other party (each, a "**Respondent**").

COMMENTARY

"Claimant" is defined here as potentially being any party. This contrasts with some "form" contracts (for example, consumer contracts) that are drafted with "one-way" equitable-relief clauses in which only one side is entitled to relief. This clause is written as a two-way provision, in part because contract reviewers tend to respond more favorably to provisions that apply equally to all parties.

(As a practical matter, though, it might be that only one side would be likely ever to seek equitable relief, for example the disclosing party in a one-way confidentiality agreement or the licensor in a patent- or trademark license agreement.)

§ 49.2 Injunctive relief is not precluded

Nothing in the AGREEMENT is intended to preclude the Claimant from obtaining injunctive relief when all of the following are true:

1. a breach of the AGREEMENT has occurred or appears to be imminent;

2. the Claimant presents proper proof in accordance with applicable law;

3. the Claimant seeks to prevent or stop irreparable injury or other harm that is not capable of being fully redressed by a monetary award.

COMMENTARY

Prospective claimants often ask for much-stronger language, namely a flat statement that the claimant is *entitled* to injunctive relief. Prospective respondents justifiably push back against stronger language, because it could severely disadvantage them in litigation.

Background: When a party asks for language in this area, *invariably* the party wants stronger language in the hope of later being able to shortcut

around its burden of proof in litigation — which could seriously disadvantage the other party. As explained by the Supreme Court of the United States, in American jurisprudence:

> … a plaintiff seeking a permanent injunction must satisfy **a four-factor test** before a court may grant such relief. A plaintiff must **demonstrate:** (1) that it has suffered an **irreparable injury**; (2) that remedies available at law, such as monetary damages, are **inadequate** to compensate for that injury; (3) that, considering **the balance of hardships** between the plaintiff and defendant, a remedy in equity is warranted; and (4) that **the public interest** would not be disserved by a permanent injunction. The decision to grant or deny permanent injunctive relief is an act of **equitable discretion** by the district court, reviewable on appeal for abuse of discretion.

eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006) (describing traditional four-factor test in context of patent-infringement injunctions) (citations omitted, emphasis added).

§ 49.3 Irreparable harm is a possibility

Respondent acknowledges that some types of breach of the AGREEMENT by Respondent could result in irreparable harm to the Claimant that would not be adequately compensable by monetary damages or other remedies at law.

COMMENTARY

Claimants usually want a stronger version of this provision in which the respondent stipulates that the breach would result in irreparable harm to the claimant**. That might well be a major concession by the respondent,** absolving the claimant from what could be a significant burden of proof in litigation, as discussed above.

In some cases, though — for example, cases involvmisappropriation of crucial trade secrets — the existence of irreparable harm might be pretty obvious. In such a case, it might not be much of a concession for a potential Respondent to stipulate in advance to the existence of irreparable harm.

Stipulations to irreparable harm have been enforced. In a 2012 opinion, then-chancellor Strine of the Delaware chancery court (now chief justice of the state's supreme court) relied in part on a similar clause in granting a four-month injunction against one company's hostile takeover bid targeting another company:

> In Delaware, parties can agree contractually on the existence of requisite elements of a compulsory remedy, such as the existence of irreparable harm in the event of a party's breach, and, in keeping with the contractarian nature of Delaware corporate law, this court has held that such a stipulation is typically sufficient to demonstrate irreparable harm.

Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1144-45 (Del. Ch.), *aff'd*, 45 A.3d 148 (Del. 2012) (en banc) (footnotes with extensive citations omitted).

On the other hand, just because a contract stipulates that a party will suffer irreparable harm from a breach, **that doesn't mean that a court will give effect to the stipulation.** The same Delaware chancery court disregarded such a stipulation in a 2015 case, saying:

> Parties sometimes, as Renco and M&F did here, agree that contractual failures are to be deemed to impose the risk of irreparable harm**. Such an understanding can be helpful** when the question of irreparable harm is a close one.
>
> **Parties, however, cannot in advance** agree to assure themselves (and thereby impair the Court's exercise of its well-established discretionary role in the context of assessing the reasonableness of interim injunctive relief) the benefit of expedited judicial review through the use of a simple contractual stipulation that a breach of that contract would constitute irreparable harm.
>
> *[In footnote 20 the court added:]* In part, this is simply a matter that allocation of scarce judicial resources is **a judicial function, not a demand option for litigants**.

AM General Holdings LLC v. The Renco Group, Inc., No. 7639-VCN, slip op. at 10, text accompanying nn.19-20 (Del. Ch. Dec. 29, 2015) (denying

request for preliminary injunction) (footnotes omitted, emphasis and extra paragraphing added).

§ 49.4 ❑ Bond Waiver Option

Respondent **WAIVES** any requirement that the Claimant post a bond as a condition of obtaining injunctive relief or other equitable relief against Respondent for breach or threatened breach of the AGREEMENT.

COMMENTARY

CAUTION: A party agreeing in advance to waive a bond requirement might later find itself subjected to a preliminary injunction, but then prevail at trial — **only to find itself unable to obtain any meaningful recovery for the wrongful injunction**, because the plaintiff was unable to pay a damage award and the prevailing party had waived a bond requirement.

Background: When a party seeks preliminary or temporary injunctive relief in a U.S. court, the court will often (and possibly *must*) require that party to post a bond as security. The purpose of the bond is to guarantee that at least some money will be available (from the insurance company that writes the bond, in return for a premium) to compensate the defendant for any damage it might have suffered from an improvidently granted preliminary injunction. See generally, e.g.: Fed. R. Civ. P. 65©; Tex. R. Civ. P. 684. Thomas E. Patterson, Handling the Business Emergency, ch.3 (American Bar Association 2009), *extensive excerpts available at* http://goo.gl/ak7Mt (books.google.com).

§ 50 Escalation Requirement

§ 50.1 Why are the parties agreeing to this Requirement?

The parties hope to resolve disputes between them before they get out of hand and possibly damage the parties' business relationship; to that end, the parties are agreeing to escalate, to higher levels of their respective managements, any issues that cannot be resolved at the working level.

COMMENTARY

A requirement for issue escalation (or, "dispute escalation") can be effective because "the threat to line managers of having to explain to senior executives of both companies the failure to effectively cooperate likely carried more weight than the threat of legal action." Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration, 109 COLUM. L. REV. 431, 470 (2009), archived at https://perma.cc/TYY2-423D. "Superiors are unlikely to look with favor on subordinates who send problems up the line for resolution. The subordinates' job is to resolve problems, not escalate them." *Id.* at 481. ¶ For another example of escalation-clause language, see the CPR International Model Multi-Step Dispute Resolution Clause (scroll down to "(A) Negotiation").

§ 50.2 What issues must be escalated?

Escalation is required, whenever requested in writing by either party, for any issue that *arises out of* or *relates to*:

1. the AGREEMENT, and/or
2. a transaction or relationship resulting from the AGREEMENT.

COMMENTARY

See the commentary to § 8.2 for a discussion of the phrase *any transaction or relationship*.

§ 50.3 How far "up" must issues be escalated?

An issue must be escalated "up" at least two levels of management, in succession — or, if the organization in question does not have two levels remaining "upward," then the maximum number of levels left.

COMMENTARY

Some escalation provisions require issues to be referred all the way up to "executive-level management." Apart from the vagueness of the quoted term, a giant multinational corporation isn't likely to want to be forced to escalate a small-dollar issue all the way to its executive suite.

§ 50.4 How are the parties actually to do the escalation?

a. Each party is to promptly advise the other party in writing of the name and contact information of its representative(s) at the relevant management level(s).

b. The party requesting escalation is to arrange one or more telephone or video-conference meetings between the representatives.

c. Each party is to participate in escalation in good faith.

COMMENTARY

Subdivision b: Affordable, high-quality, Web-based video conferencing (with screen sharing to view documents together) is becoming increasingly widespread.

Subdivision c: The good-faith requirement sets a fairly low bar.

§ 50.5 May a party skip (further) escalation?

Normally, no: Any party involved in escalation of an issue must finish the escalation in accordance with this Protocol before going to court or arbitration, EXCEPT as follows:

1. to the minimum extent necessary (i) to prevent irreparable harm, or (ii) to meet a deadline for taking action under an applicable statute of limitations or -repose; or
2. if the other party refuses to provide reasonable cooperation in escalating the issue under this Protocol.

COMMENTARY

This section seeks to forestall a non-aggrieved party from going to court (or arbitration) to seek a declaratory-judgment action about the issue.

§ 50.6 Could a party's statements in escalation be used against that party later?

All oral, written, and other communications made in the course of an issue escalation under this Protocol are to be treated as having been made in

compromise negotiations, with the same effect as stated in Rule 408 of the [U.S.] Federal Rules of Evidence. (This is regardless whether that rule would apply in a court proceeding or arbitration concerning the issue.)

COMMENTARY

This very-standard exclusion helps the parties to speak candidly. (Rule 408 does allow for some exceptions to the general rule of inadmissibility of settlement discussions.)

§ 51 Evergreen Definition

COMMENTARY

CAUTION: Some states restrict automatic extension or renewal of certain contracts unless specific notice requirements are met. See generally Faegre Baker Daniels, Automatic Renewal Laws in All 50 States: An Updated Guide, *archived at* https://perma.cc/AAS6-RNF6.

CAUTION: An agreement with an evergreen term might be held to be an agreement of indefinite duration — and therefore terminable at will — unless the agreement expressly limits the termination possibilities. That issue came up in in Burford v. Accounting Practice Sales, Inc., 786 F.3d 582 (7th Cir. 2015) (reversing and remanding summary judgment). In that case, the appeals court held that a company's contract with an outside sales representative was not terminable at will, even though it automatically "renewed" every 12 months (which made it of "indefinite" duration); that was because other limitations on the termination right precluded termination at will. *See id.* at 586-88.

§ 51.1 When would this Definition be relevant?

This Definition will apply in any case in which both of the following are true:

1. The AGREEMENT sets forth a time period, a right, or an obligation (each referred to generically as an "**Evergreen Period**"), that by its terms is to expire at a particular time; and
2. The AGREEMENT also states that the time period, right, or obligation is to be automatically renewed or extended for one or more specified periods.

§ 51.2 How long will each automatic extension be?

If neither party opts out as provided below, then the Evergreen Period will be automatically extended, at its then-current expiration date, for successive extension periods of the original duration of the Evergreen Period — but only up to a maximum of one year per extension period.

EXAMPLE 1: A six-month Evergreen Period would be automatically extended for successive six-month extension terms.

EXAMPLE 2: A three-year Evergreen Period would be automatically extended for successive one-year extension terms.

COMMENTARY

The term "extension" is used here because "renewal" (the common term) *might* require a party to renegotiate; see the discussion at § 51.5.

PRO TIP: Evergreen extension periods could be of different lengths, because it's not carved in stone that all automatic-extension periods should be of the same duration. For example, in some contractual relationships, a first extension period might be relatively short, to give the parties a chance to find out what it's like working together. Then, if neither party opts out, subsequent extension periods could be of longer duration.

CAUTION: The author once represented a client that had previously agreed to supply a customer with a product at pricing that was to be fixed for five years, with automatic renewal for an additional five-year period if the client did not opt out. Sure enough, the client did forget to opt out, and so it was stuck having to honor the same pricing for a total of ten years for that one customer.

§ 51.3 How may a party opt out of an automatic extension?

Either party may opt out of an extension by giving notice (see the Notices Protocol) to that effect; if that happens, then the Evergreen Period will come to an end automatically at its then-current expiration date.

§ 51.4 What is the deadline to opt out of an automatic extension?

Any opt-out notice must be effective no later than 30 days before then-current expiration date of the Evergreen Period.

COMMENTARY

A party might prefer to be able to opt out at a later date than this — perhaps even *after* the automatic-extension date — but it might also be able to get the same effect by asking for the right to terminate the applicable time period or relationship "at will" or "for convenience."

§ 51.5 What terms and conditions will apply during an extension period?

The terms and conditions of the AGREEMENT will continue to apply unless the parties agree to amend or waive them in accordance with the AGREEMENT.

COMMENTARY

This language is intended to forestall the result in an Eighth Circuit case, where the appellate court affirmed a declaratory judgment that a lease agreement had given the tenant an option to *renew* rather than an option to *extend*; consequently, under a state law, the landlord was free to demand that the terms be renegotiated — this, even though the lease agreement expressly termed the option as a right to extend. *See* Camelot LLC v. AMC ShowPlace Theatres, Inc., 665 F.3d 1008 (2012) (8th Cir. 2012).

In contrast, the Third Circuit held that a contractual right to renew an insurance policy meant renewal on the same or nearly the same terms and conditions. *See* Indian Harbor Ins. Co. v. F&M Equip., Ltd., 804 F.3d 310 (3d Cir. 2015). The appellate court vacated the trial court's denial of the insured's motion for summary judgment and remanded with instructions to enter summary judgment.

§ 51.6 ❑ An opting-out party must pay an opt-out fee

a. This section applies if a party wishes to opt out of an extension of an Evergreen Period ❑ before an earliest opt-out date specified in the Term Sheet.

b. In addition to giving timely notice as provided above, the opting-out party must pay the other party an opt-out fee in an amount stated in the Term Sheet.

1. The opt-out fee payment is due no later than then-current expiration date of the Evergreen Period.

2. If the payment is not timely made, then the extension will go into effect and the right to opt out will expire automatically.

c. In case of doubt, the opt-out fee is intended to provide an alternative form of performance and is not intended as liquidated damages.

COMMENTARY

This provision was inspired by an analogous provision in Foodmark, Inc. v. Alasko Foods, Inc., 768 F.3d 42 (1st Cir. 2014). In that case, the court of appeals affirmed a summary judgment that Alasko, a Canadian food distributor, owed Foodmark, a U.S. marketing firm, a fee for electing not to renew the parties' "evergreen" agreement.

Subdivision a: The intent of the optional language about the earliest opt-out date is to allow the parties give the non-opting-out party a specified minimum time in which, say, to recoup the investments it makes in supporting the parties' contractual relationship.

§ 52 Examples Definition

a. Examples are for purposes of illustration and not limitation.

b. When examples of a term are given, the parties do not intend for the principle of ejusdem generis ("of the same kind") to limit the term's meaning unless clearly stated otherwise.

c. The AGREEMENT might sometimes use longer expressions such as "by way of example and not of limitation." Such expressions do not mean that

the parties intend for shorter expressions (such as "for example") to function as limitations unless expressly stated otherwise.

COMMENTARY

> Including this definition in a contract will let drafters safely say, e.g., "including, for example," which is somewhat less stilted than "including, by way of example and not of limitation."
>
> Subdivision b hopes to avoid the effect of some judicial opinions that hold otherwise, as discussed in the commentary to the Including definition.

§ 53 Exclusivity Definition

This Definition is intended to help avoid later disputes about just how far a party's "exclusive" rights are meant to extend.

§ 53.1 When does this Definition apply?

a. This Definition applies if, in the AGREEMENT, one party ("**Alpha**") grants its consent to another party ("**Beta**") to conduct one or more activities ("**Specified Activities**").

b. As (non-exhaustive) hypothetical examples of Specified Activities, Alpha might grant a license to Beta under a patent or trademark, or it might appoint Beta as a reseller or other type of channel associate.

c. Note: The AGREEMENT might limit the scope of Alpha's consent so that it extends only to a particular "territory," which could be based on geography and/or market segment.

§ 53.2 Is the AGREEMENT exclusive for any party?

Unless the AGREEMENT clearly states otherwise:

1. Alpha's grant of consent to Beta is not exclusive; and
2. In case of doubt, Alpha and Beta are each free, each in its sole discretion, to enter into similar- or identical arrangements with other individuals and/or organizations, even if they are competitors of the other party.

COMMENTARY

A grant of exclusive rights can limit the grantor's flexibility, possibly making it difficult or impossible to do similar business with other companies. A grant of exclusivity can also make a company fatally unattractive to a potential acquirer or merger partner.

PRO TIP: Ideally, exclusivity arrangements should include limitations on time, place and manner, such as (for example) a "sunset" provision stating that the exclusivity ends (and perhaps the entire agreement ends) after a certain period if not extended.

Exclusivity arrangements could also include require performance metrics that the grantee must meet in order to retain exclusivity — or to retain the grant at all.

§ 53.3 May Alpha party continue its own activities, notwithstanding Beta's exclusivity?

a. This section applies if the AGREEMENT states that Alpha's grant of consent to Beta is exclusive to any extent.

b. Unless the AGREEMENT clearly states otherwise:

1. Beta's exclusivity does not preclude Alpha, in Alpha's sole discretion, from doing the same thing(s) that Alpha granted consent to Beta to do, even if in competition with Beta; and

2. Alpha need not account to Beta, nor need Alpha compensate Beta, if Alpha does so.

c. In case of doubt: this section applies regardless whether Alpha acts within, or outside of, a particular geographic territory and/or market segment.

COMMENTARY

Subdivision b.2: The reference to accounting is informed by the U.S. copyright law requirement that co-owners of a copyright in a work of authorship, unless they agree otherwise, must "account" to one another for their uses of the work — basically, this means sharing profits / royalties. [TO DO: Cite] The provision in the text disclaims any such obligation.

§ 54 Expense Reimbursement Protocol

This Protocol applies if the AGREEMENT requires a party (a "**Reimbursing Party**") to reimburse another party (the "**Incurring Party**") for expenses (specified or otherwise).

§ 54.1 What expenditures will be reimbursed?

The Reimbursing Party will reimburse (only) reasonable expenses, actually incurred, that are otherwise eligible for reimbursement under the AGREEMENT and this Protocol.

§ 54.2 Who is to make sure only eligible expenses are submitted?

a. The Incurring Party will not knowingly submit ineligible expenses for reimbursement; noncompliance with this subdivision a would be a material breach of the AGREEMENT.

b. In each invoice for reimbursement, the Incurring Party is to suitably flag any submitted expense as to which reasonable parties might disagree whether the expense is eligible for reimbursement.

COMMENTARY

> This section is intended to put most of the administrative burden of expense reimbursement onto the Incurring Party, which of course has the greatest ability to monitor such things.

§ 54.3 Are expense markups permitted?

☑ An Incurring Party may not mark up expenses submitted for reimbursement unless the parties expressly agree otherwise in writing.

❑ An Incurring Party may mark up its reimbursable expenses, but only by no more than 0.01%.

COMMENTARY

Some contracts are cost-plus, meaning that reimbursable expenses would be marked up.

In the alternative term above, the 0.01% number is a placeholder for negotiation.

§ 54.4 May a payer impose additional requirements for reimbursement?

a. The Incurring Party will comply with any commercially reasonable written reimbursement policy that the Reimbursing Party:

1. requires of its vendors generally from time to time; and
2. provides to the Incurring Party a reasonable time before the Incurring Party incurs the relevant expense or otherwise becomes obligated to pay it.

b. ❑ The Reimbursing Party's current reimbursement policy: ❑ is attached to the parties' agreement ❑ has been separately provided to the Incurring Party.

COMMENTARY

A customer might or might not want to impose a specific written-reimbursement policy at the time of contracting, while leaving that option open for the future.

Customers' expense-reimbursement policies are sometimes an administrative pain for providers, but they're often a practical necessity, especially for large corporate customers that by law must comply with internal-controls requirements.

Subdivision a.1: "From time to time" signals that the Reimbursing Party may update its reimbursement policy and send the updated policy to the Incurring Party.

§ 54.5 ❑ Will any particular expenses be discussed in advance?

Before the Incurring Party incurs any individual expense item in excess of *[FILL IN AMOUNT]* for which it expects to be reimbursed, the Incurring Party must: ☑ consult with the Reimbursing Party ❑ obtain the Reimbursing Party's prior written approval.

COMMENTARY

> This advance-approval requirement might be overkill for many relationships, but some reimbursing parties might want this language so as to keep very-tight control over reimbursable expenditures.

§ 54.6 ❑ Should any expenses be directly billed to the Reimbursing Party?

☑ The Incurring Party may arrange for individual expenses of at least *[FILL IN AMOUNT]* to be billed directly to the Reimbursing Party; the Reimbursing Party is to timely pay any such direct-billed expense.

❑ If requested by the Reimbursing Party for a particular expense, the Incurring Party will consult with the Reimbursing Party before arranging for direct billing of that expense to the Reimbursing Party.

COMMENTARY

> This direct-billing provision has in mind that, as a matter of prudent cash-flow management, a service provider or other contract party might want its customer to "front" significant reimbursable expenses.

§ 54.7 What if the AGREEMENT is silent about expense reimbursement?

IF: The AGREEMENT does not address expense reimbursement; THEN: As between the parties, each party is solely responsible for its expenses incurred in performing its obligations under the AGREEMENT UNLESS clearly and unmistakably agreed otherwise in writing.

COMMENTARY

See also the Expense Reimbursement entry.

§ 55 Export controls (commentary)

(Black letter:) Some key takeaways:

The export-controls laws in the U.S. are a bit complicated, but it's extremely important for companies to sort them out. Here are a couple of examples of "exports" that might be surprising:

- **Disclosure of controlled technical data to a foreign national in the U.S. can constitute an "export" that requires either a license or a license exception**.
- Emailing controlled technical data to a U.S. citizen located in a foreign country could constitute an export of the data.

Failure to get an export license (or come within a license exception) can lead to all kinds of trouble, including imprisonment for up to ten years; millions of dollars in fines and civil penalties; and denial of export privileges.

For example: **A 71-year old emeritus university professor was sentenced to four years in prison for export-controls violations** (Bloomberg.com 2012: https://goo.gl/gfvGhR) (FBI.gov 2012: https://goo.gl/jtZR7C). The professor had been doing research, under an Air Force contract, relating to plasma technology designed to be deployed on the wings of remotely piloted drone aircraft. Apparently, his crime was to use, as part of the project staff, two graduate students who were Iranian and Chinese nationals respectively. It probably didn't help that he was found to have concealed those graduate students' involvement from the government.

Optional: For additional information, see, e.g., a University of Southern California primer about export controls (USC.edu: https://goo.gl/EjnztS) and a slide deck from an Association of Corporate Counsel presentation (ACC.com 2003: https://goo.gl/qN7diu).

§ 56 Fiduciary duties (commentary)

Safe-harbor language can sometimes contractually eliminate fiduciary duties, especially when permitted by statute (such as some business-organizations acts). See, e.g., Dieckman v. Regency GP LP, 155 A. 3d 358 (Del. 2017).

§ 57 Force Majeure Protocol

This Protocol sets out rules for excusing a party from complying with its obligations because of force majeure (which defined below).

§ 57.1 What is "force majeure," exactly?

Except as stated otherwise below, the term "**Force-Majeure Event**" refers generally to any event (or series of events) as to which all of the following are true:

1. the event (or series of events) causes a failure of timely performance under the AGREEMENT;
2. a prudent person, in the position of the party invoking force majeure, would not reasonably have been able to anticipate and avoid the failure of timely performance; and
3. the AGREEMENT does not state that the event (or series of events) is an "**Excluded Event**."

COMMENTARY

For possible examples of force majeure events, see below.

§ 57.2 Who can invoke force majeure, and how is that to be done?

In response to actual- or imminent occurrence of one or more Force-Majeure Events, either party (an **Invoking Party**) may invoke force majeure by advising another affected party by notice or other reasonable means.

COMMENTARY

This is a typical provision on this subject.

The "actual or imminent occurrence" language contemplates that a party might invoke force majeure before the fact — for example, if a hurricane were approaching — as well as after the fact.

§ 57.3 If force majeure is invoked, what effect will that have?

a. An Invoking Party that invokes force majeure at a reasonable time will not be liable under the AGREEMENT for any loss, injury, delay, damages, or other harm suffered or incurred by another affected party due to failure of timely performance, by the Invoking Party, resulting from the force majeure.

b. A reasonable time for invoking force majeure might be before or after the relevant Force Majeure Event or -Events.

COMMENTARY

This is pretty much the way the law works anyway (in the U.S.).

§ 57.4 What must the parties do to respond to force majeure?

a. Each party is to make any efforts expressly specified for that party in the AGREEMENT — if any — with respect to mitigating and/or remediating the effects of the force majeure.

b. In case of doubt, though: This section is not to be interpreted as implicitly requiring any party to make any such efforts.

COMMENTARY

Mitigation, remediation, or both? Note that there are two distinct options presented here: One for *mitigation*, one for *remediation*, which are two different things.

CAUTION: **Some customers might want suppliers to commit to using "best efforts"** to mitigate or remediate the effects of force majeure; see, e.g., section 4 of a set of Honeywell purchase-order terms and conditions, apparently from February 2014.

- A supplier might be reluctant to agree to a best-efforts commitment for the reasons discussed in the commentary to the Best Efforts entry.
- Such a supplier might prefer a commercially reasonable efforts commitment instead; see the Commercially Reasonable entry.

Of course, **a drafter should be careful not to commit a client to either mitigation or remediation efforts if such efforts are not part of the client's business model**.

In a supply- or services agreement, the customer might not want to be bound by any mitigation obligation.

If the required mitigation or -remediation efforts are going to be defined, it might make sense to refer to an exhibit or appendix where the term can be spelled out in appropriate detail.

§ 57.5 What are some examples of Force-Majeure Events?

In case of doubt, the term *Force-Majeure Event* includes without limitation the following, when otherwise eligible under the AGREEMENT:

1. any event that (i) is not an Excluded Event and (ii) falls within one or more of the following categories *(some are in bold-faced type to call drafters' attention to them)*: • act of a public enemy; • act of any government or regulatory body, whether civil or military, domestic or foreign, not resulting from violation of law by the invoking party; • act of war, whether declared or undeclared, including for example civil war; • act or omission of the other party, other than a material breach of the parties' agreement; • act or threat of terrorism; • blockade; • **boycott**; • civil disturbance; • court order; • drought; • earthquake; • **economic-condition changes generally;** • electrical-power outage; • embargo imposed by a government authority; • epidemic; • explosion; • fire; • flood; • hurricane; • insurrection; • internet outage; • invasion; • **labor dispute**, including for example strikes, lockouts, work slowdowns, and similar labor unrest or strife; • law change, including any change in constitution, statute, regulation, or binding interpretation; • legal impediment such as an inability to obtain or retain a necessary authorization, license, or permit from a government authority; • nationalization; • payment failure resulting from failure of or interruption in one or more third-party payment systems; • riot; • sabotage; • **storm**; • **supplier default;** • telecommunications service failure; • **tariff imposition**; • transportation service unavailability; • tornado; • weather in general; and

2. any other particular examples of force majeure (if any) identified in the AGREEMENT — it is immaterial if one or more of them also comes within the scope of subdivision 1 above.

COMMENTARY

The "laundry list" of force-majeure examples in subdivision 1 was drawn from various agreement specimens.

Concerning economic changes generally, see Kevin Jacobs and Benjamin Sweet, 'Force Majeure' In the Wake of the Financial Crisis, Corp. Coupsel, Jan. 16, 2014.

In some customer-oriented supply- and service contract forms, labor difficulties are excluded from the definition of force-majeure event.

This list of examples does not include the so-called "act of God" because of the vagueness of that term.

Some drafters might want to use the "other particular examples …" option in subdivision (b) to specify particular force-majeure risks of concern.

§ 57.6 Will force majeure extend any deadlines for exercising rights?

Yes: IF: One or more properly invoked Force-Majeure Events make it impracticable or impossible for an Invoking Party to timely exercise a right under the AGREEMENT; THEN: The time for exercising that right will be deemed extended for the duration of the delay resulting from the Force-Majeure Event or Events.

COMMENTARY

This clause addresses a potential gap (depending on one's perspective) in many force-majeure clauses. This gap caused fracking companies to lose a case in New York's highest court. *See* Beardslee v. Inflection Energy, LLC, 25 N.Y.3d 150, 31 N.E.3d 80, 8 N.Y.S.3d 618 (on certification from Second Circuit), *subsequent proceeding*, 798 F.3d 90 (2d Cir. 2015) (affirming judgment of district court). In that case, New York's highest court aligned itself with courts in several other "oil" jurisdictions. *See id.*, 25 N.Y.3d at 159.

§ 57.7 May a party "pull the plug" in response to force majeure?

Yes: Any party may terminate all going-forward obligations under the AGREEMENT if the aggregate effect of the relevant Force-Majeure Events:

1. is material considering the AGREEMENT as a whole; and
2. lasts past the 30 days after invocation of force majeure by any party entitled to do so under the AGREEMENT.

COMMENTARY

The "material considering the AGREEMENT as a whole" language is adapted from the outsourcing master services agreement in Indiana v. IBM Corp., 51 N.E.3d 150, 153 (Ind. 2016) (procedural posture too complicated to summarize here, but IBM got whacked, albeit not as badly as it might have).

The parties might negotiate different earliest termination dates for different parties or different situations. For example, in a supply- or services agreement, the customer might want to be able to "pull the plug" after a relatively short period, while keeping the supplier "on the hook" for a longer period.

§ 57.8 ❑ Is there an "economic out" in case of force majeure?

An Invoking Party is considered not to be reasonably able (or not to have been reasonably able, as applicable) to avoid a failure of timely performance resulting from one or more Force-Majeure Events if avoidance is (or was) not possible at a commercially reasonable cost.

COMMENTARY

This language could be a source of mischief because of the potential for disputes about what would constitute "a commercially reasonable cost."

§ 57.9 Can a subcontractor's failure constitute a Force-Majeure Event?

Possibly but not necessarily:

a. Suppose that:

1. an Invoking Party does not timely perform its obligations (or exercise its rights) under the AGREEMENT; and

2. the Invoking Party's failure was due to a failure of performance of a subcontractor or supplier to the Invoking Party.

b. In that situation, the Invoking Party's failure will be excused only if both of the following are true:

1. the failure by the subcontractor or supplier otherwise qualifies as one or more Force-Majeure Events; and

2. it was not reasonably possible for the Invoking Party to timely obtain, from one or more other sources, the relevant goods or services that were to have been provided by the subcontractor or supplier.

COMMENTARY

Some customers want provisions like this in in their contracts with suppliers. (XXX)

§ 57.10 Must an Invoking Party keep other parties up to date?

a. If requested by another affected party, an Invoking Party will provide reasonable information, from time to time, about its efforts, if any, to remedy and/or mitigate the effect of the force majeure.

b. Any party receiving any force-majeure status information from an Invoking Party must maintain that information in confidence unless and until the information becomes available to the general public.

COMMENTARY

CAUTION: Depending on the nature of the contract, a party might not want to commit to providing force-majeure status reports. For example, suppose that the force-majeure clause was part of a consumer-services contract. In that situation, the service provider might well be willing to update its customers about the status of a force-majeure service outage — especially in this era of near-instantaneous public criticism on social media. On the other hand, the provider might equally well not want to be *contractually obligated* to provide such status reports.

Subdivision b: A party invoking force majeure might not want its business made public.

§ 57.11 Does a customer have any particular claim to priority in case of a supplier's force-majeure problems?

☑ No — if a supplier experiences shipping delays as a result of one or more Force-Majeure Event, the supplier may allocate its available goods or services to its customers in its discretion.

❑ Yes — if a supplier experiences shipping delays as a result of one or more Force-Majeure Event, the supplier must allocate its available goods and/or services so that the customer will receive at least the same proportion of those goods and/or services as the customer would have received before the Force-Majeure Event.

COMMENTARY

The second, unchecked paragraph is inspired by a Honeywell purchase-order form at XXXX.

§ 57.12 Additional commentary about force majeure

§ 57.12.1 Introduction

Force majeure clauses are not uncommon in commercial contracts. To one degree or another, they mirror the way that the law generally works anyway in many jurisdictions. The Supreme Court of North

Dakota provided a useful recap of the (U.S.) law concerning force majeure:

> … Black's Law Dictionary defines a force majeure clause as "[a] contractual provision allocating the risk of loss if performance becomes impossible or impracticable, esp[ecially] as a result of an event or effect that the parties could not have anticipated or controlled." Black's Law Dictionary 718 (9th ed. 2009).
>
> According to 30 Williston on Contracts § 77.31, at 364 (4th ed. 2004), a force majeure clause is equivalent to an affirmative defense. "What types of events constitute force majeure depend on the specific language included in the clause itself." *Id.*
>
> "[N]ot every force majeure event need be beyond the parties' reasonable control to still qualify as an excuse." Id. at 367.
>
> "A party relying on a force majeure clause to excuse performance bears the burden of proving that the event was beyond its control and without its fault or negligence." *Id.* at 365.
>
> [A] force majeure clause relieves one of liability only where nonperformance is due to causes beyond the control of a person who is performing under a contract.
>
> An express force majeure clause in a contract must be accompanied by proof that the failure to perform was proximately caused by a contingency and that, in spite of skill, diligence, and good faith on the promisor's part, performance remains impossible or unreasonably expensive. *Id.* at 366.

Entzel v. Moritz Sport & Marine 2014 N.D. 12 (extra paragraphing added, alteration marks by the court).

§ 57.12.2 Are force-majeure clauses even appropriate anymore?

Lawyer Jeff Gordon makes the thought-provoking argument that "most [force-majeure events] can be planned for … even something like terrorism and war (especially when they're happening right

now), should be planned for," and that contracting parties should have a backup plan for such events. *See* Jeff Gordon, Things that shouldn't count as force majeure (Jan. 5, 2010).

Of course, as a matter of business-risk allocation, parties negotiating a contract might not want to take the time for detailed planning, especially if they don't really know what such detailed plans should be. In that situation, it might well be a defensible business decision to use a force-majeure clause instead.

§ 57.12.3 Further reading about force majeure

See, e.g.:

- Michael Polkinghorne and Charles B. Rosenberg, Expecting the Unexpected: The Force Majeure Clause (WhiteCase.com 2015) (addresses both common-law and civil-law doctrines);
- Jessica S. Hoppe and William S. Wright, Force Majeure Clauses in Leases, Probate & Property, March/April 2007, at 8;
- DLA Piper, Force Majeure Clauses – Revisited (DLAPiper.com 2012) (focuses on force majeure clauses in project agreements).

§ 58 Forum Selection: Delaware

COMMENTARY

Delaware has a highly regarded judicial system that has extensive expertise and experience in adjudicating business disputes.

(The practice of providing a sensible default value, in case the Term Sheet doesn't specify a Selected Forum, is an example of the computer-programming principle of "failing gracefully.")

§ 58.1 Definition: Selected Forum

The term "**Selected Forum**" refers to the courts having jurisdiction in the location forum specified in the heading of this section.

COMMENTARY

CAUTION: **Ambiguity is a possibility here** — for example, in New York City, two different federal district courts (the Southern and Eastern Districts) have jurisdiction in different boroughs. Likewise, the City of Houston is so spread out that it extends into multiple counties; consequently, referring to "the courts of the State of Texas having jurisdiction in Houston" would cover all of those counties.

Some companies' boilerplate terms include **territory-specific** forum selections (and choice of law)). For example, here's one from Carson Wagonlit Travel, archived at https://perma.cc/6RJK-57EM:

> 18.1 This Agreement shall be exclusively governed by the exclusive laws of and all disputes relating to this Agreement shall be resolved exclusively in (i) England and Wales and governed by English law if the Seller's registered office is located in the Europe, Middle East, Africa (EMEA) region; (ii) Singapore if the Seller's registered office is located in Asia Pacific (APAC) region; or (iii) the State of New York, USA if the Seller's registered office is located the Americas region.

§ 58.2 What disputes can be heard in the Selected Forum?

If the Term Sheet does not specify otherwise, all disputes arising out of the AGREEMENT that are not required to be resolved by other means (such as, for example, arbitration) may be heard in the Selected Forum.

COMMENTARY

"All disputes arising out of the AGREEMENT" is a relatively conservative wording. At the other extreme would be "all disputes arising out of or relating to the AGREEMENT or any transaction or relationship resulting from the parties' agreement." (The phrase *any transaction or relationship* is informed in part by an arbitration provision seen in cases decided by the Fifth and Eleventh Circuits respectively; Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008) (reversing denial of motion to compel arbitration), citing Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005) (same).)

In the author's view, it's not necessarily a good idea to agree in advance to a choice of forum that applied to more than just actions "arising out of"

this Agreement. Here's a hypothetical example: • Provider licenses its software to Customer. The license agreement requires any litigation arising from the agreement to be brought in the city of Customer's principal place of business; let's assume that's Atlanta. • One day, though, a different division of Customer, located in, say, Zion (Illinois), rolls out a new product that performs some of the functions of Provider's software and bears a trademark that's confusingly similar to Provider's trademark. ¶ In that situation, if Provider wanted to sue Customer for trademark infringement, then Provider might well want to bring the lawsuit in Zion because of the better availability of witnesses and documents. But Provider might not be able to do so if the license agreement required all disputes relating to the license agreement to be brought in Atlanta.

§ 58.3 Is the Selected Forum exclusive?

Unless the AGREEMENT clearly states otherwise, the Selected Forum is permissive and non-exclusive.

COMMENTARY

CAUTION: An *exclusive* forum-selection provision might be held to trump an arbitration provision in a prior or "background" agreement. At this writing there is a split in the circuits on that point, as discussed at § 58.6.10.

§ 58.4 May a case be *transferred* from the Selected Forum?

If the Selected Forum is exclusive, then no party will seek to transfer a dispute that is properly brought there under this Protocol.

§ 58.5 What if the parties also agreed to arbitration?

Even if the AGREEMENT provides that a Selected Forum is exclusive, the parties do not intend for that provision to negate or limit any provision of the AGREEMENT, nor of any other agreement between the parties, that requires:

1. binding arbitration or other non-judicial dispute resolution procedure; nor

2. non-binding action to attempt to resolve a dispute by agreement, such as (for example) escalation of the dispute to higher levels of the parties' managements; early neutral evaluation; and/or mediation.

COMMENTARY

This provision is designed to avoid the risk that an *exclusive* forum-selection provision might be held to trump an arbitration provision in a prior or "background" agreement. At this writing there is a split in the circuits on that point, as discussed at § 58.6.10.

§ 58.6 Additional commentary

§ 58.6.1 Refresher: Legal background of forum-selection provisions

U.S. federal courts routinely enforce forum-selection clauses "unless extraordinary circumstances unrelated to the case clearly disfavor a transfer." Atlantic Marine Construction Co., Inc. v. United States District Court, 571 U.S. 49, 134 S.Ct. 568, 575 (2013); Burger King Corp. v. Rudzewicz, 471 U.S. 462, 472 n.14 (1985); BouMatic LLC v. Idento Operations BV, 759 F.3d 790, 793 (7th Cir. 2014) (vacating and remanding dismissal for lack of personal jurisdiction).

"It is well established that forum selection clauses are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances. More specifically, a forum selection clause should be enforced unless the resisting party can show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching or that enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision." Rivera v. Centro Medico de Turabo, Inc., 575 F.3d 10, 18 (1st Cir. 2009) (affirming dismissal of action based on forum-selection clause), *in part quoting* M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10, 15 (1972) (internal quotation marks, alteration marks, and citations by First Circuit omitted).

Likewise, state courts in the U.S. generally honor forum-selection provisions "unless the party challenging enforcement establishes that *such provisions* are unfair or unreasonable, or are affected by fraud or unequal bargaining power." Paul Business Systems, Inc. v. Canon U.S.A., Inc., 97 S.E.2d 804, 807-08 (Va.

1990) (affirming dismissal of complaint) (emphasis added, extensive citations and internal quotation marks omitted).

See generally Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018) (archive: https://perma.cc/3G4L-UVZB).

NOTE: Idaho Code § 29-110(1) makes it against public policy to choose a forum requiring litigation outside Idaho. In a 2019 opinion citing that statute, Idaho's supreme court upheld a lower-court decision ordering arbitration to take place in that state instead of in Dallas as specified in the parties' contract, on grounds that under the contract's choice of Texas law, the Dallas forum-selection clause was unenforceable. T3 Enterprises, Inc. v. Safeguard Bus. Sys., Inc., No. 45093, slip op. at part IV.B (Idaho Feb. 21, 2019).

§ 58.6.2 CAUTION: China might be a special case

Anyone drafting a contract with a Chinese counterparty should consider:

- whether the contract meets the language- and governing-law requirements of Chinese law to make the contract enforceable by a Chinese court (discussed in the [TO DO: LINK] governing-law section); and
- if not, whether the counterparty has sufficient reachable assets in a more-friendly jurisdiction (because Chinese courts purportedly won't enforce foreign judgments or arbitration awards).

§ 58.6.3 Caution: Saying "the courts of" a jurisdiction could be problematic

Drafters should be careful about specifying that lawsuits are to be heard "in the courts *of*" the specified forum location. A U.S. court might find that such language precluded the defendant from removing the suit to *federal* court. That happened in Doe 1 v. AOL, LLC, 552 F.3d 1077, 1081-82 (9th Cir. 2009) (per curiam). (The appeals court also held that the forum-selection clause was unenforceable.)

§ 58.6.4 Caution: The term "shall be subject to" might confer *exclusive* jurisdiction

In an English case, a Hong Kong freight forwarder used its standard bill-of-lading form in accepting cargo for shipment from China to Venezuela. The form provided in part that "[t]his Bill of Lading and any claim or dispute arising hereunder *shall be subject to* English law and the jurisdiction of the English High Court of Justice in London." The UK Court of Appeal, after reviewing case law concerning similar language, held that the bill of lading's wording conferred *exclusive* jurisdiction on the English courts. Hin-Pro International Logistics Limited v Compania Sud Americana De Vapores S.A. [2015] EWCA Civ 401 ¶¶ 4, 61-78. (Hat tip: Mark Anderson, who in his write-up makes additional observations about the case.)

§ 58.6.5 A court might not honor the parties' agreement to an *improper* forum

In many American states, a statute specifies the location where a lawsuit must be brought. Typically, this will be either the county where the plaintiff resides or the county where the defendant resides.

If a contract's forum-selection clause specifies a *county* that does not meet the statutory requirement, a court might refuse to enforce the forum selection. This happened in A&D Envt'l Serv., Inc. v. Miller, No. 14 CVS 6328 (N.C. App. Apr. 7, 2015) (affirming denial of defendant's motion to enforce forum-selection clause). The *A&D* court noted, though, that "a forum selection clause which favored a court *in another State* was enforceable …." *Id.*, slip op. at 4 (emphasis in original, citation and internal quotation marks omitted).

§ 58.6.6 A forum-selection clause might be disregarded for policy-based reasons

Courts will sometimes refuse to honor a contract's forum-selection clause if the clause offends a strong public policy of the forum location. For example:

Doe 1 v. AOL, LLC, 552 F.3d 1077, 1084 (9th Cir. 2009): a group of users of the America OnLine (AOL) service sued AOL in California and sought class-action status. The AOL user agreement required all disputes to be litigated in Virginia. Citing the forum-selection clause, a federal district court in California dismissed the case but said it could be re-filed in Virginia state courts as required by the user agreement.

The federal appeals court disagreed. It held that California had a strong public policy favoring class-action relief, noting that such relief was not available in Virginia state courts. Therefore, said the appeals court, "the forum selection clause in the instant member agreement is unenforceable as to California resident plaintiffs bringing class action claims under California consumer law."

In re AutoNation, Inc., 228 S.W.3d 663 (Tex. 2007): this Texas case had a very different outcome: a Florida-based car dealer filed suit, in Florida, against a former employee who lived in Texas and had worked for the car dealer there. The former employee's employment agreement contained a choice-of-law clause calling for Florida law to apply, together with a forum-selection clause requiring any litigation to take place in Florida.

Before learning of the Florida action, the former employee sued the car dealer in Texas, seeking a declaratory judgment that the non-competition covenant of the employment agreement was unenforceable under prior Texas supreme court precedent. Granting a writ of mandamus, the Texas supreme court ruled that while it was not questioning the validity of its prior precedent, it would still enforce the "freely negotiated" *[sic]* forum-selection clause to allow the first-filed suit in Florida to proceed.

(Thanks to my then-student Glen Tedham for alerting me to this case.)

For additional discussion and case citations, see generally Paulo B. McKeeby, Solving the Multi-State Non-Compete Puzzle Through Choice of Law and Venue (2012).

QUESTION: On the *AutoNation* facts, what are the odds that the *Florida* court would have applied Texas law, given that the contract included a Florida choice-of-law clause?

§ 58.6.7 Caution: A Massachusetts forum might be dangerous for defendants

If a contract specifies Massachusetts as the forum state for litigating disputes, the defendant might find that its bank account and other assets have been "attached" even before trial if the plaintiff can show a likelihood of success on the merits. See Shep Davidson, When an Out-of-State Company Can Be Sued in Massachusetts and Why You Should Care (2013).

§ 58.6.8 An *exclusive*-forum clause is a hand grenade: It might be thrown back at you

Consider this not-so-hypothetical example:

- You're helping to negotiate a contract between your client, "Alice," and another party, "Bob."
- Your draft contract is a tough one; among other things, it contains an exclusive-jurisdiction forum clause that requires all litigation to be conducted in Alice's home-court jurisdiction.
- In negotiating the contract, Bob's counsel says, sure, an exclusive-jurisdiction clause is fine with us — but the exclusive jurisdiction has to be Bob's home court, not Alice's.

In that case, if Bob has more bargaining power, your proposal of a tough first-draft contract might have created problems for your client Alice.

This actually happened to a client of the author: In a negotiation of a big commercial deal, the client had forwarded its standard form contract — which I hadn't written — to a prospective customer that had significantly-more bargaining power than my client did. The customer's lawyer saw the forum-selection clause, and said we needed to turn it around so that the exclusive forum would be the customer's home city. Fortunately, the customer's lawyer went along with my suggestion that we just drop the forum-selection clause entirely.

§ 58.6.9 An exclusive-forum clause might be *tactically* disadvantageous

Back to our Alice-and-Bob hypothetical: Now imagine that Alice prevailed on Bob to accept an exclusive-jurisdiction forum clause, specifying that all litigation will be in Alice's home jurisdiction. And imagine that years (or days) after signing the contract, Alice wanted to seek a temporary restraining order or preliminary injunction against Bob. That might be, for example, because Bob appeared to be violating a confidentiality clause requiring him to keep Alice's information secret.

In that case, Alice might well be better off suing Bob in his own home jurisdiction, because:

- In kicking off the lawsuit, it's likely that Alice will be able to complete the necessary service of process on Bob more quickly in his own home court.
- If Alice had to court to compel Bob to produce documents or witnesses, Bob would probably have a harder time resisting an order from a judge in Bob's own home jurisdiction.
- Even if Alice were successful in getting a court to issue an injunction affecting Bob, the injunction likely wouldn't take effect until it has been formally served on Bob; service might well be quicker and easier in Bob's home jurisdiction.
- if Bob violated the injunction, Alice probably would be able to haul him back more quickly into court for contempt proceedings in his own home jurisdiction.

So: Alice should think twice before insisting that Bob agree to exclusive jurisdiction in Alice's home court.

Moreover, asking for – or insisting on – a forum-selection clause might fall into the category of "be careful what you wish for," because the courts in the forum state might decide matters differently than what you expected. A Massachusetts company learned a painful lesson in that regard in *Taylor v. Eastern Connection Operating, Inc.*, discussed here.

§ 58.6.10

Caution: An *exclusive*-forum clause might wipe out an arbitration provision

An *exclusive* forum-selection provision might be held to trump an arbitration provision in a prior or "background" agreement. At this writing there is a split in the circuits on that point:

The Second and Ninth Circuits have held that an exclusive forum-selection clause *does* trump an arbitration provision. *See* Goldman, Sachs & Co. v. Golden Empire Schools Financing Authority, 764 F.3d 210 (2d Cir. 2014), in which the appeals court affirmed a trial court's grant of Goldman's motion to enjoin FINRA arbitration, on grounds that the forum-selection clauses in the parties' agreements superseded the arbitration provision (hat tip: Michael Oberman); *see also* Goldman, Sachs & Co. v. City of Reno, 747 F.3d 733, 736

(9th Cir. 2014), where the appeals court reversed a denial of preliminary injunction and final judgment on the same grounds.

In contrast, the Fourth Circuit has held that an exclusive forum-selection clause does *not* trump an arbitration clause, on grounds that the forum-selection clause referred to *litigation*, not arbitration, and "we believe that it would never cross a reader's mind that the *[forum-selection]* clause provides that the right to FINRA arbitration was being superseded or waived." UBS Fin. Servs., Inc. v. Carilion Clinic, 706 F.3d 319, 329-30 (4th Cir. 2013); *see also* UBS Sec. LLC v. Allina Health Sys., No. 12–2090, 2013 WL 500373 (D. Minn. Feb. 11, 2013) (following *Carilion Clinic*).

In a similar vein was a Hawai'i supreme court case, *Narayan v. Ritz Carlton Dev. Co.*, where a condominium purchase agreement said that venue for litigation would be in a specified court in Hawai'i. But the purchase agreement incorporated a condominium declaration, which contained an arbitration clause. The Hawai'i supreme court ruled that this inconsistency meant that the arbitration clause was unenforceable. (The court also held that the arbitration clause was unconscionable because it prohibited discovery and punitive damages.) Narayan v. Ritz-Carlton Development Co., 135 Haw. 327, 350 P.3d 995, 1003 (2015), *cert. granted, vacated, and remanded,* 136 S. Ct. 800 (2016), *on remand*, 140 Haw. 343, 400 P.3d 544 (2017) (reinstating original holding, this time solely on unconscionability grounds).

§ 59 Franchise-Law Benefits Waiver

a. The parties do not intend for anything in the AGREEMENT to be construed as making any party a franchisee of the other party.

b. Each party **WAIVES** the benefit of any state or federal statutes dealing with the establishment and regulation of franchises.

COMMENTARY

In some jurisdictions, this waiver will be unenforceable or even void; see, e.g., Cal. Corp. Code § 31512: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void." Even so, language like this is still sometimes seen in contracts.

§ 60 Free Trade Agreement and Drawbacks

COMMENTARY

This article draws on ideas seen in § 2.4 of a Honeywell purchase-order form archived at https://perma.cc/CUV6-NKTY.

§ 60.1 When would this article be relevant?

a. This article relates to orders for deliverables, submitted by a party ("**Customer**") and accepted by another party ("**Supplier**").

b. This article will apply if some or all the deliverables are eligible for one or more "**Special Benefits**," namely the following:

1. special status under a free trade agreement;
2. drawbacks; and/or
3. any similar industrial benefit from a governmental authority.

COMMENTARY

A "drawback" is, according to one explanation, "[a] partial refund of an import fee. Refund usually results because goods are re-exported from the country that collected the fee." Supply Chain Glossary (scm-portal.net).

§ 60.2 What will Supplier do for Customer?

At no extra charge, Supplier will provide Customer with:

1. all paperwork reasonably requested by Customer, such as certificates of origin and the like, to help Customer to claim the Special Benefit, where Supplier can provide without undue burden or expense; and
2. all cooperation reasonably requested by Customer in connection with Customer's efforts to obtain the Special Benefit.

COMMENTARY

The qualifier, " reasonable cooperation," leaves it open how much Supplier is obligated to do without compensation in addition to the price of the ordered goods.

§ 61 Freedom of Action Commitment

Unless the AGREEMENT clearly states otherwise, neither party will assert that the AGREEMENT:

1. obligates any party to enter into any other agreement, relationship, or transaction;
2. precludes any party from doing any kind of business with anyone else; nor
3. requires any party to restrict the assignment of its employees or other personnel.

COMMENTARY

This is a roadblock clause, of a kind seen in, for example, section 3 of an AT&T nondisclosure agreement (archived at http://perma.cc/G974-2ZH5).

§ 62 Gender references

When necessary, unless the context clearly requires otherwise, any gender-specific or gender-neutral term in the AGREEMENT (for example, *he*, *she*, *it*, etc.) is to be read as referring to any other gender or to no gender.

COMMENTARY

Usage definitions along these lines are sometimes seen in longer contracts.

§ 63 General Representations

a. Each party represents to each other party that, so far as the representing party is aware, the following assertions are true:

1. The representing party has the legal power to enter into and perform its obligations under the Party without obtaining any approval not already obtained.

2. In subdivision a.1, the representing party's legal power includes, without limitation, the power to make any grant that the representing party makes in or under the AGREEMENT.

3. The representing party is not a party to any agreement — nor is the representing party involved in any pending litigation or other claim — that could reasonably be regarded as posing a risk of materially interfering with the representing party's performance of its obligations under this Agreement.

b. The representing party has ☑ not necessarily made any particular inquiry ❑ has made a reasonable inquiry concerning the matters set forth in subdivision a.

COMMENTARY

Representations and *warranties* are similar, but in American law they have some significant differences, discussed in the Representations and Warranties entry

Some agreements routinely include more-detailed "reps and warranties" of this kind; see, for example, the merger agreement between United Airlines and Continental Airlines, at the SEC's EDGAR Website, https://www.sec.gov/Archives/edgar/data/100517/000095015710000587/ex2-1.htm.

Some representations use phrasing such as "to A's knowledge, X is true" — this is unwise, in the author's view, because it could be argued to mean that A is implicitly representing that A in fact has knowledge that X is true. It's likely to be safer to use the phrasing in the text, namely, "*so far as A is aware ….*"

Subdivision a.1: An organization's legal power to take particular actions might require approval by the organization's shareholders (if a corporation), members (if an LLC), limited partners (if a limited partnership), etc. Due diligence might entail examining the organization's governing documents (articles of incorporation, certificate of incorporation, etc.) and/or governing statute(s).

Subdivision a.2: **A drafter might want to add a covenant along the lines of:** "During the term of this Agreement, neither party will enter into any agreement that would interfere with that party's performance of its obligations under this Agreement."

§ 64 Good cause (commentary)

Executives' employment agreements commonly prohibit the employer from terminating the employment except for "cause," which is typically defined with great care. See, e.g., the 2012 employment agreement between Facebook and its chief operating officer Sheryl Sandberg.

In a Seventh Circuit case, the contract in suit defined *good cause*, allowing a dairy-equipment to terminate a dealership, as "Dealer's failure to comply substantially with essential and reasonable requirements imposed upon Dealer by BouMatic." Tilstra v. BouMatic LLC, 791 F.3d 749, 751 (7th Cir. 2015) (Posner, J).

§ 65 Good Faith Definition

The term *good faith* refers to conduct that both (1) is honest in fact and (2) comports with reasonable commercial standards of fair dealing in the trade.

§ 65.1 Commentary

This language is a blend of: • Restatement of Contracts (Second) § 205, which states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"; and • Uniform Commercial Code § 1-304, which imposes a duty of good faith on all contracts and duties within the UCC, and § 2-103(b), which defines *good faith* (in the case of a merchant) as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

Why bother? This definition follows the W.I.D.D. principle: **When In Doubt, *Define***, because, as the [U.S.] Supreme Court has noted, "[w]hile most States recognize some form of the good faith and fair dealing doctrine, it does not appear that there is any uniform understanding of the doctrine's precise meaning. The concept of good faith in the performance of contracts is a phrase without general meaning (or meanings) of its own."

Northwest, Inc. v. Ginsberg, 572 U.S. 273, 134 S. Ct. 1422, 1431, at part III (2014) (cleaned up; extensive citations omitted).

"English law has traditionally resisted implying an obligation to act in 'good faith' into commercial contracts. However, since 2013, in a number of first instance decisions, the English Courts have implied such a duty into 'relational contracts'. The latest case of *Alan Bates & Ors v Post Office Ltd [2019] EWHC 606* provides guidance on the types of circumstances in which a contract will be classified as a 'relational contract', which may have the effect of requiring the parties to act in good faith in the performance of their obligations under English law." John Gilbert et al., Obligations of Good Faith in JOAs - The Impact of Recent Decisions on 'Relational Contracts' (JDSupra 2019). ("JOA" stands for "joint operating agreement" as used in the international upstream oil and gas exploration and production industry.)

§ 65.1.1

Legal background

"The doctrine *[of good faith and fair dealing]* is invoked in practically every type of commercial contract dispute, including insurance, employment contracts, franchise and dealer contracts, leases, and construction disputes." Marcia G. Madsen and Michelle E. Litteken The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts — An Age-Old Concept in Need of an Update? at 6 (MayerBrown.com 2014.)

In many — but not all — U.S. jurisdictions, and in Canada, every contract includes an implied covenant of good faith and fair dealing. *See, e.g.*, the following:

- Uniform Commercial Code § 1-304, which imposes a duty of good faith on all contracts and duties within the UCC;
- UCC § 2-103(b), which defines *good faith* (in the case of a merchant) as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade";
- Restatement of Contracts (Second) § 205, which states: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement";
- For Canada: Bhasin v. Hrynew, 2014 SCC 71 [2014] 3 S.C.R. 495 (Canada).

UK courts, on the other hand, have rejected the notion of a general duty of good faith and fair dealing, on grounds that "if a general principle of good faith were

established it would be invoked as often to undermine as to support the terms in which the parties have reached agreement." Paul Davis, English Court Of Appeal Rejects The "Organizing Principle Of Good Faith" (Mondaq.com 2016), *quoting* MSC Mediterranean Shipping Company S.A. v. Cottonex Anstalt, [2016] EWCA Civ 789 ¶ 45; *see also* Claire Haynes, What Does A Duty To Act In Good Faith Mean? (Mondaq.com 2017).

§ 65.1.2 Business rationale for good-faith commitment

In Bhasin v. Hrynew, 2014 SCC 71 [2014] 3 S.C.R. 495, Canada's supreme court explained the business rationale for implying an obligation of good faith:

> [60] Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they *[the parties]* remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce.
>
> - The growth of longer term, relational contracts that depend on an element of trust and cooperation clearly call for a basic element of honesty in performance,
>
> - but, even in transactional exchanges, misleading or deceitful conduct will fly in the face of the expectations of the parties[.]
>
> [61] … [E]mpirical research suggests that commercial parties do in fact expect that their contracting parties will conduct themselves in good faith[.]
>
> It is, to say the least, counterintuitive to think that reasonable commercial parties would accept a contract which contained a provision to the effect that they were not obliged to act honestly in performing their contractual obligations.

Id. at ¶¶ 60-61 (citations omitted, bracketed paragraph numbers in original, extra paragraphing and bullets added).

§ 65.1.3 Examples of bad faith

The Restatement of Contracts lists examples of conduct that would breach the duty of good faith:

> A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions:
>
> - evasion of the spirit of the bargain,
> - lack of diligence and slacking off,
> - willful rendering of imperfect performance,
> - abuse of a power to specify terms, and
> - interference with or failure to cooperate in the other party's performance.

RESTATEMENT OF CONTRACTS (SECOND) § 205, cmt. d, *quoted in* Marcia G. Madsen and Michelle E. Litteken The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts — An Age-Old Concept in Need of an Update? at 1 (MayerBrown.com 2014). See also, e.g., Steven J. Burton, Good Faith in Articles 1 and 2 of the U.C.C.: The Practice View, 35 Wm. & Mary L. Rev. 1533 (1994),

In a 2016 decision, Massachusetts's highest court upheld a trial court's award of $44 million in damages and interest against a financial company's CEO on grounds that the CEO had violated the implied covenant of good faith and fair dealing by failing to pay an investor and friend who had staked the CEO to more than $650,000 to buy additional shares in the company. *See* Robert and Ardis James Foundation v. Meyers, 474 Mass. 181 (2016), *reversing* 87 Mass. App. Ct. 85 (2015).

§ 65.1.4 Should a contract try to define *good faith*?

The [U.S.] Supreme Court has noted that:

> While most States recognize some form of the good faith and fair dealing doctrine, it does not appear that there is any uniform understanding of the doctrine's precise meaning. The concept of good faith in the performance of contracts is a phrase without general meaning (or meanings) of its own.

> Of particular importance here, while some States are said to use the doctrine to effectuate the intentions of parties or to protect their reasonable expectations, other States clearly employ the doctrine to ensure that a party does not violate community standards of decency, fairness, or reasonableness.

Northwest, Inc. v. Ginsberg, 134 S. Ct. 1422, 1431, at part III (2014) (internal quotation marks, alteration marks, and extensive citations omitted).

Parties' use of a good-faith standard, though, itself usually results from their inability (or unwillingness to invest the time and money) to compile an exhaustive list of what will constitute a particular type of breach. Two commentators have proposed that:

> … "good faith" is interpreted by the law as meaning honesty in fact and the observance of reasonable commercial standards of fair dealing. We have suggested that the parties agree to such a standard when they wish to harness the benefit of a court's hindsight and to address the risk that the debtor will game specific events of default. It is tempting to argue, nonetheless, that this vague standard of good faith—standing alone—is simply not verifiable or is too uncertain.

Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814, 852 (2006) (footnotes omitted). The authors discuss several examples in which this is the case, such as acceleration rights in loan agreements; franchisee obligations; force majeure; and liquidated damages. *See id.* at 852-56.

§ 65.1.5 Good faith in *performance*, not *negotiation*, of the contract

The implied duty of good faith and fair dealing will normally apply (if at all) to the performance and enforcement of an agreement, not to negotiation of the agreement (unless the agreement obligates one or both parties to negotiate in good faith). *See generally* Marcia G. Madsen and Michelle E. Litteken The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts — An Age-Old Concept in Need of an Update? at 5 (MayerBrown.com 2014).

§ 65.1.6 Limitations on the duty of good faith

The Supreme Court of Canada discussed some of the limitations of the duty of good faith (in Canadian law) in the important case of Bhasin v. Hrynew, 2014 SCC 71 [2014] 3 S.C.R. 495:

> [65] … While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. **Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.**
>
> [70] The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of **the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest.** In commerce, a party may sometimes cause loss to another — even intentionally — in the legitimate pursuit of economic self-interest[.] Doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency[.]
>
> The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or "palm tree" justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.

Id. (citations omitted, extra paragraphing added).

§ 66 Governing Law: State of New York

COMMENTARY

Specifying a default jurisdiction (namely, New York law) in case of a drafting error (namely, adopting this Option but failing to specify a jurisdiction) follows the computer-programming principle of "failing gracefully."

A superb resource on the subject of choice-of-law provisions is John F. Coyle, The Canons of Construction for Choice-Of-Law Clauses, 92 WASH. L. REV. 631 (2017), archived at https://perma.cc/NQ7Q-VAJV.

§ 66.1 What disputes does the Governing Law cover?

The law of the jurisdiction specified in the heading of this Governing Law section is to apply in any dispute arising out of or relating to any of the following:

1. The AGREEMENT itself;
2. any transaction or relationship resulting from the AGREEMENT; and/or
3. any alleged fraudulent inducement to enter into the AGREEMENT.

COMMENTARY

The reference to fraudulent inducement borrows from model language in Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018) (archive: https://perma.cc/3G4L-UVZB), at part V, text accompanying note 105.

§ 66.2 Is governing-law ping pong (i.e., *renvoi*) allowed?

The Governing Law is to be applied without regard to conflicts-of-law rules that might otherwise result in the application of the law of another jurisdiction.

COMMENTARY

The "without regard to conflicts-of-law rules" language addresses the renvoi issue: The law of the chosen jurisdiction might include conflict-of-

law provisions that, at least in theory, could cause a different jurisdiction's substantive rules to be applied.

On a somewhat-related note, see T3 Enterprises, Inc. v. Safeguard Bus. Sys., Inc., 435 P.3d 518 (Id. 2019) (affirming denial of motion to vacate or modify arbitration award): In that case, the Idaho supreme court held that the agreement's choice of Texas law required arbitration in Idaho, not in Dallas as the agreement's forum-selection clause stated. "[T]he district court stated that a Texas court would consider Idaho's strong public policy against forum selection clauses as evidenced in Idaho Code section 29-110(1), and thus not enforce the forum selection clause. … the district court did not err when it determined the forum selection clause was unenforceable under Texas law." *Id.* at 528-29.

§ 66.3 How does the Governing Law relate to arbitration?

a. This section applies if the AGREEMENT also requires arbitration of some or all disputes.

b. Any such arbitration is to be governed by the Governing Law unless the arbitration agreement expressly provides for a different arbitral law; in that case, the stated arbitral law will govern.

c. Hypothetical example: Suppose that:

1. the AGREEMENT specifies Texas for the the Governing Law;

2. but the AGREEMENT also specifies that New York law will apply as the arbitral law.

In that situation, any arbitration pursuant to that provision would be governed by New York arbitration law and, if applicable, the U.S. Federal Arbitration Act, and not by Texas arbitration law.

§ 66.4 Are any laws excluded?

❑ The United Nations Convention on Contracts for the International Sale of Goods will not apply.

❑ The Uniform Computer Information Transactions Act ("UCITA") will not apply.

COMMENTARY

The United Nations Convention on Contracts for the International Sale of Goods ("UN CISG" or "Vienna Convention"), in some ways, amounts to an international version of the U.S. Uniform Commercial Code, but with some nontrivial differences. See generally the Wikipedia article on the UN CISG; for a comparison of the Uniform Commercial Code and the UN CISG, see John C. Tracy, UCC and CISG (Jul. 5, 2011).

The Uniform Computer Information Transactions Act ("UCITA") is (was?) a controversial proposed uniform law. It was enacted only in Maryland and Virginia, and otherwise appears to be essentially dead. See generally the Wikipedia article on UCITA. Section 104 of UCITA allows parties to a contract to "opt out" of the Act's applicability — and going even farther, some states have enacted so-called "bomb-shelter" legislation voiding any contractual choice of law that would result in UCITA being applied. According to materials published by an advocacy group calling itself AFFECT, Americans for Fair Electronic Commerce Transactions, such legislation has been enacted in Iowa, North Carolina, Vermont, and West Virginia.

§ 66.5 Additional commentary

§ 66.5.1 Legal background of choice-of-law provisions

In the U.S., **courts typically enforce choice-of-law provisions in a contract — with exceptions,** as noted in the discussion below. In fact:

A California statutory provision expressly validates a contractual choice of California law for non-personal contracts having a value of at least $250,000, even if there is no relationship between the contract and California. *See* Cal. Civ. Code 1646.5. (Of course, a non-California court might not give effect to that provision, as discussed below.)

By statute, some other states have declared that a written contract's choice of the law of the state is valid, even without any other connection to the state. See, e.g., 6 DEL. CODE ANN. 2708; FLA. STAT. 685.101; 735 ILL. COMP. STAT. 105/5-5; NY GEN. OBLIG. L. 5-1401; OHIO REV. CODE ANN. 2307.39; TEX. BUS. & COM. CODE § 271.001 et seq.

New York courts won't even undertake a conflict-of-law analysis when the parties have agreed to a choice of law. *See* Ministers and Missionaries Benefit

Bd. v. Snow, 26 N.Y.3d 466, 45 N.E.3d 917, 25 N.Y.S.3d 21 2015 NY Slip Op 09186, *on certification from* 780 F.3d 150 (2d Cir. 2015).

See generally Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018) (archive: https://perma.cc/3G4L-UVZB), part V, n.100 & accompanying text.

§ 66.5.2 But: Public policy might trump a choice-of-law clause

A court might not give effect to a governing-law clause in a contract if doing so would lead to a result that contravened a fundamental public policy of the law of the jurisdiction in which the court sits. Here are some examples.

In New York, a non-solicitation provision in an employment agreement (as in, *no soliciting our customers after you leave*), purporting to bind an employee in that state, is judged by New York law, not the governing law stated in the employment agreement. Brown & Brown, Inc. v. Johnson, 25 N.Y.3d 364, 34 N.E.3d 357, 12 N.Y.S.3d 606 (2015) (affirming, in pertinent part, judgment that choice-of-law clause was unenforceable in respect to non-solicitation clause).

Pathway Medical Technologies, Inc. v. Nelson, No. CV11-0857 PHX DGC (D. Ariz. Sept. 30, 2011): a medical-device sales representative quit his job in Arizona and started working for a direct competitor of his former company. So, the former company filed a lawsuit in federal court in Arizona. The former company wanted to enforce a non-competition covenant in the sale rep's employment agreement; it asked the court for an immediate temporary restraining order (TRO) to prohibit the sales rep from working for the competitor.

The Arizona federal court refused to grant the requested restraining order. The court recognized that the employment agreement's governing-law clause specified that the law of Washington state would apply. But, said the Arizona court, in this area the laws of Arizona gave more weight to employees' right to earn a living than did Washington law, and this was an area of fundamental public policy for Arizona law. Consequently, the court refused to give effect to the agreement's choice of Washington law; the court also held that under Arizona law, the sales rep's non-competition covenant was unenforceable.

Narascyan v. EGL Inc., 616 F.3d 895 (9th Cir. 2010): a California truck driver sued the Texas-based trucking company for which he worked for violating California employment law. The driver's contract with the company specified that Texas law would apply and said that the driver was an independent contractor, not an employee.

A California federal court granted summary judgment in favor of the employer. The court reasoned that Texas law governed, as required by the contract. Applying Texas law to the facts of the case, the court concluded that the driver was indeed an independent contractor and therefore could not sue the company for violating California employment law.

The federal appeals court, though, reversed. It held that California courts would not give effect to the contract's choice of Texas law, but instead would apply California law. Under *California* law, said the appeals court, the driver was really an employee, not an independent contractor, and therefore could properly sue the trucking company for violating California employment law.

Dinan v. Alpha Networks, Inc., 764 F.3d 64 (1st Cir. 2014) (vacating judgment on jury verdict): The parties were a Maine-based sales representative and his employer, a California company. The sales rep's employment agreement included a California choice-of-law clause. The company failed to pay commissions on certain sales. The appeals court held that Maine law governed, and therefore the sales rep was entitled, not only to back commissions, but also to treble damages and attorney fees under a Maine statute.

But see Exxon Mobil Corp. v. Drennen, 452 S.W.3d 319 (Tex. 2014): The Supreme Court of Texas held that it was permissible for Exxon Mobil to choose New York law for its employee stock-option and restricted-stock programs, because multi-national companies should be able to choose the laws they want to follow, in the interest of uniformity. (OK, the "choose the laws they want to follow" part does overstate the court's holding just a bit, but not by much; the court arguably opened the door wide for corporations to purport to impose onerous terms and conditions on their employees while using a choice-of-law clause to strip the employees of their legal protections.)

§ 66.5.3 Which governing law to choose?

Drafters wondering which governing law to choose should give some thought to the specifics of the laws being considered. Several years ago the author started a choice-of-law cheat sheet for U.S. states (still a work in progress) that might be helpful.

In international transactions, a party from a jurisdiction with a civil code (e.g., continental Europe; Latin America) might be reluctant to agree to the law of a common-law country (e.g., England and its former colonies), or vice versa. Those parties might find the UN CISG (discussed below) to be somewhat of a "neutral" choice.

English law is often chosen for multi-national transactions. See, e.g., Melanie Willems, English Law – a Love Letter (AndrewsKurth.com 2014), which contrasts England's common-law foundation with the civil law found on the Continent.

For an overview of different laws concerning various industry categories, see Thierry Clerc, International Contracts: From choosing applicable law to settling disputes (EuroJuris.net 2016), archived at https://perma.cc/U54S-QMBH.

§ 66.5.4 Choose the law *of the agreed forum*?

If the parties are also going to agree to a choice of forum — about which see the Forum Selection entry — then they might want to choose the law of the agreed forum as their governing law. That could increase the chances of having their choice of law enforced in a dispute.

For example: the parties might agree to New York law, in part to take advantage of the statutory provision validating clauses requiring amendments to be in writing in certain contracts (see the Amendments and Waivers Protocol). A New York court would seem to be more likely to give effect to that provision, and thus to an amendments-in-writing clause, than might a court in another jurisdiction.

§ 66.5.5 CAUTION: China might be a special case

At the China Law Blog, Dan Harris asserts that *as a practical matter*, Chinese courts:

- will not enforce a contract unless the contract is written in Chinese and the governing law is Chinese;
- will not enforce judgments of other nations' courts in contract lawsuits; and
- are unlikely to enforce arbitration awards from non-Chinese jurisdictions.

§ 66.5.6 A governing-law clause might backfire

Specifying the law that you want to govern your contract, or your contractual relationship, might lead to unexpected results.

Consider the case of Taylor v. Eastern Connection Operating, Inc., 465 Mass. 191 (2013): this was an overtime case; a group of couriers, working in New York as couriers for a Massachusetts-based company, sued the company *in Massachusetts*. These New-York based couriers claimed to be entitled to the protection of Massachusetts statutes governing independent contractors, wages, and overtime.

Normally, people who file employment-type lawsuits against their companies tend to do so in their own home jurisdictions. That's understandable; the home-court advantage is not to be sneezed at – and it's also why companies like for their contracts to specify *their* home court for any lawsuits.

Well, that's just what had happened here: the courier company had used a standard form for its contracts with its New York courier personnel. The contract form stated that Massachusetts law would apply and that all disputes would be litigated in Massachusetts.

When confronted by an actual employee lawsuit in the forum it had specified, the company moved to dismiss the case — and the Massachusetts trial court granted the motion — on theory that the employment laws of Massachusetts did not apply to people who worked in New York.

The Massachusetts supreme court disagreed; it reversed the trial court's decision, giving an interim win to the New York-based courier personnel. The supreme court held that it would not be unfair to enforce the courier company's own forum-selection and governing-law clauses against the company. Moreover, said the supreme court, enforcement of those clauses would not contravene a fundamental policy of the state of New York, where the couriers actually worked.

The supreme court said that the trial court would need to conduct an evidentiary hearing to determine whether, on the facts of the case, the forum-selection and governing-law clauses should be enforced. The court remanded the case to the trial court for further proceedings.

To similar effect was another Massachusetts case, Dow v. Casale, 83 Mass. App. Ct. 751 (2014): a Florida-based employee of a Massachusetts-based company successfully sued the CEO of his employer — personally — for unpaid sales commissions and other amounts, under a Massachusetts statute that created a private right of action. The employment agreement stated that Massachusetts

law applied. The court, citing *Taylor*, held that the Massachusetts statute applied and affirmed summary judgment in favor of the employee.

In a Canadian franchise-dispute case, an appeals court held that Ontario law — which gave franchisees specific rights — applied even to franchisees outside Ontario because the franchise agreement specified that Ontario law would apply. *See* 405341 Ontario Ltd. v. Midas Canada Inc., 2010 ONCA 478 ¶¶ 40-45. In that case, a provision in the franchise agreement stated that a franchisee, as a condition of renewing or transfering its rights, must release the franchisor from liability. The appeals court affirmed the trial court's ruling that, for purposes of the instant class action, that franchise-agreement provision was unenforceable and void.

But in contrast, in O'Connor v. Uber Tech., Inc., 58 F. Supp. 3d 989 (N.D. Cal. 2014) (granting judgment on the pleadings), a federal district court in San Francisco held that Uber drivers *working outside California* could not sue the company for violation of a California wage-and-hour statute, even though the drivers' contract with Uber included a California choice-of-law clause. *See id.*, at 1003-06 (holding that the relevant statutes did not apply extraterritorially). (The extensive subsequent proceeding in that case are not relevant to this point.)

§ 66.5.7 Too-narrow a governing-law clause can be problematic

Drafters and reviewers should pay attention to the scope of the governing-law clause. For example: a Canadian software company had too narrow a choice of Canadian law in its end user license agreement ("EULA") and, as a result, found itself forced to defend a class-action lawsuit in Chicago instead of in Victoria, B.C. The court noted that the EULA's governing-law provision applied only to the EULA per se and did not encompass the plaintiff's Illinois-law claims; this, said the court, tipped the balance in favor of keeping the case in Chicago. *See* Beaton v. SpeedyPC Software, No. 13-cv-08389 (N.D. Ill. June 5, 2015) (denying defendant's motion to dismiss for *forum non conveniens*) (subsequent history omitted).

Another example: Family Endowment Partners, L.P. v. Sutow, NO. 2015 CV 1411-BLS1 (Mass. Superior Ct. Nov. 16, 2015). In that case, the contract in suit was between an investment firm and one of its clients (a married couple). The contract contained an arbitration provision that applied broadly, encompassing all disputes *relating to* the agreement. The contract also contained a choice-of-law provision, but it applied only to the interpretation and enforcement of the agreement — and, notably, not to related claims as did the arbitration provision. The client's claims against the investment firm

included claims under a Pennsylvania unfair-trade-practices statute. The arbitrator held that, because the choice-of-law provision did not apply to non-contract claims, the Pennsylvania statute was available to the client; the arbitrator awarded treble damages under that statute. The court upheld the arbitration award, holding that the contract's provision excluding "special, consequential or incidental damages" was not sufficient to exclude punitive- or multiple damages. See, e.g., Pat Murphy, $48M arbitration award vs. investment advisor upheld (McCarter.com 2015).

§ 66.5.8 Territory-specific choice of law?

Some companies' boilerplate terms include territory-specific choices of law (and forum selections). For example, here's one from Carson Wagonlit Travel, at https://perma.cc/6RJK-57EM:

> 18.1 This Agreement shall be exclusively governed by the exclusive laws of and all disputes relating to this Agreement shall be resolved exclusively in (i) England and Wales and governed by English law if the Seller's registered office is located in the Europe, Middle East, Africa (EMEA) region; (ii) Singapore if the Seller's registered office is located in Asia Pacific (APAC) region; or (iii) the State of New York, USA if the Seller's registered office is located the Americas region.

§ 67 Government Authority Definition

a. The terms *government authority* and *governmental authority* refer to any individual or group, anywhere in the world, that exercises *de jure* or *de facto* governmental- or regulatory power of any kind.

b. The term *governmental authority* should normally be read as including, as applicable and without limitation, any agency; authority; board; bureau; commission; court; department; executive; executive body; judicial body; legislative body; or quasi-governmental authority; at any level (for example, state, federal or local).

c. The governmental- and regulatory power referred to in this definition is intended to include (without limitation) administrative; executive; judicial; legislative; policy; regulatory; and/or taxing power.

§ 68 Government Subcontracting Disclaimer

a. Each party (each, a "**Warranting Party**") represents and warrants, to each other party, that — except to the extent (if any) expressly disclosed otherwise in the AGREEMENT — the AGREEMENT is not a subcontract in respect of a contract between the Warranting Party and any governmental authority.

b. Without the other party's express prior written consent, the Warranting Party will not purport to:

1. obligate the other party, as a subcontractor or otherwise: (A) to any government authority; nor (B) to the terms of any government contract, through flow-down provisions or otherwise;

2. make any representation, warranty, or certification, on behalf of the other party, concerning the other party's business practices, work force, or other status, in any report to a government authority (for example, an equal-opportunity compliance report).

c. Each Warranting Party will defend and indemnify each other party against any claim that arises out of the Warranting Party's breach of subdivisions a or b above.

COMMENTARY

Depending on the law, a subcontractor under a government contract could be subject to specific requirements imposed by statute or regulation. See, e.g., Robin Shea, Applicant tracking and the EEOC: "You can SUE us for that?" (EmploymentAndLaborInsider.com 2016). For that reason, a disclaimer might be in order. [TO DO: NEED CITES]

Entire books have been written on the issues arising from government subcontracting, of course; this disclaimer is intended to try to rule out the need to understand those issues.

Subdivision b: A subcontractor that became bound by a government prime contract might be subject to, for example: • equal-opportunity reporting requirements; • affirmative-action obligations; • prohibitions of various employment practices; • restrictions of various kinds, e.g., on assignments.

Subdivision c: This indemnity obligation might well carry greater financial exposure than damages for a "plain" breach of contract or breach of

warranty. See generally: • Glenn D. West, Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic "Excluded Losses" Provision in Private Company Acquisition Agreements, 70 BUS. LAWYER 971, 975 (Weil.com 2015) ("III. A Basic Primer on Contract Damages"), archived at https://perma.cc/D2HC-Z5XD; • *Id.* at 998-99: "[I]t bears repeating that there is, in fact, a very clear distinction (whether or not there is an ultimate difference) between a claim for indemnification and a claim for damages for breach of a representation and warranty in an acquisition agreement."

§ 69 Gross Negligence Definition

§ 69.1 What does *gross negligence* mean?

The term *gross negligence* refers to conduct that evinces a reckless disregard for or indifference to the rights of others, tantamount to intentional wrongdoing; it differs in kind, not only in degree, from ordinary negligence.

§ 69.2 ☑ What proof is required for claims of gross negligence?

An assertion of gross negligence must be proved by clear and convincing evidence (defined).

§ 69.3 Commentary

§ 69.3.1 Legal & business contexts

The meaning of *gross negligence* often comes into play in limiting a party's liability for negligence, where the limitation might include a carve-out saying that the limitation will not apply if the party is *grossly* negligent. Unfortunately, the difference between negligence and gross negligence may be hard to assess in practice.

§ 69.3.2 Language origin: New York's definition of *gross negligence* is fairly reasonable

With a view to usage in non-U.S. jurisdictions where the term *gross negligence* might not be defined by law, this definition adopts the arguably-middle-ground standard set out by the Court of Appeals of New York (that state's highest court), which seems to achieve a reasonable balance of fairness and precision. *See* Sommer v. Federal Signal Corp., 79 N.Y.2d 540, 554 (1992).

§ 69.3.3 Other jurisdictions are less middle-of-the-road in their definitions

- Setting the bar quite high for proof of gross negligence, a Texas statute defines the term as "an act or omission: (A) which when viewed objectively from the standpoint of the actor at the time of its occurrence involves an extreme degree of risk, considering the probability and magnitude of the potential harm to others; and (B) of which the actor has *actual, subjective awareness* of the risk involved, but nevertheless proceeds with *conscious indifference* to the rights, safety, or welfare of others." Tex. Civ. Prac. & Rem. Code 41.001(11) (cleaned up, emphasis added) The definition is used in 41.003 of the Code, which conditions any award of punitive damages on a showing, by clear and convincing evidence, of fraud, malice, or gross negligence, as part of a far-reaching 2003 tort-reform package enacted by the state legislature.

- On the other hand, in an arguably vaguer definition, the California supreme court noted that *gross negligence* "long has been defined in California and other jurisdictions as either a want of even *scant* care or an *extreme* departure from the ordinary standard of conduct." City of Santa Barbara v. Janeway, 62 Cal. Rptr. 3d 527, 161 P.3d 1095, 41 Cal. 4th 747 (2007) (cleaned up, emphasis added). The supreme court held that in cases of gross negligence, advance releases of liability are unenforceable as being against public policy; the court affirmed a judgment that a release from liability in a contract did not shield a defendant from an allegation of gross negligence in the drowning death of a disabled teen-ager at a city pool.

- In the litigation over the notorious "BP oil spill" in the Gulf of Mexico, a federal district court wrote at length about the definition of *gross negligence* in the context of the (federal) Oil Pollution Act of 1990 and how BP was guilty of gross negligence; the court held that gross negligence was less than reckless conduct (much as in the California definition discussed

above). See In re: Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010, 21 F. Supp. 3d 657, 732-34 ¶¶ 481 et seq., esp. 494 & n.180, 495 (E.D. La. 2014) (findings of fact and conclusions of law).

§ 69.3.4 Require proof by clear and convincing evidence?

The default, pre-checked option in the above definition requires clear and convincing evidence to prove gross negligence; this is the same standard as is required in many jurisdictions for proof of fraud. See, e.g., Goodyear Tire & Rubber Co. v. Rogers, 538 SW 3d 637, 644-45 (Tex. App.—Dallas 2017, pet. denied) (upholding judgment on jury verdict of gross negligence, which requires proof by clear and convincing evidence).

§ 70 Guaranty

§ 70.1 Definitions

a. *Guarantor* refers to each individual or organization that states, in a writing signed by the individual or organization, that the individual or organization guarantees a Guaranteed Payment Obligation.

b. *Guaranty* refers to this Guaranty.

c. *Creditor* refers to any individual or organization to which a Guaranteed Payment Obligation is owed.

d. *Payer* refers to any person that owes a Guaranteed Payment Obligation.

e. *Guaranteed Payment Obligation* refers to any payment, under any Guaranteed Agreement, that is guaranteed in writing.

f. *Guaranteed Agreement* refers to the AGREEMENT.

COMMENTARY

The default definitions of *Guarantor*, *Creditor*, etc., are designed to give contract drafters additional flexibility: they allow a drafter to incorporate this provision by reference without having to worry about using the exact defined terms.

Only *payment* obligations are guaranteed here; that's because guaranties of performance of other types of obligation (for example, an obligation to perform consulting services, repair work, building construction, etc.) might well require considerably-more negotiation and customized language.

Drafters representing guarantors will want to be careful to define just which, and whose, payment obligations are being guaranteed; a beneficiary's aggressive position on this issue led to litigation in McLane Foodservice, Inc. v. Table Rock Restaurants, LLC, 736 F.3d 375 (5th Cir. 2013) (affirming district-court judgment in favor of alleged guarantor).

§ 70.2 What is guaranteed?

Each Guarantor guarantees the full and prompt payment, by each Payer, when due, of each Guaranteed Payment Obligation, without regard to:

1. how or when the Guaranteed Payment Obligation in question previously came to exist, is coming to exist now, or comes to exist in the future (including, for example, by acceleration or otherwise); or

2. whether the Guaranteed Payment Obligation is direct or indirect, absolute or contingent.

COMMENTARY

Some of the language of this provision is informed by the language of the guaranty in suit in Knauf Insulation, Inc. v. Southern Brands, Inc., 820 F.3d 904, 906 (7th Cir. 2016) (affirming judgment that guarantors were liable for guaranteed payment obligations) (Posner, J).

§ 70.3 Who is intended to benefit from the Guaranty?

The Guaranty is intended to benefit (i) each Creditor, and (ii) that Creditor's successors and assigns, if any.

COMMENTARY

Loans are often packaged and sold to different parties that collect payments (sometimes being "sliced and diced" in the process). This

beneficiary provision allows a guaranty to be transferred to the original lender's successors and assigns as part of the "collateral" for the loan.

§ 70.4 What consideration is the Guarantor receiving?

Each Guarantor undertakes its obligations under the Guaranty in consideration of, and to induce, the entry, by each Creditor, into the Guaranteed Agreement.

COMMENTARY

The "in consideration of" language is included because without it, a court might hold a guaranty to be unenforceable. The required consideration might well be the guarantor's desire to support the creditor — but not always. EXAMPLE: In Yellow Book, Inc. v. Tocci, 2014 Mass. App. Div. 20 (2014), a company's bookkeeper signed an order for ad space in a Yellow Pages phone book; unhappily for her, she didn't read the fine print, which contained a statement that she personally guaranteed payment. A court held that she was not liable on the guaranty, because *she* had received no consideration for it. *See id.* at 22-23. The case is discussed in Robert W. Stetson, Four Tips for Drafting Enforceable Personal Guarantees, in (BNA) Corporate Counsel Weekly Newsletter, Apr. 9, 2014, which includes numerous case citations.

§ 70.5 Where can this Guaranty be enforced?

Any action to enforce this Guaranty may be brought in any court or other forum having jurisdiction.

COMMENTARY

A forum-selection provision much like this one was readily enforced by the Seventh Circuit in the *Knauf Insulation* case, even though the guarantors purportedly did not have "minimum contacts" with the selected forum; the court remarked that the guarantors "didn't have to have *any* contacts" with that forum. *See Knauf Insulation*, 820 F.3d at 906 (citing cases; emphasis in original).

Drafters representing creditors might want to specify a convenient court for enforcement of the guaranty and to have each creditor submit to personal jurisdiction in that court (for that purpose only, not for general jurisdiction).

§ 70.6 Must *Creditors* accept (and/or sign) this Guaranty?

No: Each Guarantor WAIVES acceptance of the Guaranty by the Creditors, notice of such acceptance, and signature of the Guaranty by the Creditors.

COMMENTARY

Many guaranty clauses include waiver-of-acceptance and waiver-of-signature language, even though such language might very well merely duplicate applicable law. *See, e.g.*, US Bank Nat'l Ass'n v. Polyphase Elec. Co., No. 10-4881 (D. Minn. Apr. 23, 2012): In that case, the court granted summary judgment that a bank was entitled to enforce guaranties of loans made by the bank, even though the bank had not signed the guaranty documents.

§ 70.7 Who will pay the expenses of collecting from a Guarantor?

The Guarantor must pay or reimburse all court costs and all reasonable expenses — including for example reasonable attorney fees and expenses — that any Creditor incurs in attempting to enforce one or more of: (1) that Creditor's rights against that Guarantor under the Guaranty; and (2) the Guaranteed Payment Obligation in question.

COMMENTARY

Language similar to that of this clause was used in the guaranty in Eagerton v. Vision Bank, 99 So. 3d 299, 305 (Ala. 2012).

§ 70.8 What happens if a Creditor must refund money because of a Payee's bankruptcy filing?

a. This provision applies if a Creditor:

   1. refunds (as defined below) a payment made by a Payer on a Guaranteed Payment Obligation because of a requirement of bankruptcy law; fraudulent-transfer law; or comparable law; or

   2. makes a partial refund of such a payment in settlement of a claim for a larger refund.

b. In any such case, each Guarantor, jointly and severally, must reimburse the Creditor for the amount of the refund or partial refund and as well as reasonable attorney fees and expenses and costs of court, if any.

c. For purposes of this provision, the term *refund* includes without limitation any payments made by the Creditor to third parties, for example to a trustee in bankruptcy, a debtor-in-possession, or a receiver.

COMMENTARY

If a principal of a guaranteed payment obligation were to file for bankruptcy protection (under U.S. law), **then creditors might be forced to return any payments that were made** by the principal within the 90 days preceding the bankruptcy filing date. Such payments are known as "avoidable preferences." See, e.g., Patricia Dzikowski, The Bankruptcy Trustee and Preference Claims (Nolo.com; undated); see also the guaranty language in Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

To be sure, a creditor in bankruptcy does have the right to contest its obligation to refund an avoidable preference. That can be difficult, though; the creditor must successfully jump through some hoops to prove that it was entitled to the payment. See, e.g., Kathleen Michon, Pre-Bankruptcy Payments to Creditors: Can the Trustee Get the Money Back? (Nolo.com; undated). As a practical matter, many avoidable-preference cases are settled, with the creditor making a partial refund in lieu of incurring the expense of jumping through those proof hoops. In such a situation, if the original obligation had been guaranteed, then the creditor likely would want to try to recoup the partial refund from the guarantor.

"Courts have uniformly held that a payment of a debt that is later set aside as an avoidable preference does not discharge a guarantor of its obligation to repay that debt." Coles v. Glaser, 2 Cal. App. 5th 384, 389, 205 Cal. Rptr.3d 922 (2016) (extensive citations, internal quotation marks, and alteration marks omitted).

§ 70.9 What if foreclosing on the collateral isn't enough?

Each Guarantor will be (and remain) liable, to the fullest extent permitted by applicable law, for any deficiency remaining after foreclosure of any lien

or other security interest in collateral or other rights or property securing a Guaranteed Payment Obligation, even if the Payer's liability for such a deficiency is discharged pursuant to statute or judicial decision.

COMMENTARY

This language is based on that of the guaranty in Eagerton v. Vision Bank, 99 So. 3d 299, 309 (Ala. 2012); see also the similar language of the guaranty); see also the guaranty language in Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

§ 70.10 May a Guarantor assert any defenses against enforcement?

Each Guarantor's obligations under this Guaranty are absolute, unconditional, direct and primary; each Guarantor WAIVES, and expressly agrees that it will not assert (and it will cause its affiliates not to assert):

1. any claim or defense that the Guarantor's obligations under the Guaranty are allegedly illegal, invalid, void, or otherwise unenforceable;

2. any claim or defense pertaining to any Guaranteed Payment Obligation, other than the defense of discharge by full performance, including without limitation any defense of waiver, release, statute of limitations, res judicata, statute of frauds, fraud, incapacity, minority, usury, illegality, invalidity, voidness, or other unenforceability that may be available to the Payer or any other person liable in respect of any Guaranteed Payment Obligation;

3. any setoff available to the Payer or any other such person liable, whether or not on account of a related transaction;

4. all rights and defenses arising out of an election of remedies by a Creditor, even if that election of remedies, such as a nonjudicial foreclosure with respect to security for a Guaranteed Payment Obligation, resulted in impairment or destruction of the Guarantor's rights of subrogation and reimbursement against the Payer; and

5. any other circumstance that might otherwise give rise to a defense available to, or a discharge of, the Payer and/or any Guarantor.

COMMENTARY

At least in some jurisdictions, an "absolute, unconditional" guaranty like this one is likely to be enforced even in what might seem like unfair circumstances such as collusion between the lender and the principal. For an example of this, see the decision by the Court of Appeals of New York (which is that state's highest court) in Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015)..

This waiver language is adapted from California Civil Code § 2856© and (d).

The use of all-caps type for WAIVES is for conspicuousness, as discussed in the eponymous entry.

The phrase "will not assert" is designed to make it a breach of contract — for which attorney fees might be recoverable as damages — for a guarantor to make any of the listed assertions.

Subdivision 2: Some of the listed items are based on those of the respective guaranties in: Eagerton v. Vision Bank, 99 So. 3d 299, 309 (Ala. 2012); and Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

Subdivision 3: The "setoff" language is not uncommon; see, e.g., the guaranty in suit in Moayedi v. Interstate 35/Chisam Road, LP, 438 S.W.3d 1, 3 (Tex. 2014) (affirming that guarantor's waiver of defenses negated statutory right of offset).

After subdivision 5, **some drafters might wish to consider adding:** *Each Guarantor also waives any defense to liability that could be asserted by any Payer in respect of the Guaranteed Payment Obligation.*

§ 70.11 Which Guarantors are liable for how much?

Except to the extent (if any) otherwise agreed in writing, each Guarantor is jointly and severally liable to each Creditor for the entire amount of each Guaranteed Payment Obligation.

COMMENTARY

> It's a really good idea for drafters (and reviewers) to be clear about the extent to which multiple guarantors are to be jointly and severally liable for the guaranteed payment obligation(s). In a given transaction, for example, Alice might guarantee the obligations of Alan, and Bob might guarantee the obligations of Betty, but not vice versa — that is, Alice does not guarantee Betty's obligations nor does Bob guarantee Alan's obligations.

§ 70.12 What must a Creditor do to collect from a Guarantor?

Each Guarantor's obligations under the Guaranty will accrue immediately, upon written demand by the Creditor to the Guarantor, after any default by the Payer in the relevant Guaranteed Payment Obligation.

COMMENTARY

> This language makes it clear that a creditor needn't jump through any particular hoops to be entitled to collect from a guarantor.

§ 70.13 Will a Guarantor have to pay even if the Payer's right to cure a default hasn't ended?

IF: The Guaranteed Agreement provides the Payer with the right to notice and a cure period in which to cure an alleged breach of a Guaranteed Payment Obligation; THEN: The Guarantor's obligations under the Guaranty will not accrue before the end of that cure period.

§ 70.14 Must a Creditor go after the Payer(s) *first*?

☑ No: A Creditor is not required to attempt to enforce the Guaranteed Payment Obligation against the Payer; for example, the Guarantor is not required to attempt:

1. to collect a judgment against the Payer, nor
2. to foreclose on any lien, security interest, or other collateral securing the Guaranteed Payment Obligation.

❑ Yes: This Guaranty may not be enforced as to any Guaranteed Payment Obligation until the Creditor:

1. has obtained a final judgment against the Payer, from which no further appeal is taken or possible, enforcing, in whole or in part, the Guaranteed Payment Obligation in question; and
2. has been unable to collect the judgment after diligently making reasonable efforts to do so.

COMMENTARY

These two options are sometimes referred to as a guaranty of *payment* and a guaranty of *collection*, respectively.

Creditors will typically object to the second, unchecked option; they normally want to be able to go after guarantors immediately to get their money, as opposed to incurring the delay, burden, expense, and uncertainty of first having to file suit against their debtors.

§ 70.15 Does it matter if the Guaranteed Payment Obligation is modified?

☑ Yes: The Guaranty will no longer be effective if the Guaranteed Payment Obligation is altered, in any material respect, without the prior written consent of the relevant Guarantor.

❑ No: An amendment to or modification of a Guaranteed Payment Obligation does not discharge or otherwise affect the guaranty obligation of any Guarantor in respect of that Guaranteed Payment Obligation.

COMMENTARY

The intent of this provision is to override the general rule — which is strictly applied by courts — that "a guarantor is discharged if, without his or her consent, the contract of guaranty is materially altered." Eagerton v. Vision Bank, 99 So. 3d 299, 305-06 (Ala. 2012) (holding that modification of loan discharged guarantors from further obligations) (citations, quotation marks, and alterations omitted); *accord*, Sterling Development Group Three, LLC, v. Carlson, 2015 N.D. 39 (affirming holding that guaranty was discharged by alteration of guaranteed obligations without guarantor's knowledge or consent) (citing state statute). For an example of clause language like this, see Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. v. Navarro, 25 N.Y.3d 485, 488, 36 N.E.3d 80, 15 N.Y.S.3d 277 (2015).

§ 70.16 ❑ Guarantor Liability Cap: [FILL IN AMOUNT].

In no event will the Guarantors, in the aggregate, be liable under the Guaranty for more than the amount specified.

COMMENTARY

In some transactions a cap on Guarantor liability might be a possible negotiation point.

§ 70.17 Additional commentary about guaranties

§ 70.17.1 Spelling: Guaranty, or guarantee?

In U.S. law, the terms "guaranty" and "guarantee" are usually associated with a third party's commitment to make good on a principal party's failure to comply with an obligation.[5] Traditionally, "guaranty" is the noun, while "guarantee" is the verb; *see, e.g.*, Uhlmann v. Richardson, 287 P.3d 287 (Kan.

[5] *Author's note:* For example, when my daughter was in college, I signed a guaranty (noun) in which I guaranteed (verb) her payment of her apartment rent.

App. 2012), *citing* BRYAN GARNER, GARNER'S DICTIONARY OF LEGAL USAGE 399 (3d ed. 2011).

> A related point: People sometimes use the terms *guarantee* (or *guaranty*) and *warranty* interchangeably, but technically there are some differences in conventional usage that drafters should keep in mind; see the discussion of Warranties.

§ 70.17.2 Both guarantors and creditors should be cautious

Drafters of guaranties will want to be careful, because in the U.S., guaranties are typically construed strictly in favor of the guarantor, with ambiguities resolved against the creditor. *See, e.g.*, Haggard v. Bank of Ozarks Inc., 668 F.3d 196, 201-02 (5th Cir. 2012) (vacating and remanding summary judgment in favor of bank).

Signers of guaranties, though, should be equally cautious if not more so, because an "absolute and unconditional" guaranty is likely to be enforced even in what might seem like unfair circumstances such as collusion between the lender and the principal. See this discussion.

§ 70.17.3 Consider other ways of "guaranteeing" payment, too

Drafters representing a guaranty creditor should consider other possible ways of securing the guaranteed payment obligation, such as (for example):

- a standby letter of credit from a bank or other financial institution;
- a payment bond, which is a type of surety bond, which is in essence an insurance policy (and is often issued by an insurance carrier);
- taking — and perfecting — a security interest in an asset that could be seized and sold, with the sale proceeds being used to satisfy the payment obligation in whole or in part and any remaining proceeds being delivered to the (previous) owner(s) of the asset.

An interesting form of payment security can be seen in Falco v. Farmers Ins. Gp., 795 F.3d 8643 (8th Cir. 2015) (affirming summary judgment in favor of defendants). In that case:

- An independent insurance agent's contract with an insurance carrier entitled the agent to a certain termination payment if he ever ceased representing the carrier.

- Some 16 years after signing on with the insurance carrier, the agent took out a line-of-credit loan from the carrier's employee credit union.
- As part of the loan documentation, the agent signed a power of attorney giving the credit union the power to submit the agent's resignation from representing the carrier, in which case the carrier would pay the agent's termination payment to the credit union.
- Five years later, the agent didn't make his payments on his line-of-credit loan, so the credit union did just as described above: It tendered the agent's resignation from representing the insurance carrier; collected the termination payment and applied it to the agent's outstanding loan balance; and remitted the balance to the agent.

The agent filed suit against pretty much everyone in sight. The district court granted summary judgment in favor of all defendants; the appeals court affirmed.

§ 70.17.4 Additional reading about guaranties

See, e.g.:

- Henri Chalouh, The Commercial Lease Guarantee: An Overview For Landlords And Tenants(Mondaq.com 2015)

[DCT to-do items]

Add language for:

- Guarantor must provide audited financials periodically
- Guarantor consents to jurisdiction somewhere convenient to the creditor (e.g., where leased property is located if guarantor is guaranteeing tenant's payment of lease)
- Guarantor appoints an agent for service of process
- Representation by signer of corporate guaranty that the signer is duly authorized to do so.

These are inspired by Pamela Westhoff, Charles Donovan and Lydia Lake, Commercial Lease Guaranties From Foreign Entities: What You Need to Know to Safeguard Your Security (Shepard Mullin 2015).

§ 71 Hold harmless (commentary)

The term "hold harmless" is very often the second part of the doublet *indemnify and hold harmless*. Famed lexicographer Bryan Garner marshals an impressive body of evidence that ***indemnify* and *hold harmless* should be treated as synonyms**, asserting that the former is Latinate in origin, while the latter is the English counterpart. *See* Bryan A. Garner, *Garner's Dictionary of Legal Usage*, at 443-45 (2011), *excerpt available at* http://goo.gl/LdVxN; Bryan A. Garner, indemnify *[sic]*, 15 GREEN BAG 2d 17 (2011), archived at http://perma.cc/4VBV-FDJS.

(This, even though courts ordinarily construe contracts so as to give effect to each provision.)

In the Majkowski case (2006), Delaware's then-vice-chancellor Leo Strine observed:

> As a result of its traditional usage, the phrase "indemnify and hold harmless" just naturally rolls off the tongue (and out of the word processors) of American commercial lawyers. The two terms almost always go together.
>
> Indeed, modern authorities confirm that "hold harmless" has little, if any, different meaning than the word "indemnify." Black's Law Dictionary in fact defines "hold harmless" by using the word "indemnify." It defines "hold harmless agreement" as a "contract in which one party agrees to indemnify the other." In defining "hold harmless clause," it simply says "[s]ee INDEMNITY CLAUSE.") *[Footnotes omitted]*

Majkowski v. American Imaging Management Services, LLC, 913 A.2d 572, 588-89 (Del. Ch. 2006) (Strine, V.C.) (holding that indemnity- and hold-harmless provision did not entitle a protected person to advancement of expenses in a lawsuit against him by the indemnifying party).

Still, the conceptual distinction between *hold harmless* and *indemnify* is worth pondering:

- On the one hand, the term *indemnify* is more-or-less universally understood as a commitment by the promisor to reimburse the protected person for stated losses or liabilities.
- On the other hand, the term *hold harmless* has been treated by some courts as amounting to an advance waiver, release, or exculpation, of

stated claims against the person held harmless. For example, in its 2012 *Morrison* opinion, the Idaho supreme court consistently referred to an advance-release form, and to similar language in other contracts, as a "hold harmless agreement." Morrison v. Northwest Nazarene University, 273 P.3d 1253, *passim* (Id. 2012) (affirming summary judgment dismissing injured employee's claim against university).

- And a California court of appeals, after reviewing (and in some cases distinguishing) California case law, mused:

> Are the words "indemnify' and "'hold harmless" synonymous? No. One is offensive and the other is defensive — even though *both* contemplate third-party liability situations. "Indemnify" is an offensive right — a sword allowing an indemnitee to seek indemnification. "Hold harmless" is defensive: the right *not to be bothered* by the other party itself seeking indemnification.

Queen Villas Homeowners Ass'n v. TCB Prop. Mgmt., 149 Cal. App. 4th 1, 56 Cal. Rptr. 3d 528, 534 (2007) (reversing summary judgment in favor of defendant; emphasis in original, extra paragraphing added).

Bryan Garner mocked the *Queens Villa Homeowners* reasoning as "just explicit judicial nonsense," Garner at 445, while Ken Adams, author of A Manual on Style for Contract Drafting, dismisses it as a "fabricated" distinction. *See* Kenneth A. Adams, Revisiting "Indemnify," July 27, 2012.

For extensive additional citations, see the entry on Indemnify in GARNER'S DICTIONARY OF LEGAL USAGE (Oxford Univ. Press, 3d ed. 2011), reproduced in full in The Green Bag at https://perma.cc/4VBV-FDJS.

Regardless who is right, the brute fact is that opinions differ: not all lawyers and judges equate *hold harmless* with *indemnify*. Prudent contract drafters will therefore do well to follow the W.I.D.D. principle: **When In Doubt, Define.** If parties negotiating a contract believe that *indemnify* and *hold harmless* ought to have different meanings, then they should seriously consider drafting their contract language accordingly, so as to make their intentions clear to future readers.

With that in mind, the definition of *hold harmless* in the text follows what seems to be the conventional approach: It peremptorily declares *hold harmless* and *indemnify* to be synonymous. That approach also fits in with the fact that the hold-harmless language of UCC § 2-312(3), concerning infringement warranties, appears to have been treated by courts as simply an indemnification obligation. See generally the cases cited in Charlene M.

Morrow, Indemnity Exclusions for Goods Made According to Specification or Industry Standard, parts I-B and I-G (2009).

§ 72 If Definition

The term *if*, when used in granting a right or imposing an obligation that would not otherwise apply, means *if and only if* unless the context clearly indicates otherwise

COMMENTARY

This definition might seem to be overkill — but consider Trovare Capital Group, LLC v. Simkins Indus., Inc., 646 F.3d 994 (7th Cir. 2011) (reversing and remanding summary judgment): The principal owner of a cardboard-box manufacturer entered into a letter of intent (LOI) to sell the company. The LOI stated that: "**IF** the Seller … provides to Customer written notice that negotiations toward a definitive asset purchase agreement are terminated, **THEN** Seller shall pay Customer a breakup fee of two hundred thousand dollars ($200,000)." *Id.* at 996 n.1 (emphasis and all-caps added). The seller never provided written notice of termination, as stated in the breakup-fee obligation, but the buyer claimed that the seller was obligated to pay the breakup fee anyway. The above definition of *if* might have helped establish that the seller was required to pay the breakup fee *only* if it sent the buyer a written notice of termination before the sunset date. *Postscript:* On remand, the trial court found that the seller did not have to pay the breakup fee; the appeals court affirmed. *See* Trovare Capital Group, LLC v. Simkins Indus., Inc., 794 F.3d 772 (7th Cir. 2015).

§ 73 Implied Warranty Disclaimer

§ 73.1 What types of commitment does this Disclaimer cover?

Each party making this Disclaimer disclaims not only all implied *warranties*, but also all (implied) representations, conditions, terms of quality, and other commitments as to the accuracy of assertions about past, present, or future fact — collectively, "**Implied Warranties**."

COMMENTARY

A vendor doing a sales transaction under UK law (England, Wales, Northern Ireland) will want to be sure that its warranty disclaimer addresses not just implied warranties but also implied *conditions* and implied *terms of quality*. See § 157.4.11 for more details (and examples of the dangers of screwing this up).

§ 73.2 Does this Disclaimer cover specific Implied Warranties?

Yes: This Disclaimer has the effect of disclaiming — without limitation — any and all Implied Warranties concerning any or all of the following: • merchantability; • fitness for a particular purpose (whether or not the disclaiming party or any of its suppliers or affiliates know, have reason to know, have been advised, or are otherwise in fact aware of any such purpose); • quiet enjoyment; • title; • noninfringement; • absence of viruses; • results; • workmanlike performance or effort; • quality; • non-interference; • accuracy of informational content; • correspondence to description

COMMENTARY

In the preamble, the "without limitation" phrase is intended to avoid a very-strange holding by the Georgia supreme court in a case in which a used-car sales agreement contained an "as is, no warranty" disclaimer that included the following additional terms: "The dealership assumes no responsibility for any repairs regardless of any oral statements about the vehicle" and "NO SALESMAN VERBAL REPRESENTATION IS BINDING ON THE COMPANY." The Georgia court held that those additional terms "arguably qualif[y] and limit[]" the as-is disclaimer. Raysoni v. Payless Auto Deals, LLC, 296 Ga. 156, 766 S.E.2d 24, 26 (2014). The author's reaction upon reading this opinion was: *Seriously? How could this possibly be the case?*

§ 73.3 Are *express* warranties, etc., affected by such a disclaimer?

No: Any express warranties, etc. — that is, clearly-stated specific warranties, etc. — in the AGREEMENT would be unaffected by this Disclaimer.

COMMENTARY

This is a "comfort" provision to get the attention of contract reviewers who might be reading the disclaimer language very quickly.

§ 73.4 Does this Disclaimer cover *non-contract* Implied Warranties?

Yes, this Disclaimer applies regardless whether any alleged Implied Warranty was claimed to arise • by law; • by an alleged custom, practice, or usage in the trade; or • by an alleged course of dealing or performance by the parties themselves.

COMMENTARY

See generally UCC §§ 1-303 and 2-314(3) concerning course of dealing, etc.

§ 73.5 Can this Disclaimer be revoked?

This Disclaimer can be revoked, but only by a writing, signed by the disclaiming party, that satisfies the requirements of § 5 (amendments and waivers) for a waiver, by the disclaiming party, of this Disclaimer.

§ 73.6 What other terms apply to this Disclaimer?

The Limitation of Liability General Terms (§ 90) are incorporated by reference into this Disclaimer.

§ 73.7 No party will make a contrary assertion

No party will assert that any party making this Disclaimer is liable for breach of any Implied Warranty.

COMMENTARY

The intent here is to make such an assertion a separate breach of contract, so that a party making such an assertion would be liable for damages in the form of attorney fees even without an attorney-fee provision such as XXX.

§ 73.8 ❑ No authority for other representations or warranties

No person except an officer of [FILL IN PARTY NAME] at the vice-president level or higher is authorized to agree to any other Implied Warranty on behalf of that party.

COMMENTARY

> This optional provision is designed to negate any claim that a lower-ranking signer had "apparent authority." See generally Apparent authority, at https://en.wikipedia.org/wiki/Apparent_authority.

§ 74 Including Definition

a. Unless the context manifestly indicates otherwise, the term *including* is not to be taken as limiting — instead, the term is to be read as though it had been written as, *including but not limited to*. The same is true for like terms such as *include*, *includes*, and *included*.

b. In some places the AGREEMENT might use expressions such as *including but not limited to* or *including without limitation*. If that is the case, it does not mean that the parties intend for *shorter* expressions — such as, simply, *including*, by itself — to serve as limitations unless the AGREEMENT expressly states otherwise. (In legalese: The parties do not wish for the principle of *expressio unius est exclusio alterius* to call for a different result.)

COMMENTARY

> This definition eliminates (or at least reduces) the need to repeatedly write (and read), for example, "including without limitation." It's not uncommon in contracts, and generally uncontroversial.
>
> Subdivision b: As the Third Circuit pointed out, in an opinion by then-Judge Samuel Alito: "By using the phrase 'including, but not limited to,' the parties unambiguously stated that the list was not exhaustive. … [S]ince the phrase 'including, but not limited to' plainly expresses a contrary intent, the doctrine of *ejusdem generis* is inapplicable." Cooper Distributing Co. v. Amana Refrigeration, Inc., 63 F.3d 262, 280 (3d Cir. 1995) (Alito, J.) (citations omitted).

To like effect is Eastern Air Lines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 988-89 (5th Cir. 1976). *See also* Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 YALE L.J. 814 (2006): "Contracting parties can avoid a restrictive interpretation under the ejusdem generis rule by providing that the general language includes but is not limited to the precise enumerated items that either precede or follow it." *Id.* at 850 & n.100 (citing *Cooper Distributing* and *Eastern Airlines*).

For debate on this subject between legal-writing mavens Ken Adams and Bryan Garner, with additional case citations (and a bit of snark on Adams's part), see Kenneth A. Adams, An Update on "Including But Not Limited To" (AdamsDrafting.com 2015) and Bryan A. Garner, LawProse Lesson #227: Part 2: "Including but not limited to" (LawProse.org 2015).

§ 75 Incorporation by Reference Protocol

§ 75.1 What effect does incorporation by reference have?

Incorporation of material by reference into the AGREEMENT has the same force and effect as setting forth the full text of the material in the body of the AGREEMENT.

COMMENTARY

This language is adapted from Clauses Incorporated by Reference in the Federal Acquisition Regulations, set forth in the Code of Federal Regulations at 48 C.F.R. § 52.252-2.

§ 75.2 Additional commentary

§ 75.2.1 Incorporation by reference language must be clear

If an incorporation by reference of external terms is not clear and unmistakable, a court might hold that the external terms are not part of the contract. For example: The Oklahoma supreme court ruled that a form contract for the sale of hardwood flooring, which referenced "Terms of Sale" but gave no indication where to find them, did *not* incorporate the external terms. The court held that:

> [A] contract must make clear reference to the extrinsic document to be incorporated, describe it in such terms that its identity and location may be ascertained beyond doubt, and the parties to the agreement had knowledge of and assented to the incorporated provisions. … BuildDirect's attempt at incorporation was nothing more than a vague allusion.

Walker v. BuildDirect.com Technologies, Inc., 2015 OK 30, 349 P.3d 549, 551, 554 (2015) (on certification from 10th Circuit).

Drafting tip: At the very least, provide a Web link — preferably a short, memorable one — where the additional incorporated terms can be found.

§ 75.2.2 Attachment "for general reference" might *not* incorporate by reference

A Nebraska case reinforces the lesson that incorporation-by-reference language must be clear: When a contract incorporated an architecture's response to a request for proposal (RFP) "for general reference purposes," that was not enough to incorporate the response's price estimate into the contract as a guaranteed maximum price. *See* Facilities Cost Mgmt. Group v. Otoe Cty. Sch. Dist., 868 N.W. 67, 75, 291 Neb. 642, 653-54 (2015) (affirming partial summary judgment but reversing and remanding on other grounds). **Caution:** It's not hard to see how another court might have held that the contract *did* incorporate the architecture firm's guaranteed-maximum-price response. It's also worth noting that the contract's drafters, who presumably worked for the school district, might have been more clear about their client's intent; see the *Contra Proferentem* entry.

§ 75.2.3 But a clear intent to incorporate might suffice

In a 2014 case, the Fifth Circuit held that a supplier's price quotation did sufficiently incorporate by reference a standard-terms-and-conditions document published by the European Engineering Industries Association (the "ORGALIME"). The supplier's price quotation didn't expressly incorporate the ORGALIME by reference; instead it stated, "Terms and conditions are *based on* the general conditions stated in the enclosed ORGALIME S2000." (Emphasis added.) The Fifth Circuit reviewed Texas law on the point and held that this was sufficient because "the reference to the other document is clear and the circumstances indicate that the intent of the parties was incorporation

...." Al Rushaid v. National Oilwell Varco, Inc., 757 F.3d 416, 420-21 (5th Cir. 2014) (reversing denial of motion to compel arbitration) (emphasis added).

§ 75.2.4 Caution: Purchase-order language might be read as incorporating by reference any *mentioned* document

In the 2016 Watson Bowman Acme Corp. v. RGW Construction, Inc. case from California:

- A prime contractor issued a purchase order to a subcontractor in connection with a highway construction project.
- The prime contractor's purchase order mentioned, *but did not expressly incorporate by reference*, a sales quotation that the subcontractor had previously sent to the prime contractor.
- Further down in the purchase order, though, the P.O. language referred to "the contract documents *described above or otherwise incorporated herein* ...." (Emphasis added.)

Applying the *contra proferentem* principle of contract interpretation — and therefore construing the quoted term *against the prime contractor* — the court held that the "described above or *otherwise* incorporated" term had the effect of incorporating *the subcontractor's sales quotation* by reference into the purchase order.

See Watson Bowman Acme Corp. v. RGW Construction, Inc., 2 Cal. App. 5th 279, 206 Cal. Rptr. 3d 281 (2016) (affirming, in pertinent part, judgment on verdict awarding damages to subcontractor).

§ 75.2.5 Mentioning one provision of a document won't necessarily incorporate the whole thing

Drafters should pay attention to just what portion or portions of another document are being incorporated by reference. That issue made a difference in a Second Circuit case, where:

> ... Addendum 5 *[to the contract in question]* refers only to a single specific provision in *[another agreement]* – the non-compete clause. Where, as here, the parties to an agreement choose to cite in the operative contract "only a specific portion" of another agreement, we apply "the well-established rule that **'a reference by the**

> **contracting parties to an extraneous writing for a particular purpose makes it part of their agreement only for the purpose specified**.'" Lodges 743 & 1746, Int'l Ass'n of Machinists & Aerospace Workers v. United Aircraft Corp., 532 F.2d 422, 441 (2d Cir. 1975) (quoting Guerini Stone Co. v. P. J. Carlin Constr. Co., 240 U.S. 264, 277 (1916)).

VRG Linhas Aereas S/A v. MatlinPatterson Global Opportunities Partners II L.P., No. 14-3906-cv (2d. Cir. July 1, 2015) (summary order affirming denial of petition to confirm arbitration award; emphasis added). (Hat tip: Michael Oberman.)

§ 75.2.6 Pro tip: At least provide a link to external documents

In Nebraska Machinery Co. v. Cargotec Solutions, LLC, 762 F.3d 737 (8th Cir. 2014), a buyer's purchase-order form referred to an external document with additional terms and conditions, and said the document would be provided on request. In a subsequent lawsuit, the seller later denied having ever received the additional document. That led to what had to have been an expensive court fight (still not resolved) over whether an arbitration provision and an indemnification provision were part of the contract. This case presents a nice illustration of the Battle of the Forms under UCC 2-207. The Eighth Circuit ruled that, before ruling on that issue, the district court should have conducted a bench trial (there having been no jury demand) to make findings of fact about just who had received what contract documents, and therefore just what terms were or were not part of the parties' contract under the UCC.

Lesson: It's understandable that the buyer didn't want the hassle and expense of having to provide a hard copy of its additional terms and conditions with every purchase order. Merely offering to provide a copy of the form, though, might well have been insufficient to bind the seller to its terms. The buyer could have put itself in a stronger position in court if it had posted the additional terms and conditions on its Web site and then included a link to the form in its printed purchase order.

§ 75.2.7 Incorporation by reference is consistent with an entire-agreement clause

The Seventh Circuit rejected an argument that incorporation by reference negated a contract's entire-agreement clause, holding that "When a contract expressly incorporates specific extrinsic materials by reference, the proper

inference is that other, unmentioned extrinsic agreements are not part of the contract." Druckzentrum Harry Jung GmbH & Co. v. Motorola Mobility LLC, 774 F.3d 410, 416 (7th Cir. 2014).

§ 76 INCOTERMS for shipping goods (commentary)

Contract drafters should usually try to take advantage of the INCOTERMS three-letter options for the shipment of goods; those options spell out things such as responsibility for freight charges, insurance, and export- and customs clearance, as well as the passage of title and risk of loss. See the helpful Wikipedia entry. (At this writing, INCOTERMS 2010 is soon to be replaced by INCOTERMS 2020.)

EXW means, in essence, that Customer will show up at Supplier's shipping dock (Supplier's "works"), pick up the deliverables, and then handle all other shipping- and delivery matters itself.

DDP is basically the complete opposite of EXW: It means, in essence, that Supplier will deliver the goods to Customer's receiving dock, with all taxes, fees, and paperwork taken care of.

Drafters who don't want to use EXW or DDP should look up the appropriate INCOTERMS abbreviation for their particular needs. The U.S. Government's export.gov site explains that other frequently used INCOTERMS include: • FCA Free Carrier • CPT Carriage Paid To • CIF Cost, Insurance, and Freight (sea and inland-waterway transport only) • CIP Carriage and Insurance Paid To • DAT Delivered at Terminal • DAP Delivered at Place. The same Web page states that "**Most B2B ecommerce agreements** will use EXW, CPT, or CIF; **most business-to-consumer (B2C) transactions** will use CPT or CIF (and sometimes DDP). Except for DDP, the Incoterms mentioned above require the buyer to pay all tariffs and taxes upon arrival." (Emphasis added.)

§ 77 Indemnity and Defense Protocol

§ 77.1 When does this Protocol apply?

This Protocol will apply whenever the AGREEMENT requires one party (the "**Payer**") to defend and/or indemnify another party (the "**Beneficiary**") in respect of a specified "**Event**."

COMMENTARY

> The "Event" that triggers the Payer's obligation to indemnify (read: reimburse) the Beneficiary could be just about anything.

§ 77.2 Why does this Protocol uses *pay for* instead of *indemnify* or *hold harmless*?

a. In the context of this Protocol, the terms *indemnify* and *hold harmless* are synonyms: Each means that, if a specified Event occurs, then the Payer must pay for any loss or expense that the Beneficiary incurs as a result of the Event.

b. This Protocol often uses the term *pay for* in lieu of *indemnify* because the former term is likely to be more familiar to non-lawyers.

COMMENTARY

> This definition reflects what seems to be a consensus by legal-writing experts: The term *hold harmless* is the second part of the doublet *indemnify and hold harmless*. As discussed in the Hold harmless entry, famed lexicographer Bryan Garner marshals impressive evidence that the two terms should be treated as synonyms, because the former term is Latinate in origin, while the latter is its English counterpart. Some courts, however have held otherwise, treating the term *hold harmless* as amounting to an advance waiver, release, or exculpation, of stated claims against the person held harmless. Regardless who is right, the brute fact is that opinions differ: not all lawyers and judges equate *hold harmless* with *indemnify*. Prudent contract drafters will therefore do well to follow the W.I.D.D. principle: **When In Doubt, Define.** If parties negotiating a contract believe that *indemnify* and *hold harmless* ought to have different meanings, then they should seriously consider drafting their

contract language accordingly, so as to make their intentions clear to future readers.

§ 77.3 Can the parties agree to limit the Payer's pay-for obligation?

a. The wording of the Payer's obligation to pay for the Beneficiary's losses or expenses might, by its terms, exclude one or more types of harm, e.g., consequential damages.

b. The AGREEMENT may impose a cap on the amount that the Payer must pay for the Beneficiary's losses and expenses, separate from a general damages cap, but only if the AGREEMENT clearly so states.

c. The Payer's pay-for obligation might be limited by applicable law.

COMMENTARY

Subdivision a: In negotiating a pay-for obligation, a paying party might want to try to exclude any obligation to pay for consequential, indirect, special, punitive, exemplary, or similar damages suffered by a Beneficiary, including (for example) loss of profits from collateral business arrangements or loss from business interruption.

(Portions of the list of excluded damages in the previous paragraph are adapted from the definition of "Excluded Damages" offered by Glenn West as "a potential starting point" for drafting. See Glenn D. West, Consequential Damages Redux …, 70 BUS. LAWYER 971, 1001 (Weil.com 2015), archived at http://perma.cc/D2HC-Z5XD.)

Subdivision b: Damages caps need not be one size fits all. a reimbursement obligation might be limited (for example) to: • a specified dollar amount; or • the amount of the reimbursing party's relevant insurance coverage (in which case the agreement should probably specifically require the reimbursing party to carry such coverage). PRO TIP: In some situations, drafters might prefer simply to cap the reimbursing party's financial exposure to reimbursement- and defense obligations for particular reimbursement obligations, instead of potentially getting into disputes about what kinds of damages were or were not excluded under this language.

Subdivision c: In some jurisdictions, legislatures have enacted anti-indemnity statutes that, *for certain types of contract*, prohibit pay-for

clauses that would require the Payer to pay the Beneficiary for losses or expenses caused by the Beneficiary's own negligence. Such pay-for clauses are often found in construction contracts, in which prime contractor the Beneficiary might require subcontractor the Payer to pay the Beneficiary even for the consequences of the Beneficiary's own negligence. See, e.g., the Texas Anti-Indemnity Act, codified in Chapter 151 of the Texas Insurance Code. *See also* Foundation of the American Subcontractors Ass'n, Inc., Anti-Indemnity Statutes in the 50 States (2013).

§ 77.4 Are "consequential damages" reimbursable?

Unless the AGREEMENT specifically states otherwise, the Payer is not responsible for paying for the Beneficiary's uncommon losses and expenses from the Event, namely losses and expenses apart from those that reasonable people in the business would have expected to occur, in the usual course, from of an event of that type.

COMMENTARY

This provision is designed to avoid positioning a reimbursing party as an insurer for another party's *unusual* losses, etc., if the parties have not affirmatively so specified.

By way of background: • In Anglo-American jurisprudence, damages for breach of contract are generally limited to those that are within the contemplation of the parties as likely to occur within the usual course (see the discussion at the consequential damages entry. • On the other hand, liability *for indemnity* might not be subject to such a limitation (although the case law is unclear on this point). See generally: • Glenn D. West, Consequential Damages Redux, *supra,* at 975 (Weil.com 2015) ("III. A Basic Primer on Contract Damages"), archived at https://perma.cc/D2HC-Z5XD; • *Id.* at 998-99: "[I]t bears repeating that there is, in fact, a very clear distinction (whether or not there is an ultimate difference) between a claim for indemnification and a claim for damages for breach of a representation and warranty in an acquisition agreement."

§ 77.5 Must the Beneficiary prove that the Payer was negligent?

The Beneficiary need not prove that the Payer was negligent to be entitled to have the Payer pay for the Beneficiary's losses and/or expenses, unless

the pay-for obligation, by its clear terms, extends only to the Payer's negligence.

COMMENTARY

For citations of cases holding that proof of negligence is not required, see the Montana supreme court's opinion in A.M. Welles, Inc. v. Montana Materials, Inc., 2015 MT 38, 378 Mont. 173, 342 P.3d 987, 989, ¶¶ 10-11 (2015) (reversing denial of summary judgment in favor of reimbursed party).

§ 77.6 Is a pay-for obligation limited to *third-party* claims?

Unless the AGREEMENT clearly specifies otherwise, the Payer's pay-for obligations are not limited to *third-party* claims against the Beneficiary and do not exclude the Beneficiary's own claims against the Payer.

COMMENTARY

This section tries to settle a split in the case law as to whether a pay-for obligation must be "unmistakably clear" that it *does* or does *not* cover so-called "first-party claims," i.e., claims between the parties themselves, in addition to third-party claims. For citations, see the briefs in a Texas supreme court case, Claybar v. Samson Exploration LLC, on appeal from a 2018 decision by the Texas Court of Appeals: Appellant's brief, at https://tinyurl.com/ClaybarSamsonAppellantBrief, and respondent's brief, at https://tinyurl.com/ClaybarSamsonRespBrief.

§ 77.7 Must the Payer obtain insurance for its pay-for obligation?

Unless the AGREEMENT clearly specifies otherwise, it is up to the Payer to decide whether to not carry insurance to cover the Payer's pay-for obligation(s) under the AGREEMENT.

COMMENTARY

Whenever an agreement requires a Payer to pay for losses and/or expenses incurred by a Beneficiary, the Beneficiary should think about requiring the Payer to maintain appropriate insurance coverage. [TO DO: Link to Insurance chapter when drafted].

§ 77.8 Would the Payer's pay-for obligation apply to harm due to the Beneficiary's own fault?

a. The Payer is *not* required to pay the Beneficiary for losses and/or expenses resulting from *the Beneficiary's own negligence* or gross negligence unless both of the following prerequisites are met:

1. The AGREEMENT must clearly so state, in terms that are both (i) express, and (ii) conspicuous; and

2. Applicable law must not prohibit such a pay-for obligation.

b. The Payer is not required to pay the Beneficiary for losses and/or expenses resulting from the Beneficiary's willful misconduct, as defined in the TANGO Terms.

COMMENTARY

Subdivision a.1: This section adopts the express-negligence doctrine that applies **in some states**; that doctrine holds that **a party can be indemnified from the consequences of its own negligence, but only if the contract provision to that effect is expressed in specific and conspicuous terms.** See, e.g., Crawford v. Weather Shield Mfg. Inc., 44 Cal. 4th 541, 552 (2008); Dresser Industries v. Page Petroleum, Inc., 853 S.W.2d 505, 508 (Tex. 1993) (conspicuousness requirement); Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987) (express-negligence doctrine). *See generally, e.g.*, Byron F. Egan, Indemnification in M&A Transactions for Strict Liability or Indemnitee Negligence: The Express Negligence Doctrine (JW.com 2014), archived at http://perma.cc/RS63-FWKE.

Subdivision a.2**: In some jurisdictions, an indemnity obligation is unenforceable to the extent it purports to require a party to be paid for the consequences of its own negligence.** (Insurance policies are usually exceptions to this rule.) See, e.g., Ashley II of Charleston, L.L.C. v. PCS Nitrogen, Inc., 409 S.C. 487, 490-92, 763 S.E.2d 19 (S.C. 2014) (on certified question from federal court).

Subdivision b: The rule stated here would probably be the law in most U.S. jurisdictions, on grounds that allowing a party to shuck off liability for its own willful misconduct would create "moral hazard" and be against public policy.

§ 77.9 How and when must the Payer actually *pay* the Beneficiary?

The Payer must pay the Beneficiary for covered losses and expenses as follows:

1. If the Beneficiary has not already paid for a covered loss or expense itself, then the Payer must reimburse the Beneficiary for the loss, or pay the expense, promptly after being presented with a request for payment from the Beneficiary, accompanied by reasonable supporting evidence.

2. If the Beneficiary has already paid for a covered loss or expense itself, then the Payer must reimburse the Beneficiary for the payment in the same manner as stated in subdivision 1.

COMMENTARY

Subdivision 1 aims to prevent a reimbursable obligation from creating a cash-flow crunch for the protected party.

§ 77.10 Does the Payer's *pay-for* obligation also include a *defense* obligation?

a. Suppose that:

1. the AGREEMENT requires the Payer to pay the Beneficiary for losses and expenses resulting from specified third-party claims;

2. but the AGREEMENT is silent about whether the Payer must *defend* the Beneficiary against such claims;

3. and a Claimant does make such a claim against the Beneficiary (a "**Claim**").

b. In those circumstances, unless the AGREEMENT clearly provides otherwise, the Payer must provide the Beneficiary with a defense against the Claim — at the Payer's expense — as provided below in this Protocol.

c. The obligation of subdivision b is in addition to any other relevant reimbursement obligation that the Payer has under the AGREEMENT.

COMMENTARY

If a contract requires A to *indemnify* B against third-party claims, then the law, especially in California, might require A to *defend* B against such a claim even if the AGREEMENT didn't expressly include such a requirement — and possibly even if the third-party claim was eventually unsuccessful. For example:

- The California Supreme Court has held that, by statute — specifically, Cal. Civ. Code 2778(3) — unless the parties to a contract agree otherwise, a party having an indemnity obligation under the contract is also obligated, upon request, to provide a defense for the protected person. See Crawford v. Weather Shield Mfg. Inc., 44 Cal. 4th 541, 553 (2008) (affirming court of appeal's affirmance of trial-court judgment).

  But the duty to defend might not apply if the party obligated to indemnify "can conclusively show by undisputed facts that plaintiff's action is not covered by the agreement." Centex Homes v. R-Help Constr. Co., 32 Cal. App. 5th 1230, 1237 (2019), *citing* Montrose Chemical Corp. v. Superior Court, 6 Cal. 4th 289, 298, 861 P.2d 1153 (1993).

- On the other hand, as Dentons partner Stafford Matthews pointed out in a 2014 LinkedIn discussion thread (membership required): "Under the common law of most states, including New York and Illinois for example, *an indemnitor generally has no duty to defend unless* the contract specifically requires such defense. See, e.g., Bellefleur v. Newark Beth Israel Med. Ctr., 66 A.D.3d 807, 809 (N.Y. App. Div. 2d Dep't 2009); CSX Transp. v. Chicago & N. W. Transp. Co., 62 F.3d 185, 191-192 (7th Cir. 1995)." (Emphasis added; Mr. Matthews was responding to one of the present author's comments there about California law.)

§ 77.11 When and how must the Beneficiary request a defense?

The Beneficiary must advise the Payer, in writing, of the Claim against the Beneficiary, on or before ten business days after the Beneficiary first learns, by any means, of the Claim.

COMMENTARY

This rule only makes sense: The Payer can't carry out the Payer's obligation to defend the Beneficiary against the Claim unless the Payer knows about the claim.

§ 77.12 What if the Beneficiary's request for defense is untimely?

☑ If the Beneficiary is late in advising the Payer of the Claim against the Beneficiary, then:

1. the Payer need not reimburse the Beneficiary against any harm resulting from the delay in notification, but
2. the Payer must still provide the Beneficiary with a defense against the Claim.

❑ If the Beneficiary is late in advising the Payer of the Claim, then: (i) the Payer need not defend the Beneficiary against the Claim, and (ii) the Payer need not reimburse the Beneficiary against the Claim even if the AGREEMENT would otherwise require it.

COMMENTARY

A drafter representing the Payer might prefer to say instead that the Payer will be *completely absolved* from any duty to defend or reimburse the Beneficiary against the claim, as in the alternative above. That, of course, would be a much stronger statement than the (checked) first option — but the Beneficiary would likely push back hard against it.

§ 77.13 How much of an effort must the Payer make for the defense?

The Payer must provide the Beneficiary with a timely, competent, diligent defense — by suitably-experienced and reputable defense counsel — against the Claim.

COMMENTARY

The substantive standards in this rule are really no more than the general requirements of legal-ethics rules for lawyers.

The "suitably-experienced and reputable defense counsel" language is necessarily vague, but it should serve as a warning that, say, a traffic-ticket lawyer would not necessarily be a sound choice to defend against, say, a bet-the-product-line patent infringement claim.

The "reputable" requirement for defense counsel recognizes that when the Payer proposes defense counsel, the Beneficiary might not have any way of assessing whether the proposed defense counsel actually know what they're doing; the requirement that the defense counsel be reputable is intended to give the Beneficiary some assurance on that point.

§ 77.14 Who must pay for the Payer's defense against the Claim?

The Payer is to pay for all fees and expenses charged by the defense counsel engaged to defend the Beneficiary against the Claim.

§ 77.15 What if the Beneficiary never *asks* for a defense?

a. This section applies if the Beneficiary never asks the Payer to defend the Beneficiary against the Claim — and even if the Beneficiary tells the Payer that the Beneficiary does not *want* a defense against the claim.

b. The Payer may elect — in the Payer's sole discretion — to defend the Beneficiary against the Claim anyway, in the same way as if the Beneficiary *had* asked for such a defense.

c. The Payer, however, will have no *obligation*:

1. to defend the Beneficiary against the Claim, nor

2. to reimburse the Beneficiary for losses or expenses, of any kind, arising from the Claim, even if the Payer does elect to defend the Beneficiary against the claim, and even if the Payer's and the Beneficiary's agreement would have otherwise required reimbursement.

COMMENTARY

The Payer might find it desirable to defend the Beneficiary against a claim even if the Beneficiary itself is uninterested in the claim or its result. EXAMPLE: Suppose that: • the Beneficiary is the Payer's customer; the Beneficiary is sued by the Claimant, which claims that the Beneficiary's *past* use of the Payer's product constituted infringement of the Claimant's patent rights. • Because the Beneficiary no longer uses the Claimant's product and didn't use it all that much to begin with, the Beneficiary

doesn't really care whether or not the Claimant's infringement claim succeeds, because the Payer, not the Beneficiary, will have to pay any resulting damage award. IN THAT SITUATION: • the Beneficiary will have little or no "skin in the game" and might not even bother asking the Payer to defend against the Claimant's infringement claim. • *The Payer*, though, might be keenly interested in *not* having a court hold that the Payer's product infringes the Claimant's patent.

If the Beneficiary *doesn't* ask for a defense, then it waives the Beneficiary's right to have the Payer *reimburse* the Beneficiary against the Claim. So suppose that (i) the Beneficiary doesn't ask for a defense; (ii) the Payer *doesn't* defend the claim; and then (iii) the Claimant were to win its case against the Beneficiary. In that situation, *the Beneficiary* would be on the hook to pay the Claimant for any resulting damage award, etc.; the Beneficiary would not be able to demand that the Payer pay the Claimant in the Beneficiary's stead.

§ 77.16 What role must the Beneficiary play in its own defense?

a. The Beneficiary must provide reasonable cooperation with the Payer and the Payer's counsel in defending against the Claim (whether or not the Beneficiary requested a defense).

b. Without limiting subdivision a, the Beneficiary must provide the Payer and/or the Payer's counsel with all information reasonably requested for the defense.

COMMENTARY

Beneficiaries are normally glad to agree to cooperate in their own defense, as long as it's at the Payer's expense.

The "reasonably request" language allows some flexibility, which might be appropriate if requested information is subject to, for example, the attorney-client privilege and the Beneficiary has other reasons for not risking waiver of the privilege by providing the information to the Payer's counsel.

§ 77.17 Who will pay the Beneficiary's expenses of cooperating in its defense?

If the Beneficiary so requests in writing, then the Payer will pay directly, or reimburse the Beneficiary for, all reasonable, out-of-pocket expenses that the Beneficiary pays *to third parties* (specifically not including, without limitation, the Beneficiary's own employees) in providing the required cooperation.

COMMENTARY

> This rule limits the Payer's reimbursement obligation here to the out-of-pocket expenses that the Beneficiary pays to third parties. If the Beneficiary has bargaining power, it might try to ask for reimbursement of the Beneficiary's *internal* costs as well, but in the author's experience, that would be fairly unusual for most business contexts.

§ 77.18 Who will control the defense?

For as long as the Payer provides the Beneficiary with a defense against the Claim in accordance with this Protocol, the Payer is entitled to control the defense — albeit with some exceptions as stated below.

COMMENTARY

> If the Payer doesn't "step up" to provide the Beneficiary with a defense against the Claim, then *the Beneficiary* should be able to control the Beneficiary's own defense. But if the Payer *does* provide a defense, then the Payer should be able to control the defense — otherwise, the Beneficiary counsel will know that it will be the Payer, not the Beneficiary, that will eventually be paying the bills. That could tempt the Beneficiary's counsel to put on an expensive, gold-plated defense that it might not have done otherwise.

§ 77.19 May the Beneficiary bring in its own attorneys to keep an eye on the case?

a. This section applies when the Payer is controlling the defense against the Claim.

b. The Beneficiary may engage the Beneficiary's own, separate counsel to monitor the defense that the Payer is providing.

c. If the Beneficiary does engage separate counsel under subdivision b, it will be at the Beneficiary's own expense.

d. The Payer and the Beneficiary must each instruct their respective counsel to provide reasonable cooperation with each other concerning the defense.

COMMENTARY

> in many defense-of-claims cases, the Payer is likely to want to have the Payer's own regular legal counsel be the ones to represent the Beneficiary in defending against the Claim. But the Beneficiary might want for the Beneficiary's own regular counsel to keep an eye on what the Payer's lawyers are doing — even though, under legal ethics in the U.S. (and probably in many other jurisdictions as well), an attorney's loyalty is to the client, not to a third party that's paying the bills.

§ 77.20 May the Beneficiary ever take over control of its defense?

Suppose that reasonable minds could conclude that the Payer's counsel had a conflict of interest that, under applicable ethics rules, would preclude the Payer's counsel from representing the Beneficiary in the defense against the Claim. In that situation, the Beneficiary may, in its sole discretion:

1. assume control of the Beneficiary's defense; and
2. engage separate counsel for that defense, at *the Payer's* expense.

COMMENTARY

> The language, "reasonable minds *could* conclude" (emphasis added) is intended to make sure that close calls go in favor of separate counsel.

§ 77.21 Who will control settlement discussions — and what limits will apply?

a. Except as provided in subdivision b, the Payer may — at the Payer's own expense — settle the Claim against the Beneficiary.

b. Without the Beneficiary's prior written consent, however, the Payer may not settle the claim — and the Beneficiary will not be bound by any purported settlement — if the settlement would:

1. restrict or place conditions on the Beneficiary's otherwise-lawful activities; or
2. require the Beneficiary to take any action, other than making one or more payments of money, *funded in advance* by or on behalf of the Payer, to one or more third parties; or
3. encumber any of the Beneficiary's assets; or
4. include (or require) any admission or public statement by the Beneficiary; or
5. call for the entry of a consent judgment inconsistent with any of subdivisions (1) through (4).

COMMENTARY

This is a detailed example of a type of clause that is often found in reimbursement- and defense obligations. As a particular example, some categories of insurance contract give the insurance carrier essentially complete control over the settlement of third-party claims. That could cause problems for the protected person if the insurance carrier were to settle a claim but then try to recoup the settlement amount from the protected person. This could happen, for example, if a contractor's surety bond decided to settle a claim and then sued the contractor to recoup the settlement payment. *See, e.g.*, Hanover Ins. Co. v. Northern Building Co., 891 F. Supp.2d 1019, 1026 (N.D. Ill. 2012) (granting summary judgment awarding damages and attorney fees to insurance company), *aff'd*, 751 F.3d 788 (7th Cir. 2014).

§ 77.22 May a settlement include a consent judgment binding on the Beneficiary?

Yes, but only within limits: IF: the Payer is entitled under this Protocol to control settlement of the Claim against the Beneficiary; THEN: the Payer is free — in the Payer's sole discretion — to agree, on the Beneficiary's behalf, to a settlement with the Claimant that includes entry of a consent judgment that is binding on the Beneficiary, as long as the consent judgment is not inconsistent with this Protocol.

COMMENTARY

In intellectual-property cases, settlements of claims sometimes include the entry of consent judgments; this rule gives the Payer the ability to commit the Beneficiary to a consent judgment, within limits.

§ 77.23 May the Beneficiary settle with the Claimant on its own?

Suppose that the Payer is defending the Beneficiary against the Claim, and that the Beneficiary settles with the Claimant without the Payer's prior written consent.

The relevant question will then be: Did the Payer *unreasonably* withhold consent to the Beneficiary's settlement?

1. IF NO: The Beneficiary will be deemed to have released the Payer from any further defense- or reimbursement obligation as to the Claim.

2. IF YES: The Payer's defense- and reimbursement obligations will remain in place.

COMMENTARY

This provides the Payer with at least some protection against the possibility that the Beneficiary's people might decide, *what the hell, let's agree to pay the Claimant a big settlement; after all, it'll be* the Payer*, not the Beneficiary, who has to put up the money*.

§ 77.24 What may the Beneficiary admit, or waive, in the action?

a. IF: The Payer is entitled to control the Beneficiary's defense against the Claim; THEN: Without the Payer's prior written consent:

1. the Beneficiary must not make any non-factual admission or stipulation concerning the Claim — for example, an admission that a third party's patent was valid and enforceable would be such a non-factual admission; and

2. the Beneficiary must not waive any defense against the Claim.

b. If the Beneficiary does either of these things without the Payer's prior written consent, then the Payer will have no further obligation to the Beneficiary, in respect of the Claim in question, by way of either defense or reimbursement.

COMMENTARY

Admissions and stipulations can greatly streamline litigation (and arbitration). *Factual* admissions should be made as required. EXAMPLE: Suppose that the Claimant asked the Beneficiary to admit that, in calendar year 20XX, he sold Y units of the Beneficiary's Model ABC widget; if that were true, then it would make sense for the Beneficiary to make the admission. But if the Beneficiary were to admit, let's say, that the Claimant's patent claims were valid and infringed, then that could seriously screw up the Payer's defense of the Beneficiary against the Claims.

§ 77.25 Can the Payer's liability for defense be limited?

Yes: The AGREEMENT may limit the Payer's liability under an obligation to defend against third-party claims, separate from a general limitation of liability, but only if the AGREEMENT clearly so states.

COMMENTARY

Limitations of liability need not be one size fits all. A defense obligation might be limited (for example) to: • a specified dollar amount; or • the amount of the defending party's relevant insurance coverage (in which

case the agreement should probably specifically require the defending party to carry such coverage).

§ 77.26 Additional commentary

§ 77.26.1 A template for indemnity- and defense obligations

As a hypothetical example, consider an agreement between Alice and Bob under which Alice's workers are to come onto Bob's property to paint two specified buildings. If Alice or her workers cause any problems for third parties, Bob wants Alice to "just take care of it." The agreement might therefore include a defense-and-indemnity obligation such as the following:

> Alice will (i) defend Bob against any claim by a third party (including but not limited to Alice's workers) that arises from alleged negligence or other fault by Alice or her workers, and (ii) pay for any monetary award entered against Bob in connection with any such claim, all in accordance with the TANGO Terms.

(The above template should not be relied on as a substitute for legal advice, of course.)

§ 77.26.2 Language origins

For a review of the etymology of the term *indemnify*, see Bryan A. Garner, indemnify *[sic]*, 15 GREEN BAG 2d 17 (2011), archived at http://perma.cc/4VBV-FDJS.

A California appeals court explained indemnity obligations:

> Generally, indemnity is defined as an obligation of one party to [i] pay or [ii] satisfy the [x] loss or [y] damage incurred by another party.
>
> A contractual indemnity provision may be drafted either[:] • to cover claims between the contracting parties themselves, or • to cover claims asserted by third parties.
>
> Indemnity agreements are construed under the same rules which govern the interpretation of other contracts. Accordingly, the contract must be interpreted so as to give effect to the mutual intention of the parties.

> The intention of the parties is to be ascertained from the clear and explicit language of the contract.
>
> And, unless given some special meaning by the parties, the words of a contract are to be understood in their ordinary and popular sense.
>
> In interpreting an express indemnity agreement, the courts look first to the words of the contract to determine the intended scope of the indemnity agreement.

Rideau v. Stewart Title of Cal., Inc., 235 Cal. App. 4th 1286, 1294, 185 Cal. Rptr. 3d 897 (2015) (internal quotation marks, alteration marks, and extensive citations omitted; extra paragraphing, bracketed numbering, and bullets added).

§ 77.26.3 Is the indemnity obligation backed by enough money?

A right to be indemnified (like any other) might be worthless if the indemnifying party can't afford to do the needful. Consequently, a party wanting an indemnity commitment should consider negotiating backup sources of cash to support the indemnity obligation, commonly in the form of (for example) an insurance policy; a guaranty from a third party; an escrow; and/or a standby letter of credit (which of course is itself a form of guaranty).

§ 77.26.4 Is agreeing to an indemnity obligation a good idea?

Any party asked to agree to an indemnity obligation should think about it carefully. That's especially true if the indemnity obligation would apply regardless of the other party's own negligence or other "misconduct"; if you agree to that kind of obligation, in effect you've become the other party's insurance carrier.

§ 77.26.5 Will a contractual indemnity be excluded from the indemnifying party's insurance coverage?

Any party that is asked to agree to indemnify another party should consider checking whether its applicable insurance policies exclude coverage for indemnity obligations. This was an issue in Ewing Constr. Co. v. Amerisure Ins. Co., 420 S.W.3d 30 (Tex. 2014), where the supreme court "conclude[d] that a general contractor who agrees to perform its construction work in a good and workmanlike manner, without more, does not enlarge its duty to exercise

ordinary care in fulfilling its contract, thus it does not 'assume liability' for damages arising out of its defective work so as to trigger the Contractual Liability Exclusion." *Id.* at 38.

§ 77.26.6 Anti-indemnity statutes

In some jurisdictions, an indemnity obligation is unenforceable to the extent it purports to indemnify a party against the consequences of its own negligence. (Insurance policies are usually exceptions to this rule.) See, e.g., Ashley II of Charleston, L.L.C. v. PCS Nitrogen, Inc., 409 S.C. 487, 490-92, 763 S.E.2d 19 (S.C. 2014) (on certified question from federal court).

Moreover, in some jurisdictions, legislatures have enacted anti-indemnity statutes that, *for certain types of contract*, prohibit indemnity clauses that would shift the risk of Bob's own negligence onto Alice. Such indemnity clauses are often found in construction contracts, in which prime contractor Bob might require subcontractor Alice to indemnify him even against the consequences of Bob's own negligence. See, e.g., the Texas Anti-Indemnity Act, codified in Chapter 151 of the Texas Insurance Code. *See also* Foundation of the American Subcontractors Association, Inc., Anti-Indemnity Statutes in the 50 States (2013).

Relatedly but not directly on point, California Civil Code Section 1668 provides that "[a]ll contracts which have for their object, directly or indirectly, to exempt any one from responsibility for [i] his own fraud, or [ii] willful injury to the person or property of another, or [iii] *violation of law, whether willful or negligent*, are against the policy of the law." (Bracketed lettering added.) Such contracts are therefore void under section 1667(2).

§ 77.26.7 Special topic: Knock for knock

In the oil and gas industry it's common for parties involved in drilling and operations to agree that each party will be responsible for all harm to its own people and property, no matter who causes the harm, and that each party must maintain insurance. Texas law allows this (in limited form) under a safe harbor in an anti-indemnity statute relating to oil-, gas-, and water wells and to mines. See Tex. Civ. Prac. & Rem. Code 127.005; see generally, e.g., Tina Maddis, Knock for knock indemnities – are they appropriate for on-shore infrastructure projects? (AddisonLawyers.com.au 2015), archived at https://perma.cc/2BPK-J5J7.

§ 77.26.8 **Indemnity obligations should be "unmistakably clear" if they are to change default risk-allocation rules**

Under New York law, a contract provision will not be held to impose an indemnification obligation on a party unless the provision is unambiguous about it. See Bradley v. Earl B. Feiden, Inc., 8 N.Y.3d 265, 276-77, 864 N.E.2d 600, 605 (2007). This is especially true if a party seeks to use an indemnification obligation to force another party to reimburse the first party's attorney fees in a lawsuit between the parties themselves. See Hooper Assocs., Ltd. v. AGS Computers, Inc., 74 N.Y.2d 487, 548 N.E.2d 903, 905 (1989), where the court held:

> When a party is under no legal duty to indemnify, a contract assuming that obligation must be strictly construed to avoid reading into it a duty which the parties did not intend to be assumed. The promise should not be found unless it can be *clearly implied* from the language and purpose of the entire agreement and the surrounding facts and circumstances. Inasmuch as a promise by one party to a contract to indemnify the other for attorney's fees incurred in litigation between them is *contrary to the well-understood rule* that parties are responsible for their own attorney's fees, the court should not infer a party's intention to waive the benefit of the rule unless the intention to do so is *unmistakably clear* from the language of the promise.

74 N.Y.2d at 491-92, 548 N.E.2d at 905 (cleaned up, emphasis added).

To like effect, see the unpublished, unsigned opinion in Pettibone v. WB Music Corp., No. 18-1000-cv, slip op. at 3-4 (2d Cir. Apr. 17, 2019): A songwriter, who had been a co-author of the Madonna hit "Vogue," was sued (unsuccessfully) by a third party for allegedly infringing the copyright in another work. The publisher of "Vogue," which had been a co-defendant, deducted its defense costs (exceeding $500,000) from the songwriter's royalty payments for the song. The songwriter sued to force the publisher to pay the deducted royalties; the district court dismissed the case on grounds that the deduction was purportedly authorized by an indemnification provision in the royalty agreement. The Second Circuit reversed and remanded with instructions to enter judgment for the songwriter *and* to consider the songwriter's claim for attorney fees; the court held:

> We conclude that Section 8.1 is pock-marked with ambiguity and, in fact, more readily evinces an understanding between the parties that, in the absence of a

> breach, each party will shoulder its own attorneys' fees and costs. * * *
>
> … Warner would have us read the parties' agreement to shift attorneys' fees of *[nearly $1 million]* to individual songwriters for any and all infringement claims brought against them, regardless of merit or frivolousness. *Because the parties' agreement's language does not come close to unambiguously requiring such an extraordinary resul*t, we hold that Warner cannot enforce section 8.1 against Pettibone.

Id., slip op. at 4, 5 (citations omitted, emphasis added).

§ 77.26.9 Additional reading on indemnification *(optional)*

Indemnification (MorganLewis.com; undated)

Sarah E. Swank, Clarifying the Confusing World of Indemnification, Hold Harmless, and Defense Clauses (Ober.com 2013)

Corbin Devlin, Indemnity Clause "Red Flags" (2016): This is a list of bullet points of concern, with a brief explanation of each point.

§ 77.27 Exercises (not part of the AGREEMENT)

§ 77.27.1 Indemnities: Duty to defend

FACTS: Suppose that:

- You draft an indemnity obligation that does not expressly require the subcontractor to *defend* your client, the general contractor, from claims, but merely obligates the subcontractor to *indemnify* the general contractor.
- An employee of the subcontractor writes a letter to the general contractor, asserting a claim. Assume for this purpose that the employee's claim comes within the scope of the subcontractor's indemnity obligation.
- The general contractor forwards the employee's letter to the subcontractor and demands that the subcontractor engage outside counsel to investigate the claim.

QUESTIONS:

1. Must the subcontractor engage outside counsel for the general contractor?
2. Would your answer be different if all of this were taking place in Los Angeles instead of Houston? Cite the relevant authority.

§ 77.27.2 Indemnity exercise: The spontaneously combusting widgets

FACTS:

1. Alice manufactures electronic widgets. Each widget has a battery that is sealed into the widget and not replaceable.
2. Bob manufactures electronic gadgets that include electronic widgets.
3. Bob enters into a contract with Alice to buy electronic widgets from her.
4. The contract includes, among other provisions:
    - a warranty that the widgets do not contain any defects in design or manufacture;
    - a provision requiring Alice to indemnify Bob against any harm Bob suffers from defects in the widgets; and
    - an exclusion of incidental and consequential damages.
5. Bob takes delivery of a large quantity of Alice's widgets and stores them in an appropriate storage room.
6. In the storage room, the batteries in several of Alice's widgets spontaneously catch fire, resulting in major damage and causing significant "down time" for Bob's gadget-manufacturing operations. *(Think: Hoverboards.)*
7. Citing the indemnity provision, Bob demands that Alice reimburse him for the cost of:
    - repairs;
    - replacement of the damaged contents of the storage room;
    - the travel expenses that Bob incurred in going to China and India to check out alternative sources of widgets;
    - the profits that Bob lost from the manufacturing down time.

QUESTIONS:

1. EXPLAIN IF FALSE: Alice is not required to reimburse Bob because an indemnity provision covers claims by third parties against the protected party, not direct claims by the protected party against the indemnifying party.

2. EXPLAIN IF FALSE: If Bob sues Alice for breach of her indemnity obligation, Alice can probably get Bob's claim for lost profits thrown out early (by moving for partial summary judgment) as barred by the contract's exclusion of consequential damages.

3. EXPLAIN IF FALSE: If Alice had negotiated the indemnity provision to cover only third-party claims, the provision likely would be enforceable.

4. EXPLAIN IF FALSE: Alice can probably get Bob's claim for travel expenses dismissed on partial summary judgment as barred by the contract's exclusion of incidental damages.

§ 77.27.3 Exercise: Defense against indemnified claims

FACTS:

A. Alice's contract with Bob obligates her to reimburse Bob for his attorney fees and expenses in defending against certain third-party claims.

B. A third party, Carol, brings such a claim against Bob.
C. Bob hires Skadden Arps *(a top NYC firm)* to defend him against Carol's claim.

D. Alice has plenty of money to pay legal bills.

QUESTION: Speculate about what incentives might motivate Skadden in conducting Bob's defense.

QUESTION: Name *two* ways that Alice, during negotiation of her contract with Bob, could have limited her financial exposure to Bob's cost of defending against Carol's claim.

MORE FACTS:

E. Alice's contract with Bob also requires her to *indemnify* Bob against any monetary awards resulting from such third-party claims.

F. Bob neglects to mention to either Alice or Skadden that Carol had filed her third-party claim weeks before, and that when Bob failed to file a timely

answer, Carol moved for and obtained a default judgment for a large amount of money.

QUESTION: Name two ways that Alice, during negotiation of her contract with Bob, could have limited her exposure to Bob's screw-up.

ALTERNATE FACTS:

G. Alice's contract with Bob requires her to *provide* Bob with a defense, as opposed to reimbursing Bob for his defense expenses.

H. Alice engages her regular lawyer, Andy, to conduct Bob's defense against Carol's claim.

I. Bob finds that he and Andy don't get along so well.

QUESTION: During negotiation of the contract, what sort of clause could Bob have asked to be included in the contract to protect him against this uncomfortable situation?

ALTERNATE FACTS:

J. It turns out that Alice can't afford to pay Bob's legal bills for defending against Carol's claim.

QUESTION: What if anything might Bob have done during contract negotiation to mitigate this problem?

§ 77.27.4 Flashcards: Indemnities

You might see quiz questions based on one or more of the following:

QUESTION 1: How does an *indemnity* relate to a *warranty*?[6]

QUESTION 2: IF FALSE, EXPLAIN WHY: IF: Alice agrees to indemnify Bob against damage arising from occurrence of Event X; THEN: This reduces the risk to the parties associated with the (possible) occurrence of Event X. *(CAUTION: Read this carefully.)* [7]

[6] An *indemnity* is a reimbursement; a *warranty* is a promise to reimburse (i.e., indemnify) someone if a warranted state of affairs turns out not to be true.

[7] False — it doesn't *reduce* the risk, it *allocates* the risk.

QUESTION 3: IF FALSE, EXPLAIN WHY: An indemnity obligation allocates at least some of the financial risk of Event X.[8]

QUESTION 4. IF FALSE, EXPLAIN WHY: The following is an acceptable conventional phrasing: *Alice* ***hereby indemnifies*** *Bob against any damage Bob might incur if it rains tomorrow.* [9]

§ 78 Independent Contractors

§ 78.1 The parties intend a strictly independent-contractor relationship

Each party acknowledges the following and agrees not to assert otherwise except to the extent — if any — that the AGREEMENT clearly and unmistakably says otherwise.

a. The parties intend for their relationship to be strictly that of independent contractors; they do not intend to create any other kind of relationship between them, such as (for example) an employment relationship, joint venture, or partnership.

b. In particular, the parties do not intend for the AGREEMENT to establish, nor to evidence, a fiduciary relationship between the parties.

c. Neither party has authorized any other party to act as the first party's agent.

COMMENTARY

The agreement not to assert otherwise is intended to make it a breach of contract to dispute the substance of the declaration.

CAUTION: *A contract's declaration that the parties are independent contractors will not necessarily carry the day.* See § 78.3 for extended discussion.

Subdivision b, which disclaims a fiduciary relationship, is a lawyer-repellent clause, intended to try to dissuade trial counsel from alleging that

[8] True.

[9] False — it should be "Alice *will indemnify* Bob [i.e., future tense] …."

counsel's client was owed a previously unsuspected and now-breached fiduciary duty by another party. Such claims of fiduciary duty are not unheard of; for an example, see Pappas v. Tzolis, 20 N.Y.3d 228 (2012).

Subdivision c: One reason for parties to disclaim an *agency* relationship would be to try to avoid results such as what happened in Dye v. Tamko Bldg. Prods. Inc., 908 F.3d 675 (11th Cir. 2018), where roofers were held to be the agents of homeowners for purposes of agreeing to an arbitration provision in an "agreement" shrink wrapped into packages of roofing shingles. (For a different result on the merits, however, see Hobbs v. Tamko Bldg. Prods., Inc., 479 S.W.3d 147 (Mo. App. 2015): the court held, albeit on other grounds, that the arbitration agreement was not binding on homeowners. (Hat tip: Liz Kramer.))

CAUTION: Just because a contract *declares* that the parties were not each other's agents, the declaration might have little or no effect on the rights of third parties if the contracting parties *in fact* conducted themselves as if they were in an agency relationship.

§ 78.2 What must the parties do, or not do, as independent contractors?

a. Each party will conduct itself in accordance with the statement of intent in § 78.1; without limitation, each party agrees not to do (nor to purport or attempt to do) any of the following EXCEPT to the minimum extent (if any) that the AGREEMENT expressly states otherwise:

1. make any promise, representation, or warranty *on behalf of any other party* concerning the subject matter of the AGREEMENT, other than as expressly stated in it;
2. hold itself out as an employee, agent, partner, joint venturer, division, subsidiary, branch, or other representative of that other party;
3. hire any individual to be an employee of the other party;
4. determine the working hours or working conditions of that other party's employees;
5. select or assign any employee of the other party to perform a task;

6. direct or control the manner in which any employee of the other party performs his or her work, as distinct from the result to be accomplished;

7. remove any employee of the other party from a work assignment;

8. discharge or otherwise discipline any employee of the other party;

9. incur any debt or liability on behalf of the other party;

10. bind the other party to any other type of obligation, commitment, or waiver.

b. Any party that fails to comply with the requirements of this Protocol must, upon request by another affected party to the AGREEMENT:

1. defend and indemnify that party against any third-party claim resulting from the non-compliance; and

2. indemnify that party against any other loss or expense resulting from such non-compliance.

COMMENTARY

Subdivision a.2: Suppose that a manufacturer terminates (say) a distributor relationship. It's not unheard-of (as in, the author had it happen to a client) for the terminated distributor to continue holding itself out as an authorized representative of the manufacturer. This subdivision is intended to make that a specific breach of contract, which might be easier to "sell" to the distributor's management (and possibly to a court) as requiring the distributor to cease and desist.

Subdivision b: Without an express defense- and indemnity obligation, a party harmed by a breach of the independent-contractor clause might have to pay for a defense and/or for the resulting harm itself, and only then make a claim for reimbursement against the other party.

See also the Indemnity and Defense Protocol in the General Terms.

§ 78.3 Additional commentary

§ 78.3.1 There's no magic protective incantation

A contract's declaration that the parties are independent contractors will not necessarily carry the day. For example, in 2014 a three-judge panel of the Ninth Circuit held that the plaintiffs in a class-action suit, who were **drivers for FedEx**, were not independent contractors but employees; the panel reversed summary judgment in favor of FedEx and remanded to the trial court with instructions to enter summary judgment for the drivers on the question of their employment status. *See* Alexander v. FedEx Ground Package System, Inc., 765 F.3d 981 (9th Cir. 2014). A separate concurring opinion noted that "[l]abeling the drivers 'independent contractors' in FedEx's Operating Agreement does not conclusively make them so …." *Id.* at 998 (Trott, J., concurring).

On the other hand, such a statement of intent — in an unsigned agreement, no less — paid off for one company: The statement of intent helped to defeat a claim that the company had entered into a partnership. *See* nClosures, Inc. v. Block & Co., 770 F.3d 598, 604 (7th Cir. 2014) (affirming summary judgment dismissing claim for breach of fiduciary duty).

Supreme Court precedent makes it clear that "**there is no shorthand formula or magic phrase**" for independent-contractor status. NLRB v. United Insurance Co. of America, 390 U.S. 254 (1968). "[A]ll of the incidents of the relationship must be assessed and weighed with no one factor being decisive. What is important is that the total factual context is assessed in light of the pertinent common-law agency principles." *Id.* at 258.

§ 78.3.2 The IRS's guidance

The [U.S.] Internal Revenue Service's Web site offers easy-to-read guidance about what the Service considers in determining whether someone is an employee (for whom the employer must pay certain taxes) or an independent contractor:

> Under common-law rules, anyone who performs services for you is your employee **if you can control what will be done and how it will be done.** This is so even when you give the employee freedom of action. **What matters** is that you have the right to control the details of how the services are performed. *[Emphasis edited]*

The IRS Web site also provides a more-detailed but still-readable explanation of how the law generally works:

> Facts that provide evidence of the degree of control and independence fall into three categories:
>
> 1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
>
> 2. Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
>
> 3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?
>
> Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another.
>
> The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

§ 78.3.3 Improper classification of employees as independent contractors can attract class-action plaintiffs' attorneys

Independent-contractor litigation can be expensive because it can attract the attention of class-action attorneys. For example:

Ride-sharing service Uber has been deluged with class-action lawsuits alleging that Uber violated the (U.S.) Fair Labor Standards Act by not treating its drivers as employees; the company settled two such lawsuits in California and

Massachusetts for up to $100 million, but then was hit with more suits in other states.

As an older example, Microsoft had contracts with a number of alleged independent contractors who were not entitled to employee benefits, such as the right to participate in Microsoft's employee stock purchase plan. Microsoft, however, later conceded to the IRS that the workers were indeed employees. After extensive litigation, an appeals court held that the now-employees were entitled to employee benefits after all. Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997).

§ 79 Industry Practice Interpretation Disclaimer

The parties do not intend, and neither party is to assert, that industry practice or usage of the trade will have the effect of modifying or supplementing the AGREEMENT.

COMMENTARY

> This borrows (and modifies) ideas from a Honeywell purchase order form, archived at https://perma.cc/84BS-KYXB, which states: "No course of prior dealing or usage of the trade may modify, supplement, *or explain* any terms used in this Purchase Order." (Emphasis added.) The language in the text omits the phrase "or explain," because in case of ambiguity, the parties' course of past dealings might be useful to help the parties and the courts reconstruct what the parties meant by the ambiguous language.

§ 80 Insurance *(in progress)*

(BEGIN HIDDEN TEXT FOR LATER DCT USE)

(END HIDDEN TEXT)

§ 80.1 Commentary

§ 80.1.1 Types of coverage

Insurance-requirement clauses commonly mandate at least the following types of insurance:

- **Commercial general liability ("CGL")** coverage, including bodily injury, personal injury, and property damage liability, along with contractual liability coverage for Insured-Party's indemnity obligations under the contract, if any.

  The laundry list of specific perils might not be necessary if an ISO CGL form is used; according to one reference, "Unlike older forms that required endorsements to broaden coverage, the CGL provides very broad coverage that can be narrowed by endorsement. It is a modular policy that can provide several coverages in combinations." Rupp's Insurance & Risk Management Glossary, Commercial General Liability (accessed Aug. 22, 2007).

- Errors and omissions ("E&O") / professional liability coverage.

- Business automobile bodily injury and property damage liability for owned, non-owned, and hired automobiles.

- **Worker's compensation** coverage and **employer-liability** coverage as required by applicable law (including maritime-related law where applicable) where work is to be performed pursuant to the contract or anywhere else an employee performing such work is normally employed.

§ 80.1.2 (Read:) Duration of coverage

The time during which insurance coverage must be maintained will sometimes be a matter to be negotiated. In services contracts, it's not uncommon for coverage to be required at any time services are being performed, at any time the service provider is present at the customer's premises, and for one- to three years thereafter.

§ 80.1.3 (Skim:) Carrier ratings

Coverage is often required to be maintained with carriers having at least a stated A.M. Best rating.

§ 80.1.4 (Study:) Occurrence- or claims-made basis?

"The coverage trigger of an occurrence form is bodily injury or property damage that occurs during the policy period." Chubb Commercial Insurance General Liability Definitions (accessed Aug. 22, 2007).

In contrast, "[t]he coverage trigger of a claims-made form is the making of a claim against the insured during the policy period." *Id.*

§ 80.1.5 Combined single limit

See generally Leland-West Insurance Company, What is a Combined Single Limit? (accessed Aug. 22, 2007).

§ 80.1.6 (Skim:) How much coverage to require a vendor to maintain?

Jeff Gordon's Insurance Basics posting makes specific suggestions about coverages that a customer might want to request in a services contract.

§ 80.1.7 Certificates of insurance

Customers often want their contractors to provide proof of insurance coverage. A contractor might be able to do this informally by simply emailing a scanned PDF of its file-copy certificate.

But many **times the customer (really the customer's lawyer) will want the proof of insurance to be in the form of one or more original certificates of insurance.** These are issued by the insurance carrier(s) and are normally sent directly to the other party, with the other party's name in the "Certificate holder" box.

For an example of an insurance certificate on an ACORD industry-standard form, see this annotated version from the Environmental Systems Research Institute.

Ordinarily, a plain-vanilla certificate of insurance is purely informational and does not give the certificate holder any rights under the policy. That's where "**endorsements**" come in. Two commonly used endorsements, as seen in the example ACORD certificate cited above, are:

- Additional-insured endorsements, discussed in more detail below

- Notification endorsements, requiring the insurance carrier to *endeavor* to give prior notice to the certificate holder before termination or expiration of the policy (it can be difficult or impossible to get a carrier to agree to an absolute *obligation* to give prior notice).

§ 80.1.8 (Optional:) Managing insurance certificates

Providing insurance certificates and endorsements can be a low-grade administrative annoyance; it often isn't a high priority for either party's operational people. Even if the contract requires the insured to do so, it can sometimes fall through the crack (possibly putting the insured in breach of contract).

PRO TIP: Keep insurance certificates where they can be found, even years later — failing to do so could end up costing a lot of money if they can't be found when a claim arises.

§ 80.1.9 (Read:) Additional-insured status

Introduction: Contract drafters can sometimes get confused about the nature and purpose of additional-insured endorsements. These endorsements commonly arise when a party negotiating a contract is concerned that it might be sued by a third party for acts or omissions by the other party.

For example, a customer hiring a contractor to perform services might be concerned that it could be sued by by one of its own employees who is physically injured by the contractor's negligence.

Or, the customer might fear being sued by a *contractor* employee who is injured by negligence of just about anyone — the contractor, a subcontractor, the customer, etc.

Consequently, the customer might negotiate a contract requirement that contractor defend and indemnify the customer against such third-party claims.

But what if the contractor doesn't have the money to make good on this obligation? **That's where negotiating for an additional-insured endorsement clause comes in:** The customer requires the contractor to name the customer as an additional insured on the contractor's own relevant policies. That way, the odds are greater that at least some money will be available to defend and indemnify the customer from a third-party claim.

(Read:) **Mechanics:** An additional-insured endorsement might take the form of a specific line item on the certificate of insurance, or it might take the

form of a separate document; both types are shown in [[this annotated version][this document]].

(Read:) **Whose insurance coverage is primary?** Some insurance clauses require additional-insurance endorsements to contain primary-insurance language. This is something that a customer will usually press for: The customer wants to spend the contractor's insurance coverage first, so that its claims history with its own carrier, and thus its premium expenses, will be less likely to take a hit from such a claim.

Customers might want the primary-insurance statement to be included in the endorsement document provided by the insurance carrier, not just in the contract clause between the parties. Otherwise, a court might not enforce it; the general but not unanimous rule has been that, even though a contract might state which insurance carrier has primary responsibility, such a statement isn't binding on the carrier without the carrier's agreement. See generally Joseph P. Postel, How Does an Extrinsic Contract Impact Additional Insured Coverage? (2003) (reviews several court cases in which primary- versus excess coverage was disputed; accessed Apr. 14, 2007); Can an Indemnity Agreement Determine Who's Primary and Who's Excess? (2002) (accessed Apr. 14, 2007).

This problem can be handled — and the risk of expensive satellite litigation over insurance coverage reduced — by expressly requiring the primary-insurance language to be included in the additional-insurance endorsement.

(Black letter:) Additional-insured endorsements and E&O policies: Not a good fit? Some parties might seek additional-insured coverage under the named insured's professional liability / E&O policy. Their reasoning might be that, if the named insured is negligent in performing services, the additional insureds want to be able to make a claim directly to the carrier, instead of having to go to court.

An E&O claim by an additional insured against a primary insured, however, might well be blocked by the "insured versus insured" exclusion found in many such policies. See generally Tennant Risk Services, Who is an Insured – Professional Liability (2000) (accessed Apr. 14, 2007).

Moreover, there seems to be some opinion in the insurance bar that it's inappropriate and even dangerous for an E&O policy to name customers or other professionals as additional insureds.

(Skim:) **Exclusion of completed operations?** An additional-insured endorsement might not cover the insured's completed operations, for example, a contractor's work on a completed project. See generally Craig F.

Stanovich, Additional Insured Endorsements—A Potential Minefield (Part 3) (2006).

(Skim:) Exclusion of additional insured's own negligence?

It's possible that a customer's own negligence might not be covered by an additional-insured endorsement. In 2004, an Oregon court held in 2004 that under that state's statutes, an additional-insured endorsement in an insurance policy did not cover the additional insured's alleged negligence. The court upheld a summary judgment that the insurance company did not have a duty to defend the additional insured. See John W. Ralls, Oregon Court Voids Subcontract's Insurance Provision Because It Would Cover General Contractor's Own Negligence(2004) (accessed Apr. 14, 2007).

(See also the express-negligence rule applicable in some jurisdictions, under which a contractual indemnity will not extend to the indemnified party's own negligence unless the indemnity language is explicit on that point (and it may need to be conspicuous as well). See generally, e.g., The "express negligence rule" might impose conspicuousness requirements for some indemnity obligations, § 4.68.6.

§ 80.1.10 (Read:) Subrogation waiver

"A waiver of subrogation clause is placed in the … contract to minimize lawsuits and claims among the parties. The result is that the risk of loss is agreed among the parties to lie with the insurers, and the cost of the insurance coverage is contractually allocated among the parties as they may agree. *The risk, once assigned to the insurers by the parties, is determined to stop there,* without allowing the insurer to seek redress from the party 'at fault.'" Kenneth A. Slavens, What is Subrogation . . . and Why Is My Contract Waiving It? (2000; accessed Aug. 22, 2007) (emphasis added); see also the Wikipedia article on Subrogation.

§ 80.1.11 Be sure your contract specifies the required counterparty coverage

If you want your client's counterparty to maintain a specific type of insurance coverage, then the parties' agreement had better say so. Sensibly, so said the Supreme Court of Nebraska in Meyer Natural Foods LLC v. Greater Omaha Packing Co., 302 Neb. 509, 925 N.W.2d 39 (2019). In that case, the court affirmed summary judgment that a meat-packing company was not liable for failing to maintain insurance coverage against *E. coli* contamination in the meat it processed, because the relevant contract's insurance provisions did not

require the meat-packing company to maintain that particular coverage. *Id.* at 45-46.

§ 81 Infringement Warranty

§ 81.1 What products and/or services are covered?

This warranty concerns all products and services delivered by the warranting party (each, a "**Deliverable**").

§ 81.2 What types of infringement claim are covered by this warranty?

a. Except as otherwise stated, this warranty covers claims concerning Deliverables as delivered by the warranting party, ☑ that a copyright or trade-secret right is infringed ❑ and/or that a patent right is infringed:

1. by any such Deliverable; and/or
2. by the use of any such Deliverable, by a Warranty Beneficiary, in accordance with the instructions provided by the warranting party.

b. This warranty does not cover any other type of claim.

§ 81.3 What types of infringement claim are *not* covered?

This warranty does not cover claims of infringement arising from a Deliverable's compliance with a written specification provided by any Warranty Beneficiary, or by a third party on behalf of a Warranty Beneficiary, pursuant to the AGREEMENT.

§ 81.4 Infringement claims *by whom* are covered?

a. This warranty covers only infringement claims by third parties.

b. In case of doubt: for purposes of this warranty, the term *third party* does not encompass any *affiliate* of any Warranty Beneficiary.

§ 81.5 Infringement claims *against whom* are covered?

This warranty covers only claims asserted against (i) a Warranty Beneficiary and/or (ii) any member of the Warranty Beneficiary's Protected Group.

§ 81.6 Who is entitled to benefit from this warranty?

This warranty is for the benefit only of the party or parties to whom the warranty is expressly made (each, a "**Warranty Beneficiary**").

§ 81.7 What jurisdictions does this warranty cover?

☑ This warranty covers claims brought under the specified types of third-party intellectual property rights under the law of any jurisdiction.

❑ This warranty covers only claims brought under the specified types of third-party intellectual property rights under the laws of the United States of America and its states and territories.

§ 81.8 Are there any other infringement warranties?

No — **this warranty replaces and supersedes** any and all other representations and/or warranties in the AGREEMENT concerning infringement of intellectual property rights by any Deliverable. (The Implied Warranty Disclaimer also applies.)

§ 81.9 Noninfringement Warranty [TO DO]

INFRINGEMENT.

Innovative Litigation Services agrees to defend or, at its option, settle any claim or action against Reseller to the extent arising from a third party claim that a permitted use of a Product by End Users infringes any U.S. patent or copyright, provided Innovative Litigation Services has control of such defense or settlement negotiations and Reseller gives Innovative Litigation Services prompt notice of any such claim and provides reasonable assistance in its defense.

In the event of such a claim of infringement, ILS , at its option, may provide Reseller with substitute Products reasonably satisfactory to Reseller to replace those affected Products then in Reseller's inventory.

Innovative Litigation Services will not be liable under this Section if the infringement arises out of Reseller's activities after Innovative Litigation Services has notified Reseller that innovative Litigation Services believes in good faith that Reseller's activities will result in such infringement.

The foregoing states the entire liability of Innovative Litigation Services with respect to infringement of intellectual property rights.

§ 82 Interest on Past-Due Amounts

§ 82.1 How much interest may be charged, and on what?

A party to which payment is owed under the Agreement may charge interest on past-due unpaid amounts at no more than 5% per annum simple interest or the maximum rate permitted by law under the circumstances, whichever is less.

COMMENTARY

> If a party will be charging "interest," then before specifying an interest rate (or an interest start date), the party should be sure to check applicable usury laws.

§ 82.2 When will interest charges begin to accrue?

Interest charges will begin to 30 days after the payment due date.

COMMENTARY

> The usury statutes in some states (e.g., Texas) might prohibit charging interest before the end of a specified grace period.

§ 82.3 How are payments to be applied?

All payments are to be applied first to accrued interest (if any), then to unpaid principal, in each case in the order in which the obligations were incurred (that is, oldest-first).

COMMENTARY

Provisions of this kind are often seen in promissory notes. This clause is adapted from a suggestion in David Cook, *The Interest Tail Wags the Profit Dog*, in *Business Law News* Issue No. 3, 2014 (State Bar of California Business Law Section; available on-line to Section members).

§ 82.4 Usury savings: What if too much interest is charged?

a. The parties intend for any interest charged or paid in connection with the AGREEMENT, in any contingency, to comply with law.

b. IF: A charge or payment in connection with the AGREEMENT is properly characterized as interest; AND: The charge or payment is determined to have exceeded the maximum interest permitted by law (after taking all permitted steps to spread such payments over time); THEN:

1. The excess interest is to be deemed the result of an inadvertent error, even if the party charging or paid the excess intended to take the action(s) resulting in the excess;

2. If the excess interest has not yet been paid, then the charge for the excess interest will be canceled; and

3. If the excess interest has been paid, then the party that was paid the excess interest will refund it, or credit it to any balance still owed by the payer, along with interest on the excess at the maximum rate permitted by law.

COMMENTARY

Contractual interest provisions sometimes state that any excess interest will be promptly refunded. Such usury savings clauses, however, might or might not be effective in a given jurisdiction. Consider two contrasting examples:

- Texas law permits usury-savings clauses. *See* Ross Spence, Usury and How to Avoid It: Impact of New Legislation on Collection Practices at 34 (SnowSpenceLaw.com; undated).

- On the other hand, Rhode Island's state supreme court acknowledged that Rhode Island's usury statute was "draconian" and "strong medicine." LaBonte v. New England Development R.I., LLC, 93 A.3d 537 (R.I. 2014). The court said that the legislature had put the risk of charging too high an interest rate onto the lender in "an inflexible, hardline approach to usury that is tantamount to strict liability ...." *Id.* at 544. The supreme court affirmed a trial-court ruling that a commercial loan agreement for more than $400,000 was void as usurious.

§ 82.5 Additional commentary

§ 82.5.1 (Black letter:) Usury: Even *invoicing* excess interest can cause serious trouble

Vendors sometimes add interest charges to invoices; doing so without the customer's prior agreement can result in the charge being usurious. *See generally* Ross Spence, *Usury and How to Avoid It: Impact of New Legislation on Collection Practices* at part VI-B at 24-25, (SnowSpenceLaw.com; undated), which includes extensive citations to Texas case law. (The author is a friend.)

§ 82.5.2 (Read:) Is a given late charge really "interest"?

Not all so-called "interest" charges will be subject to usury laws. For example, in Texas, interest is defined by statute as "compensation for the use, forbearance, or detention of money. The term **does not include time price differential**, regardless of how it is denominated. ..." Tex. Fin. Code § 301.002(4); *See* Ross Spence, Usury and How to Avoid It: Impact of New Legislation on Collection Practices at 9 (SnowSpenceLaw.com; undated).

What is this "time price differential" of which the statute speaks? One article explains the quoted term in relation to Texas law:

> **If certain requirements are met** and a transaction is not designed to circumvent the usury laws, **a merchant may sell merchandise at a higher price for credit than for cash** and the price difference is not usurious. The new statute codifies the common law time-price doctrine.

> In order to apply the time-price doctrine, **it must be shown** that the seller clearly offered to sell goods for both a cash price and a credit or time price, that the purchaser was aware of the two offers, and that the purchaser knowingly chose the higher time or credit price.
>
> If an agreement fails to qualify as a time-price differential contract, then the finance charges may be found to constitute usurious interest.

Spence, *supra*, part VI-F at 27 (citations omitted, extra paragraphing added).

§ 82.5.3 (Skim:) Putting an "interest on past due amounts" clause in an "audit rights" provision might backfire

It's probably a good idea to separate an interest clause from an audit-rights clause (XXX). Failure to do so cost some money for Cellport Systems, Inc., which won a lawsuit against Peiker, a German company, for unpaid patent royalties under a license agreement. The license agreement included an audit provision that required Peiker to pay interest on past-due royalties at 1.5% per month. The trial court, however, awarded Cellport interest at the (lower) statutory rate. The court reasoned that, *in context*, the *contractual* interest rates was intended to apply only to underpayments revealed in an audit. The Tenth Circuit agreed that the lower, statutory rate was proper. Cellport Sys., Inc. v. Peiker Acustic GmbH & Co., KG, 762 F.3d 1016 (10th Cir. 2014) (affirming trial-court judgment in part).

§ 82.5.4 Is the juice worth the squeeze?

Whether a payee will *actually* charge and try to collect interest is a real question. For example, suppliers sometimes hesitate to charge interest to their customers, even if their contracts permit them to do.

Some large customers have been known to announce, imperiously: *We don't pay interest, period.* (On the other hand, some customers can be notoriously slow payers, insisting on as high as net-120-day terms from their suppliers.)

So, when a drafter's client will be the payee of interest payments, it's worth considering whether its even worthwhile to push for an interest provision.

§ 83 Invoicing Requirements

COMMENTARY

See also Payments.

§ 83.1 When are invoices needed for payment?

A party desiring payment from another party must send the other party an invoice for the amount asserted to be due *unless* both of the following are true:

1. the parties have agreed in writing that one or more specific amounts are to be paid at a specific time; and
2. the parties have *not* agreed in writing that invoices are required for those amounts.

COMMENTARY

Paying parties almost invariably want to receive invoices before paying amounts due, not least because they might be required to do so as part of their internal financial controls to help detect and prevent fraud.

Of course, some contracts are explicit about what is to be paid when; if that's the case, then an invoice requirement might be a burden. But a paying party might still want an invoice because of its internal-controls requirements.

PRO TIP: A party submitting an invoice might want to confirm the address to which the invoice should be sent, lest the invoice be lost in the other party's internal correspondence routing system. (With the rise of electronic invoicing- and payment systems, this provision might become less relevant.)

§ 83.2 What information must be included in an invoice?

a. An invoice must include such information as the paying party reasonably requests in writing in advance.

b. Invoices are to be detailed enough to permit the paying party to exercise any audit rights it might have under the AGREEMENT (if any).

COMMENTARY

Alternative: An invoice must include the following information: [DESCRIBE].

Some companies want their suppliers' invoices to include (in addition to the details specified in this provision) information such as, for example: • a purchase-order number; • a supplier identification code; • a contract identifier; • part numbers; • quantities; • units of measure; • hours billed; • unit- and total prices; • export- and safety-related information.

For excruciatingly detailed invoicing requirements, see section 13 of a Honeywell purchase-order form archived at https://perma.cc/84BS-KYXB.

§ 83.3 What language is to be used for invoices?

An invoice must be written: (i) in the language in which the Term Sheet is written; or (ii) if required by law, in the official language of the destination country.

§ 83.4 When are invoices to be sent?

a. If the parties have agreed in writing to a schedule for invoices to be sent, then that agreement will control.

b. Otherwise, invoices are to be sent when the applicable performance being invoiced has been completed (e.g., delivery of goods or completion of services).

COMMENTARY

Invoicing schedules are often a subject covered in construction- and other services agreements, where the service provider wants to be paid as work is done, as opposed to waiting to be paid until the work is 100% complete.

§ 83.5 How are shipping charges, insurance, taxes, etc., to be invoiced?

A party issuing an invoice is to separately itemize, on the invoice, any charges for shipping and/or delivery; insurance; and (to the extent not prohibited from being billed) taxes.

§ 83.6 ❑ Late-submitted invoices are WAIVED

An invoice received by the paying party after an agreed invoicing deadline need not be paid (ever) if the paying party so chooses.

COMMENTARY

> Under (U.S.) generally-accepted accounting principles, publicly-traded companies likely will be required to account for expenses in a particular fiscal quarter, and might make it a policy not to pay invoices where that's not possible due to delay in submission. That's because if a supplier were to submit an invoice very late, conceivably the customer could have to restate its earnings for the relevant period. As the Hertz rent-a-car company's 2014 restatement reminded us, for a company to restate its earnings is generally considered a Very Bad Thing, not least because it can almost immediately lead to shareholder lawsuits claiming securities fraud.

§ 84 IP Ownership Protocol

§ 84.1.1 This Worksheet relates to intellectual property ("IP") relating to the parties' agreement.

§ 84.2 Will ownership of any *preexisting* IP "change hands"?

Neither party will acquire ownership of any preexisting IP owned or assertable by another party.

§ 84.3 Who will own newly created IP?

IF: Intellectual property is created in the course of the performance of the AGREEMENT; THEN: As between the parties:

COMMENTARY

The "As between the parties" language recognizes that other factors such as preexisting contracts might affect ownership; see Bd. of Trs. of the Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 583 F.3d 832 (Fed. Cir. 2009) (holding that Roche was part-owner of Stanford patent because of Stanford co-inventor's previous signing of Roche visitor agreement), aff'd as to a tangential issue, 563 U.S. 776, 131 S. Ct. 2188, 2194-95 (2011).

a. Each party will own whatever IP (if any) that it creates on its own.

COMMENTARY

The text follows the general rule (in the U.S.) that — with certain well-known exceptions such as "hired to invent" doctrine — inventors and authors initially own their creations, possibly subject to contractual- and statutory rights. 35 U.S.C. § 111(a)(1) (inventor may apply for patent), § 261 (transfers of patent ownership); 17 U.S.C. § 201(a) (author owns copyright in original work of authorship).

b. The parties will jointly own whatever IP (if any) that they jointly create under the AGREEMENT.

COMMENTARY

For patents, see 35 U.S.C. § 262, which states that "In the absence of any agreement to the contrary, each of the joint owners of a patent may make, use, offer to sell, or sell the patented invention within the United States, or import the patented invention into the United States, without the consent of and without accounting to the other owners." (Emphasis added.) ¶ For copyrights, see, e.g., Goodman v. Lee, 78 F.3d 1007 (5th Cir. 1996): The rock and roll hit song "Let the Good Times Roll" was supposedly authored by one man, Leonard Lee; he and his heirs were paid more than $1 million in royalties during the relevant time period. But his childhood friend, Shirley Goodman, won a case in which she alleged that she was Lee's co-author of the song; she was awarded one-half of the royalties, plus pre-judgment interest.

§ 84.3.2 **[ ] *[FILL IN PARTY NAME]* will own all such created IP *except* Toolkit Items, defined below.**

§ 84.3.3 **[ ] *[FILL IN PARTY NAME]* will own all such created IP.**

§ 84.3.4 **Must the parties agree on use of jointly created IP?**

Either party may make whatever use it desires of jointly created IP without the other party's permission.

§ 84.3.5 **SUPPOSE: Two parties jointly own certain IP (newly created or otherwise). QUESTION:**

[x] Yes. [ ] Yes, with the following restrictions: *[DESCRIBE]*.

[ ] No.

§ 84.3.6 **SUPPOSE: A party makes use of the jointly owned IP referred to in § 84.3.4. QUESTION: Must that party account to the other party for that use, for example, by sharing profits or paying royalties?**

[x] No. [ ] Yes, as follows: *[SPECIFY]*.

COMMENTARY

In the U.S., joint owners of a copyrighted work must "account" to each other for their uses of the work; generally, this means an equal split of profits unless the owners agree otherwise, preferably in writing. ¶ In contrast, joint owners of a patent may use the patented invention without accounting to each other. See Stanford v. Roche, supra n.**Error! B ookmark not defined.**.

§ 84.3.7 **SUPPOSE: IP is to be created under the parties' agreement. QUESTION: Do the parties agree for any part of that IP to be considered a "work made for hire" under copyright law?**

[x] No. [ ] Yes, as follows: *[SPECIFY]*.

COMMENTARY

> Under U.S. copyright law, the "author" — and thus the initial owner — of a "work made for hire" is "the employer or other person for whom the work was prepared …." 17 U.S.C. § 201(b). NOTE: Under U.S. law, only certain categories of copyrighted work are eligible to be considered works made for hire. 17 U.S.C. § 101 (definition).

HAVE MADE: "under long-established principles of agency law, a licensee under a non-exclusive copyright license may use third-party assistance in exercising its license rights unless the license expressly provides otherwise." Great Minds v. Fedex Office & Print Servs., Inc., 886 F.3d 91, 94 (2d Cir. 2018). (FedEx Office reproduced Creative Commons-licensed materials for schools, so it wasn't commercial).

(CONTINUED ON NEXT PAGE)

§ 85 Jury Trial Waiver

a. When agreed to, this Option applies to the greatest extent not prohibited by law.

b. Each party (each, a "**Waiving Party**") **KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY WAIVES ANY RIGHT IT MIGHT HAVE TO TRIAL BY JURY** of any dispute arising out of or relating to (i) the AGREEMENT or (ii) any transaction or relationship arising from the AGREEMENT.

c. Each Waiving Party certifies that no representative, agent or attorney of any other party has represented, expressly or otherwise, that such other party would not seek to enforce the AGREEMENT's waiver of jury trial.

d. Each Waiving Party acknowledges that the other party has been induced to enter into the AGREEMENT by, among other things, the mutual waivers and certifications in this section.

COMMENTARY

CAUTION: In California and Georgia, advance waivers of jury trial are not enforceable. **California**: Grafton Partners, L.P. v. Superior Court, 36 Cal. 4th 944, 32 Cal. Rptr. 3d 5, 116 P.3d 479 (2005) (state constitution prohibits advance waivers of jury trial); Rincon EV Realty LLC v. CP III Rincon Towers, Inc., 8 Cal. App. 5th 1, 213 Cal. Rptr. 3d 410 (2017) (California prohibition of pre-dispute jury trial waiver overrode parties' contractual choice of New York law); *accord*, In In re County of Orange (v. Tata Consultancy Services Ltd.), 784 F. 3d 520 (9th Cir. 2015) (adopting *Grafton Partners* rule for federal diversity cases). **Georgia**: Bank South, N.A. v. Howard, 264 Ga. 339, 444 S.E.2d 799 (1994).

The above jury-trial waiver is set up as a two-way waiver, because a court would be more likely to disregard a one-way waiver.

The use of bold-faced type is for conspicuousness (see **Error! Reference source not found.**).

CAUTION: Failing to include a jury-trial waiver in the "correct" agreement document can result in disputes under that agreement being tried to a jury even if other related agreement documents include a waiver. That happened in Bank of America, N.A. v. JB Hanna, LLC, 766 F.3d 841 (8th Cir. Sept. 8, 2014). That case involved a tangle of loan agreements, interest-rate swap agreements, and personal guaranties. All contained jury-trial waivers except two loan agreements. The trial court let the jury decide the bank's entire case against the borrowers, on all agreements, notwithstanding the jury-trial waivers in the other agreements; the appeals court affirmed that much of the judgment. (The jury found for the borrowers on all counts; the appeals court vacated the judgment, and remanded for a new trial, on grounds that the verdict was against the great weight of the evidence.)

CAUTION: A later agreement, styled as an "attachment" to an earlier one, can inherit provisions from the earlier agreement — such as a waiver of jury trial. BMC Software, Inc. v. IBM Corp., No. H-17-2254, slip op. at part III-B (S.D. Tex. Jan. 25, 2019) (granting IBM's motion to strike BMC's jury demand).

Optional reading: Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018) (archived at https://perma.cc/3G4L-UVZB).

§ 86 Knowledge Definition

a. The term *knowledge* refers to actual knowledge; related words such as *knows*, *knowingly*, and like words have corresponding meanings.

b. An organization is not considered to have knowledge of something unless the something is known by an individual who has management responsibility concerning the associated subject matter.

c. A representation or other statement about a party's knowledge (or lack of knowledge) concerning a particular matter does not imply that the party made any particular inquiry about the matter unless otherwise stated.

COMMENTARY

Merger- and acquisition (M&A) agreements often contain definitions of knowledge that are much more elaborate than this one; such definitions seem to be less common in contracts for commercial transactions.

Subdivision a is adapted *almost* verbatim from subdivision b of UCC 1-202. Other subdivisions of UCC 1-202 are not incorporated into this definition. Some of those other subdivisions define "notice" and specify default rules for when *an organization* has knowledge or notice of a fact, but those default rules might conflict with the notice provisions of a contract.

Subdivision b is intended to avoid imputing knowledge to an organization just because, let's say, a janitor knows it.

Subdivision c, in contrast to UCC 1-202, does not impose a duty of inquiry; a party desiring to impose such a duty should specify it explicitly.

§ 87 Language Requirements

§ 87.1 What language are the parties to use for *written* communications?

a. The AGREEMENT is written in the "**Contract Language**," namely English as used in the United States of America.

b. Except to the extent (if any) expressly agreed otherwise in writing, that language is to be used for:

1. the interpretation and enforcement of the AGREEMENT (and its appendixes, exhibits, and attachments, if any);

2. any Notices under the AGREEMENT;

3. all service of legal process in any dispute arising out of or relating to the AGREEMENT or any transaction or relationship resulting from it — if applicable law requires that service of process be made in another language, then a translation into the Contract Language of each other-language document so served is to be served with the other-language document; and

4. ❑ except in cases of emergency, any other written communication in connection with the AGREEMENT.

COMMENTARY

Subdivisions b.2 and b.3: Requiring notices to be in the Contract Language could be important: A U.S. retailer found itself losing an arbitration in China, and having a sizable damages award entered against it, because the notice of arbitration was written in Chinese, and the U.S. retailer did not get the notice translated in time to avoid adverse consequences under the arbitration rules. (Fortunately for the U.S. retailer, a U.S. court refused to enforce the award, on grounds that a different agreement controlled, under which the arbitration notice was required to be in English, not Chinese.) *See* CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016), *affirming* No. 14-cv-03118 (D. Colo. May 29, 2015).

Subdivision b.4 is optional because it might be overkill.

§ 87.2 What effect is to be given to translations?

a. The parties anticipate that the AGREEMENT and/or related documents might be translated into a language other than the Contract Language.

b. Any such translation is to be considered as being for convenient reference only and not binding on any party; the version in the Contract Language is to take precedence in case of discrepancy.

COMMENTARY

Drafters dealing with multi-lingual appendixes, exhibits, etc., will want to consider this provision carefully.

Drafters of transnational contracts will want to check local law (and perhaps engage local counsel) for possible language requirements. For example: • Indonesia • Québec • China.

See also CD-20.14. Language Capability for Oral Communications and CD-20.13. Language for Written Communications.

In a LinkedIn discussion (membership required), the following points were suggested:

- English is the global *lingua franca*.
- The choice of language should take into account the jurisdiction(s) in which the contract is likely to be enforced — even with translations, it can be expensive, burdensome, and risky to ask a court to interpret and apply a contract written in a language not its own.
- Translations can be iffy, because specialized words and phrases, such as *fraud* and *gross negligence*, conceivably might be translated into other languages in ways that have subtly different meanings than the original.
- An expensive but sometimes-worthwhile approach is to negotiate a contract in one language; have the final draft translated into another desired language; and then have the translation retranslated back into the original language.
- It *might* be possible to "write around" legal requirements that contracts be written in a local language by requiring binding arbitration in the desired language. (It would make sense to include, in the contract, a translation of the arbitration provision into the local language.)
- A party acting in bad faith might try to claim that it misunderstood a term in a foreign language.

§ 87.3 ❑ Must the parties maintain any particular *oral* language capability?

Yes, as follows:

a. Each party is to maintain the capability of conducting routine business orally (e.g., in person or by telephone) in the Contract Language, whether through party personnel who can speak that language or through translators engaged at the party's expense.

b. Subdivision a does not limit any party's right to communicate orally in any other language:

1. when agreed to by the individuals involved, and

2. not a hindrance to the purpose of the AGREEMENT.

COMMENTARY

This provision tries to balance: • the parties' interest in making sure they can communicate orally, against • the possible threat of legal action from employees claiming discrimination on the basis of national origin. See, e.g., Can You Require Employees to Speak Only English on the Job? (CBIA.com, undated).

§ 88 Lead Representatives Protocol

§ 88.1 When would this Protocol apply?

a. This Protocol will apply if a party (referred to as "**Alpha**") designates an individual ("**Alice**"), in a written communication to another party ("**Beta**") as being authorized to act as a "**lead representative**" on behalf of Alpha.

b. The AGREEMENT may require one or both parties to designate a lead representative.

COMMENTARY

Provisions like this are often seen in, e.g., services- and project agreements, where it can be important for parties to have designated points of contact.

§ 88.2 May a party designate multiple lead representatives?

Yes: Alpha may designate multiple lead representatives, for the same purpose or for different purposes (possibly at different times).

COMMENTARY

Alpha might designate Alice as its lead representative for the day shift; Allen for overnight; Amy for weekends; etc.

Or, Alpha might designate Alice as its lead representative for engineering matters; Allen for personnel matters; Amy for financial matters; etc.

§ 88.3 May a party limit the authority of a lead representative?

Yes: Alpha's written designation of Alice as a lead representative may limit the area and/or extent of Alice's authority.

COMMENTARY

Example: Alpha's designation of Alice as its lead representative might state that Alice is not authorized to make commitments on behalf of Alpha that would cost more than X dollars, etc.

(As an analogy, think of organizations that, when spending money, require two authorized signatures on checks for amounts exceeding X dollars.)

§ 88.4 May a party change its lead-representative designation?

Yes:

a. Alpha may "un-designate" Alice as its lead representative at any time in the same way as it makes such a designation.

b. In case of doubt: Alpha's un-designation of Alice as a lead representative would not change the effect of Alice's prior communications as lead representative.

§ 88.5 To what extent may another party rely on communications from a lead representative?

a. Except as otherwise provided in this section, Beta is entitled to rely on any communication from Alice — of any kind, whether oral or written, by any means, and on any subject — as being both (i) authorized by, and (ii) binding on, Alpha.

b. If Alice's lead-representative designation limits her authority, however, then a communication by Alice outside her designated authority limits will not be binding on Alpha.

c. And in case of doubt: Any communication from Alice that states that it is not binding (in one or more respects) will not be binding on Alpha to that extent.

d. ☑ An *oral* communication from Alice will not be binding on Alpha unless followed up with a written summary containing reasonable detail and transmitted by any reasonable means, including but not limited to email and text where appropriate.

COMMENTARY

> Subdivision b: The "unreasonable" language helps to "roadblock" Beta from complaining that it relied to its detriment on a communication from Alice if that communication was outside Alice's authority to binding Alpha.
>
> Subdivision d: This provision is intended to encourage *written* communications in the interest of trying to forestall future "he said, she said" disputes.

§ 88.6 ❑ What about communications from other party personnel?

a. This section applies unless otherwise specified in the AGREEMENT or in Alpha's written designation of Alice as a lead representative.

b. IF: An employee or other representative of Alpha, other than Alice, purports to make a request or issue an instruction on behalf of Alpha; THEN: Other parties are not to consider the request or instruction to have been made on behalf of Alpha.

COMMENTARY

This option addresses one of the major causes of "troubled" contracts, which is that is unauthorized people can make change requests that can lead to cost overruns and delays. *See, e.g.*, Steve Olsen, Troubled contracts – why missing these steps may trip you up (IACCM.com 2015).

§ 89 Letter of Intent Protocol

COMMENTARY

CAUTION: The "consequences" of parties' entering into a "non-binding" letter of intent can be significant if a court finds that the parties intended to enter into a *binding* contract. A canonical example of this danger is Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. App.—Houston [1st Dist.] 1986, writ. ref'd n.r.e.). In that case, Texaco was hit with a damage award of some $10.5 billion, or more than $22 billion in 2014 dollars, for *interfering* with what the jury and the courts found to be Pennzoil's *binding* memorandum of understanding with Getty Oil.

§ 89.1 Why are the parties entering into a letter of intent?

a. The parties are entering into the AGREEMENT in the form of a letter of intent, memorandum of understanding, or similar document that is intended to be at least partly nonbinding; the AGREEMENT is sometimes referred to in this Protocol as a partially-binding letter of intent, or "**PBLOI**."

b. The parties intend to discuss (or to continue discussing) a potential business arrangement (a potential "**Arrangement**"). The parties anticipate that they might eventually enter into a definitive written agreement (a "**Final Agreement**") that:

1. sets forth final, agreed terms of the Arrangement; and
2. is signed and delivered by all relevant parties.

c. Instead of proceeding directly to negotiation of a Final Agreement, the parties are entering into the Term Sheet as a PBLOI, with the following purpose:

1. to make it clear that the parties have not yet agreed to all material terms of the potential Arrangement;

2. to provide the parties a convenient working outline of the potential Arrangement as then-currently contemplated; and

3. to set out the agreed "ground rules" for the parties' anticipated discussions about the potential Arrangement.

d. Each party acknowledges that without the parties' agreement to the PBLOI, the other party would not go forward with discussions about the potential Arrangement.

COMMENTARY

This section will give a future reader — such as a reviewing court — some background information about why the parties are agreeing to these general terms.

Subdivision b: The term "potential business arrangement" is borrowed from generally accepted accounting principles, which require "[p]ersuasive evidence of *an arrangement*" before revenue can be recognized (emphasis added).

§ 89.2 How much of the PBLOI is binding?

a. The parties intend for only the following terms in the Term Sheet to be binding unless and until the parties enter into a Final Agreement:

1. this Protocol; and

2. any other terms in the Term Sheet that the parties have clearly agreed in writing will be binding (which includes, but is not limited to, the TANGO General Terms and General Definitions).

b. Otherwise, neither party will be bound by any obligation, or entitled to any right, concerning the potential Arrangement unless and until they sign and deliver a Final Agreement.

c. Subdivision b applies whether the purported right or obligation supposedly arises in contract; tort; strict liability; *quantum meruit*; quasi-contract; unjust enrichment; or otherwise.

COMMENTARY

What provisions should *be binding?* Drafters should consider some annotated examples of short- and long-form provisions that the parties

might wish to be binding: See American Bar Association Section of Business Law, Letters of Intent (Ancillary Document B to Model Stock Purchase Agreement, Second Edition), Part Two, at 10, archived at https://perma.cc/Z4UX-LN9X.

CAUTION: Merely *saying* that the parties' discussions are "subject to contract" might not be enough to avoid a binding effect. As an example, consider the famous case of *Pennzoil v. Texaco*: • The selling entities ("Getty") and the buyer, Pennzoil, issued press releases announcing their deal. • The press releases said that "the transaction is subject to execution of a definitive merger agreement." But that wasn't enough to save an outside party, Texaco, from liability of over $10 billion for interfering with the Getty-Pennzoil contract. An appeals court said that "[r]egardless of what interpretation we give to the conditional language in the press release, we conclude that it did *not* so clearly express the intent of the parties *not* to be bound to conclusively resolve that issue, as Texaco asserts." Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 789-90 (Tex. App. – Houston [1st Dist.] 1987, writ ref'd n.r.e.) (affirming judgment against defendant Texaco as to liability and actual damages, but ordering a remittitur as to punitive damages) (quoting press release) (emphasis added).

§ 89.3 Will the parties' discussions, messages, etc., be binding?

a. In case of doubt, and without limiting § 89.2: The parties' discussions and other messages concerning the potential Arrangement will not be binding on either party (only the Final Agreement will be binding).

b. Subdivision a applies:

1. no matter how long a discussion and/or an exchange of messages continues concerning the potential Arrangement; and

2. no matter how many different discussions and/or messages exchanges occur about the potential Arrangement.

c. For purposes of subdivision a, the term "message" includes, without limitation: emails; text messages; Internet chat messages; hard-copy letters, memos, and notes; and other messages of any kind; regardless of the form- or method of transmission of the message.

COMMENTARY

In negotiating agreements, parties often exchange emails, texts, and other messages. Under the law in many jurisdictions, parties can unwittingly create a binding contract if their messages, taken together, show that the parties agreed to all of the "material" terms needed to create an enforceable contract.

So just what *are* the "material" terms of a contract? That will depend on the type of contract — and perhaps, to an extent, on the views of the particular court. As an example, the material terms for a contract for the sale of goods are likely to be the description, quantity, price, and date of delivery or pickup.

§ 89.4 What if one or both parties "get going" early?

It is possible that one or both parties might take action concerning the potential Arrangement before a Final Agreement has been fully signed and delivered. If that happens, then:

1. each party taking action does so entirely at its own risk (including but not limited to legal risk) and expense; and
2. no party will assert that such action indicates that the parties intended to form or did agree to the Final Agreement, nor to form a partnership, joint venture, or other kind of relationship.

COMMENTARY

This section tries to forestall a particular type of finding: That contract — or *a partnership* or other relationship — was formed, not by negotiation as contemplated in a letter of intent, but instead by the parties' actions.

- Every first-year law student (at least in the U.S.) learns that an offer for a contract can be accepted by performance. *See, e.g.*, UCC § 2-206.
- Under state law a partnership can arise even without a contract: According to a Texas jury — whose verdict was subsequently overturned on appeal — two parties formed a partnership *after* signing an LOI by conducting themselves as though they were partners, notwithstanding the contrary language in the LOI itself. See Energy Transfer Partners, L.P. v. Enterprise Products Partners, 529 S.W.3d 531 (Tex. App.—Dallas 2017). (At this writing, in August 2019, the case is pending at the Supreme Court of Texas; the parties' briefs on the merits,

as well as *amici* briefs, are available at the court's Website under docket number 17-0862.)

§ 89.5 Must the parties' discussions be kept confidential?

☑ Yes:

a. Without the prior written consent of the other party, neither party will disclose to any third party the existence, contents, or status of the parties' discussions concerning the potential Arrangement, whether or not those discussions lead to a Final Agreement.

b. In case of doubt, though: The parties do not intend for subdivision a to limit, nor to expand, any otherwise-applicable confidentiality agreement between the parties.

❑ No.

COMMENTARY

Parties to a letter of intent often want their discussions to be kept between them only, even if they are not agreeing to exclusivity.

Letters of intent often contain their own extensive confidentiality provisions, but sometimes parties enter into separate confidentiality agreements concerning their discussions. This subdivision takes the latter possibility into account.

Parties can consider also agreeing to the TANGO Confidential Information Module and/or to the Confidentiality of Dealings Module in the TANGO Ground Rules.

§ 89.6 Are the parties' discussions to be exclusive?

☑ No:

a. Until such time (if any) as the parties enter into a Final Agreement, each party remains free — in its sole and unfettered discretion — to seek, discuss, negotiate, and/or enter into arrangements with other parties that are similar or even identical to the Proposal.

b. Subdivision a applies even if, as a result of other discussions, a party would no longer be willing (or would be unable) to finalize the potential Arrangement and enter into a Final Agreement.

❑ Yes, as follows: *[DESCRIBE]*.

COMMENTARY

In some LOIs, one or both parties might insist on an exclusivity provision, but any such provision should be negotiated carefully.

§ 89.7 May a party withdraw from discussions?

Yes:

a. Any party may withdraw from discussion of the potential Arrangement and negotiation (if any) of a Final Agreement:

1. at any time until the Final Agreement is signed and delivered by all parties;
2. in the withdrawing party's sole discretion, with a view toward none but its own interests and desires; and
3. without obligation or liability of any kind, under any legal- or equitable theory, to any other party.

b. Each party agrees not to claim, under any circumstances, that a withdrawing party's withdrawal under subdivision a was done in bad faith.

c. Any obligation to negotiate a Final Agreement in good faith is to be conclusively deemed to have been satisfied.

COMMENTARY

This section tries to forestall a claim that a party failed to comply with a putatively applicable duty of good faith or fair dealing. It is inspired by UCC § 1-302(b) (which by its terms applies only to contracts that come within the scope of the Uniform Commercial Code): "The parties, by agreement, may determine the standards by which the performance of those obligations *[of good faith, etc.]* is to be measured if those standards are not manifestly unreasonable."

Note the "optics" approach taken by these subdivisions: They do not state that the parties are not required to act good faith. Leaving aside whether such a statement would be enforceable, imagine how a judge or juror might react to the statement, and/or how the statement might look if reported in the newspaper.

CAUTION: Business people sometimes like to include obligations to negotiate in good faith as a way of trying to signal (or protest) their own bona fides. But business people also sometimes think such provisions are mere throwaways. That's far from the case: in many jurisdictions, *an agreement to negotiate in good faith will be legally binding* — and also is likely to be a serious mess to litigate.

§ 90 Limitation of Liability General Terms

This section applies to any limitation of liability stated in or incorporated into the AGREEMENT, including without limitation • any disclaimer of warranties, and • any exclusion- or cap on damages.

§ 90.1 What types of claims are affected by limitations of liability?

The parties have specifically agreed that each limitation of liability set forth in the AGREEMENT is to apply to all claims for damages or other monetary relief, whether alleged to arise in contract, tort (including without limitation negligence, gross negligence, and/or willful misconduct), or otherwise.

COMMENTARY

This language is an avoidance-of-doubt "roadblock" clause; it hopes to prevent aggressive litigation counsel from trying to do an end-run around the limitations of liability.

§ 90.2 Would it matter if exclusive remedies had "failed"?

a. Suppose that:

1. the AGREEMENT says that a harmed party is entitled only to certain specific types of remedy, and perhaps even to just one type of remedy; but

2. none of these remedies did the trick (in legalese: the remedies "failed of their essential purpose").

b. In any situation described by subdivision a, any limitation(s) of liability in the AGREEMENT will remain in effect anyway.

c. To illustrate subdivision b with a made-up example, suppose that:

1. A customer signs an agreement to buy a car from a dealer.

2. Under the agreement, the customer's only recourse, if the car has a problem while it's still under warranty, is for the dealer to fix the problem. (This is known as an "exclusive remedy.")

3. The agreement also says that the dealer will not be liable for "consequential damages" (that term is defined in § 87).

4. The customer's specific car has a problem that the dealer is simply unable to fix.

5. In that situation, the agreement's exclusive remedy is said to have failed — but the exclusion of consequential damages will remain in effect anyway.

COMMENTARY

This section simply states how the law applies in many U.S. jurisdictions — but not in all states. See Sanchelima Int'l, Inc. v. Walker Stainless Equipment Co., 920 F.3d 1141 (7th Cir. 2019), which discusses this point with citations.

§ 90.3 Would it matter if the liable party knew the potential harm?

No: Any limitation(s) of liability of the AGREEMENT will apply even if the liable party and/or its agents knew (or had reason to know), at any time, that the harmed party had some special, out-of-the-ordinary vulnerability to being harmed.

COMMENTARY

TO DO: Cite to Hadley v. Baxendale discussion

§ 90.4 What if the law says otherwise?

A limitation of liability in the AGREEMENT would not apply if, and to the extent that, the limitation would be unenforceable under applicable law. (For example: The law might provide that limitations of liability are unenforceable when it comes to personal injury or death.)

§ 91 Marketing Protocol *[TO DO]*

§ 92 Master Agreement Definition

§ 92.1.1 When would this Definition be relevant?

a. This Definition will apply if the Term Sheet indicates, expressly or implicitly, that the AGREEMENT is to be a master agreement under which multiple transactions might be conducted, with the AGREEMENT setting forth terms and conditions for possible individual written agreements (each, an "Order"; see the Order-Processing Rider) for any specific agreed "transactions."

b. In case of doubt: One or more such Orders may be entered into at the same time as the Term Sheet is fully signed, or possibly afterwards, as agreed by the parties.

COMMENTARY

Parties often negotiate master agreements when they think that they might do multiple transactions together. Typically, a master agreement itself does not obligate the parties, but merely serves as a reference document for one or more order forms — e.g., purchase orders for goods or work orders for services, see § 130 — that incorporate the master agreement by reference. That lets the parties avoid renegotiating the major terms and conditions each time they want to do a transaction.

§ 92.1.2 Does the master agreement itself impose any obligations?

Unless the parties expressly agree otherwise in writing, the AGREEMENT itself does not obligate either party to agree to (i) a particular transaction, or (ii) a particular aggregate number or volume or rate or price of transactions.

COMMENTARY

The main text is informed by a lawsuit in which a subcontractor claimed that IBM had breached an alleged promise to provide the subcontractor with $3.6 million of work on a project for the Chicago Transit Authority. IBM won the case on summary judgment, but it still had to defend against the claim. See Bus. Sys. Eng'g v. IBM, 547 F.3d 882 (7th Cir. 2008), *affirming* 520 F. Supp. 2d 1012 (N.D. Ill. 2007).

Alternative: [PARTY NAME] commits to one or more specific transactions under this Agreement as follows: *[FILL IN]*.

§ 93 Master agreements

§ 93.1 Business purpose of a master-agreement acknowledgement

Companies often enter into master agreements that don't create any obligations of their own, but that do set up a framework for any agreed transactions. Such a master agreement can be useful in business by allowing parties to pre-negotiate the "legal T&Cs" just one time; the parties can later re-use those T&Cs in future transactions by signing short-form contracts that (ideally) incorporate the master agreement by reference and set forth any transaction-specific terms.

§ 93.2 Some specific terms to consider for master agreements

- **Pricing terms** are sometimes pre-negotiated in master agreements. When that happens, it is useful also to include an agreed mechanism for periodically adjusting the pricing, so that the supplier won't potentially be stuck with outdated pricing long after the deal was struck.

- (Skim:) Unilateral extensions, § 4.102 and (Read:) Evergreen extensions, § 4.53 can also be useful, but should be approached with caution.

§ 93.3 A company can negotiate a master agreement for its corporate "family"

Companies sometimes want to negotiate pricing and other terms & conditions on behalf of their affiliates; that can help to reduce the transaction costs that would attend negotiation of individual contracts between each affiliate and the same counterparty. An easy way to do this is to pre-negotiate a "master" agreement that can be incorporated by reference into other contracts.

EXAMPLE: A company signs a master purchase agreement. It wants its affiliates to be able to make purchases from the seller, on the same negotiated terms and conditions and/or at the same negotiated pricing. By having the master agreement say just that, the company can ensure that its affiliates won't *have* to negotiate their own deals with the seller. (Of course, any given affiliate might *want* to negotiate its own deal.)

In that situation, consider doing the following:

- The parent company signs a master agreement with stated pricing and other T&Cs.
- The master agreement states that either party *and its affiliates* can utilize the master agreement by entering into a short-form agreement (for example, a purchase order) that incorporates the master agreement by reference.
- If a buyer's subsidiary places a purchase order with the seller, then the subsidiary doesn't become a party to the master agreement per se; it's a party only to the contract formed by its own purchase order.
- The purchasing subsidiary is a third-party beneficiary of the master agreement, but only in the limited sense that it has the right to place orders at the stated pricing and under the stated T&Cs.
- The purchasing subsidiary's parent company avoids being liable for the subsidiary's financial obligations under the subsidiary's purchase orders (unless of course the seller negotiates a guarantee from the parent). That's something the parent company's lawyers and finance people will usually want.

- If a lawsuit should come to pass over a particular purchase order, there's little room for satellite disputes about who has standing to sue whom and who the necessary parties are.

§ 93.4 Pro tip: Have "subsidiary" contracts expressly state that the master agreement controls

CAUTION: When using a master agreement, it's best for any subsequent contracts to *expressly* state that the master agreement's terms are to control. Consider CEEG (Shanghai) Solar Science & Tech. Co. v. LUMOS LLC, 829 F.3d 1201 (10th Cir. 2016), *affirming* No. 14-cv-03118 (D. Colo. May 29, 2015). In that case:

A Chinese manufacturer of solar-panel products entered into a co-branding agreement with a U.S. retailer. That agreement called for the retailer to order solar-panel products from the manufacturer at stated prices. The co-branding agreement contained an arbitration provision, which expressly required that arbitration proceedings be in English.

- The retailer also entered into specific written sales contracts with the manufacturer; the sales contract contained an arbitration provision, but that provision did not require English-language arbitration.
- The retailer's CEO testified, and the U.S. trial court accepted, that the parties had intended for the co-branding agreement to be a "master" agreement that would govern all sales contracts.
- Apparently, though, neither the co-branding agreement nor the sales contract in question actually said referred to the master agreement (the courts' opinions were not specific on this point).
- The manufacturer and the retailer communicated exclusively in English.
- One shipment of goods had quality problems; the retailer refused to pay. After negotiations went nowhere, the manufacturer filed a demand for arbitration with the Chinese arbitration institution designated in the earlier, co-branding agreement.
- The Chinese arbitration institution sent the U.S. retailer a notice of arbitration, in Chinese. The U.S. retailer did not realize what the notice of arbitration was. Consequently, the retailer did not realize that under the agreed arbitration rules, a 15-day clock was ticking on the retailer's right to participate in

selecting the members of the arbitration panel. That deadline passed, and the panel members were selected without input from the retailer.

- The arbitration panel ruled that the so-called master agreement did not apply and that the sales contract controlled. The arbitration panel awarded damages to the manufacturer, which then sought to enforce the award against the retailer in a U.S. court.

The Colorado district court ruled that, contrary to the decision of the arbitration panel, the testimony of the retailer's CEO established that the co-branding agreement had indeed been a "master" agreement; this meant that the Chinese-language notice of arbitration had been insufficient, and that in turn meant that, under the New York Convention, the court could decline to enforce the damages award.

Citing the virtual unreviewability of arbitration awards even when grounded on errors of law, the Tenth Circuit chose not to address the master-agreement issue:

> [O]ur holding does not rely on the conclusion that the [sales contract] was bound by the terms of the [co-branding agreement]. Rather, the [co-branding agreement] is *one piece of evidence* demonstrating that the parties understood their relationship would proceed in English,
>
> and that [the manufacturer] suddenly deviated from that understanding and practice when providing notice.

Id., 829 F.3d at 1207 n.2 (emphasis and extra paragraphing added).

DRAFTING LESSON: It's best if purchase orders, statements of work, etc., expressly identify a "master" agreement and state that the master agreement applies.

§ 93.5 Should a master agreement override purchase orders, etc., no matter what?

A master agreement might state that its terms apply to all transactions between the parties, even if the parties use a purchase order, statement of work, etc., that doesn't refer to the master agreement. This was suggested in a LinkedIn comment (group membership required) by attorney Michael Little.

I'm on the fence about that one:

- In one sense, Mike's suggestion might be safer, at least in the short term, in that the parties (and thus the client) wouldn't have to remember to incorporate the master agreement by reference.

- On the other hand, it might not be ideal for parties that did a lot of business together in different divisions, geographic territories, etc.

- And this practice could lead to parties, long afterwards, inadvertently incorporating a forgotten "zombie" master agreement by reference, to unclear effect.

The author's own preference is often to be silent on this point in the master agreement, so that the parties will have to remember to expressly incorporate the master agreement by reference. My guess is that they'll be more likely to remember to do that than to research whether any previously negotiated master agreement still applies. But this is a judgment call, to be made based on the particular circumstances and the client's desires.

§ 93.6 Danger of a master agreement's setting the bar too high

In an Eighth Circuit case, the parties' master services agreement set the bar too high for services agreements, and as a result the master agreement was found not to apply. The master agreement prescribed the exact language that a statement of work was required to include to incorporate the master agreement by reference:

> Barkley shall perform for [Gabriel Brothers] certain services which shall be agreed to by the parties on a project-by-project basis . . . . The Services agreed to for each Project shall be designated in a written Statement of Work ("Statement of Work").
>
> Each Statement of Work shall contain the following provision:
>
> "This Statement of Work is incorporated into, and made a part of, that certain Master Services Agreement . . . between the parties dated [October 5,] 2012, which Agreement governs the relationship of the parties. All terms and conditions provided in the Agreement shall apply to this Statement of Work."

Barkley Inc. v. Gabriel Bros. Inc., 829 F.3d 1030, 1034-35 (8th Cir. 2016) (extra paragraphing added, alteration marks by the court).

As to the relevant statement of work:

- The service provider began working while the parties were negotiating the statement of work.
- At some point the customer pulled the plug by invoking a termination-at-will provision in the master agreement — and at that point the parties had not signed the statement of work; consequently, there was no signed statement of work containing the prescribed incorporation-by-reference language.
- The provider sued the customer; it alleged that, because the customer failed to pay for the work already started for the (unsigned) statement of work, the customer thereby breached the master agreement.

The district court granted partial summary judgment in favor of the customer, on grounds that because the statement of work was never signed, the specific requirements of the master agreement had not been met, so there was no breach of that agreement. The appeals court affirmed:

> The Agreement states that "[t]he services agreed to for each Project shall be designated in a written Statement of Work" and that "[e]ach Statement of Work shall contain" the Agreement's incorporation clause. The use of the word "shall" indicate that a written statement of work is **required** and that any statement of work **must** contain the incorporation clause. Accordingly, because the alleged February 21, 2013, draft 2013 statement of work **was not** part of a written contract and the document did not contain the Agreement's incorporation clause, the district court did not err in granting summary judgment to Gabriel Brothers on Barkley's breach-of-the-Agreement claim.

Id., 829 F.3d at 1038-39 (alteration marks by the court, emphasis added). In the court below, though, a jury held the customer liable for damages for breaching a subsequent [oral?] agreement that apparently wasn't "under" the master agreement; the appeals court affirmed judgment on that verdict.

§ 93.7 Should a master agreement specify the form to be used?

In a thoughtful LinkedIn group discussion comment (group membership required), attorney Michael Little suggested that a master agreement should "specify" the form of purchase orders, statements of work, etc., by including the form(s) in an exhibit.

The author's view is different: It can be useful to include such a form *as an example*, but I don't like to specify that use of that form is *required*. That's because, in a particular transaction, the parties might thoughtlessly (or intentionally) use a different form instead of one matching the exhibit. That, in turn, might give rise to a dispute over whether the master agreement's terms applied to that transaction, just as happened in the *Barkley v. Gabriel Bros.* case discussed above.

§ 93.8 A master agreement might (inappropriately) contain an entire-agreement clause

For an example of a master agreement with an entire-agreement clause, see Grandoe Corp. v. Gander Mountain Co., 761 F.3d 876 (8th Cir. 2014) (affirming denial of defendant's motion for judgment as a matter of law). In that case:

- The plaintiff was a manufacturer of gloves; the defendant was a national retailer of outdoor sporting goods.
- The manufacturer and the retailer entered into a written contract (the "RAC") that established percentage discounts and a few other terms that would apply to the retailer's *oral* orders for gloves.
- The written contract did not obligate either party to sell or buy gloves.

The court noted that:

... notwithstanding the RAC's integration clause, it does not appear that the parties intended the RAC to be the final expression of their agreement.

Rather, the RAC explicitly contemplates a future contract for the sale of gloves, and it does not specify that such a contract must be in writing.

The RAC's integration clause itself reflects this understanding: it states that the RAC "is the entire agreement between the parties *with respect to the subject*

matter of this Agreement" (emphasis added), but the subject matter of the RAC does not include the actual sale or purchase of gloves.

If that were the case, then no gloves would ever have been exchanged, since the RAC does not include a quantity term.

Id. at 887 (emphasis by the court, extra paragraphing added).

§ 94 Material Definition

A thing is material (for example, material information) if a substantial likelihood exists that a reasonable person would consider the thing important in making a relevant decision.

COMMENTARY

This definition is adapted from the opinion of the Supreme Court of the United States in Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988), a securities-law case.

(Skim:) For a hair-trigger statutory definition of "material" (in the context of residential-real-estate disclosures), see Hawaii Rev. Stat. 508D-1(3): "'Material fact' means any fact, defect, or condition, past or present, that would be expected to *measurably affect* the value to a reasonable person of the residential real property being offered for sale." (Emphasis added.) *See generally* Santiago v. Tanaka, 137 Haw. 137, 366 P.3d 612, 624 (2016).

§ 95 Material Breach Definition

§ 95.1 What makes a *breach* "material"?

a. If the AGREEMENT states that a certain type of breach is considered material, that statement is conclusive.

b. Otherwise, any determination whether a breach of the AGREEMENT was (or would be) material is to take into account the factors listed in the Restatement (Second) of Contracts 241 (1981), considering the AGREEMENT as a whole, with no single factor necessarily being decisive.

COMMENTARY

Why define *material* breach? Because under U.S. law, even if a contract is silent on the subject, a major consequence of an *uncured* breach's being "material" is that the breach excuses further performance by the other party for so long as the breach remains uncured. See, e.g., Ryan Data Exchange, Ltd. v. Graco, Inc., 913 F.3d 726, 733-34 (8th Cir. 2019) (affirming judgment on jury verdict; breach was not material).

Subdivision a: For example, a real-estate lease might state that a failure to pay rent, after notice and an opportunity to cure, is a material breach.

Subdivision b: Many U.S. courts look to the Restatement (Second) of Contracts 241 (1981) in determining the materiality of a breach. The Restatement lists five factors that are to be taken into account, with no single factor being decisive:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
>
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
>
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
>
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
>
> (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

Norfolk Southern Ry. Co. v. Basell USA Inc., 512 F.3d 86, 92 (3d Cir. 2008) (vacating and remanding summary judgment that breach of contract was not material), *quoting* Restatement (Second) of Contracts § 241 (1981).

Subdivisions a and b: The Indiana supreme court held that a contract's specific identification of standards of materiality took precedence over a Restatement analysis: "**when a contract sets forth a standard for assessing the materiality of a breach, that standard governs.** Only in the absence of such a contract provision does the common law, including the Restatement, apply." Indiana v. IBM Corp., 51 N.E.3d 150, 153 (Ind. 2016) (emphasis added).

Subdivision b: The "AGREEMENT as a whole" language is modeled on section 16.3.1(1)(A) of the master service agreement in the *Indiana v. IBM* case, cited above. CAUTION: The "AGREEMENT as a whole" language probably increases the likelihood that a party's motion for summary judgment about the materiality or immateriality of a breach would be denied.

§ 95.2 Can non-material breaches add up to materiality?

A history of non-material breaches could collectively constitute a material breach of the AGREEMENT when considering the AGREEMENT as a whole; this is true whether the individual breaches are related or unrelated and whether or not any or all of them are cured.

COMMENTARY

At some point, a party might respond to a series of non-material breach by (figuratively) slapping the table and saying, "Enough is enough!"

Language along these lines is found in some contracts, such as section 16.3.1(1)(c) of the master service agreement in Indiana v. IBM Corp., 51 N.E.3d 150, 155 (Ind. 2016).

§ 95.3 Additional commentary

§ 95.3.1 Getting a summary judgment about materiality could be problematic

In Norfolk Southern, the Third Circuit noted that issues of materiality of a breach of contract might not be resolvable on summary judgment if a party's intent was at issue:

> In addition, we note that, although it is not impossible, determining whether a breach is material on summary judgment is inherently problematic where, as here, **the materiality analysis might well turn on subjective assessments as to the state of mind of the respective parties.**
>
> As we have emphasized in the past, **a court should be reluctant to grant a motion for summary judgment**

> **when resolution of the dispositive issue requires a determination of state of mind**, for in such cases much depends upon the credibility of witnesses testifying as to their own states of mind, and **assessing credibility is a delicate matter best left to the fact finde**r.

Norfolk Southern Ry. Co. v. Basell USA Inc., 512 F.3d 86, 96 (3d Cir. 2008) (vacating and remanding summary judgment that breach of contract was not material) (cleaned up, emphasis and extra paragraphing added).

§ 95.3.2 Caution: "Letting it slide" could result in a waiver even of repeated material breaches

In a 2015 case, the Connecticut supreme court noted that "it is a settled principle of contract law that a party to an executory bilateral contract **waives** a material breach by the other party if he continues the business relationship, and accepts future performance **without some warning** that the contract is at an end." RBC Nice Bearings, Inc. v. SKF USA, Inc., 318 Conn. 737, 123 A.3d 417, 425 (2015) (citations omitted, emphasis added).

§ 95.3.3 Just complaining about a material breach won't preclude a finding of waiver of the breach

In the *RBC Nice Bearings* case discussed above, the Connecticut supreme court also noted that, just because you complain to the other side that they're breaching the contract, that won't necessarily preclude a finding that you waived the breach:

The rule applies with particular force in the present case, where there was evidence that the plaintiffs gave the defendant intentionally mixed signals with regard to its minimum purchase requirement, and where the trial court found that the plaintiffs always had intended to terminate the contract prematurely and merely used the shortfall invoices as a pretext to do so when they decided that the time was right.

RBC Nice Bearings, Inc. v. SKF USA, Inc., 318 Conn. 737, 123 A.3d 417, 432-33 (2015) (extra paragraphing added, footnotes omitted).

§ 95.3.4

Indiana v. IBM (1): An appeals court substitutes its judgment about materiality

A fascinating material-breach case is Indiana v. IBM Corp., 4 N.E.3d 696 (Ind. App. 2014) (reversing trial court in pertinent part), *affirmed*, 51 N.E.3d 150 (Ind. 2016), *after remand*, 112 N.E.3d 1088 (Ind. App. 2018) (affirming in part, reversing in part, trial court's recalculation of damages), *affirmed in pertinent part,* No. 19S-PL-19 (Ind. June 26, 2019). In that case:

- The state of Indiana and IBM entered into a ten-year, $1.3 billion contract to modernize and improve the state's welfare system.
- Things did not go as expected; three years in, the state terminated the contract, alleging material breach by IBM.
- The state and IBM sued each other; the trial court conducted a six-week bench trial, hearing 92 witnesses and admitting 7,500 exhibits. *See id.*, 4 N.E.3d at 713.

While the trial court held that IBM had not materially breached the contract, the appeals court reversed on the materiality question, asserting:

> While IBM's software, computers, and employee training aided in delivering welfare services, **the primary focus of the contract** was to provide food and medical care to our poorest citizens in a timely, efficient, and reliable manner within federal guidelines, to discourage fraud, and to increase work-participation rates. **In the most basic aspect of this contract** — providing timely services to the poor — **IBM failed.** We therefore **reverse the trial court's finding that there was no material breach**.

Id., 4 N.E.3d at 702 (emphasis added).

One judge, though, dissented on the materiality standard to be applied, asserting that the Agreement went into great detail about the standard of performance and therefore should be followed by courts. *Id.* at 747-48 (Friedlander, J., dissenting in part; citations omitted).

§ 96 May and may not

a. The term *may* is permissive; if the AGREEMENT states that a party may take (or omit) an action, it means that the party has the right, but not the

obligation, to take (or omit) the action, in its sole discretion, unless the AGREEMENT clearly states otherwise.

b. If the AGREEMENT states that a party may not take an action, it means that the party is prohibited from taking the action.

COMMENTARY

This clause is intended to preclude a party from arguing that another party that "may" do X must exercise good faith, or be reasonable, or anything like that. See generally Ken Adams, "May" Can Mean "Might," But I Sleep Well at Night Anyway (AdamsDrafting.com Aug. 10, 2014).

§ 97 Merchant (commentary)

As used in U.S. commercial law, the term *merchant* generally includes not only regular sellers of particular types of goods, but also buyers who regularly acquire such goods. The Uniform Commercial Code states as follows in UCC § 2-104(1):

> "Merchant" means a person[:]
>
> • who *deals in* goods of the kind
>
> • or otherwise by his occupation *holds himself out as having knowledge or skill* peculiar to the practices or goods involved in the transaction
>
> • or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(Emphasis, extra paragraphing, and bullets added.) Legendary federal judge Richard Posner explained:

> Although in ordinary language a manufacturer is not a merchant, "between merchants" is a term of art in the Uniform Commercial Code. It means between commercially sophisticated parties (see UCC § 2-104(1); White & Summers, Handbook of the Law Under the Uniform Commercial Code 345 (2d ed. 1980)) ....

Wisconsin Knife Works v. Nat'l Metal Crafters, 781 F.2d 1280, 1284 (7th Cir. 1986) (Posner, J.). To similar effect is the commentary to the UCC's definition of that term in section 2-104, apparently reproduced in Nebraska Uniform Commercial Code § 2-104; see also, e.g.:

- Brooks Peanut Co. v. Great Southern Peanut, LLC, 746 S.E.2d 272, 277 n.4 (Ga. App. 2013) (citing another case that cited cases)
- Sacramento Regional Transit v. Grumman Flxible *[sic]*, 158 Cal. App.3d 289, 294-95, 204 Cal. Rptr. 736 (1984) (affirming demurrer), in which the court held that a city's transit district, which had bought buses from a manufacturer, was a merchant within the meaning of § 2-104
- Douglas K. Newell, The Merchant of Article 2, 7 VAL. U. L. REV. 307, 317, part III (1973).

§ 98 Midnight Definition

References to midnight on a stated day are to exactly midnight at the end of that day.

COMMENTARY

This definition of *midnight* and *12 a.m.* is included because the terms are ambiguous — as pointed out by the (U.S.) National Institute of Standards and Technology:

> 12 a.m. and 12 p.m. are ambiguous and should not be used. … "a.m." and "p.m." are abbreviations for "ante meridiem" and "post meridiem," which mean "before noon" and "after noon," respectively. Since noon is neither before noon nor after noon, a designation of either a.m. or p.m. is incorrect. Also, midnight is both twelve hours before noon and twelve hours after noon.

National Institute of Standards, Times of Day FAQs (https://perma.cc/Z44M-EAMH). The NIST FAQ document points out that drafters could use 24-hour time, where 0000 refers to midnight at the beginning of the day and 2400 to midnight at the end of the day. *See id.*

§ 99 Month Definition

a. The term month refers to the Gregorian calendar.

b. A period of N months (where N is a number), beginning on a specified date, ends at exactly midnight (in the relevant time zone) at the end of the same day of the month N months later (or at the end of the last day of that later month, if earlier).

c. Hypothetical examples: A one-month period beginning on November 15 ends at exactly midnight at the end of December 15. A two-month period beginning on December 31, 2015 ends at exactly midnight at the end of February 29, 2016.

COMMENTARY

> This clause could be useful for the avoidance of doubt in contracts involving companies in Muslim countries, and possibly in Israel, where a lunar calendar might be used. See generally the blog post and comments at Ken Adams's post, Referring to the Gregorian calendar? (Nov. 14, 2013), especially the comments of Mark Anderson, Francis Davey, Richard Schafer, and Benjamin Whetsell.

§ 100 Need Not Definition

a. A statement in the AGREEMENT that a party need not take a particular action means that the agreement does not obligate the party to take that action.

b. If for any reason or no reason the party does not take the action in question, then unless the AGREEMENT clearly states otherwise, the party:

1. is to be conclusively deemed to have complied with any applicable standard of good faith, fair dealing, or reasonableness; and
2. will not be liable for not taking the action under any legal- or equitable theory arising from or relating to the agreement, and no party is to assert the contrary.

COMMENTARY

This is a roadblock clause to try to forestall claims that a party failed to comply with some implied obligation of good faith and fair dealing.

Subdivision b.1 borrows from UCC 1-302(b) (which applies only to contracts that come within the scope of the UCC), which reads as follows: "The parties, by agreement, may determine the standards by which the performance of those obligations *[of good faith, etc.]* is to be measured if those standards are not manifestly unreasonable."

§ 101 Notices Protocol

§ 101.1 When would this Protocol apply?

This Protocol governs any communication — each, a "**Notice**" — that can reasonably be interpreted as intended to have some significant effect under the AGREEMENT, such as (without limitation, and where applicable) any communication that:

1. formally invokes a right or obligation under the AGREEMENT or otherwise;
2. advises a party that the party has allegedly breached the AGREEMENT;
3. advises a party that the advising party is terminating the AGREEMENT or some aspect of the parties' business relationship or engagement.

COMMENTARY

The "significant effect" language seeks to avoid the possible confusion that might arise if a party were to claim that *all* communications must comply with the formalities required for significant notices.

The Seventh Circuit was forced to confront such an argument in a case where the contract in suit said, "*Any* notice or communication required or permitted hereunder … shall be in writing and shall be sent by registered mail, return receipt requested, postage prepaid." (Emphasis added.) The court ruled that "[t]o require the companies to send *every* communication via registered mail is commercially unreasonable, *if not absurd* in the

twenty-first century." Kreg Therapeutics, Inc. v. VitalGo, Inc., 919 F.3d 405, 414 (7th Cir. 2019) (affirming summary judgment in favor of Kreg) (cleaned up; emphasis added).

§ 101.2 Are *oral* Notices to be given effect?

No — each Notice must be given in writing.

COMMENTARY

Contracts typically contain notices-in-writing provisions to try to avoid "he said, she said" disputes over whether notice was or was not given.

§ 101.3 What addresses may be used for Notices?

Notices may be addressed to the address or addresses for notice stated in the AGREEMENT, if any.

COMMENTARY

Many notices clauses specify *mandatory* addresses for notice, but such provisions are often cumbersome (for example, requiring formal notice of a change of address for notice). Given that notices are effective only upon receipt or refusal (see below), the permissive approach of this clause likely will be easier for the parties to manage.

§ 101.4 How may a change of address for Notices be communicated?

☑ A party may change its address for Notices by communicating the new address in any reasonable written manner.

❑ A party desiring to change its address for Notice must do so by giving Notice of the address change.

COMMENTARY

The prechecked choice doesn't require formal notice of a change of address; some contracts' notice provisions do include such a requirement.

§ 101.5 A Notice to an organization requires an "Attention" line

To reduce the chances of Notices going astray, any Notice to an organization must be addressed to the attention of a specific individual or position of responsibility in the organization.

COMMENTARY

This section puts the burden on a party giving notice to be sure that the notice gets into the hands of a responsible individual at the organization that is being notified.

§ 101.6 What if the address for Notice says, "with a copy to ...."?

A copy of any Notice must be sent to, or to the attention of, any particular individual or position so designated in a party's address for notice, if any — for example, "With a copy to the attention of the Legal Department" — in a manner prescribed or permitted by this Article.

§ 101.7 When is a Notice considered effective?

Each Notice is considered effective — regardless what address was used — if and when the Notice is (i) actually communicated to, or (ii) actually refused by:

1. the addressee, if an individual; or
2. someone who is the addressee's agent for purposes of receiving communications of the general type sent (for example, a mailroom clerk).

COMMENTARY

If a notice was actually received, a court is likely to consider the notice to have been effective, even if the contractual notice requirements were not strictly followed. (It might be a different matter, though if the notice is of breach of a lease that results in termination of the lease and thus in forfeiture of the leasehold interest.

See, e.g., Rose, LLC v. Treasure Island, LLC, No. 71941-CO, slip op. at 5-7 (Nev. App. June 6, 2009) (citing cases).

In business-to-business contracts, the better practice is not to provide that notices are automatically effective a certain number of days after being mailed.

In 2014 the U.S. Court of Appeals for the Third Circuit said, in the context of whether an employee had been denied her rights under the Family Medical Leave Act ("FMLA"): "In this age of computerized communications and handheld devices, it is certainly not expecting too much to require businesses that wish to avoid a material dispute about the receipt of a letter to use some form of mailing that includes **verifiable receipt** when mailing something as important as a legally mandated notice. **The negligible cost and inconvenience of doing so is dwarfed** by the practical consequences and *potential unfairness of simply relying on business practices in the sender's mailroom*." Lupyan v. Corinthian Colleges, Inc., 761 F.3d 314, 322 (3d Cir. 2014) (emphasis added). The appeals court reversed and remanded a summary judgment in favor of the employer; the appellate court held that a genuine issue of material fact existed as to whether the employee had in fact received notice from the employer about her rights under the FMLA.

Author's note: The Third Circuit's *Lupyan* opinion, quoted above, shows how, when it comes to whether a notice has in fact been received, "that's a conversation I don't want to have" (to borrow from one of my former students).

On the other hand, if a company might need to send out notices in bulk (e.g., in consumer contracts), a drafter should consider adopting language allowing such notices (§ 101.11).

§ 101.8 What if a Notice is undeliverable?

An undeliverable Notice is considered effective after reasonable efforts to deliver the Notice to the addressee at any reasonable address.

§ 101.9 Copies of some Notices should be sent to *counsel* — why?

If a Notice relates to a possible dispute, then the notifying party is strongly encouraged (but not required) to provide a copy of the Notice to the

notified party's legal counsel (if known), using any reasonable means to do so.

COMMENTARY

The intent here is to get lawyers involved in a potential dispute sooner rather than later, in the hope of keeping a dispute from arising or at least resolving it amicably.

§ 101.10 May Notices be sent by email or FAX?

a. Any Notice may be sent by email or FAX, but it will not be effective unless one or more of the following is true:

1. the party being notified has expressly designated the specific address, in writing, as one to which such notices may be sent; or
2. the Notice is expressly or implicitly acknowledged in writing by the actual human to whose attention the Notice was addressed (as opposed to by an autoresponder); or
3. the Notice is otherwise shown to have been actually received or -refused by a human agent of the party to whom the notice was addressed.

b. In case of doubt, the inclusion of an individual's FAX number or email address in contact information for that individual or for a party does not in itself satisfy the express-designation provision of subdivision a.1.

COMMENTARY

Some contracts make the categorical statement that notices by email (and/or FAX) are ineffective. That seems too extreme. This provision offers a compromise that should accommodate all concerned.

Subdivision a.1: If a party designates a FAX number or email address for notice, then it should be on that party to be sure someone regularly checks that FAX number or email address. PRO TIP: A party that does agree to receive notice by FAX or email might want to set up a special "notice" FAX number or email address that automatically forwards to a specific individual — or, preferably, more than one such individual — or to whoever is designated as having a specific role in the company.

Subdivision a.2: CAUTION: Absent agreement otherwise, a notice received by email might well be effective even if no human agent of the recipient ever saw the notice. This could occur, for example, under § 15(e) of the Uniform Electronic Transactions Act.

Subdivision a.3 addresses (for example) the situation in which a notice email is sent to an individual's email address*, but that individual doesn't read the email* because (let's say) she is ill, or is on leave, or — perhaps seeing the subject line of the email — simply chooses not to read it. When that situation arises, it might be days, if ever, before anyone sees the notice email. Making things worse: While a notice delivered to an absent person in hard copy would likely be noticed by others in the company who saw the hard copy, the same might well not be true for a notice delivered by email. ¶ Much the same thing might be true for FAX numbers: There is no way to know whether a human has actually read a particular incoming FAX.

§ 101.11 ❑ Notices by Regular Mail Option

A properly addressed Notice is rebuttably presumed to have been received three business days after being deposited in the official mail of the jurisdiction where the Notice is sent, either:

1. with first-class postage affixed; or
2. in compliance with applicable bulk-mail regulations.

COMMENTARY

Notices by regular mail can benefit from a so-called mailbox rule that applies in many jurisdictions: "When a letter, properly addressed and postage prepaid, is mailed, there exists a presumption the notice was duly received by the addressee. This presumption may be rebutted by proof of non-receipt. In the absence of proof to the contrary, the presumption has the force of a rule of law." Stuart v. U.S. Nat'l Bank Ass'n, No. 05-14-00652-CV, slip op. at 4 (Tex. App.—Dallas Oct. 28, 2015) (affirming foreclosure on home) (cleaned up). ¶ The presumption might be statutory; see, e.g., Mont. Code. Ann. 26-1-602, *explained in* Kenyon-Noble Lumber Co. v. Dependant *[sic]* Foundations, Inc., 2018 MT 308, 393 Mont. 518, 432 P.3d 133, 138 (Mont. 2018) (affirming judgment based on failure to rebut presumption).

Drafters might want to adjust the time at which notice by mail becomes effective, so as to match the expected postal delivery time.

The first class-mail option for notice does not require *certified*- or *registered* mail, because mailed notices are most likely to be used in mass-mailing situations, in which case certified- or registered-mail would likely be burdensome.

Some consumer-facing companies (e.g., utilities) are likely to want to use less-expensive bulk mail to send out notices by mass mailing.

§ 102 Order-Processing Protocol

§ 102.1 How does this Protocol fit into the AGREEMENT?

a. When adopted in the AGREEMENT, this Protocol sets out plans for parties (referred to as "**Customer**" and "**Supplier**" respectively) to conduct specific transactions such as, for example, a sale of tangible- or nontangible goods or equipment or other deliverables, or the performance of services. Each such transaction agreement is referred to as an "**Order**."

b. Depending on the AGREEMENT, the "Customer" (i) might not be an end-customer, but instead might be a reseller, a distributor, etc., and (ii) might not itself be a party to the AGREEMENT.

§ 102.2 Order Submission

§ 102.2.1 What information must Customer include in an Order?

☑ Supplier may decide from time to time what information must be included in an Order.

❑ Orders are to include the following specific information: *[SPECIFY]*.

COMMENTARY

The default pre-checked option will usually be a workable approach, because as a practical matter, Supplier usually won't be too onerous about demanding information in an Order — in turn because Customer will (usually) have the choice whether to place the Order or not.

Here's a real-world example: Section 2 of the Honeywell Terms of Sale calls for orders to specify "(1) Purchase Order number; (2) Honeywell's

part number; (3) requested delivery dates; (4) price; (5) quantity; (6) location to which the Product is to be shipped; and (7) location to which invoices will be sent for payment."

§ 102.2.2 How are Orders to be submitted to Supplier?

☑ Supplier may decide, from time to time, how orders are to be submitted, for example via hard copy, Web-based system, etc.

❑ Orders are to be submitted as follows: *[DESCRIBE]*.

COMMENTARY

Again, Supplier is not likely to be unreasonable about making Customer jump through hoops in placing Orders.

§ 102.2.3 Are Orders considered to be (i) new agreements, or (ii) additions to the AGREEMENT?

☑ Each Order is to be considered a separate, standalone agreement that incorporates the AGREEMENT — including but not limited to this Protocol — by reference (whether or not the incorporation is explicit) unless the Order clearly says otherwise.

❑ Each Order is to be considered an addition to this Agreement and not as a separate agreement.

COMMENTARY

Language along the lines of the unchecked version above is seen in some contracts where "netting out" of multiple transactions is desired, such as, e.g., the ISDA Master Agreement cited in § 162.1.

For standalone commercial transactions, the unchecked version would be unwise to use, in the author's view, because:

- a default in one order could affect other orders — this is sometimes referred to as "cross-default" and should be provided for expressly if desired; and
- if Supplier's liability for damages were to be capped at "the amounts paid or payable under the parties' agreement," then that amount would grow over time as more statements of work were completed; Customer might like that just fine, but Supplier likely wouldn't be wild about it.

§ 102.2.4 May Supplier decline an Order?

☑ Supplier may decline any proposed Order; for this purpose, "decline" has the same meaning as "reject."

❑ Supplier is deemed to have accepted an Order, and to have waived its right to decline or otherwise reject the Order, if Supplier has not declined the Order in writing within five business days after Supplier receives the Order.

❑ IF: Customer has failed to pay amounts due to Supplier when due; THEN: Supplier may decline subsequent proposed Orders by Customer until all such past-due amounts have been paid.

❑ Supplier will not unreasonably decline an Order.

COMMENTARY

This section uses the term "decline" because it has somewhat of a less-confrontational tone than "reject."

In some master agreements, Customer might want Supplier to contractually commit to accepting any orders that Customer submits, at least within certain defined parameters.

§ 102.2.5 Is there a minimum size for Orders?

☑ No.

❑ Supplier may decline an Order for goods or other deliverables if the ordered quantity of any single stock-keeping unit (SKU) is less than *[QUANTITY]*.

❑ Supplier may decline an Order where the aggregate Order price is less than *[AMOUNT]*, exclusive of taxes, shipping, and insurance.

COMMENTARY

Suppliers are often concerned with economies of scale, especially for goods that are manufactured to order, and so they might want to establish a minimum order quantity (MOQ). See generally, e.g., Justin Reaume, 6 Procurement Actions that Can Boost Your Business (SCMR.com 2010), archived at https://perma.cc/56CD-MYEG.

§ 102.3 May Supplier revoke its acceptance of an Order?

☑ IF: Customer has failed to pay amounts due to Supplier when due; THEN: Supplier may revoke Supplier's acceptance of Customer's Orders that Supplier previously accepted but has not yet filled.

❑ Supplier may not revoke its acceptance of an Order.

❑ Supplier may revoke its acceptance of an Order only under the following circumstances: *[DESCRIBE]*.

§ 102.4 ❑ May Customer cancel an Order?

Consider the following alternatives:

❑ Customer may cancel an Order for goods that are not to be specially manufactured for the Order — but only before Supplier has shipped the goods — by sending a written cancellation advice to Supplier.

❑ Customer may not cancel an Order for goods that are to be specially manufactured for the Order.

❑ Customer may not cancel an Order for services.

❑ Customer may not cancel an Order for goods once the Order has been accepted by Supplier.

❑ An Order for goods or other deliverables will not be deemed canceled unless Supplier receives a written cancellation request, signed by an authorized representative of Customer, no later than *[SPECIFY DEADLINE]*.

❑ IF: Customer cancels an Order for goods or other deliverables; THEN: Supplier may invoice Customer for, and Customer will pay, a cancellation fee of *[SPECIFY AMOUNT]*.

COMMENTARY

> CAUTION: Some of the alternatives set forth above might be mutually exclusive.

§ 102.5 ❑ Prepayment of Orders may be required

Supplier reserves the right, in its sole discretion, to require Customer to pay in full, in advance for an Order; this will be true even if the parties' agreement otherwise provides for Supplier to perform first and be paid later.

§ 102.6 A Supplier quotation is an offer

a. A quotation from Supplier for a proposed sale or other transaction constitutes Supplier's offer to conduct the transaction on the terms specified in the quotation (including but not limited to any terms incorporated by reference).

b. If Customer accepts Supplier's quotation — including but not limited to by sending a purchase order — then the quotation becomes an Order.

c. See also **Error! Reference source not found.** (effect of additional t erms).

§ 102.7 A Supplier quotation may specify an expiration date

If a Supplier quotation specifies an expiration date, then the quotation will expire if Supplier has not received Customer's acceptance on or before the close of business at Supplier's relevant location on the specified date.

§ 102.8 Supplier may modify or withdraw a quotation (before acceptance)

Unless a Supplier quotation expressly states otherwise, Supplier may withdraw and/or modify the quotation at any time until Supplier has received Customer's timely acceptance (if any) or the quotation expires, whichever occurs first.

§ 102.9 Catalogs and price lists are not "offers"

Supplier's catalog or price list for goods or other deliverables; services; or other items does not constitute Supplier's offer to sell or otherwise deal in any particular quantity of the items at any particular time or place.

COMMENTARY

The idea for this option comes from section 1 of a Honeywell terms-of-sale document archived at https://perma.cc/5MB9-H6VK.

§ 102.10 Order modification

§ 102.10.1 May an Order be changed orally?

☑ Changes to Orders ("**change orders**") may be agreed to orally, *but* any assertion to that effect must be supported by (i) clear and convincing evidence, with (ii) reasonable corroboration of any testimony by interested witnesses.

❑ Any change to an Order must be in writing; no party will assert that an Order was modified in any other way.

COMMENTARY

Why allow oral modifications to an Order? Because that's how it often happens in the real world: Parties agree orally to modify an Order but then forget to follow up with a written confirmation. That can be a danger: If things didn't work out, then the parties might end up arguing about whether or not the Order had indeed been modified. (EXAMPLE: A customer asks a service provider to modify a work request and agrees to pay more, but then later challenges the provider's invoice for the increased amount.) This Protocol therefore sets out general terms to give the parties flexibility in modifying an Order while still providing some safety in case of later disputes.

Concerning the reasonable-corroboration requirement, see § 35. For any given situation, "reasonable corroboration" might include — as a hypothetical example — a contemporaneous entry in a written journal or log, made in the ordinary course of business.

CAUTION: In some jurisdictions, courts might not enforce a writing requirement like the above alternative; see § 5.2 and its annotations.

§ 102.10.2 Which party must agree to a change order?

☑ A change order must be agreed to by both parties.

❑ A change order must be agreed to by the party against which the change order is sought to be enforced.

COMMENTARY

In the author's view, the parties are better off if change orders must be agreed to by both parties, so as to encourage the parties to talk to each other.

The alternative borrows from the approach of the (U.S.) Uniform Commercial Code, which states in UCC § 2-201 that (with certain exceptions) a contract for the sale of goods for the price of $500 or more is not enforceable "unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and *signed by the party against whom enforcement is sought* or by his authorized agent or broker." (Emphasis added.)

§ 102.10.3 What level of management must approve change orders?

☑ A change order may be agreed to on behalf of a party by any person having actual- or apparent authority.

❑ A change order may be agreed to on behalf of a party by an officer of the party at the vice-president level or higher.

COMMENTARY

Concerning what qualifies as "apparent authority," see the discussion at § 7.

In the author's view, it's better to require *all* parties to sign change orders, to keep the parties talking and thus help reduce the chances of later disputes.

§ 102.11 Affiliate orders

§ 102.11.1 May Customer's affiliates submit Orders?

One or more affiliates (defined in § 27) of Customer may submit one or more proposed Orders for transactions with Supplier; if accepted by Supplier, each such Order will be governed by the AGREEMENT in the same manner as if Customer itself had submitted the Order.

COMMENTARY

> A customer will sometimes want its "affiliated" companies to be allowed to take advantage of the contract terms that the customer negotiates with a supplier. See the additional discussion in § 4.3.

§ 102.11.2 May Supplier decline a proposed Order from a Customer affiliate?

Each proposed Order from a Customer affiliate under the AGREEMENT must be specifically agreed to by Supplier, in Supplier's sole discretion.

COMMENTARY

> Supplier might want to decline an order from a Customer affiliate if Supplier doesn't have a basis for believing that the affiliate is sufficiently creditworthy.

§ 102.11.3 What responsibility does Customer bear for its affiliates' Orders?

☑ Customer is not responsible for its affiliates' obligations under Orders entered into with Supplier under the AGREEMENT.

❑ IF: A Customer affiliate enters into an Order with Supplier under the parties' agreement for a transaction; THEN: Customer is jointly and severally responsible, together with its affiliate, for the affiliate's obligations under that Order.

COMMENTARY TO ALTERNATIVE

Supplier might want Customer to guarantee orders from Customer's affiliates, because any given affiliate might not (in Supplier's view) be sufficiently creditworthy.

§ 103 Organization Definition

a. The term *organization* refers to the following: • a corporation; • a business trust; • estate; • a trust; • a general- or limited partnership; • a limited liability company; • an association; • a joint venture; • a joint stock company; • a government; • a governmental subdivision, agency, or instrumentality; • a public corporation; and • any other legal or commercial entity.

b. *Entity* (the last word in § 103a) refers to an organization that has a legal identity apart from its members or owners.

COMMENTARY

Subdivision a: This "laundry list" in this definition is adapted from UCC §1-201(25) and 1-201(27) and from the definition of *person* in U.S. securities laws, at 15 U.S.C. § 77b(a)(2).

Subdivision b is derived from *Entity*, BLACK'S LAW DICTIONARY (10th ed. 2014), *quoted in* Ineos USA LLC v. Elmgren, 505 S.W.3d 555, 563 (Tex. 2016).

§ 104 Other Necessary Actions Commitment

Each party will execute any documents, and take any further actions, as may be reasonably requested by the other party or necessary to carry out the intent and purpose of the Agreement.

COMMENTARY

Provisions like this are sometimes seen in agreements where unanticipated glitches might arise, such as merger- and acquisition agreements.

§ 105 Past Dealings Disclaimer

The parties do not intend, and neither party is to assert, that the parties' past dealings will have the effect of modifying or supplementing the AGREEMENT.

COMMENTARY

See the comment just above.

§ 106 Pay if Paid / When Paid Protocol

§ 106.1 When does this Protocol apply?

This section applies if, under the AGREEMENT, a party is obliged to make a particular payment (the "**Contingent Payment**"), AND the AGREEMENT clearly states that:

1. the payment obligation is contingent on the paying party's receipt of one or more third-party payments; and
2. the payment-obligation contingency is either "pay if paid" or "pay when paid" (or comparable wording in either case).

COMMENTARY

Suppose that a contractor enters into a contract with a homeowner, under which the contractor will remodel the homeowner's kitchen. The contractor enters into a subcontract with a painter, under which the painter will do the necessary painting in the kitchen. In this example, *pay if paid* means that the contractor is not required to pay the painter unless the homeowner pays the contractor.

§ 106.2 When — if ever — will the Contingent Payment be due?

a. The paying party is not required to make the Contingent Payment until all specified third-party payments have been unconditionally made to, and accepted by, the paying party.

b. Once that has occurred, the paying party must promptly make the Contingent Payment.

§ 106.3 OK — but how hard must the paying party work to collect the third-party payments?

That depends on whether the Contingent Payment obligation is pay-if-paid or pay-when-paid, as follows:

a. For a pay-if-paid obligation, the paying party is not required to make any particular efforts to collect any third-party payment; if the paying party does make such efforts, it does so in its sole discretion and solely for its own benefit.

b. For a pay-when-paid obligation, the paying party must make commercially reasonable efforts to collect all relevant third-party payments.

COMMENTARY

A pay-*if*-paid clause makes the end-customer's payment a condition precedent to the subcontractor's right to payment; in other words, if the end-customer doesn't pay the prime contractor, then the subcontractor isn't entitled to payment even from the prime contractor's performance bond. *See* BMD Contractors, Inc. v. Fid. & Dep. Co., 679 F.3d 643 (7th Cir. 2012) (applying Indiana law; affirming summary judgment in favor of surety). This essentially puts the risk of non-payment on the subcontractor — and as a result, in in some jurisdictions the clause **might be void as against public policy**. For example, in **New York**, pay-*if*-paid clauses are void, but pay-when-paid are enforceable, according to that state's highest court. *See* West-Fair Elect. Contractors v. Aetna Cas. & Surety Co., 87 N.Y.2d 148, 158, 661 N.E.2d 967 638 N.Y.S.2d 394 (1995) (on certification from Second Circuit). • In contrast, the **Ohio** supreme court upheld a pay-*if*-paid clause in Transtar Electric, Inc. v. A.E.M. Electric Serv. Corp., 2014 Ohio 3095; the court affirmed a summary judgment that the contract's "condition precedent" payment language was sufficient to transfer the risk of nonpayment by a customer from the prime contractor to its subcontractor. The decision was criticized for not addressing public-policy considerations; *see* Scott Wolfe, Jr., Ohio Supreme Court Gets Pay If Paid Decision Wrong, Hurts Subcontractors (ZLien.com 2014). • In **New Jersey**, the courts are split about pay-if-paid clauses, according to Michelle Fiorito, The Consequences of "Pay-If-Paid" and "Pay-When-

Paid" Construction Contracts Clauses (ZDLaw.com 2012). • Still another court — in passing, and arguably in a dictum — seems to have implicitly treated a pay-if-paid clause as a pay-*when*-paid provision. Allstate Interiors & Exteriors, Inc., v. Stonestreet Constr., LLC, 730 F.3d 67, 70 (1st Cir. 2013) (affirming judgment below).

In some jurisdictions, a pay-*when*-paid clause implicitly means *within a reasonable time*; for example, if an end-customer does not pay a prime contractor within a reasonable time, then the prime contractor — or more likely, the insurance carrier that wrote the prime contractor's payment bond — must pay the subcontractor anyway.

§ 106.4 Has the payee really thought this through?

The party to which the Contingent Payment is owed (the "payee") represents and warrants that, in entering into the AGREEMENT, the payee:

1. has taken into account the likelihood that the relevant third party or -parties will pay the paying party;
2. is relying on the credit and the willingness and ability to pay of those third parties, and not on that of the paying party, for the Contingent Payment; and
3. KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY **ASSUMES AND ACCEPTS THE RISK** that one or more third parties might be unable or unwilling to perform the terms of its contract with the paying party, in which case the Contingent Payment would not be paid (or would not be paid in full).

§ 107 Payment- and performance bonds (commentary)

§ 107.1 Payment bonds

Payment bonds are in essence a type of insurance policy. They are often required by contracts such as, e.g., construction contracts.

The prime contractor is likely to have to buy materials from suppliers, and it also might engage subcontractors. Those costs are normally built into the prime contractor's bid price.

The customer, however, doesn't want to pay the prime contractor up front for materials and subcontractors, but then have the prime contractor go out of business or file for bankruptcy protection, stiffing one or more suppliers and/or subcontractors. Those companies might have a legal right to sue *the customer* for payment. A stiffed supplier or subcontractor might also have the statutory right to put liens [LINK] on the customer's relevant property or properties. Such liens could well impede the customer's ability to get financing; the existence of liens could also constitute a breach of covenants in the customer's financing agreement(s) with lender(s).

To avoid these hassles, customers often insist on a requirement, in the prime contract, that the prime contractor must buy a payment bond. (The cost of the payment-bond premium will of course be factored into the prime contractor's bid price.)

Government contracts often require payment bonds. Think about why that is the case: A government contract will often be for a local construction project, with local suppliers and subcontractors — and those people vote and make political contributions.

§ 107.2 Performance bonds

The Seventh Circuit succinctly explained the rudiments of how performance- and payment bonds work:

> Aptly named, • a *performance* bond on a construction project is a surety's *[i.e., an insurance company's]* guarantee that the principal's work will be completed. • A *payment* bond guarantees the principal will pay its laborers, subcontractors, and suppliers.

Fidelity & Dep. Co. of Md. v. Edward E. Gillen Co., 926 F.3d 318, 321 n.1 (7th Cir. 2019) (citations omitted; emphasis and bullets added). An insurance carrier that issues a performance- or payment bond will pay out if the insured contractor fails to perform or to pay its subcontractors — but if the carrier does have to pay out, then it will almost certainly go after the contractor to recoup its payments. As summarized by the *Fidelity* court:

> To secure its work, the joint venture obtained over $30 million in performance and payment bonds issued by Fidelity and Deposit Company of Maryland ("Fidelity").
>
> Fidelity received in return *(in addition to its premium)* an indemnity agreement and a net worth retention agreement, both executed by Gillen.
>
> The indemnity agreement obligated Gillen to "exonerate, *indemnify, and keep indemnified" Fidelity for all losses and expenses incurred on the bonds*. In the net worth retention agreement, Gillen promised to maintain a net worth greater than $7.5 million.
>
> During 2012, over a dozen subcontractors sued Gillen in Illinois state court, alleging Gillen failed to pay for labor and materials used on the harbor project. Those plaintiffs named Fidelity as a co-defendant based on its payment bond obligations. … *Fidelity then sued Gillen in federal court,* alleging five claims: breach of the indemnity agreement ….

Id., 926 F.3d at 321 (paragraphing edited, emphasis added).

§ 108 Payment Terms Protocol

See also Invoicing Requirements.

§ 108.1 When is payment due for an invoice?

☑ Invoice payments are due net 30 days from ☑ the date that the paying party receives a correctly stated invoice ❑ the date of the invoice.

❑ Invoice payments are due 2% 10 days, net 30 days.

COMMENTARY

"Net X days" means that payment in full is to be received by the payee no later than X days after the stated date.

A *payee* might prefer that the payment due date be determined by the date of an invoice. The *paying party*, however, will generally want the clock to start at its receipt of the invoice, because the party sending the invoice (the

payee) might have inadvertently delayed sending out the invoice (or might even have backdated the invoice).

The alternative "2% 10 days, net 30 days" language means that the paying party may deduct 2% as a discount for payment in full within 10 days, but payment in full is due in any case within 30 days.

The Wikipedia article on net days explains:

> Net 30 is a term that most business and municipalities (federal, state, and local) use in the United States.
>
> Net 10 and net 15 are widely used as well, especially for contractors and service-oriented business (as opposed to those that deal with tangible goods).
>
> Net 60 is not used as frequently due to its longer payment term.
>
> * * *
>
> In certain markets such as the United Kingdom, a construction such as "net 30, end of the month" indicates that payment in full is expected by the end of the month following the month of the invoice. This is not universally followed.

Net D (Wikipedia.com) (extra paragraphing added).

§ 108.2 What payment method(s) may be used?

☑ Payments may be made by any payment method to which the payee does not reasonably object.

❑ Payments are to be made using the following means: *[DESCRIBE]*.

COMMENTARY

The prechecked version above is a commonly used formulation. Specific acceptable payment methods might include, for example:

1. A check — see generally Investopedia at https://goo.gl/19C7Rv — possibly required to be drawn on a U.S. bank, or on a specified bank, or on any bank to which the payee does not reasonably object in writing. When an ordinary check is written. The money stays in the payer's account until the check is "presented" to the payer's bank for payment.

(These days this is almost always done electronically if the payee uses a different bank.) CAUTION: *If the payer files for U.S. bankruptcy protection before the check clears, then the check might* never *clear*; see the bankruptcy discussion in section [TODO].

2. An automated clearing house ("ACH") electronic debit transaction in lieu of a check — see generally Investopedia at https://goo.gl/1P9EQa;

3. A *certified* check — see Investopedia at https://goo.gl/aVLbsE: This is a check (see above) written by the payer and drawn on the payer's account. The bank guarantees to the payee that the bank has put a hold on the payer's account for the amount of the check, meaning that the check should not bounce. *The money stays in the payer's account until the check clears;* this means that the same bankruptcy issues exist as for regular checks. CAUTION: Certified checks can be counterfeited, in which case the bank might not have to pay, and if the payee cashes the check, the payee might have to refund the money.

4. A *cashier's* check — see Investopedia at https://goo.gl/EZ7Vec: This is a check (see above) written by the bank itself, not by the payer. When writing the check, the bank *transfers* the stated amount of money from the payer's account to the bank's own account. (Note the difference between this and a *certified* check, discussed above.) The parties' agreement might specify what bank, or what type of bank, is to be used. CAUTION: Cashier's checks can be counterfeited.

5. A "wire transfer" (Investopedia at https://goo.gl/t6kisl) to give the payee "immediately-available funds" that can be immediately withdrawn and spent (Investopedia at https://goo.gl/51Ai5A).

§ 108.3 What will happen if a paying party disputes an invoice?

This section applies if the paying party disputes an invoice.

a. The paying party must:

   1. notify the payee in writing that it is disputing the invoice;

   2. in the notice, specify in reasonable detail the basis of the dispute; and

   3. provide reasonable written documentation to support the paying party's reason for the dispute.

b. The payee will promptly issue a (refundable) credit to correct any portion of the invoice that the parties agree are in error.

c. The due date for undisputed portions will remain the same.

§ 108.4 May a paying party apply offsets against amounts due?

☑ Yes, as follows:

a. A paying party may, in its sole discretion, offset against amounts it allegedly owes to another party, any amount that the other party owes to it.

b. The paying party must timely:

1. advise the payee in writing that the paying party is applying an offset; and

2. provide the payee with reasonable documentation to support the claimed offset.

❑ No: A paying party may not offset against amounts it allegedly owes to another party, any amount that the other party owes to it.

COMMENTARY

> Apparently in some jurisdictions (e.g. France), an automatic right of offset might not be enforceable, according to a LinkedIn commenter (see http://goo.gl/aWpjDv; membership required).

§ 108.5 Does payment of an invoice waive the paying party's rights?

No:

a. A payment under this Agreement will not waive (nor otherwise affect) any rights the paying party might have, under the AGREEMENT or the law, concerning the subject matter of the invoice.

b. Such rights might include, without limitation, warranty rights concerning goods delivered and/or services performed.

§ 108.6 How are deposits and other advance payments to be handled?

Deposits and other advance payments, if any, are to be applied as stated in the AGREEMENT or as otherwise agreed in writing; any remaining balance is to be promptly refunded, without interest.

COMMENTARY

Drafters can consider stating instead that deposit balances will be refunded with interest at a specified rate. ¶ CAUTION: Be *very* careful about usury laws, discussed in the commentary to the Interest protocol.

§ 108.7 ❑ COD Terms Option

For the avoidance of doubt, in case of (i) multiple late payments, or (ii) one or more significant late payments, by a party, the other party may require cash-on-delivery (COD) terms for any subsequent transactions.

COMMENTARY

Applicable law might well implicitly permit a payee to demand COD terms after late payment if the late payment constituted a material breach of the AGREEMENT.

§ 108.8 ❑ Non-Payment Not Infringement Option

For the avoidance of doubt, IF: A party (**Customer**) does not timely pay another party (**Provider**) amounts required by the AGREEMENT for goods or services furnished by Provider; THEN: Provider's remedies (if any) will be for breach of contract and not for infringement of Provider's intellectual property rights.

COMMENTARY

A customer purchasing and using (or reselling) goods, or acquiring a license to use software, might be interested in this clause. Without such a clause, non-payment of the required fee might conceivably result in the customer's infringement of the provider's intellectual property rights, which in some circumstances could result in a significantly-higher damage award than simply having to pay the required fee.

Consider the case of Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc., 886 F.2d 1545 (9th Cir. 1989) (*Frank Music II*): • The MGM Grand Hotel had a floor show called *Hallelujah Hollywood!*, which included 'tributes' to various MGM movies. • The floor show incorporated significant portions of the musical *Kismet*, which had been made into an MGM movie. • The court found that this went beyond MGM's 'movie rights' and therefore infringed the copyright in the musical. • The resulting damage award included not just a portion of profits from the floor show itself, but 2% of the overall profits from the MGM Grand's hotel operations — *including 2% of the casino profits* — which, the court found, were indirectly attributable to the promotional value of the infringing floor show. This Option would avert such a result if a customer were to fail to pay a provider.

Cf. also the *Cincom* case, in which a software customer found itself having to pay copyright-infringement damages to the software vendor, in an amount equal to the licensee fee that the customer had already paid, because the customer switched the use of the software to an unauthorized affiliate. Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009) (affirming summary judgment in favor of software vendor).

§ 109 Payment Security Protocol

See also the Guaranty Rider.

§ 109.1.1 When would this Rider apply?

This Rider will apply if the AGREEMENT calls for a party (referred to as "**Customer**") to establish security for Customer's payments to another party ("**Supplier**").

COMMENTARY

This payment-security provision draws on ideas seen in § 2.2 of the General Electric PO, cited at § 162.1.

§ 109.1.2 When is Customer's deadline for establishing payment security?

No later than ten business days after agreeing to an order so specifying, Customer will establish — and will keep in force as set forth below — payment security that meets any and all requirements stated in this Protocol and the AGREEMENT.

§ 109.1.3 What form must payment security take?

The payment security must:

1. be in the form of an irrevocable, unconditional, sight letter of credit or bank guarantee, on terms reasonably acceptable to Supplier;
2. be issued (or confirmed) by a financial institution, reasonably acceptable to Supplier (referred to as the "**Bank**").

COMMENTARY

> "A sight letter of credit is a document that verifies the payment of goods or services, payable once it is presented along with the necessary documents. An organization offering a sight letter of credit commits itself to paying the agreed amount of funds provided the provisions of the letter of credit are met." Sight Letter of Credit (Investopedia.com)

§ 109.1.4 What types of payment must be supported by the payment security?

The form of payment security must allow for payments by the Bank to Supplier as follows:

1. pro-rata payments for goods as they are shipped and for services as they are performed, as applicable to the relevant order;
2. payment of any cancellation- or termination charges under the order; and
3. payment of any other amount due from Customer in connection with the order.

§ 109.1.5 How long must the payment security remain in effect?

The payment security must remain in effect for at least three months after the latest to occur of the following:

1. the last scheduled shipment of ordered goods, if any;
2. completion of all ordered services, if any; and
3. Supplier's receipt of the final payment required under the order.

§ 109.1.6 May Supplier require Customer to modify the payment security?

This section will apply if Supplier gives Customer notice that, in Supplier's judgment in view of the circumstances, the payment security should be modified by, for example:

1. increasing the amount of the payment security by a reasonable amount;
2. extending the term of the payment security by a reasonable time;
3. making any other modifications to the payment security that Supplier reasonably deems appropriate.

b. The circumstances referred to in subdivision a may include, without limitation, Customer's payment history and other facts bearing on Customer's ability to pay.

c. Supplier's notice under subdivision a is to include reasonable supporting detail.

d. Customer is to make the payment-security modifications requested by Supplier no later than ten days after Supplier gives Customer notice under subdivision a.

§ 109.1.7 Who is to pay for the payment security?

Customer will bear all costs and expenses associated with establishing and maintaining (all forms of) payment security.

§ 109.1.8 What if Customer does not timely obtain payment security?

Supplier need not begin its performance under an order (nor continue such performance, if already begun) until Supplier has received the fully effective payment security (and/or any required modified payment security); all Supplier performance deadlines will be extended accordingly

§ 109.1.9 Payment-security failure is a material breach

Any failure by Customer to timely provide, maintain, and/or update the required fully-effective payment security will be a material breach of the AGREEMENT in respect of the order (see § 143).

(END OF RIDER)

§ 109.2 ❑ Most-Favored Customer Option

12. Price: Most Favored Customer and Meet or Release Supplier warrants that the prices charged for the Goods delivered under this Purchase Order are the lowest prices charged by Supplier for similar Goods.

If Supplier charges a lower price for similar Goods, Supplier must notify Honeywell and apply that price to all Goods ordered under this Purchase Order.

If at any time before full performance of this Purchase Order Honeywell notifies Supplier in writing that Honeywell has received a written offer from another supplier for similar Goods at a price lower than the price set forth in this Purchase Order, Supplier must immediately meet the lower price for any undelivered Goods. If Supplier fails to meet the lower price Honeywell, at its option, may terminate the balance of the Purchase Order without liability.

As directed by Honeywell, Supplier will provide the Goods at the prices listed on the face of this Purchase Order, subject to these terms and conditions, to other Honeywell divisions and affiliates and any third-party Honeywell sub-supplier or designee.

Healey case: https://www.wsj.com/articles/SB849025283184778000

§ 110 Pricing-Change Restrictions

§ 110.1 ❑ Only generally applicable price increases will apply

During the term of the AGREEMENT, Supplier will not increase the prices charged to Customer except as part of — and by a percentage no greater than the percentage of — a price increase to Supplier's customers generally for the same products and/or services.

COMMENTARY

> This restriction on price increases substitutes "market discipline" for contract verbiage — it might well be sufficient for Customer to know that Supplier won't target Customer for price increases.

§ 110.2 ❑ Pricing is locked in

☑ During the term of the AGREEMENT, pricing for transactions under the AGREEMENT will be as stated in Schedule XXX.

❑ During the term of the parties' agreement, pricing for transactions under the parties' agreement will be as posted on Supplier's Web site at the effective date of the parties' agreement.

§ 110.3 ❑ Price increases are capped

During the term of the AGREEMENT, Supplier will not charge Customer more than: ❑ as stated in Schedule XXX. ❑ as posted on Supplier's Web site at the effective date of the parties' agreement.

§ 110.4 ❑ Price adjustments are not restricted

Supplier is not restricted in its ability to adjust its pricing from time to time in its sole discretion.

§ 110.5 ❑ Required advance notice of price changes: 30 days

During the term of the AGREEMENT, Supplier will give Customer at least the specified advance written notice of any pricing changes.

COMMENTARY

> A requirement for advance notice of price increases would give Customer the chance to "stock up" at the old price if it desired.

§ 110.6 ❑ Price-increase limits

During the term of the AGREEMENT, Supplier may increase its prices no more (and no more often) than once per year only, by not more than 0.01% (YOY) each time.

§ 110.7 ❑ Pass-through of Supplier's cost increases

a. During the term of the AGREEMENT, , IF: Supplier's relevant costs increase; THEN: Supplier may pass the increase on — without markup — to Customer.

b. If Customer so requests, Supplier will provide Customer with documentation showing the increase in Supplier's relevant costs.

§ 111 Personnel Compensation Protocol

This section applies except to the extent (if any) that the AGREEMENT manifestly provides otherwise.

a. Each party is responsible for all salary and employment benefits (if any) of its personnel.

b. Each party is responsible for paying any employment-related taxes and/or fees relating to that party's personnel.

c. Each party must defend and indemnify the other party and hold it harmless against any claim or determination that the other party is responsible for any payment under subdivision b and/or subdivision c.

d. The parties do not intend for the AGREEMENT to confer, on any party's personnel, any right or interest in the employment benefits (if any) provided by the other party to its employees.

§ 112 Price-fixing, etc. (commentary)

Sometimes it might seem tempting to agree with a competitor to divvy up customers, or to keep your prices at an agreed level, or to take turns submitting the winning bid in response to RFPs. Those activities, though, can lead to indictment and prosecution by federal- or state authorities for violation of the antitrust laws.

For example, in 2005, the German airline Lufthansa and the British airline Virgin Atlantic blew the whistle on a price-fixing scheme by a total of 21 non-U.S. airlines, including British Airways, Qantas, and Korean Air. The U.S. Department of Justice prosecuted, resulting in a total of some $1.7 billion in fines, and in four airline executives being sentenced to prison terms in the U.S. (NBCNews.com 2011: https://goo.gl/UQQTKH) (Justice.gov 2007: https://goo.gl/i75Knn).

Don't forget that prosecutors might reach for the low-hanging fruit — instead of trying to prove up an antitrust violation, they might bring charges of obstruction of justice (akin to prosecuting Al Capone for tax evasion, or Martha Stewart for making a false statement to the SEC). For example, in December 2010 a British executive, after being extradited to the U.S., was sentenced to 18 months in prison and a $25,000 fine — not for price fixing itself, but for conspiring to obstruct a price-fixing *investigation* (Justice.gov 2010: https://goo.gl/5ch725).

For more information about unlawful collusive practices, the Department of Justice has a useful antitrust primerthat explains many of the relevant concepts (Justice.gov: https://goo.gl/vMMb7m).

§ 113 Product Returns Protocol *[TO DO]*

§ 114 Prohibitions apply to attempts

The prohibitions and restrictions of the AGREEMENT extend, without limitation, to:

1. attempts to do a prohibited or restricted thing; and
2. inducing, soliciting, permitting, or knowingly assisting anyone else to do, a prohibited or restricted thing.

COMMENTARY

This provision can be useful in contracts — such as intellectual-property license agreements — that restrict a party's right to do something.

§ 115 Prompt Definition

The term prompt, along with corresponding terms such as promptly refer to taking specified action within a reasonable time and as a high priority, but not necessarily immediately nor as the highest priority.

COMMENTARY

This term is of course vague, but it can be useful in requiring reasonably-fast action — but not necessarily immediate action — when the parties don't necessarily know (or perhaps can't agree on) a specific time frame for the action.

§ 116 Protected Group Definition

a. The term "**Protected Group**," in respect of an individual or organization that is identified by name in the AGREEMENT as being the beneficiary of a defense and/or indemnity obligation (a "Protected Party"), refers to the following:

1. the Protected Party itself;
2. the Protected Party's affiliate;
3. any other individuals or organizations specified in the AGREEMENT; and
4. the employees, officers, directors, shareholders (in that capacity), general- and limited partners, members, managers, and other persons occupying comparable positions in respect of each

individual and organization within the scope of subdivisions 1 through 3, as applicable.

b. As a hypothetical illustration, the term "ABC Protected Group" would refer to the Protected Group of an individual or organization that is referred to as "ABC."

COMMENTARY

"Protected Group" is a convenience abbreviation that can be used to specify the scope of an indemnity obligation by defining which individuals and organizations that associated with an indemnified party are entitled to indemnity.

Some parties might want their Protected Groups also to include even their indirect customers, suppliers, etc. — but that could dramatically expand the risk for the indemnifying party.

§ 117 Reasonable Efforts Definition

a. The term *reasonable efforts* refers to one or more reasonable actions that together are reasonably likely to achieve the stated objective.

b. A requirement to make reasonable efforts does not necessarily require taking every conceivable reasonable action.

c. Any assessment of reasonable efforts should give due weight to the information reasonably available, to:

1. the relevant person(s) at the relevant time, about (for example) the likelihood of success and likely costs of specific action(s) and alternative(s);

2. the safety of individuals and property; and

3. where relevant, the public interest.

d. In complying with an obligation to use reasonable efforts, the obligated party may give due consideration to its own lawful interests, including but not limited to avoiding putting itself in a position of undue hardship or incurring unduly burdensome costs.

§ 117.2 Commentary

§ 117.2.1 Language choices

Subdivision b: Defining *reasonable efforts* in this way might be a good idea in case a court were to hold that the term requires making *all* reasonable efforts. (See also the definition of *best efforts*, above.)

Subdivision c.1: The "likelihood of success" and "likely cost" phrases are inspired by a comment by Janet T. Erskine, Best Efforts versus Reasonable Efforts: Canada and Australia (Nov. 30, 2007).

Subdivision d: The "undue hardship" language is adapted from the Janet Erskine comment cited above. The "incurring unduly-burdensome costs" is adapted from an email suggestion by Houston lawyer Stephen Paine. (More: 18.6.3.3.)

§ 117.2.2 "Reasonable efforts" is vague, but clients (sometimes) like to use it

The term *reasonable* efforts is vague, but contract drafters sometimes use it in setting out specific rights and obligations. Most of the time that's not an unreasonable choice — no pun intended — because:

- Clients are typically eager to get to signature and get on with their business; and
- The odds are that:
    - a dispute about reasonableness won't arise; and
    - if a dispute does arise, the parties will be able to work it out themselves on a business basis.

§ 117.2.3 Pay me now, or pay me later

Drafters should always keep in mind that using a *reasonable efforts* term might be a case of "you can pay me now, or you can pay me even more later" — if a dispute about reasonableness ever did arise, then each party might:

- spend a lot of time and money on discovery and expert witnesses to prove what is or isn't reasonable; and
- roll the dice about what the factfinder decides is reasonable.

§ 117.2.4 Are ALL reasonable efforts required?

Do the term *reasonable efforts* mean **all** reasonable efforts? A commenter in an extended LinkedIn group discussion (membership required) opined that anything less than *all* reasonable efforts supposedly was, by definition, unreasonable.

This author responded that many people would disagree: Reasonable efforts can encompass a *range* of efforts; making reasonable efforts doesn't have to be a binary, yes-no dichotomy.

EXAMPLE:

- Alice's contract with Bob requires Alice to make "reasonable efforts" to advise Bob in writing if some (non-emergency) Event X occurs. Event X occurs, and so Alice sends Bob an email to that effect, using the email address that Bob had consistently used in his dealings with Alice.
- Alice does *not* try every available means of communicating with Bob: She doesn't send him a letter via FAX, certified mail, FedEx, UPS, showing up at Bob's house, etc.

In that scenario, many *business* people would think that Alice had complied with her contractual obligation to make reasonable efforts to advise Bob, even if for some reason Bob never got the email.

If Bob had wanted Alice to make **all** reasonable efforts to advise him that Event X had happened, then Bob should have said so in the contract.

§ 118 Reckless Definition

a. A person (the "actor") acts *recklessly* when the actor • consciously disregards • a substantial and unjustifiable risk • that harm will result • from the actor's conduct.

b. The risk of harm must be of such a nature and degree that — considering the nature and purpose of the actor's conduct and the circumstances known to the actor — the disregard of the risk involves a gross deviation from the standard of conduct that a reasonable person would observe in the actor's situation.

COMMENTARY

This definition is based on Model Penal Code 2.02©, as implemented in, e.g., Tex. Pen. Code 6.03©.

Some of the terms used here, such as *substantial and unjustifiable risk* and *gross deviation*, are of course vague and likely to be the subject of debate.

§ 119 Record Definition

The term record, in the context of documents and the like, refers to books, documents, and other data that are stored in any tangible- or intangible medium regardless of type, without regard to whether such items are in written, graphic, audio, video, or other form.

COMMENTARY

This definition is adapted from the (U.S.) Federal Acquisition Regulations, Contractor Records Retention, 48 C.F.R. § 4.703(a).

§ 120 Recordkeeping Protocol

COMMENTARY

Any contract drafter who will be negotiating recordkeeping- and audit clauses would do well to study carefully the primer found in Ryan C. Hubbs, The Importance of Auditing In An Anti-Fraud World — Designing, Interpreting, And Executing Right to Audit Clauses For Fraud Examiners (Assoc. of Certified Fraud Examiners 2012).

§ 120.1 Who must follow this Protocol?

This Protocol sets out requirements to be met by any party required by the AGREEMENT to keep records (each, a "**Recordkeeping Party**").

§ 120.2 When must records be kept?

The Recordkeeping Party must keep the Required Records during the term of the AGREEMENT.

§ 120.3 What records must be kept?

a. The term **Required Records** refers to records sufficient to document the following, as applicable:

1. all deliveries of goods and services, by the Recordkeeping Party to another party, under the AGREEMENT;
2. billing of charges or other amounts, by the Recordkeeping Party to another party, under the AGREEMENT;
3. all payments, by the Recordkeeping Party to another party, under the AGREEMENT, of amounts not verifiable by the payee, such as, for example, royalties or rents to be paid to the other party as a percentage of the Recordkeeping Party's sales; and
4. all other information (if any) that the AGREEMENT requires the Recordkeeping Party to report to another party.

b. The Required Records are to include, for example, where applicable, the following: Sales journals; purchase-order journals; cash-receipts journals; general ledgers; and inventory records; as well as any other records expressly required by the AGREEMENT.

COMMENTARY

In some situations, parties might want to negotiate specific records to be kept.

The list in subdivision b is adapted from the contract in suit in Zaki Kulaibee Establishment v. McFliker, 771 F.3d 1301, 1308 n.13 (11th Cir. 2014) (reversing, as abuse of discretion, and remanding district court's denial of plaintiff's request for an accounting).

According to a study of U.S. construction companies, interviewees reported that unless the contract spells out in detail just what records are to be kept, "**it is incredibly difficult to obtain the proper records from the Contractor in order to conduct a proper audit**." Albert

Bates, Jr. and Amy Joseph Coles, Audit Provisions in Private Construction Contracts: Which Costs Are Subject to Audit, Who Bears the Expense of the Audit, and Who Has the Burden of Proof on Audit Claims?, 6 J. AM. COLL. CONSTR. LAWYERS 111, 114 (2012) (footnote omitted, emphasis added).

A sample clause published by the Association of Certified Fraud Examiners contains a laundry list of specific types of documents that a vendor might want to require a contractor to maintain.

§ 120.4 What recordkeeping standards must be met?

All Required Records must:

1. be accurate;
2. be materially complete;
3. comply with at least commercially reasonable standards of recordkeeping; and
4. comply, if stricter, with any other recordkeeping standards specified in the AGREEMENT.

COMMENTARY

The terms used to describe the Required Records are *accurate* and *materially complete*. Some drafters use the term *true and correct*, but that seems both redundant and incomplete. Perhaps in an archaic sense the term *true* might be interpreted broadly to mean *materially complete and accurate*, but there seems to be little reason to take a chance that a judge would see it that way.

In some situations, parties might want to negotiate specific recordkeeping standards.

§ 120.5 For how long must records be retained?

The Recordkeeping Party will keep each of the Required Records for at least the longest of the following (the **Record-Retention Period**):

1. any retention period required by applicable law;

2. the duration of any timely commenced audit of the Required Records permitted by the Agreement; and

3. any other period specified in the Agreement, if any.

COMMENTARY

When services are involved, retaining records for two- to four years after final payment seems to be a not-uncommon requirement. See, for example, the [U.S.] Federal Acquisition Regulations, e.g., Contractor Records Retention, 48 C.F.R. §§ 4.703(a)(1), 4.705.

Some industries or professions might require specific record-retention periods.

NOTE: The Record-Retention Period is not the same as the recordkeeping period in § 120.2.

§ 120.6 Who may audit the Required Records?

Any party described in § 120.3 may audit the Required Records in accordance with the procedures set forth in the Audits protocol.

§ 120.7 ❑ Record Retention Per FAR Standards

a. The Recordkeeping Party will maintain each of the Required Records for at least the period that the record would be required to be maintained under the (U.S.) Federal Acquisition Regulations ("FARs"), Contractor Records Retention, 48 C.F.R. Subpart 4.7.

b. In case of doubt: This section is included for the convenient reference of the parties, who do not intend to imply or concede that the Agreement and/or their relationship are in any way subject to the FARs.

COMMENTARY

The FARs' record-retention requirements go into some detail; drafters might want to take advantage of that specificity.

§ 121 Redlining Representation

In agreeing to the AGREEMENT or any related document, each party represents that it or its counsel has "redlined" (or otherwise called attention to) all changes that it made and sent to the other party in drafts previously seen by the other party, including but not limited to drafts of any attachments, schedules, exhibits, addenda, etc.

§ 121.1 Commentary

§ 121.1.1 Purpose

The above redlining representation helps to streamline the process of final review and signature of the parties' agreement: it allows a party to assume that all changes have been called to its attention instead of taking the time to re-read the entire agreement. See § 121.1.2 for more-extensive discussion.

This provision is a *representation*, not a warranty, because the former comes across as "softer" and is more likely to be accepted by a contract's legal reviewer.

§ 121.1.2 Background: Redlining is an expected professional courtesy

In contract negotiation, two professional courtesies are considered standard practice: • The drafter sends the reviewer an *unlocked, editable* Microsoft Word document. • The reviewer then uses the Track Changes feature of Microsoft Word to "redline" the changes the reviewer makes. (In lieu of redlining *every* change — which can result in a messy visual presentation — it's acceptable to start a paragraph or sentence with "[REVISED:]" to signal that the paragraph or sentence needs to be reread. • A party can also use the Compare Documents feature of Microsoft Word to create a new redlined version showing changes between Version N and Version N+1.

This works well when *electronic* copies are exchanged. But suppose that "Alice" sends "Bob" a signed, original, *hard-copy* contract and asks Bob to countersign and return it.

• Bob could do a word-for-word *manual* comparison, to make sure the hard copy matches the agreed electronic document. But that would take time that surely could be put to better use — especially (say) at the end of a fiscal quarter,

when a lot of contracts are in negotiation at once and negotiator time is a scarce resource that must be used judiciously.

• But if Bob doesn't do a word-for-word comparison, how does he know Alice didn't surreptitiously change something before printing the document for signature? The overwhelming majority of lawyers would never try to pull something so underhanded, not least because it could severely damage the lawyer's reputation and possibly even lead to disciplinary action.

But surreptitious changes to contract documents do happen. See, for example, Hand v. Dayton-Hudson, 775 F.2d 757 (6th Cir. 1985); in that case, the appellate court affirmed the trial court's judgment reforming (that is, editing after the fact) a release that had been surreptitiously altered before signature.

In fact, this type of sneaky behavior can happen even in what should have been a relationship of trust and confidence; the author once served as an expert witness in a case in which a corporate officer did that with his employment agreement (surreptitiously changing a two-*year* noncompetition provision to a two-*month* period).

But a court might not come to the rescue as happened in the *Hand* case. For example:

• A Russian court reportedly enforced a "contract" created by a man who changed a bank's credit-card agreement, then (successfully) sued the bank when it didn't comply with the altered terms. *See* Nick Shchetko, Russian Man Turns Tables on Bank, Changes Small Print in Credit Card Agreement, Then Sues, Minyanville.com (Aug. 7, 2013).

• In Cambridge North Point LLC v. Boston and Maine Corp., No. C.A. No. 3451-VCS (Del. Ch. June 17, 2010), the court refused to declare that a $3.5 million payment obligation was unenforceable on grounds that it allegedly had been "quietly" inserted into settlement agreement.

• This landlord could have used a redlining representation in its lease form: As a prank, a prospective tenant, reviewing the Word document of the lease form, inserted a requirement that the landlord provide birthday cake on the weekend nearest the tenant's birthday. Understandably, the landlord didn't notice the insertion.

§ 122 Referral Commissions Protocol

This Protocol contemplates that under a "**Referral Arrangement**" specified in the AGREEMENT, a party ("**Company**") is to pay commissions to another

party ("**Associate**") for certain referrals. The following terms are placeholders for discussion & legal review:

> Company will pay commissions to Associate ABC Corporation ("**Associate**"), on sales by Company to qualified customers referred by Associate, in accordance with the TANGO Referrals Rider 2019A, with details as follows:
>
> • The following "**Referrals**" are eligible for commissions:
>
> ❑ Referrals leading to sales of any and all of Company's products and/or services.
>
> ❑ Referrals of [FILL IN].
>
> • To be eligible for commissions, Associate's sales must be made in in the following "**Territory**": Anywhere in the world, in any market segment.
>
> • Associate's right to commissions is: Non-exclusive.
>
> • The "**Commission Payment**" will be: 0.001% of Company's collected invoiced sale amounts (with certain exclusions as stated in the Commissions Agreement) ☑ without deduction of any Company expenses.
>
> ALTERNATIVE: The "Commission Payment" will be as follows: 1. [FILL IN AMOUNT] for each referral of a lead that results in a sale of at least [FILL IN MINIMUM AMOUNT] within the three-month period following Associate's initial referral of the lead; or 2. [FILL IN AMOUNT] for each referral of a "suitable" lead that does not qualify under subdivision 1; Company has sole authority to determine whether a lead is suitable.

COMMENTARY

This Protocol is set up for commission payments for referrals, because that's often the case in a contract between companies, as opposed to internal use by a single company paying commissions to (e.g.) sales personnel.

Parties might want to negotiate different commission-eligible items for different time periods and/or different territories.

Company might want to consider limiting Associate's authorized offerings to those for which Associate has been suitably trained.

The 0.001% commission rate is of course a placeholder number.

Some parties might prefer to negotiate some other basis than a percentage, such as (for example) some kind of fixed-fee schedule, perhaps declining over time.

Deduction of expenses could lead to claims of "Hollywood accounting" (see https://en.wikipedia.org/wiki/Hollywood_accounting).

If the commission right will be exclusive, then consider adopting § 53 (exclusivity protocol).

In the above alternative, Company would have at least some economic incentive not to be arbitrary or capricious in determining whether a lead is "suitable," for fear that Associate might stop referring leads at all.

§ 122.1 Commission-eligible sales

§ 122.1.1 What does "qualified customer" mean?

Associate will be eligible for commissions only on Company's sales of Offerings to prospective customers referred by Associate (each, a "**Prospect**"), where each customer meets all of the following qualifications:

a. The Prospect must have substantial operations in the agreed Commission Territory.

b. The Prospect must not be barred by law from acquiring the Offering(s).

c. The Prospect must not be a competitor of Company (unless Company gives its prior written consent).

d. The Prospect must not have had a previous connection with Company at the time of Associate's initial referral; Company's good-faith determination of that point will be final and binding.

COMMENTARY

Subdivision b: A given customer might be barred by law from acquiring Offerings, e.g., by export-control laws or other governmental trade policy.

Subdivision c: A supplier might not care if its competitors acquire the supplier's products, but that might not be the case if a competitor could reverse-engineer a supplier product to figure out the supplier's trade secrets.

Subdivision d: Company might be reluctant to pay commissions for sales it thinks it would have made even without Associate's involvement.

Subdivision e: Company will have an economic incentive not to be arbitrary or capricious in determining whether it had a previous connection with a customer, lest Associate stop referring prospects at all.

§ 122.1.2 Are any specific customers <u>not</u> qualified for commissions?

☑No; Associate will be entitled commissions for sales to any otherwise-eligible customer.

❑ Sales to the following specific customers are not eligible for commissions: *[LIST]*.

COMMENTARY

Company might want to maintain a specific list of already-existing prospective customers. This sometimes happens in residential real-estate sales: A seller that lists her home with a listing agent might give the agent a list of the seller's friends, neighbors, and family, so that the seller won't have to pay the agent a commission if the seller sells the home to one of the listed people.

§ 122.1.3 When will a referral be considered "dead"?

For any given customer, Associate will not be eligible for commissions unless the first sale of one or more Offerings to that customer is closed on or before the date one year after Associate's written communication to Company of suitable contact information (in Company's sole judgment) for the customer.

COMMENTARY

This first-sale deadline allows Company to consider a referral to be "dead" (and thus not eligible for commissions) if Company has not collected revenue before the deadline.

The written-communication limitation is designed for greater certainty.

The "suitable contact information" term is necessarily vague and would have to be determined on a case-by-case basis. Leaving that determination in Company's hands should normally be a safe bet: Company can be

expected not to want to "stiff" a referring Associate, because Associate could retaliate by not delivering leads.

§ 122.1.4 For a given customer, how long will Associate be paid commissions?

For any given customer, Associate will not be eligible for commissions for sales occurring later than one year from the date of Company's first closed sale to that customer; see also the Commission Term (defined below).

COMMENTARY

The one-year cutoff is a placeholder for negotiation, designed to encourage Associate to keep looking for new customers instead of passively coasting on its past efforts.

Instead of a "cliff" cutoff of commissions for a given referred customer, the parties could consider gradually reducing the commission rate over time for sales to that customer.

§ 122.1.5 When will commissions end, as to all referrals?

Associate will not be eligible for commissions for sales that are closed by Company later than the date two years after the date of this Agreement (the "**Commission Term**").

COMMENTARY

This is a "sunset" date when the commission relationship will automatically expire unless extended.

§ 122.1.6 Will the commission-eligibility period be automatically extended?

Yes: The Commission Term will be automatically extended for successive one-month extension terms, unless either party opts out, in accordance with the TANGO Evergreen Extension Plan.

COMMENTARY

If things are going well, the parties likely won't want to have to think about whether or not to proactively extend their relationship; in that situation, the parties will probably want the relationship to be extended automatically until one of them does something to end it.

§ 122.1.7 Will any amounts be excluded from commissions?

Associate will not be eligible for commissions on any of the following:

1. separately itemized charges for taxes, shipping, and insurance; nor
2. a reasonable allowance for returns in accordance with Company's then-effective return policy — that policy is to be determined by Company in its sole judgment from time to time, but Company will not "play games" in that regard.

COMMENTARY

This is a pretty-standard exclusion; subdivision 2 recognizes the economic realities of customer returns.

§ 122.2 Commission payments & reporting

§ 122.2.1 When are commission payments due?

Associate will be paid each commission within 30 days after the end of the fiscal quarter in which Company collects the associated invoiced price.

COMMENTARY

In some arrangements, the parties might agree that commissions might be paid very shortly after a sale closes (as is seen, for example, in real-estate sales).

§ 122.2.2 What commission reports will Company provide to Associate?

With each commission payment, Company will provide Associate with a written statement of the amount due, with reasonable supporting detail.

§ 122.2.3 Will Associate have audit rights for Company's commission reports?

☑ Yes, per the audits protocol.

❑ No.

§ 122.3 Third-party claims

§ 122.3.1 What responsibility does Company have for third-party complaints about Offerings?

IF: A customer or other third party makes a claim against *Associate* because of what the third party alleges was a breach of a Company warranty about an Offering; THEN: Company will:

a. provide Associate with a legal defense against the claim; and

b. pay for any resulting monetary award against Associate.

§ 122.3.2 What responsibility does Associate have for its business?

IF: A third party makes a claim against *Company* because of what the third party claims was some fault on the part of Associate; THEN: Associate will:

1. provide Company with a legal defense against the claim in accordance with § 43 (defense protocol); and
2. reimburse Company for any resulting monetary award in accordance with **Error! Reference source not found.** (indemnities p rotocol).

§ 122.4 Other commission provisions

§ 122.4.1 These commission arrangements are confidential

Each party will keep the details of these commission arrangements confidential, but they may freely disclose to others the fact that they have entered into a commission agreement.

COMMENTARY

> In some circumstances, it might be appropriate and even necessary for one or both parties to disclose that Company will be paying commissions to Associate.

§ 122.4.2 Is either party's information considered confidential?

☑ Yes: Company's otherwise-eligible information is considered Confidential Information in accordance with **Error! Reference source not found.** (confidential information). This includes, without limitation, the fact and status of Company's discussions and/or dealings with any particular referred customer.

☑ As between Associate and Company, *Associate's* information is not subject to confidentiality obligations.

§ 122.4.3 Can the Commission Arrangement be terminated?

Yes:

a. Either party may terminate the Commission Arrangement at will upon 30 days' notice in accordance with XXX.

b. Either party may terminate the Commission Arrangement for breach in accordance with XXX.

§ 122.4.4 Will Associate be able to help with Company's sales negotiations?

Yes, but only within limits: Associate will not attempt, without Company's prior written consent (which may be given or withheld in Company's sole discretion):

a. to participate in Company's discussions with a Prospect, in the way of (without limitation) assistance; advice to the Prospect; and/or interference; nor

b. to object to, or to demand to be consulted about, (i) whether Company will engage in a potential transaction with a Prospect, or (ii) the terms of any such transaction.

(CONTINUED ON NEXT PAGE)

§ 123 Reliance Waiver

COMMENTARY

See the extended discussion of reliance waivers at § 123.5.

§ 123.1 When does this waiver apply, and why?

a. This section applies if the AGREEMENT states, in substance, that one or more parties waives reliance on extra-contractual statements by one or more other parties.

b. If the AGREEMENT states simply that this section applies, but it does not specify a waiving party, then each party is considered to be a "waiving party" under this section.

c. When this section applies, the parties have agreed to it as part of their knowing, intentional allocation of the risks and benefits associated with the AGREEMENT.

§ 123.2 What commitments does a waiving party make?

In entering into the AGREEMENT, each waiving party represents and warrants to each other party that:

a. The waiving party is capable of evaluating and understanding (on its own behalf or through independent professional advice) the terms, conditions and risks of the AGREEMENT and the transaction(s) contemplated by the AGREEMENT;

b. The waiving party understands and accepts those terms, conditions, and risk;

c. The waiving party is not relying on any representation, warranty, recommendation, advice, statement, or other communication, written or oral, by that other party **other than:**

1. the specific representations and warranties set forth in the AGREEMENT (if any), including without limitation in applicable exhibits, schedules, etc.; and
2. any representations or warranties expressly incorporated into the AGREEMENT by reference; and

d. The waiving party:

1. intends for each other party to rely on the waiver; and
2. stipulates that such reliance is reasonable.

COMMENTARY

This provision draws on a disclaimer successfully invoked by a bank in Bank of America, N.A. v. JB Hanna, LLC, 766 F.3d 841, 856 (8th Cir. 2014) (affirming summary judgment in favor of bank). (Hat tip: Brian Rogers).

§ 123.3 Advance release of claims arising from reliance

In entering into the AGREEMENT, each waiving party — having had the opportunity to consult legal counsel of the waiving party's choice — thereby:

1. releases each other party from any and all claims by the waiving party arising from any reliance by the waiving party on any Extra-Contractual Statement by (or otherwise attributable to) that other party; and

2. **KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY WAIVES** the benefits of Section 1542 of the California Civil Code, which states: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

COMMENTARY

> This release language is based on an online comment. ¶ The author has not researched the extent to which advance releases are enforceable or not.

§ 123.4 What other terms apply to this disclaimer?

The Limitation of Liability General Terms (§ 30) are incorporated by reference into this section.

§ 123.5 Commentary

§ 123.5.1 Black letter

An entire-agreement provision in a contract, standing alone, generally won't preclude "Bob" from claiming that "Alice" should be liable for "fraud in the inducement" in convincing Alice to enter into the contract in the first place.

BUT: In some jurisdictions, including Texas, if the contract states that Alice has not relied and will not rely on any representation by Bob outside the four corners of the contract, that might do the trick.

§ 123.5.2 Legal background of reliance disclaimers

Under the law in many U.S. jurisdictions, **a contracting party that claims misrepresentation by the other side normally would have to prove, among other things, that it reasonably relied on the alleged misrepresentation.** That gives the other side's contract drafter a reason to include a disclaimer of reliance.

Suppose that the following takes place:

- Alice and Bob enter into a contract for Alice to sell Bob a house located several hundred miles away from either of them.
- In the contract, Alice *represents* to Bob that the house is in good condition, but she does not *warrant* it.
- After the closing, the house turns out to be a wreck.

Even though Alice didn't *warrant* the condition of the house, Alice might be liable for misrepresentation. For Bob to succeed with a misrepresentation claim, though, he would have had to jump through some additional proof hoops: He would have to show (probably among other things) that (1) Alice had acted (i) negligently or (ii) with intent to deceive, and (2) that he (Bob) had *reasonably relied* on Alice's representation.

Of course, Bob might well have a powerful incentive to try to jump through these proof hoops: If he could establish liability for misrepresentation, then he might be able to rescind the contract, and perhaps even recover punitive damages. Neither of those remedies is normally available in a breach-of-warranty action.

Moreover, a non-expert fact finder, such as a judge or juror, might not fully understand the technical aspects of a case — but she probably *would* understand the simple claim "they lied!"

Alice will want to try to prevent Bob from even starting down that road. **One way to try to do that is to include a statement in the contract that Bob isn't relying on any representations by Alice.** That way, if Bob were to sue her for misrepresentation, a judge might very well rely (pardon the expression) on the disclaimer and **summarily toss out Bob's claim by dismissing it on the pleadings.** Courts have been known to give effect to no-reliance disclaimer clauses, especially when the parties are sophisticated (but often not in cases of *intentional* false representations).

If Hewlett-Packard's EDS subsidiary had included a no-reliance disclaimer clause in its software-system development agreement with British Sky

Broadcasting, then **perhaps EDS might not have had to pay some $ 460 million to settle Sky's successful claim for fraudulent inducement**. *See* BSkyB Ltd. v. HP Enterprise Services UK Ltd., [2010] EWHC 86 (TCC).

In the same vein, a software developer found itself having to defend against a customer's claim that the developer had not only "breached its obligations under the contract … but also that *[the developer]* wrongfully induced *[the customer]* into entering a contractual relationship knowing that *[the developer]* did not have the capability to perform any of the promised web-related services." The Colorado supreme court held that those allegations "state a violation of a tort duty that is independent of the contract" and thus should not have been dismissed under the economic-loss doctrine. Van Rees v. Unleaded Software, Inc., 2016 CO 51, 373 P.3d 603, 608 (Colo. 2016).

§ 123.5.3 An entire agreement "merger" (or "zipper") clause alone won't defeat "they lied!"

Standing alone, an entire-agreement provision (also known as a merger clause or integration clause or zipper clause) generally won't protect Alice if Bob claims that Alice fraudulently induced Bob to enter into the contract in the first place. The Supreme Court of Texas explained:

> Pure merger clauses, without an expressed clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement, have never had the effect of precluding claims for fraudulent inducement. …
>
> **There is a significant difference** between a party[:]
>
> • disclaiming its *reliance* on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and
>
> • disclaiming the *fact* that no other representations were made.
>
> *[DCT comment: In the context of a fraudulent-inducement analysis, though, don't these two disclaimers amount to exactly the same thing? As explained further down in this excerpt, though, the Texas supreme court seems to have felt that a disclaimer of extrinsic representations, standing alone, wasn't sufficiently explicit and "in your face" to alert the other side about what it was being asked to give up.]*

> * * *
>
> Here, the only plain reading of the contract language in sections 14.18 and 14.21 is that the parties intended to include a well-recognized merger clause. Nothing in that language suggests that the parties intended to disclaim reliance.
>
> * * *
>
> We have repeatedly held that **to disclaim reliance, parties must use clear and unequivocal language**. This elevated requirement of precise language helps ensure that parties to a contract — even sophisticated parties represented by able attorneys — **understand that the contract's terms disclaim reliance, such that the contract may be binding even if it was induced by fraud**.
>
> Here, the contract language was not clear or unequivocal about disclaiming reliance. For instance, the term "rely" does not appear in any form, either in terms of relying on the other party's representations, or in relying solely on one's own judgment.
>
> This provision stands in stark contrast to provisions we have previously held were clear and unequivocal *[three-column table, contrasting different clauses, omitted]*.

Italian Cowboy Partners, Ltd. v. Prudential Ins. Co., 341 S.W. 3d 323, 333-37 (Tex. 2011) (reversing court of appeals; merger clause did not preclude tenant's claim that landlord had fraudulently induced lease agreement by misrepresenting condition of property) (extra paragraphing and bullets added, citations and some internal quotation marks omitted).

As another example, Bank of America sold a foreclosed home subject to an "as-is" disclaimer, but the bank stated that it had "little or no direct knowledge" of problems, when in fact it knew that there were serious mold problems. The appeals court affirmed judgment on a jury verdict in favor of the buyer, saying that:

> There was sufficient evidence to support the jury's verdict that the Bank made a deceptive statement concerning the sale of the property *[namely, that the bank had little or no direct knowledge of the condition of the house]* with the

> intention of inducing the sale of the property and that Fricano suffered a loss as a result of that representation. **The "as is" and exculpatory clauses in the parties' contract do not, as a matter of law, relieve the bank/seller of liability under § 100.18(1) for its deceptive representation in the contract which induced agreement to such terms.** We affirm.

Fricano v. Bank of America NA, 2016 WI APP 11 (2015).

§ 123.5.4

But a clear non-reliance disclaimer *might* work

When a reliance disclaimer is sufficiently clear, courts might well give effect to it. For example:

• Shakeri v. ADT Security Services, Inc., 816 F.3d 283 (5th Cir. 2016) (per curiam): The contract between an alarm-system company and its jewelry-store customer contained the following reliance disclaimer: "**In executing this Agreement, Customer is not relying on any advice or advertisement of ADT**." *Id.* at 288 (capitalization omitted, emphasis added). The Fifth Circuit held that this language "was sufficiently clear as to disclaim any reliance by plaintiffs on any alleged misrepresentation ADT made prior to Plaintiffs entering into the contract. Accordingly, Plaintiffs' fraudulent inducement claim is barred under Texas law." *Id.* at 296.

• Pappas v. Tzolis, 20 N.Y.3d 228 (2012): Tzolis, a businessman, owned part of a limited liability company ("LLC") along with two colleagues, Pappas and Tziolis invested $50,000 in the company, while Ifantopoulos invested $25,000. The relevant agreement documents included statements by Pappas and Ifantopoulos disclaiming any reliance on representations by Tzolis, and vice versa. New York's highest court ruled that "**plaintiffs in the plainest language announced and stipulated that they were not relying on any represent**ations as to the very matter as to which they now claim they were defrauded," and thus the plaintiffs' claims should have been dismissed. *Id.* at 234.

IBM v. Lufkin Industries, LLC, 573 S.W.3d 224 (Tex. 2019): The supreme court held that "contractual disclaimers bar the buyer from recovering in tort for misrepresentations the seller made both to induce the buyer to enter into the contract and to induce the buyer to later agree to amend the contract." *Id.* at 226.

Of course, fraud claims might survive even a no-reliance provision. Suppose that Alice claims that Bob misrepresented facts to induce Alice to

enter into a contract, and that Bob's misrepresentation wasn't merely negligent, but intentional. And suppose also that the contract contains a no-reliance clause. In that situation, **Bob should not hold out much hope that a court would *summarily* toss out Alice's fraudulent inducement claim** against him; the judge might very well insist on a full trial. See generally Andrew M. Zeitlin & Alison P. Baker, At Liberty to Lie? The Viability of Fraud Claims after Disclaiming Reliance, Apr. 23, 2013. See also Neal A. Potischman, Stephen Salmon, Alyse L. Katz, John A. Bick, Kirtee Kapoor and Lawrence Portnoy, Will Anti-Reliance Provisions Preclude Extra-Contractual Fraud Claims? Answers Differ In Delaware, New York, And California (Mondaq.com 2016).

§ 123.5.5 Drafting tip: Be specific about what's disclaimed?

Courts seem to have more sympathy for a reliance disclaimer if, in the words of the Second Circuit's *Caiola v. Citibank* opinion, the disclaimer "tracks the substance of the alleged misrepresentation." The court reversed a lower court's dismissal of a claim under federal securities law, but the underlying principle might well apply in contract cases as well. *See* Caiola v. Citibank, NA, 295 F.3d 312, 330 (2d Cir. 2002) (reversing dismissal of claim under federal securities law) (citing cases; internal quotation marks and alteration omitted).

§ 123.5.6 Drafting tip: Initial the disclaimer?

If there's a concern that a party might someday try to repudiate its reliance disclaimer, it can't hurt to have that party separately initial the contract as close as possible to the disclaimer, *and be sure the party actually does initial it*.

For example: In a New York case, an estranged married couple reconciled — temporarily, as it turned out. During their reconciliation, the wife voluntarily dismissed her three pending lawsuits against the husband, and they signed a settlement agreement to that effect. But then the couple separated again, and the wife sued the husband again, this time claiming that he had fraudulently induced her to dismiss her other lawsuits by promising that he would return to her and permanently resume their marital relationship. Unfortunately for the wife, the settlement agreement she signed included a reliance disclaimer, which she had specifically initialed; as the court acidly noted: "There is no allegation in the complaint that plaintiff did not read or did not understand the agreement; *in fact, she initialed the agreement in the margin opposite the very paragraph disclaiming the alleged representation*." Cohen v. Cohen, 1 A.D.2d 586 (N.Y. App. Div. 1956) (per curiam; affirming dismissal of complaint for insufficiency).

In this situation, the drafting party should make damned sure the signing party actually does initial the disclaimer where indicated. Otherwise the drafting party might have an even worse problem: the uninitialed blank line could help persuade a judge or jury that the signing party really did overlook the disclaimer; that's just the opposite of what the drafting party wanted.

§ 123.5.7 One-way or two-way disclaimer of reliance?

In some situations, a one-way disclaimer of reliance might be appropriate, i.e., if one party really was relying on the other party's extrinsic representations.

Of course, in that situation the better practice might be to list such external representations in the parties' agreement, so that the representations were no longer extrinsic but instead were express.

§ 123.5.8 Even a non-reliance disclaimer might not be enough, depending on the facts

A no-reliance clause in a contract might not enough to convince a court to toss out a fraudulent-inducement or negligent-misrepresentation claim. That was the outcome in a case due to factors explained by the court of appeals in Carousel's Creamery, L.L.C. v. Marble Slab Creamery, Inc., 134 S.W.3d 385 (Tex. App.–Houston [1st Dist.] 2004) (reversing and remanding directed verdict for defendant on negligent-misrepresentation claim) (emphasis and extra paragraphing added).

§ 123.5.9 (Optional) Further reading about non-reliance provisions

Joseph M. McLaughlin and Yafit Cohn, Corporate Litigation and Non-Reliance Provisions (Harvard.edu 2016)

Daniel P. Elms, Using Contractual Merger Clauses in Defense of Fraud Claims (Jan. 27, 2011; accessed Nov. 24, 2012).

Brian S. Fraser and Tamala E. Newbold, Big Boy Update: Recent New York Case Demonstrates Limits of Big Boy Provisions Where Affirmative Acts of Concealment Are Alleged (Sept. 24, 2010, accessed Oct. 21, 2010).

R. Bruce Wallace and Christie Matthews, Using Non-Reliance Clauses in Defense of Fraud Claims (accessed Oct. 15, 2007).

Joseph M. McLaughlin, Corporate Litigation: Big Boy Letters and Non-Reliance Provisions, *New York Law Journal*, Dec. 13, 2012

§ 124 Representations and warranties (commentary)

Parties entering into a contract almost always make assumptions about past, present, or future facts. The parties are likely to want to expressly allocate responsibility for ensuring the truth of those facts, or at least for checking on them. (The alternative might be to roll the dice on doctrines such as mistake.) Representations and warranties are classic ways of allocating that responsibility.

*(For more on warranties specifically, see **Error! Reference source not found.**.)*

§ 124.1 Different proof requirements, different remedies

Representations and warranties are similar but in significant ways different in U.S. law. Perhaps most notably, a claim of *misrepresentation* requires the claimant to show:

a. that the claimant in fact relied on the representation — although that usually won't be a heavy burden if the representation is explicitly stated in the contract — and

b. that the claimant's reliance was reasonable under the circumstances; reliance could be unreasonable if the representation was obviously false or misleading when made.

In contrast, neither of these showings is required for a claim of breach of *warranty*.

And a proven claim of *misrepresentation* could entitle the claimant to tort remedies such as punitive damages and/or rescission of the contract, whereas neither is normally available for breach of warranty.

§ 124.2 Which do I want: A rep, or a warranty?

A party who is asked to represent or warrant something (such as a seller) will always want to consider whether to *warrant* the thing or to *represent* it.

In contrast, a party *asking for* a representation or warranty (such as a buyer) will always want to push for both a representation *and* a warranty, so as to give that party more flexibility in litigation.

§ 124.3 (Black letter:) Key takeaways about reps and warranties

Here are some things every contract drafter and reviewer should know about representations and warranties:

1. **A representation is *not* the same thing as a warranty**, at least not in U.S. law. The two terms relate to different categories of fact, and they have different legal ramifications in litigation.

2. A representation is, in essence, a statement of past or present fact. Example: Alice represents that her car has never been in an accident [past fact] and is in good working order [present fact].

3. A representation might be paraphrased as: So far as I know, X is true, but I'm not making any promises about it.

4. When qualifying a representation as in #3 above, use a term such as, *so far as I know,* and not the term *to my knowledge*. In a lawsuit, an aggressive trial counsel might claim that the latter term amounts to an implicit representation that the representing party did indeed have knowledge.

5. A representation can include the disclaimer without any particular investigation; this could be paraphrased as: I represent that X is true, but I'm not saying that I've done any particular investigation into the question.

6. The term *warranty* is a shorthand label for a kind of *conditional covenant*, a promise that if the warranted fact(s) are shown to be untrue, then the warranting party will make good on any resulting losses suffered by the party to whom the warranty was made.

Example: Consider the simple warranty, *Alice warrants to Bob that Alice's car will run normally for at least 30 days*. This is tantamount to a promise by Alice that, if Alice's car fails to run normally for at least 30 days, then Alice will pay for repairs, a rent car, and any other foreseeable damages resulting from the failure.

7. A warranty might be paraphrased as: I'm not going to say whether X is or isn't true, but I'll commit that, if it turns out that X isn't true, then I'll reimburse you for any resulting foreseeable losses that you suffer (or alternatively: then I'll take the following specific steps, and only those steps, to try to make it right for you).

8. Representations and warranties can be carefully drafted so as to be narrowly specific.

9. A warranty can be drafted to limit the remedies available if the

warranted facts turn out not to be true. (A typical triad of remedies can be summarized as, *repair, replace, or refund*.)

10. A party that is asked to make a representation and warranty about particular facts (e.g., a seller of goods being asked to represent and warrant the quality of the goods) should consider whether it really wants to make both of those commitments for all the requested facts — that party might want to make only representations as to some facts and only warranties as to other facts.

On the other hand, suppose that a services provider and a customer are entering into a contract for services. If the provider will be giving any kind of warranty about its services, the customer should always at least try to get both a representation and a warranty; that will give the customer more flexibility in litigation.

11. Don't use the term *represents* to indicate that a party will take or abstain from action — commitments to future action should instead be written as promises (covenants).

Before: Bob *represents* that he will pay Alice ….

After: Bob *will* pay Alice …

In the "Before" example above, if Bob failed to pay Alice, he might try to claim that he should not be liable for nonpayment because when he made the representation, he had no reason to believe that he would not make the payment. A court *might* treat such a "representation" as a simple promise, *see* Lyon Fin. Serv., Inc. v. Illinois Paper & Copier Co., 848 N.W.2d 539 (Minn. 2014) (on certification from 7th Circuit), but the drafter would do all concerned a disservice by not making the obligation clear.

§ 124.4 (Black letter:) Representations vs. warranties

Suppose that the following takes place: • Alice and Bob enter into a contract for Alice to sell Bob a house located several hundred miles away from either of them. • In the contract, Alice *represents* to Bob that the house is in good condition, but she does not *warrant* it. • After the closing, the house turns out to be a wreck.

Even though Alice didn't *warrant* the condition of the house, Alice might be liable for misrepresentation. For Bob to succeed with a misrepresentation claim, though, he would have had to jump through some additional proof hoops: He would have to show (probably among other things) that (1) Alice had

acted (i) negligently or (ii) with intent to deceive, and (2) that he (Bob) had *reasonably relied* on Alice's representation.

Of course, Bob might well have a powerful incentive to try to jump through these proof hoops: If he could establish liability for misrepresentation, then he might be able to rescind the contract, and perhaps even recover punitive damages. Neither of those remedies is normally available in a breach-of-warranty action.

Moreover, a non-expert fact finder, such as a judge or juror, might not fully understand the technical aspects of a case — but she probably *would* understand the simple claim "they lied!" (see XXX for more discussion.)

From a litigator's perspective, the following chart summarizes the key differences between representations and warranties under American law (see also the notes following the chart):

ITEM	REP.	WARRANTY
Can be disclaimed	[a]	[b]
Can relate to past facts	x	x
Can relate to present facts	x	x
Can relate to future facts		x
Plaintiff must prove falsity	x	x
Strict liability if false		x
Plaintiff must prove reliance	[c]	
Plaintiff must prove *reasonable* reliance	[c]	[d]
Plaintiff must prove materiality of statement	x	
Plaintiff must prove scienter	[e]	
Proof of due diligence can help defeat liability	[f]	
Remedy: Expectancy damages		x
Remedy: Rescission	x	
Remedy: Restitution / reliance damages	x	
Remedy: Punitive damages	[g]	

NOTES:

[a] Disclaimers of *representations* usually relate to representations external to the contract; under Texas law, such extrinsic representations technically can't be disclaimed, but the contract *can* state that a party is not *relying* on such representations, as discussed in XXX.

[b] Warranties can typically be disclaimed, but in some U.S. jurisdictions, some warranties might be non-disclaimable; *see* XXX.

[c] A party's reasonable reliance on a representation will probably be a given if the contract expressly uses the term *represents*. For example, if a contract stated that "Alice *represents* to Bob that her candy meets the health-code requirements for human consumption," then it seems very likely that a jury would find both (i) that Bob relied on Alice's representation and (ii) that his reliance was reasonable.

[d] Normally, a plaintiff claiming that a warranty was breached need not prove that it reasonably relied on the warranty. In some jurisdictions, though, the warranting party might be able to defeat the plaintiff's claim by showing that the warranting party itself disclosed facts to the plaintiff that made it unreasonable for the plaintiff to have relied on the warranty; see XXX.

[e] For misrepresentation, scienter could take the form of (i) negligence in making the representation; (ii) reckless disregard for the truth; or (ii) intentional misstatement. (This gives plaintiff's trial counsel a reason to use "They lied!" in front of a jury.)

[f] Proof of due diligence in making a representation would normally defeat a claim of scienter (see above).

[g] Punitive damages would be available in cases of intentional misrepresentation, and possibly in cases of negligent misrepresentation as well.

§ 125 Representation

A representation is a statement of past or present fact; the verb represent has a corresponding meaning.

COMMENTARY

> The phrase "statement of past- or present fact" was suggested by Professor Tina Stark, author of the highly-regarded Drafting Contracts textbook.

Drafters should keep in mind the subtle but potentially significant differences between representations and warranties, as discussed in XXX.

§ 126 Reseller Protocol

Consult your lawyer about the following placeholder Term Sheet language:

ABC ("**Reseller**") will deal in products, services, and/or other offerings of XYZ ("**Supplier**") per the TANGO Agreement 2019A, with details as follows:

The "**Reseller Relationship**" begins on the effective date of the parties' agreement and ends (unless extended, or sooner terminated, in accordance with the parties' agreement) two years thereafter (§ 89).

The "**Territory**" in which Reseller may deal in Offerings during the Reseller Relationship is: Worldwide, in all market segments (whether now or later existing).

The Reseller Relationship will be automatically extended for successive two-year extension terms (**Error! Reference source not found.**).

The Reseller Relationship is non-exclusive (§ 53).

The "**Offerings**" that Reseller may deal in during the Reseller Relationship are: All products, services, and other items offered by Supplier at any given time.

Reseller's discount for Offerings is: 0.01%.

Reseller is not Supplier's agent and will conduct itself accordingly at all times.

COMMENTARY

This agreement uses the term "Reseller" instead of "Partner" because under U.S. law, a "partner" might well be jointly and severally liable for whatever harm might be caused by other partners.

This agreement also uses the general term "deal in," instead of the possibly narrower terms "resell" and/or "distribute."

Subdivision e: Supplier might want to consider limiting Reseller's authorized offerings to those for which Reseller has been suitably trained — apropos of training, see § 140.4. Supplier might also want to make different Offerings available to Reseller at different times.

Subdivision f: The 0.01% discount will almost certainly be negotiated.

Subdivision g: An agent would generally have at least some authority to represent the principal and perhaps even to sign contracts on behalf of the principal — and, relevantly here, the principal might well be liable for the agent's acts and omissions.

§ 126.1 Reseller performance obligations

§ 126.1.1 Required sales-promotion efforts

During the Reseller Relationship, Reseller must make the following efforts to promote sales of the Offerings within the Territory:

☑ commercially reasonable efforts, as defined at **Error! Reference source not found.**.

❑ best efforts, as defined at § 30.

COMMENTARY

See the definition of commercially reasonable at **Error! Reference source not found.** and in the extended commentary at **Error! Reference source not found.**.

See the discussion of best efforts in the footnotes and in the extended commentary at **Error! Reference source not found.**.

Supplier might want for Reseller to commit specifically to, for example: • feature the Offerings in Reseller's own offering lists; • advertise the Offerings in specified publications; • attend customary trade shows; and • for foreign markets, translate Supplier's sales- and marketing materials [but this is something that Supplier might want to do itself for quality-control purposes].

A best-efforts commitment would normally go hand-in-hand with exclusivity [CITE NEEDED].

§ 126.1.2 **❑ Reseller Performance Targets**

During the Reseller Relationship, Reseller must achieve the following "Reseller Performance Targets" — with consequences for failure as stated in § 126.1.3: No targets specified.

COMMENTARY

> Performance targets for Reseller could include, for example, achieving stated levels of the following metrics per year, quarter, etc.: (i) amounts to be paid to Supplier regardless whether actual sales are made; (ii) actual sales, to encourage development of the Territory; (iii) number of Offering orders placed, possibly subdivided by Offering category; (iv) new customer acquisitions; (v) any other key performance indicator, or "KPI."

§ 126.1.3 **❑ Consequences of missing targets**

a. This section applies only if: (i) the AGREEMENT specifies Reseller Performance Targets for Reseller's performance, and (ii) Reseller fails to achieve such performance.

b. Reseller will then automatically lose any exclusivity that it has under the AGREEMENT in respect of the Territory, without the need for notice from Supplier.

c. The Reseller Relationship will nevertheless continue — on a nonexclusive basis — unless and until either party gives at least one month's notice that it is terminating the Reseller Relationship at the end of the notice period.

d. ❑ This § 126.1.3 sets forth Supplier's EXCLUSIVE REMEDY for any failure by Reseller to meet the Reseller Performance Targets.

COMMENTARY

> For Supplier, it might not be enough for Reseller to lose just its exclusivity for failing to meet performance targets: If Reseller were allowed to continue as a channel associate, even on a non-exclusive basis, then Supplier wouldn't be able to later offer an exclusive relationship to a replacement channel associate, which Supplier might well want to do.

§ 126.1.4 ❑ Required marketing activities

In addition to Reseller's obligations under 0, Reseller will engage in any specific marketing efforts set forth in the parties' agreement.

COMMENTARY

> Required marketing efforts in a given time period could include, for example: • maintaining a dedicated Web page; • X number of placements on TV shows, radio shows, podcasts, YouTube videos, etc., possibly with a show-host endorsement of a minimum time duration; • X number of Twitter promotions; • X number of Facebook placements.

§ 126.1.5 ❑ Advance consultation about marketing activities

To reduce the chances of mutual interference between Supplier's and Reseller's marketing activities, Reseller MUST consult Supplier in advance about Reseller's own proposed marketing activities concerning Offerings.

§ 126.1.6 ❑ No use of non-Supplier trademarks

Reseller will not promote or offer Offerings under any brand name other than those authorized in advance by Supplier.

§ 126.1.7 ❑ Additional Territory-related restrictions

Reseller must not:

❑ solicit or support any customer for Offerings if the customer has significant operations outside the Territory.

❑ establish or maintain facilities specifically for supporting customers' use of Offerings if such use is reasonably likely to occur outside the Territory.

❑ make any Offering available to any individual or organization that Reseller knows, or should know, that the Offering will be taken, installed, or used outside the Territory.

§ 126.1.8 ❑ No Reseller participation in competing offerings

During the term of the Reseller Relationship and for one year thereafter, Reseller must not participate, nor acquire any interest, in any enterprise that offers or promotes a product or service that competes with any Offering, *unless* Supplier gives its prior written consent.

COMMENTARY

CAUTION: Restrictions on Reseller's other activities could have implications under antitrust- and/or competition law.

§ 126.2 Identification of Reseller Relationship

§ 126.2.1 Reseller may identify itself as a Supplier channel associate

During the term of the Reseller Relationship, Reseller may (i) identify itself, in a non-misleading way, as a Supplier channel associate; and (ii) provide publicly available contact information for Supplier; as follows:

1. on Reseller's Website; and/or
2. in promotional materials approved in advance by Supplier.

§ 126.2.2 Reseller may use Supplier's logos (with restrictions)

a. During the term of the Reseller Relationship, Reseller's identification of itself as a Supplier channel associate (per § 126.2.1) may include commercially reasonable use of Supplier's logos for the relevant Offerings.

b. Any such use of Supplier's logos must conform to § 152 (trademark use).

c. Reseller must promptly stop using Supplier's logos if requested in writing by Supplier.

§ 126.2.3 Supplier may identify Reseller as a channel associate

During the Reseller Relationship, Supplier may identify Reseller as a Supplier channel associate, and use Reseller's logos, in the same

general way as in § 126.2.1 and § 126.2.2 (substituting "Reseller" for "Supplier" and vice versa).

§ 126.3 Fulfillment of orders for Offerings

§ 126.3.1 ☑ Reseller's customers may order directly from Supplier

Supplier may fill any orders for Offerings that it receives directly from Reseller's customers.

§ 126.3.2 ☑ Reseller may order from Supplier

The parties anticipate that *Reseller* will order Offerings from Supplier or its designee.

COMMENTARY

> In a pure referral arrangement, Reseller likely would not place orders for Offerings. In other arrangements, Reseller might, e.g., (i) acquire an inventory of physical products, software-installation codes, etc.; (ii) pay for those items when acquired; and (iii) sell to its customers from that inventory.

§ 126.3.3 How will orders be handled?

Channel-Offering orders are to be handled in accordance with XXX.

§ 126.3.4 ❑ Must Reseller maintain any particular level of inventory?

❑ Reseller must keep a minimum quantity of Offerings in inventory as follows: *[DESCRIBE]*.

❑ Reseller must <u>not</u> keep more than *[AMOUNT]* of Offerings in inventory without Supplier's prior written consent.

§ 126.3.5 ❑ May Reseller sell the Offerings at retail?

❑ Reseller may offer or sell Offerings from physical premises (for example, in stores).

❑ Reseller will not offer or sell Offerings from physical premises (for example, in stores) without Supplier's prior written consent

§ 126.3.6 **❑ Who is responsible for order delivery to Reseller customers?**

Reseller will acquire any physical Offerings and — at its own expense and risk — arrange for all storage and/or delivery to Reseller's customers.

❑ *Supplier* will arrange for delivery of Offerings to customers at Reseller's written direction.

COMMENTARY

In resale- and distributor arrangements, Reseller will often take delivery of Offerings and be responsible for getting them to Reseller's customers.

The alternative, where *Supplier* is responsible, is sometimes referred to generically as "drop-shipping."

§ 126.4 Pricing for Offerings

§ 126.4.1 **What pricing for *Reseller's* orders?**

During the Reseller Relationship, ☑ Reseller will pay for Offerings
❑ Reseller will be *entitled* to pay for Offerings at Supplier's then-standard list pricing, less the Reseller Discount for Offerings *[see § 130.1]*.

COMMENTARY

The "Reseller will pay" option (as opposed to "Reseller will be entitled to pay") would have the effect of locking in the prices that Reseller must pay — that, though, might not sit well with Reseller if Reseller could otherwise obtain Offerings elsewhere for a lower price (e.g., in "gray market" situations).

Reseller might wish to propose including restrictions on Supplier's right to increase prices; see XXX for some possibilities.

§ 126.4.2 What pricing for Reseller's *customers'* orders?

During the Reseller Relationship, Reseller's customers will be entitled to pay for Offerings:

1. at Supplier's then-standard list pricing, less the Reseller Customer Discount for Offerings; or
2. at the customer's option, at pricing as agreed by Supplier and the customer.

COMMENTARY

> See the commentary to § 126.4.1. In contrast to that section, this section recognizes that it's probably unrealistic (and likely not even enforceable) to try to contractually bind Reseller's customers to a particular pricing scheme, as opposed to binding Reseller itself for Reseller's own purchases.

§ 126.4.3 Supplier has no say in Reseller's resale pricing

As between Reseller and Supplier, Supplier has no authority to determine the prices that Reseller charges to Reseller's customers.

COMMENTARY

> It could be dangerous for Supplier to exercise control over the price at which Reseller sells products. That's because such "resale price maintenance" (or sometimes, "vertical price fixing") can create issues under antitrust- and competition laws.

§ 126.5 Payment for Offerings

(See also § 6.)

Supplier will be paid for Offerings that are provided (either by Reseller or directly by Supplier) to Reseller's customers as follows:

1. Supplier or its designee will invoice Reseller or Reseller's customers, in Supplier's discretion; and
2. The invoice will be paid to Supplier or its designee as stated in the invoice.

§ 126.6 Warranties, etc., for Offerings

§ 126.6.1 What warranty protection will Supplier provide?

a. Supplier will honor the same Offering warranty terms for Reseller's customers as it does for its own customers of the same offerings.

b. Supplier will defend (§ 43) and indemnify (§ 53) the Reseller Protected Group (§ 116) from and against any claim by any Reseller customer that acquired an Offering from Reseller, where the claim arises out of an alleged breach of a Supplier warranty concerning the Offering.

§ 126.6.2 Reseller has no authority to offer special Supplier terms

Reseller has no authority to make — and will not purport to make — any commitment to its customers on behalf of Supplier, except:

a. with Supplier's express, prior, written consent; and/or

b. as publicly stated by Supplier in (for example) Supplier's published marketing materials, end-user license agreement, terms of service, privacy policy, warranty document(s), etc.

§ 126.6.3 May Reseller offer its own warranties to its customers?

☑ Reseller may offer warranties or other commitments to its customers that are more favorable to customers than those offered by Supplier, but:

a. If Reseller does so, it is at Reseller's own risk;

b. Reseller must make it clear to its customers that Supplier is not liable for Reseller's commitments; and

c. Reseller must defend and indemnify Supplier against any third-party claim against Supplier arising from or relating to any Reseller-offered warranty.

❑ Reseller may not offer warranties or other commitments to its customers that are more favorable than those offered by Supplier.

COMMENTARY

In theory, there's no reason Reseller shouldn't be allowed to offer more-generous warranties to its customers than Supplier's standard warranties — but Supplier will want to assess whether Reseller's customers might get confused and try to claim that Supplier was obligated to stand behind Reseller's more-general warranties.

CAUTION: The alternative, prohibiting Reseller from offering more-favorable warranties to its customers, could be problematic under antitrust / competition law.

§ 126.7 Changes to content of Offerings

§ 126.7.1 May Supplier make changes to its line of offerings?

Yes: Supplier reserves the right — at any time and from time to time, in Supplier's sole discretion:

a. to add to or delete from Supplier's line of offerings;*

b. to modify any particular item in its line of offerings; and

c. to modify or discontinue support for any such item.

• For this purpose, "line of offerings" includes, without limitation, (i) items that are part of the Offerings, and (ii) support for any such items.

§ 126.7.2 Will Supplier *consult* with Reseller about modifications?

As a matter of commercial practice, Supplier may elect in its sole discretion to consult or notify Reseller in advance of any action that it takes under § 126.7.1. Supplier is not contractually bound to do so, however, and it will have no liability to Reseller for any such action that it does take, whether or not Supplier consults with Reseller about the action.

§ 126.7.3 May *Reseller* modify Offerings?

☑ No: Reseller will not package, repackage, modify, or otherwise alter any Offering without Supplier's prior written consent; Supplier may grant or

withhold such consent in its sole discretion. For example (and without limitation):

a. If any Offering comes in a sealed package — e.g., a software license code envelope — then Reseller must not open the package.

b. If any Offering comes in separable components, Reseller must not separate the components.

c. Reseller must not remove or alter any legend or notice (e.g., copyright, trademark and the like) and/or warnings on any Offering, promotional materials, or documentation.

§ 126.8 Customer data

§ 126.8.1 What information must Reseller provide about its customers?

Reseller will provide Supplier with data about Reseller's customers and transactions involving Offerings as follows:

1. ☑ from time to time, as reasonably requested by Supplier for purposes relating to the Reseller Relationship; and
2. ☑ at the end of the Reseller Relationship, as reasonably requested by Supplier to transition Reseller's customers to a relationship directly with Supplier.

§ 126.8.2 Supplier will comply with privacy laws

Supplier will follow any restrictions, imposed by applicable law, on Supplier's use of customer data provided by Reseller.

§ 126.9 Offering-related support

§ 126.9.1 Who will provide what support to Reseller's customers?

Customer support (defined in more detail below) for Offerings will be provided to Reseller's customers as follows:

- Level 1 support by: ☑ Reseller. ❑ Supplier.
- Level 2 support by: ❑ Reseller. ☑ Supplier.
- Level 3 support by: ❑ Reseller. ☑ Supplier.

Level 1 support refers to routine basic support for a product or service; it entails providing customers, where applicable, with compatibility information, installation assistance, general usage support, assistance with routine maintenance, and/or basic troubleshooting advice.

Level 2 support refers to more in-depth attempts to confirm the existence, and identify possible known causes, of a defect in a product or an error in a service that is not resolved by Level 1 support.

Level 3 support refers to advanced efforts to identify and/or correct a defect in a product or an error in a service.

§ 126.9.2 Reseller will follow Supplier's support guidance

In providing support for its customers, Reseller will follow any written- and oral guidance for customer support provided to Reseller by or on behalf of Supplier (to the extent that such guidance is not inconsistent with the AGREEMENT).

§ 126.9.3 Reseller will promptly flag any support difficulties

Reseller will promptly notify Supplier if Reseller finds that it is unable to respond effectively to a request for support from a Reseller customer.

§ 126.10 Closing out the Reseller Relationship

This section applies whenever the Reseller Relationship ends, whether by expiration or termination.

§ 126.10.1 How long will the Close-Out Period be? Ten business days

a. Except as otherwise provided in this § 126.10, Reseller will have a "**Close-Out Period**" lasting the specified time after the end of the Reseller Relationship; during that time, Reseller may attempt to complete any then-

pending transactions (in conformance with the AGREEMENT) on the same terms as before the end of the Reseller Relationship.

b. EXCEPTION: Reseller will not be entitled to a Close-Out Period if Reseller is in breach of the AGREEMENT at the time that the Reseller Relationship ends.

COMMENTARY

> A Close-Out Period likely wouldn't be appropriate if Reseller had sufficient advance notice that the Reseller Relationship was coming to an end.

§ 126.10.2 Which transactions may Reseller try to close out?

a. If Reseller wishes to utilize the Close-Out Period, then — not later than two business days after the date that the Reseller Relationship ends — Reseller must furnish Supplier with a complete written list of pending transactions that Reseller wishes to complete during the Close-Out Period.

b. Supplier may ask Reseller to furnish Supplier with evidence, reasonably satisfactory to Supplier, that Reseller has in fact been actively engaged in negotiating any particular transaction(s) specified by Supplier. If Reseller does not comply with the request within a reasonable time, then Reseller will not be eligible to complete the transaction(s) so specified by Supplier.

§ 126.10.3 What if the parties disagree about whether Reseller may close out a pending transaction?

Supplier's good-faith determination will be final as to whether Reseller is entitled to complete a particular pending transaction during the Close-Out Period.

§ 126.11 After the Reseller Relationship ends

§ 126.11.1 May Reseller keep promoting Offerings afterwards?

No: After the end of the last day of the Reseller Relationship, Reseller may not advertise, market, or otherwise promote Offerings, nor identify itself out as a channel associate of Supplier.

COMMENTARY

> This prohibition might not be necessary, because it's likely that Reseller wouldn't continue to promote sales of Offerings if it were no longer getting paid.

§ 126.11.2 Will the end of the Reseller Relationship have retroactive effect?

No: Ending of the Reseller Relationship will not affect either party's rights or obligations with respect to dealings in Offerings after the end of the last day of the Reseller Relationship.

COMMENTARY

> This prohibition might not be necessary, because it's likely that Reseller wouldn't continue to promote sales of Offerings if it were no longer getting paid.

§ 126.11.3 Will Reseller's *customers'* rights be protected afterwards?

Yes: The ending of the Reseller Relationship will not affect any then-established rights or obligations of Reseller's customers concerning Offerings.

§ 126.12 Software-related Offerings

This section applies to any Offering that includes software (including but not limited to software-as-a-service, or "SaaS") to be used by Reseller's customers.

§ 126.12.1 How will software be provisioned for Reseller's customers?

☑ Supplier will provide a Web-based provisioning system for Reseller's customers to sign up for access to (and licensing of) software-related Offerings; Reseller is to refer its customers to that provisioning system.

❑ Supplier will provide Reseller with access to a Web-based provisioning system; Reseller is to use that system to provision software-related Offerings for Reseller's customers.

§ 126.12.2 Reseller's customers must agree to Supplier's license terms

a. Supplier in its sole discretion may require Reseller's customers to agree to Supplier's applicable end-user agreement(s) and/or privacy policy, each as then in use by Supplier, as a prerequisite for being able to install and/or use an Offering.

b. Reseller is to advise each of its customers in writing (e.g., in a written quote form) that the customer will be required to agree to Supplier's forms referred to in subdivision 1.

§ 126.12.3 How will software updates be provided to Reseller customers?

IF: Supplier releases a superseding version of a software Offering — including for example an update, patch, new release, supplement and/or add-on component — THEN: Reseller will promptly (i) notify all of its customers of the availability of the superseding version and (ii) encourage them to download and install it.

§ 126.12.4 How may *Reseller* use Supplier's software?

a. Reseller may use any software Offering acquired from Supplier, in executable form only, for purposes of (i) demonstrations to prospective customers or clients; (ii) testing; and (iii) internal training.

b. All such use must comply with the applicable end-user license agreement and/or terms of service and privacy policy.

c. In conjunction with such use, Reseller may make a reasonable number of backup copies in accordance with Reseller's normal backup procedures.

d. Otherwise, Reseller will not use any software Offering acquired from Supplier in any manner (including but not limited to production use for Reseller's own benefit and/or service-bureau use for the benefit of any Reseller customer) unless Reseller has obtained the appropriate licenses from Supplier.

§ 126.12.5 Reseller will take certain actions if it suspects piracy, etc.

IF: Reseller suspects that unauthorized use, copying, distribution, or modification of an Offering (collectively, "unauthorized activities") might be taking place; THEN: Reseller must:

a. promptly advise Supplier;

b. provide Supplier with all relevant information reasonably requested by Supplier about the unauthorized activities;

c. provide reasonable cooperation with any efforts by Supplier to prevent or stop the unauthorized activities ("Policing Efforts"); and

d. not make any Policing Efforts itself without Supplier's prior written approval.

COMMENTARY

> Subdivision b: The "reasonably requested by Supplier" is a way of deferring the question: Who pays?
>
> Subdivision d: Supplier will probably want to maintain control over Policing Efforts because of the potential for adverse publicity and/or legal liability if Reseller were to go charging in like a bull in a china shop.

§ 126.13 Feedback about Offerings

a. IF: Reseller receives any *written* feedback, as defined in subdivision f, concerning any Offering, at any time; THEN: Reseller will promptly provide Supplier with a complete and accurate copy of the written feedback.

b. IF: Reseller receives any *oral* or other nonwritten feedback, concerning any Offering, at any time; THEN: Reseller will brief Supplier orally about the feedback, on a schedule to be determined by Supplier in its reasonable judgment.

c. Supplier may use or disclose feedback as Supplier sees fit in its sole discretion.

d. Supplier will have no financial- or other obligation, of any kind, to Reseller or any of its customers, in respect of feedback, unless expressly agreed otherwise in writing by Supplier.

e. Feedback from Reseller itself about Offerings will be treated in the same way as feedback from Reseller's customers.

f. For purposes of this § 126.13, "feedback" refers to any and all suggestions, comments, opinions, ideas, or other input.

§ 126.14 Product recalls

§ 126.14.1 What responsibility does Reseller have in an Offering recall?

Reseller will provide reasonable cooperation with Supplier and its designees in connection with any recall of Offerings.

§ 126.14.2 Who will bear Reseller's expenses in an Offering recall?

At Reseller's request, Supplier will reimburse Reseller, in accordance with **Error! Reference source not found.**, for certain expenses — when actually i ncurred by Reseller in providing the cooperation required by § 126.14.1 — as follows:

a. ☑ reasonable out-of-pocket external expenses such as (without limitation) shipping charges by carriers for returning physical Offerings

b. ❑ reasonable compensation for internal expenses, e.g., wages and salaries for Reseller personnel involved in the cooperation.

COMMENTARY

> "Internal" expenses such as wages and overhead are capable of being "gamed"; consequently, this provision does not make such expenses reimbursable.

§ 126.14.3 Deadline for recall-expense reimbursement requests

Reseller must make any request for reimbursement no later than three months ☑ after Reseller becomes obligated to pay the expense in question ❑ after Reseller pays the expense in question.

COMMENTARY

> The "after Reseller pays" option might be undesirable because it could allow Reseller to slow-pay its expenses and then suddenly spring the reimbursement request on Supplier.

§ 126.15 Reseller's servicing of Offerings

This section applies if Reseller engages in repair or other servicing of Offerings for its customers.

§ 126.15.1 What quality of parts must Reseller use?

Reseller must use parts of equal or better quality than the original parts in the Offering.

❑ Reseller may not use parts not previously approved in writing by Supplier.

§ 126.15.2 May Reseller use refurbished parts?

Reseller may not offer or provide as "new" any Offering that Reseller has repaired after return by a customer.

§ 126.16 ❑ Subassociates

§ 126.16.1 May Reseller appoint Subassociates?

Reseller may appoint one or more "Subassociates" to help carry out Reseller's obligations and exercise Reseller's rights under the parties' agreement, BUT only as stated in this section.

§ 126.16.2 Is Supplier's consent needed?

Reseller: ☑ must obtain ❑ need not obtain Supplier's written consent before appointing a Subassociate.

§ 126.16.3 What information about potential Subassociates must Reseller provide?

Before appointing a prospective Subassociate (a "prospect"), Reseller must provide Supplier with the following concerning that prospect:

1. the identity of the prospect;
2. such background information about the prospect as Reseller might reasonably request;
3. evidence, satisfactory to Supplier in its sole judgment, that the prospect has sufficient training and experience to carry out its duties as a Subassociate in a manner that will not reflect adversely on Supplier; and
4. *(if requested by Supplier:)* any authorization required by law for Reseller to cause a background check to be conducted on the prospect.

§ 126.16.4

❑ What discretion does Supplier have to reject a prospective Subassociate?

> Supplier may grant, withhold, or condition its consent to appointment of a Subassociate in its sole discretion.

❑ Supplier will not unreasonably withhold, delay, or condition its consent to the appointment of a Subassociate.

§ 126.16.5

❑ What agreement(s) must a Subassociate enter into?

Each Subassociate must enter into an agreement (a "Subassociate Agreement"); at a minimum, each such agreement must:

1. impose at least the same restrictions and obligations on the Subassociate as the AGREEMENT does on Reseller;
2. clearly state that Supplier will have no liability to the Subassociate in connection with the Sub-Reseller Agreement or the Subassociate's dealing in Offerings);
3. prohibit the Subassociate from appointing sub-Subassociates;
4. terminate automatically at the end of the Reseller Relationship; and
5. expressly name Supplier as a third-party beneficiary of the Subassociate Agreement.

§ 126.16.6

❑ Must *Supplier* be a party to a Subassociate Agreement?

Each Subassociate Agreement is to be entered into both by the Subassociate and: ☑ by Reseller ❑ by Supplier.

§ 126.16.7

❑ What responsibility does Reseller have for its Subassociates' actions?

Reseller will defend and indemnity the Supplier Protected Group against any claim arising out of acts or omissions of a Subassociate.

§ 126.17 ❑ Other sourcing of Offerings

§ 126.17.1 ❑ May Reseller acquire Offerings from other sources?

Reseller must not acquire Offerings from sources other than Supplier.

COMMENTARY

> CAUTION: Depending on the jurisdiction, restricting Reseller's right to acquire or dispose of products elsewhere might trigger legal complications.

§ 126.17.2 ❑ May Reseller provide Offerings to non-end-customers?

Reseller must not provide Offerings to others for resale or redistribution.

§ 126.18 Channel-Relationship miscellany

§ 126.18.1 ☑ Reseller must indemnify Supplier

Reseller will defend (§ 43) and indemnify (**Error! Reference source not found.**) the Supplier Protected Group (§ 116) from and against any and all claims by any third party arising out of Reseller's activities under the AGREEMENT.

§ 126.18.2 ☑ Reseller gains no rights not granted by the parties' agreement

Supplier reserves all rights not specifically granted by the AGREEMENT; this reservation includes (without limitation) copyrights, patent rights, trademark and service mark rights, trade secret rights and other intellectual property rights.

§ 126.18.3 ☑ No implied franchise- or business-opportunity relationship

a. This § 126.18.3 applies unless the AGREEMENT clearly and unmistakably provides otherwise.

b. No party intends, by entering into the AGREEMENT, to create a relationship that would be subject to laws governing franchises and/or business opportunities.

c. Each party **WAIVES**, to the fullest extent not prohibited by law, any rights or claims under laws governing franchises and business opportunities, to the extent or similar Laws arising out of or in connection with this Agreement.

§ 126.18.4 **☑ No Supplier responsibility for Reseller's finances**

Reseller acknowledges and agrees that Supplier has no responsibility for:

1. any dependence that Reseller might have on the Reseller Relationship for Reseller's revenues; nor
2. any harm that might come to Reseller from the Reseller Relationship's coming to an end.

(END OF RIDER)

§ 127 Responsible

The term *responsible*, in the sense of taking responsibility, refers to action that is both reasonable and conscientious. As an illustrative example, to make *responsible* efforts to achieve an objective (whether or not the term is capitalized) means to make at least such efforts as a reasonable person would make in a conscientious attempt to achieve that objective.

COMMENTARY

> The term *responsible* is perhaps vague, but it's not unknown in the law. For example, the Delaware chancery court, in describing the duration of a preliminary injunction, referred to it as a "responsible period," albeit shorter than the period to which the claimant arguably would have been entitled. *See* Martin Marietta Materials, Inc v. Vulcan Materials Co., 56 A.3d 1072, 1147 (Del. Ch. 2012), *aff'd*, 45 A. 3d 148 (Del. 2012) (en banc).

§ 128 Review restrictions (commentary)

Some contracts purport to prohibit one party from participating in reviews of products of the other party; this has been seen in agreements between hotels and guests and even between dentists and patients. This type of provision, though, could lead to serious complications down the road, such as adverse publicity and even litigation:

See, for example, the federal Consumer Review Fairness Act, which "makes it illegal for a company to use a contract provision that: 1. bars or restricts the ability of a person who is a party to that contract to review a company's products, services, or conduct; 2. imposes a penalty or fee against someone who gives a review; or 3. requires people to give up their intellectual property rights in the content of their reviews." Federal Trade Commission, Consumer Review Fairness Act: What Businesses Need to Know (FTC.gov 2017).

Consider also the so-called Streisand effect: When the legendary singer and actress tried to suppress unauthorized photos of her residence, the resulting viral Internet publicity resulted in the photos being distributed even more widely — thus defeating her purpose. (The Wikipedia article linked at the beginning of this paragraph contains numerous other examples.)

§ 129 Risk-Related Options

None of the terms in this chapter apply unless the AGREEMENT specifically says so.

§ 129.1 Limitation of Liability: Claim Deadline

a. Any claim arising out of or relating to the AGREEMENT must be brought on or before the date one year after the date when the claimant knew or should have known of the potential existence of the claim.

b. The claimant's failure to bring the claim within the time specified in subdivision 1 PERMANENTLY AND IRREVOCABLY WAIVES the claim.

c. The Limitation of Liability: General Terms (§ 30) are incorporated by reference into this section.

§ 129.2 Liability Disclaimer: Non-Contractual Liability

§ 129.2.1 When does this Disclaimer apply?

This section applies if the AGREEMENT states, in substance, that one or more parties disclaims liability other than for breach of contract.

§ 129.2.2 What effect does a disclaimer under this section have?

To the extent not expressly prohibited by law, each party other than the disclaiming party KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY:

1. AGREES that the agreeing party's rights and obligations of the parties arising out of or relating to the AGREEMENT, or any transaction or relationship resulting from the AGREEMENT, are to be defined solely under the law of contract in accordance with the express provisions of the AGREEMENT; and
2. WAIVES any such obligations allegedly owed by the disclaiming party that are not expressly stated in the AGREEMENT, whether such obligations are alleged to arise in (for example) quasi-contract; *quantum meruit*; unjust enrichment; promissory estoppel; tort; strict liability; by law (including for example any constitution, statute, or regulation); or otherwise.

§ 129.2.3 What other terms apply to this section?

The Limitation of Liability: General Terms (§ 30) are incorporated by reference into this section.

§ 130 Services Protocol

This Protocol applies when the Term Sheet says that one party ("Provider") will perform services for another signatory party ("Customer").

COMMENTARY

The Term Sheet should also reference a statement of work that specifies deliverables; timing; and compensation.

Statements of work

§ 130.1 Statements of work must be in writing

a. Services under the AGREEMENT are to be provided — and need only be provided and paid for — as specified in one or more agreed "**statements of work**."

b. No party will assert a right or obligation for services, nor for payment for services, under the AGREEMENT unless the right or obligation: (i) is in writing, and (ii) is signed on behalf of both Provider and Customer.

c. The Order-Processing Rider (§ 85) will apply to all statements of work as applicable.

COMMENTARY

It's extremely common — and a very good idea — for services agreements to separate the "technical" details of a services contract in a work order.

(Optional reading: For a useful overview of work orders, see Stephen F. Pinson, Negotiating a work order: Key Terms (ScottAndScottLLP.com 2016), archived at https://perma.cc/8JYJ-KEJT.)

CAUTION: Don't assume legal review of work orders won't be necessary. Some contract reviewers make the mistake of ignoring work orders, on the sometimes-mistaken assumption that *only* "technical" information is to be found there. It's a worthwhile exercise for a contract drafter or reviewer (here, "reviewer") at least to glance through any work order, because:

- The reviewer will be better able to negotiate the terms and conditions if she has some idea of the technical details; and
- Perhaps unconsciously — or perhaps deliberately — the other side's drafter might have included important "legal"-type terms and conditions in the work order, in the hope that the contract reviewer might overlook them.

Other terms for "statement of work" are "scope of work" and "work order."

The no-assertion language is intended to make it a breach of contract to contend otherwise, with the resulting damages being the attorney fees and expenses needed to defend against the contention.

CAUTION: In some jurisdictions, non-written statements of work might be enforceable under the Statute of Frauds notwithstanding this requirement.

§ 130.2 How may statements of work be modified?

A statement of work may be modified via "change order" as stated in § 102.10.

§ 130.3 Who will obtain routine licenses, permits, etc.?

Provider will obtain any permits and licenses needed for Provider's performance of services generally — for example, building permits, contractor- and occupational licenses, etc.

COMMENTARY

One or more government licenses or permits might be required for Provider's activities in connection with the services. The required authorizations might be relatively straightforward, as in local building permits for building a house or office building. On the other hand, in some circumstances — for example, building a nuclear reactor or an oil pipeline — the government-permitting process could be a decidedly non-trivial matter.

In addition, one or more intellectual-property licenses from third parties might be required for the customer to *use* any resulting deliverables.

For some work orders, it might make more sense for Customer to obtain at least some of the required building permits, etc.

CAUTION: Not getting the proper permits and licenses could have serious consequences. For example:

- In California and possibly other jurisdictions, a contractor that undertakes work required to be done by a licensed contractor (e.g., certain construction- or remodeling work), but that does not itself have

the proper license(s) at all times while performing the work, may forfeit its right to be paid for any of the work. See, e.g., Great West Contractors, Inc., v. WSS Industrial Construction, Inc., 162 Cal. App. 4th 581, 76 Cal. Rptr. 3d 8 (2d Dist. 2008) (reversing $220,000-plus judgment in favor of subcontractor, on grounds that subcontractor had not obtained the required license when it prepared initial shop drawings and did other preliminary work).

- Under a 2002 'disgorgement' amendment to the California statute, such a contractor might have to repay any payments it did receive for the work. *Cf.* The Fifth Day, LLC v. Bolotin, 72 Cal. App. 4th 939 (2d Dist. 2009) (reversing summary judgment that party was barred from recovering compensation for services; party was not a "contractor" within the meaning of the statute).
- California courts have looked to Cal. Lab. Code § 2750.5 to hold that a contractor that uses an unlicensed subcontractor is responsible for unpaid wages, withholding, and worker's compensation premiums of the subcontractor's employees; see generally this Pillsbury Winthrop memo.

§ 130.4 Who will obtain any required special authorizations?

Provider will obtain any special authorizations for performance of the services that go beyond what would normally be required in Provider's general line of work.

COMMENTARY

This task, too, might be better allocated to Customer in some circumstances.

§ 130.5 Who will obtain any required licenses for *use* of deliverables?

a. Ordinarily, *Customer* is responsible for obtaining any intellectual-property ("IP") licenses or other authorizations that might be required for use of deliverables in connection with Customer's business.

b. On the other hand, if Provider warrants that Customer's use of deliverables will not infringe specified third-party IP rights, then *Provider* will obtain any licenses needed for such use not to infringe those rights.

COMMENTARY

Customer might need to obtain, e.g., patent licenses to use the deliverables, or software licenses to use software needed to make use of deliverables. The parties' agreement might warrant that *deliverables per se* do not infringe third-party IP rights; such a warranty might be express, or it might be implied under UCC 2-312. But a third party might claim that Customer's use of the deliverables infringes the third party's IP rights, e.g., by infringing a patent or copyright.

CAUTION: It can be a big mistake for Customer to fail to establish clear lines of responsibility about who will obtain any third-party authorizations that might be needed. A California business owner received an expensive lesson on that subject when he hired a Web developer to revamp the business's Website: The Web developer used copyrighted photographs without permission of the copyright owner; this eventually led to an award of damages and attorney fees — against the business owner — of more than $636,000. See Erickson Productions, Inc. v. Kast, 921 F.3d 822 (9th Cir. 2019); proceedings below, e.g., No. 5:13-cv-05472-HRL (N.D. Cal. 2018).

§ 130.6 What if the need for a particular authorization isn't clear?

IF: Provider and Customer disagree in writing about the need for a particular third-party authorization; THEN: Provider will not be in breach of the AGREEMENT or the statement of work if, by notice to Customer, Provider suspends work on the relevant portion(s) of the services pending resolution of the disagreement.

COMMENTARY

It's been known to happen: A services provider tells a customer that a particular permit or license (or other third-party approval) is needed. But then the customer says nah, we don't need no stinkin' permit; get to work. In such a situation, the provider — not wanting to become liable for patent infringement, with a potentially-huge liability risk — might want (i) to have the right to suspend work, and/or (ii) to demand that the

customer take financial responsibility if the provider proceeds despite its misgivings.

§ 130.7 Who will "take care of" third party claims resulting from failure to obtain a needed authorization?

IF: A party (the "Responsible Party") fails to obtain one or more permits or licenses for services as agreed; AND: That failure leads to a third party's making a claim against another party;

THEN: The Responsible Party will defend and indemnify (**Error! Reference source not found.**) the other party and its Protected Group (§ 116) against all damages and losses incurred as a result of the claim.

COMMENTARY

Some illustrative examples of third-party claims covered by this section might be: • a governmental entity orders a job site to be shut down because the service provider failed to get a required permit; • a third-party software vendor sues the customer for patent infringement because the provider used an illegal copy of the vendor's software in providing the services.

Keep in mind that damages for breach of a contractual obligation would normally be limited to foreseeable damages, whereas an indemnity obligation might encompass even unforeseeable damages (unless otherwise specified in the indemnity language); see XXX for additional details.

§ 130.8 What are Provider's responsibilities for getting the work done?

Provider will see to it that the following are accomplished:

1. the successful completion of all individual tasks and other actions necessary for the proper rendering of the services set forth in the statement of work, even if one or more such individual tasks is not expressly set forth there;
2. the furnishing of all materials, equipment, supplies, computer hardware and -software, work locations, electrical power, Internet-

and other communications capability, and other items needed to meet Provider's performance responsibilities — this obligation includes any necessary acquisition, installation, and maintenance of all such items;

3. the furnishing, as necessary, of prudent, properly functioning safety equipment for Provider's personnel and the personnel of its contractors; this includes, without limitation, any necessary personal protective equipment (PPE); and

4. the supervision and, to the extent necessary, training of individuals engaging in the services.

COMMENTARY

Some customers are likely to want their services-agreement forms to expressly require the provider to complete all individual tasks, furnish all materials, etc., that are necessary to complete the work.

Subdivision 1: A provider might be concerned that this subdivision could lead to disputes about expensive (and delay-causing) "scope creep." It seems more likely, though, that such language wouldn't do any significant harm. Here's why: • Suppose the parties were to end up fighting about the scope of what Provider is supposed to do. In that case, the presence or absence of this all-individual-tasks language seems unlikely to make a difference one way or the other. • So, if the all-individual-tasks language gives Customer some comfort, why not include it; doing so can help to remove a potential delay on the path to signature.

Subdivision 2: Keep in mind that for some services projects, it might make sense for Customer to provide some or even all materials, tools, etc. If so, that should be spelled out in the statement of work.

Subdivision 3: Many services contracts include detailed written compliance requirements concerning health, safety, security, and environment ("HSSE") issues. Providers typically take these requirements into account in pricing their work.

§ 130.9 What level of Provider performance is required?

☑ Provider will see to it that all services are performed in a **workmanlike** manner; the term *workmanlike* refers to work that would generally be

considered proficient by those who regularly engage in the relevant trade or profession.

❑ Provider will see to it that all services are performed in a **first-class** manner; the term *first class* refers to excellent- to outstanding performance (but not necessarily flawless performance), as would generally be judged by those who successfully engage in the relevant trade or profession.

COMMENTARY

These performance requirements are phrased as covenants, that is, promises, and not representations or warranties – although a warranty is in fact a type of covenant (specifically, a conditional covenant); see BLACK'S LAW DICTIONARY 1725 (9th ed. 2009), quoted in Fed. Ins. Co., 354 S.W.3d at 293.

The term workmanlike seems to be widely used in court decisions, sometimes as "skillful and workmanlike" (which seems redundant). See generally Fed. Ins. Co. v. Winter, 354 S.W.3d 287, 292-93 (Tenn. 2011) (extensively reviewing case law and treatises). S

Some service providers might balk at using the term "workmanlike" performance because they fear the term could be ambiguous. They might prefer in accordance with the specifications, or perhaps competent and diligent. Of course, any of those terms is likely to involve factual determinations in litigation or arbitration, so it's hard to see how one is more- or less favorable than the other.

The "considered proficient" language in the workmanlike standard is adapted from a decision by the Supreme Court of Texas. Melody Home Mfg. Co. v. Barnes, 741 S.W.2d 349, 354 (Tex. 1987), quoted in Ewing Constr. Co. v. Amerisure Ins. Co., 420 S.W.3d 30, 37 (Tex. 2014).

The language "by those who regularly engage …" calls for judging Provider's performance according to a pragmatic, real-world standard — but which of course would likely require (expensive) expert testimony in the event of a dispute and thus might make a relatively-quick summary judgment unlikely.

A requirement of "first-class" performance might be appropriate in some situations, but Provider might charge more, and Customer might prefer to pay for simply "workmanlike" performance as described above.

§ 130.10 What qualifications are required for individual personnel?

Provider will see to it that all individuals who are assigned to perform services under a statement of work:

1. are competent and suitably trained for the task;
2. are bound by confidentiality obligations to Supplier sufficient to support any confidentiality obligations that Supplier has to Customer under the AGREEMENT;
3. are legally able to be employed in any jurisdiction where those personnel are to be physically present; and
4. to the extent so stated in the AGREEMENT or statement of work, have been screened with (for example) criminal background checks.

See also XXX (personnel).

❑ In addition, all personnel assigned to perform services under a statement of work must meet the following qualifications: *[DESCRIBE]*.

COMMENTARY

Subdivision 1: The "competent and suitably-trained" criterion for personnel is included here as a proxy that can make it easier for others to determine whether Provider is in fact complying with the statement of work. Consider this: In a given situation where work is being done, Customer might not be competent to judge whether the work is in fact being done correctly. On the other hand, it might be obvious that the person trying to perform the work simply doesn't know what he or she is doing.

§ 130.11 How are defects to be handled?

Provider will proceed in accordance with XXX in any case of (i) defective performance of services, and/or (ii) delivery of defective deliverables, in either case by or on behalf of Provider.

COMMENTARY

A services contract will typically obligate the provider to fix problems with the services and/or the deliverables *as delivered* in accordance with a specified procedure or protocol; one common protocol can be summed up as "repair, replace, or refund" (see [LINK]).

The "as delivered" phrase takes into account the possibility that Customer might modify a deliverable after delivery — because in such a situation, Provider likely wouldn't want to have to fix a defect for free if the defect wasn't of Provider's doing.

§ 130.12 What is *Customer's* responsibility for the services?

Customer is to provide reasonable basic cooperation with Provider (and with Provider's agents and subcontractors, if applicable) as reasonably requested by Provider from time to time.

COMMENTARY

This provision should be unobjectionable — and it can serve as a "canary in the coal mine" clause: • to identify potential problem customers; and/or • to alert both parties if the customer wants the provider to "just take care of it and send me the bill when you're done."

This provision intentionally does not specify who will pay for specific aspects of Customer's cooperation. The reasonableness requirement should give each party some comfort on that point

§ 130.13 Who is to control the "means and manner" of the work?

As between Provider and Customer, Provider has the sole authority and the sole obligation to control the means, manner, time, and place of performance of the services.

COMMENTARY

This declaration is intended to support Customer's position that Provider is an "independent contractor" and not an employee of Customer — the latter status could be problematic for Customer, as discussed at § 78.3 (independent-contractor status)

§ 130.14 ❑ Mitigation efforts are required to make up for schedule slips

IF: A statement of work clearly states that *a particular milestone* must be completed by a specified date; AND: The statement of work specifically identifies the milestone as material milestone; AND: The milestone is not completed by the specified date;

THEN: Provider must make efforts that are reasonable under the circumstances to mitigate any harm resulting from the delay and to get the statement of work back on schedule.

(Depending on the circumstances, Provider's efforts might *or might not* need to be at Provider's sole expense in order to be reasonable.)

COMMENTARY

The idea for this provision comes from a clause suggested at the Redline.net Website by lawyer Cynthia Abesa.

This provision embraces the vagaries inherent in the situation and simply says that Provider will make "efforts that are reasonable under the circumstances. The approach here accepts the business risk that by using this provision, the parties will be "kicking the can down the road," but they will be doing so in the service of getting the contract to signature sooner and taking the chance that they can agreeably work out any issues that might arise in actual practice.

§ 130.15 How will services be priced?

Provider will charge — and Customer will pay — for services as stated in the statement of work.

COMMENTARY

Services agreements typically require billing by the provider to be 1) as specified in the statement of work, e.g., with progress payments; and 2) accompanied by supporting detail sufficient to document the invoiced charges.

A customer might want a service provider to issue interim invoices as specified milestones are completed, or perhaps at specified time intervals.

A customer also is likely to want an audit provision (see XXX) if the service provider will be billing on anything other than a flat-fee, all-inclusive fee.

§ 130.16 Will Provider's out-of-pocket expenses be reimbursed?

If the statement of work so states, Customer will reimburse Provider's reasonable out-of-pocket expenses actually incurred in providing services, in accordance with **Error! Reference source not found.** (expense r eimbursement).

§ 130.17 When are invoices to be sent?

Provider will send Customer one or more invoices for services, and for reimbursable expenses, if applicable:

1. on the schedule specified in the statement of work, if any;
2. otherwise, upon completion and acceptance of the services.

See also payment terms, § 6.

COMMENTARY

Payment milestones will often be negotiated and specified in a work order.

§ 130.18 May Provider suspend services for nonpayment?

☑ Yes: IF: Customer does not pay Provider an amount due under the Agreement within seven days following the original payment due date; AND: The nonpayment is not due to fault attributable to Provider; THEN:

1. Provider may suspend its performance of the relevant Services at any time beginning at the end of seven days following notice of suspension, without prejudice to Provider's other remedies for the nonpayment; and
2. The price of the relevant services is to be appropriately adjusted for account for Provider's reasonable costs, including for example those (if any) associated with: (A) any resulting delay; and (B) redeployment of personnel- and material resources in

connection with (i) the suspension of work and (ii) any resumption of work.

❑ No: In no event may Provider suspend or terminate performance of the services *because of a payment dispute*.

❑ No: In no event may Provider suspend or terminate performance of the services except as expressly provided in the AGREEMENT or in the relevant statement of work.

COMMENTARY

The "Yes" option's language is modeled on an American Institute of Architects contract form, which was litigated in U.W. Marx, Inc. v. Koko Contracting, Inc., 124 A.D. 3d 1121 (N.Y. App. 2015). ¶ Drafters should consider providing for an independent expert to oversee and, if necessary, to decide the pricing adjustment in subdivision (2) of the "Yes" option.

The first "No" option is modeled on § 2.5 of a 2008 outsourcing agreement between Boise Cascade, L.L.C., and Boise Paper Holdings, L.L.C.

The second "No" option language ties up a potential loose end in an American Institute of Architects contract form, the relevant clause of which was litigated in the *U.W. Marx* case cited above.

§ 130.19 How may Customer utilize deliverables from services?

a. Customer may utilize any and all deliverables from services under the AGREEMENT in Customer's business as Customer sees fit, EXCEPT to the extent (if any) that the AGREEMENT, or the relevant statement of work, expressly states otherwise.

b. Customer's right under subdivision a applies to any and all intellectual-property rights owned or otherwise assertable by Provider.

c. Customer acknowledges that its right under subdivision a might be subject to any applicable rights of third parties unless Provider warrants otherwise in writing.

COMMENTARY

This will normally be a no-brainer. See also the service-bureau-use provision below.

§ 130.20 May Customer use deliverables *for service-bureau purposes*?

☑ Customer may use deliverables for service-bureau use. NOTE: For this purpose, "service-bureau use" refers to the providing of services to or for third parties, where those services are comprised substantially of functions performed by one or more deliverables under the AGREEMENT.

❑ Customer may use deliverables for service-bureau use, but only within the following limits: *[SPECIFY]*.

❑ Customer may not use deliverables for service-bureau purposes.

COMMENTARY

Service-bureau use by Customer might be problematic for Provider if the proposed service bureau use would compete with Provider's own products or services. (Of course, Provider should ask: How likely this is to happen, and is it a big enough business risk to make it worth arguing about it with my customer?)

§ 130.21 May Customer allow *others* to use deliverables?

☑ Customer may allow others (for example, Customer's other contractors) to use deliverables for Customer's business purposes.

❑ Customer may not allow competitors of Provider to use deliverables.

§ 130.22 May Customer continue development of deliverables?

☑ Customer may modify or otherwise continue development of deliverables or have the same done by others.

a. Any permitted modification or development activity must not violate: (i) applicable law such as export-controls laws, nor (ii) any unrelated IP rights assertable by Provider, if any.

b. ❑ The following restrictions on modification and continued development of deliverables will apply: *[SPECIFY]*.

c. ❑ *Exception*: To help protect Provider's trade secrets and other confidential information, Customer may not have deliverables modified by competitors of Provider.

❑ Customer may not modify or otherwise continue development of deliverables, nor have the same done by others.

COMMENTARY

> Just because Customer paid for the deliverable does not mean that Customer necessarily gets to further develop it. For example, if the deliverable is a copyrighted work of authorship such as computer software, then Provider might have the statutory right to prevent Customer from modifying or improving the deliverable without Provider's permission.
>
> True, Customer might be able to argue that Provider implicitly granted Customer a license to do as it wished with the deliverable. See, e.g., Effects Resellers, Inc. v. Cohen, 908 F.2d 555, 558-59 (9th Cir. 1990). But it might take extended and expensive litigation for Customer to win that fight. See, e.g., Numbers Licensing, LLC v. bVisual USA, Inc., 643 F. Supp. 2d 1245, 1252-54 (E.D. Wash. 2009) (denying preliminary injunction); *cf.* Joint Comm'n Resources, Inc., v. Siskin Tech. Inc., No. 14 CV 1843, slip op. (N.D. Ill. Sept. 29, 2016) (denying summary judgment).

§ 130.23 Is Provider *required* to support modifications by others?

☑ No: Provider may, in its sole discretion, decline to provide support for a deliverable if Provider reasonably determines that the request for support arises from or relates to modification of the deliverable by any individual or organization other than (i) Provider, or (ii) an individual or organization expressly authorized or directed in writing by Provider to make that modification of the deliverable. (In case of doubt: This section

in itself neither authorizes nor prohibits *Customer* from modifying any deliverable.)

COMMENTARY

Providers will often be reluctant to take on any responsibility for deliverables that anyone else has "messed with."

§ 130.24 Could Customer lose its rights in deliverables if it doesn't pay?

☑ Customer's timely payment of any amounts required by the applicable statement of work in respect of a particular deliverable is a prerequisite to Customer's continued exercise of its rights in that deliverable.

COMMENTARY

A services provider, concerned about the possibility of not getting paid, might seek to include a contract provision that the customer's rights in the deliverables are dependent on the customer's timely payment of amounts required by the statement of work. A customer likely would object to such a provision; the customer would assert that a minor payment dispute should not call into question the customer's right to use the deliverable(s), possibly even disrupting an M&A transaction.

A provider, on the other hand, will legitimately be concerned that the customer might file for bankruptcy protection, meaning that the customer would continue to enjoy its rights in the deliverable(s) while paying the provider pennies on the dollar if anything.

In the U.S., as a compromise the provider might want:

- to take a security interest in the customer's right to use the deliverable(s), using a clause provision such as [TO BE DRAFTED]; and
- to "perfect" the security interest by filing a UCC-1 financing statement.

§ 130.25 Who will own any resulting intellectual property?

a. As between Provider and Customer, unless the statement of work expressly provides otherwise, Provider (the **IP Owner**) will own the intellectual-property rights in and to:

1. any deliverables, and/or

2. any Toolkit Items, defined in subdivision b below.

that may be created, in the performance of Provider's obligations under the statement of work, by one or more employees of Provider (and/or of Provider's subcontractors, if any).

b. "**Toolkit Item**" refers to any concept, idea, invention, strategy, procedure, architecture, or other work, that:

1. is, in whole or in part, created by Provider in the course of providing services under the AGREEMENT; but

2. is not specific, and/or is not unique, to Customer and its business; and

3. does not constitute confidential information of Customer.

c. The provisions of the IP Ownership Rider (§ 84) will apply to all such intellectual-property rights; upon request by the IP Owner, the other party or parties will take the steps called for by that section.

d. IF: Customer is the IP Owner under subdivision a; THEN: Provider will seasonably disclose to Customer, in writing and in detail, all intellectual property to be owned by Customer under subdivision a.

e. IF: Provider is the IP Owner under subdivision a; THEN: Provider's ownership rights are subject to Customer's rights in the Deliverables under the AGREEMENT.

COMMENTARY

Subdivision a: Note the separation of ownership of the intellectual property contained in deliverables versus IP in Toolkit Items.

It's not unusual for a big customer with bargaining power to insist on owning the IP rights in **any** intellectual property that a smaller provider might create in the course of a services project. Such a customer's attitude is usually along the lines of, "if I pay for it, I *own* it." Such a customer might want the right to sue third parties for infringing the IP rights in the Deliverables. If that were ever to be the case, it might be necessary for the customer to own the IP rights in order to establish the customer's standing to bring an infringement action. [TO DO: CITATION NEEDED] In many cases, though, the customer really won't be especially concerned about

third-party infringement, which would tend to negate *that* purported justification for demanding ownership of the IP rights.

Often a customer's insistence on IP ownership simply won't make business sense, because: • The provider's ability to do projects at a reasonable price will often depend on its ability to re-use its work product from its prior projects. • The customer's ownership could choke the provider's ability to compete in its market. • The customer might have no particular reason to own the IP, other than "I *wanna*." • The *provider* might not have standing to sue for infringement of the IP rights.

FALLBACK: If the customer persists in demanding outright ownership, the provider could propose that: • The customer's ownership of intellectual-property rights extends only to the specific deliverables identified in the statement of work. • The provider has a permanent, irrevocable, worldwide, royalty-free license to use the IP for any and all purposes. These would not be ideal for the provider, but could be an acceptable business risk.

§ 130.26 What must Customer do to terminate a statement of work for cause

Customer may terminate a statement of work for cause by giving notice of termination (see § 20) to Provider, but ONLY if all of the following prerequisites are satisfied:

1. one or more of the events of cause listed in § 130.27 occurs;
2. Customer gives Provider notice (see § 20) that the event(s) have occurred; and
3. the occurrence is not cured within two business days after Provider's receipt of Customer's notice of the occurrence(s) of the event(s) of cause.

COMMENTARY

These termination-for-cause provisions draw on terms found in various services-agreement forms.

§ 130.27 What events would qualify as "cause" for termination by Customer?

Any one or more of the following events — other than for unmistakably-good reason, for example, as agreed in writing, including without limitation in a force-majeure provision in the AGREEMENT, or as authorized or required by law — would allow Customer to terminate a statement of work for cause under § 130.26:

1. Provider does not timely start to perform the services, if the parties have agreed in writing to a specific start time;
2. Provider is shown to have clearly abandoned performance;
3. Provider is shown to have clearly suspended performance if the AGREEMENT or the statement of work prohibits suspension; or
4. Provider does not timely complete the services in compliance with the standards set forth in the AGREEMENT and/or the statement of work.

COMMENTARY

> Subdivisions 2 and 3 allow Customer to terminate a statement of work if Provider abandons or (in certain circumstances) suspends performance of the work. Either such event must be clearly shown, however; this requirement aims to reduce the chances of premature- or bad-faith terminations.

§ 130.28 Is termination Customer's sole recourse for cause?

☑ Customer's right to terminate a statement of work for cause would be in addition to any other recourse available to Customer under the AGREEMENT, the statement of work, or the law. NOTE: See also § 130.42 for required post-termination actions.

❑ Customer's right to terminate a statement of work for cause would be Customer's **EXCLUSIVE REMEDY** for the event(s) of cause that gave rise to Customer's right to terminate.

§ 130.29 May *Provider* terminate a statement of work for cause?

☑ Provider may terminate a statement of work for cause, effective immediately upon notice to Customer per § 20, **BUT ONLY** if Customer:

1. materially breaches the AGREEMENT in respect of the statement of work; and
2. the occurrence is not cured within ten business days after Customer's receipt of Provider's notice of the event occurrence(s).

❑ Provider may not terminate a statement of work for cause unless clearly so stated in the statement of work or otherwise agreed in writing.

COMMENTARY

> In many cases, the most-significant breach Customer will likely commit is failing to pay Provider's invoices.

§ 130.30 Termination for cause is presumed to be in good faith

Assuming that the applicable prerequisites are satisfied to allow a party to terminate a statement of work for cause, then the decision whether to actually terminate the statement of work will be entirely up to that party, in its sole discretion (defined in § 42b).

§ 130.31 May Customer terminate a statement of work at will?

a. ☑ Customer may terminate a statement of work at will by giving notice of termination (see § 20) to Provider.

b. ☑ Any termination at will by Customer that complies with the requirements of this section is to be conclusively deemed to satisfy any applicable standard of good faith and fair dealing.

c. ❑ Customer may not terminate a statement of work at will.

For purposes of this Protocol, "termination at will" and "termination for convenience" are synonyms.

COMMENTARY

CAUTION 1: Customer's right to terminate "at will" or "for convenience" can give a customer significant leverage over a services firm that hopes to get repeat business. For example, in 2019 New York City's Metropolitan Transit Authority demanded that many of its services firms accept 10% cuts in their bills or face termination for convenience. Paul Berger, MTA Vendors Mull Ending Contracts as Authority Seeks 10% Cuts (WSJ.com May 18, 2019).

CAUTION 2: Provider likely would not want Customer to pull the plug before Provider has a chance to recoup its investment in personnel, matériel, etc., and before it finds other work for personnel who had been occupied largely with the statement of work; see the options below for possible ways of addressing that concern.

Subdivision b: This good-faith conclusive presumption is intended to roadblock aggressive trial counsel from trying to gum up a dispute by accusations of bad faith. See XXX.

§ 130.32 How much advance notice of termination at will is required?

Any termination at will of a statement of work by Customer will be effective no earlier than six months after the effective date of Customer's notice to Provider (see § 20) of termination at will.

COMMENTARY

This advance-notice requirement will be especially appropriate in outsourcing-type arrangements, where Provider might well need some lead time in which to find replacement work for its people involved in providing the services.

§ 130.33 ❑ Fee for Customer termination at will: [SPECIFY]

Termination at will of a statement of work by Customer will not become effective until Customer pays Provider a fee, in the amount stated in the

parties' agreement or in the statement of work, at the same time as giving notice of termination.

COMMENTARY

The fee for termination at will could be reduced as time goes on and Provider presumably recoups more of its investment in the project.

§ 130.34 ❑ Required milestones before Customer may terminate at will: [SPECIFY]

Customer may not terminate a statement of work at will until the specified milestones in the parties' agreement or statement of work have been achieved.

§ 130.35 ❑ Earliest date for Customer notice of termination at will: [SPECIFY]

A notice of termination at will by Customer will not take effect as a notice before the date specified in the AGREEMENT or in the statement of work, whichever is later. (This is a different issue than when the termination itself will take effect.)

§ 130.36 May *Provider* terminate at will?

☑ Provider may not terminate a statement of work at will.

COMMENTARY

In a services agreement, it's likely that Customer would not want a provider of critical services to be able to walk away and leave Customer in the lurch.

In any of these situations, the customer will generally want the option to keep the project going on its own or to transfer it to another provider. The customer will thus want the provider to turn over items as discussed below. *See generally* Blaine Green and Michael Murphy, Lessons from Litigating Technology Services Agreements(PillsburyLaw.com 2014).

§ 130.37 After termination, Provider will issue final invoice(s)

After any termination of a statement of work, Provider is to send Customer one or more final invoices for the statement of work, to cover all previously unbilled amounts for which Provider seeks or will seek to be paid or reimbursed in connection with that statement of work.

COMMENTARY

> After any termination of a statement of work, the provider's first priority will probably be to get paid. (This might involve an awkward discussion if the customer claims that the provider failed to meet its obligations under the statement of work. And *that's* especially likely in an unfriendly termination, whether for breach or at will.
>
> Multiple "final" invoices might be needed if some billable charges still have to "catch up" to Provider (e.g., invoices from subcontractors and/or providers of matériel).

§ 130.38 Provider will make specific post-termination deliveries

Promptly after any termination of a statement of work, Provider will cause the "**Termination Deliverables**," namely the following, to be delivered to Customer or to Customer's designee:

1. all completed deliverables and work-in-progress for that statement of work — those will remain subject to any agreed restrictions on providing them to competitors of Provider;
2. any equipment that was provided or paid for by Customer for use in connection with that statement of work; and
3. any Customer-owned data that was: (i) provided by or on behalf of Customer, or (ii) generated by or on behalf of Provider, in connection with that statement of work.

COMMENTARY

> If Customer is pulling the plug on a statement of work, it might want to turn over work-in-progress to another service provider to finish up the work. (See also § 107.2 concerning performance bonds.)

§ 130.39 Provider may hold off if its invoices are not yet paid

a. ☑ IF: Provider's already-sent invoices — for any statement of work — are past due when a statement of work is terminated; THEN: Provider need not deliver the Termination Deliverables to Customer until all such invoices are paid in full.

b. ☑ Provider may wait to deliver the Termination Deliverables to Customer until Provider's final invoices for all terminated statement of work(s) are paid in full.

c. ❑ Provider must deliver the Termination Deliverables to Customer whether or not Customer has fully paid Provider's outstanding invoices and/or final invoice

COMMENTARY

> In some situations, Customer might terminate (let's say) statement of work #3 but hasn't paid the invoices for statement of work #2. In that situation, Provider might legitimately want to hold on to the partial deliverables, etc., for statement of work #3 until the other work order's invoices are paid.

§ 130.40 Each party's confidentiality obligations continue

Each party will continue to honor any applicable confidentiality obligations stated in the AGREEMENT and/or in the terminated statement of work, even after its termination.

§ 130.41 Customer will make final payments

a. Promptly upon any termination of a statement of work, upon Provider's compliance with its applicable obligations above, Customer will pay:

1. all then-pending Provider invoices.
2. Provider's subsequent final invoice(s) for previously unbilled (i) services, and/or (ii) reimbursable expenses, under the statement of work.
3. any other items agreed in writing.

b. IF: The statement of work specifies that payments are to be made based on meeting particular performance criteria (for example, milestone achievement); THEN: Provider will be entitled to payment only in accordance with the criteria actually and completely met as of the effective date of termination.

c. IF: The Statement of Work is terminated for material breach by Provider; THEN: Customer's payment obligation under this section is to be adjusted (i) as agreed by the parties, or (ii) as determined by a tribunal of competent jurisdiction.

COMMENTARY

Subdivision c is likely to be important to a customer that "pulls the plug" because of (alleged) poor performance by the provider.

Drafters should consider requiring that disputes about amounts due must be resolved using a last-offer procedure ("baseball arbitration"), which is designed to encourage the parties to settle, as described in XXX.

§ 130.42 Does expiration of a statement of work count as "termination"?

Yes, unless the AGREEMENT clearly states otherwise.

COMMENTARY

A statement of work for services might expire by its terms. For example, the term of an outsourcing agreement will come to an end and one or both parties doesn't want to extend the term.

§ 131 Shall Definition

Unless the context clearly and unmistakably requires otherwise, terms such as "Party A shall take Action X" mean that Party A is required to take Action X; likewise, terms such as "Party B shall not take Action Z" means that Party B is prohibited from taking Action Z.

COMMENTARY

This definition is provided because not all English speakers understand the term "shall" to mean "must"; see **Error! Reference source not found.** for more discussion.

A plain-language drafting guide published by a coalition of (U.S.) federal employees says:

> The word "must" is the clearest way to convey to your audience that they have to do something. "Shall" is one of those officious and obsolete words that has encumbered legal style writing for many years. The message that "shall" sends to the audience is, "this is deadly material." "Shall" is also obsolete. When was the last time you heard it used in everyday speech?
>
> Besides being outdated, "shall" is imprecise. It can indicate either an obligation or a prediction. Dropping "shall" is a major step in making your document more user friendly. Don't be intimidated by the argument that using "must" will lead to a lawsuit. Many agencies already use the word "must" to convey obligations. The US Courts are eliminating "shall" in favor of "must" in their Rules of Procedure. One example of these rules is cited below.
>
> Instead of using "shall", use:
>
> - "must" for an obligation,
> - "must not" for a prohibition,
> - "may" for a discretionary action, and
> - "should" for a recommendation.

Federal Plain Language Guidelines at 25 (PlainLanguage.gov 2011).

Likewise, in some English-speaking countries, the term *shall* might be construed as tentative or optional, not as mandatory. See, e.g., a New Zealand legislative drafting guide:

> A3.33 Although "shall" is used to impose a duty or a prohibition, it is also used to indicate the future tense. This can lead to confusion. "Shall" is less and less in common usage, partly because it is difficult to use correctly. "Shall" is now rarely used in New Zealand legislation (for a rare example, see the Royal Warrant of the New Zealand Service Medal 1946–1949 2002, SR 2002/225). "Must" should be used in preference to "shall" because it is clear and definite, and commonly understood.

And this Australian legislative-drafting guide, at page 20:

> 83. The traditional style uses "shall" for the imperative. However, the word is ambiguous, as it can also be used to make a statement about the future. Moreover, in common usage it's not understood as imposing an obligation.
>
> Say "must" or "must not" when imposing an obligation, not "shall" or "shall not". [sic; note that the period is outside the closing quotation mark in British fashion]
>
> If you feel the need to use a gentler form, say "is to" or "is not to", but these are less direct and use more words.

(Thanks to English solicitor Paul de Cordova for the links to the above Australian- and New Zealand drafting guides.)

For a U.S. Supreme Court dispute about whether the word *shall* was mandatory in the context of a particular federal statute, see Gutierrez de Martinez v. Lamagno 515 U.S. 417, 433 n.9 & accompanying text (1995); *id.* at 439 & n.1 (Souter, J., dissenting). (*Author's note:* From a strictly lexical perspective, it seems to me that Justice Souter's dissent had the better of the argument.)

Here's another illustration of the Court's non-mandatory use of *shall*, from Florida v. Georgia, 585 U.S. __, 138 S. Ct. 2502 (2018) (Breyer, J.):

> **As we shall discuss** in more detail, ... *[138 S. Ct. at 2508.]* * * * ***As we shall explain**, ... *[Id. at 2511.]* * * * At this stage, **we shall do the same**. *[Id. at 2520.]*

(Emphasis added.)

§ 132 Signature Protocol

§ 132.1 To what documents does this Protocol apply?

This Protocol applies in all cases where one or more parties is to sign a document — including but not limited to the Term Sheet.

COMMENTARY

> It might seem puzzling how parties can "agree" to a signature protocol before they've even signed the parties' agreement. Technically, this Protocol likely would be held to have been *ratified* by the parties' signature to the Term Sheet.

§ 132.2 Must all parties sign the same physical copy of a document?

No: If a document is to be signed by more than one party, then the parties may sign separate physical copies — these are referred to as "counterparts" — as long as each party whose signature is required signs at least one counterpart.

COMMENTARY

> In the days before FAX and email, typically one party would print out three copies of a contract; sign two of the copies; and send both signed hard copies to the other side, keeping the unsigned copy in case the other two went astray. The other side would then sign both hard copies; keep one of them; and return one fully signed copy to the first party. ¶ Nowadays, parties typically sign and deliver contracts in generally the way described in this Protocol.

§ 132.3 May a party send over just a signed signature page?

a. Yes: As long as subdivision c is complied with, any party may deliver a signed document to another party by electronically transmitting

just a signed signature page by email, FAX, or other electronic transmission means.

b. The Term Sheet, when signed, is one such document that may be delivered in this way.

c. It must be clear from the totality of the circumstances that the signature page is actually of the document in question (for example, the final agreed draft of the Term Sheet) and not of some other document.

COMMENTARY

Emailing PDFs of scanned, signed signature pages *only* has become fairly typical.

Subdivision c: A signature page could be tied to a specific version of the parties' agreement by including, on each page of the parties' agreement, a running header or -footer that identifies the document and its version. *Example:* In a draft confidentiality agreement between ABC Corporation and XYZ LLC, a running header could read "ABC-XYZ Confid. Agrmt. ver. 2019-03-01 15:00 CST" (where the date and time at the end are hand-typed, versus being in an automatically-updating code). Including such a running header can also help avoid confusion when the parties are discussing a draft of the agreement by allowing the parties to make sure that everyone is looking at the same draft.

PRO TIP: It's not a bad idea to combine the PDF of the unsigned agreement and the PDFs of the signed signature pages into a single "record copy" PDF, then email the record-copy PDF to all concerned; the email will then serve as a paper trail to help establish the authenticity of the record copy.

§ 132.4 May a document be signed electronically?

Documents may be signed electronically in any way that the law allows, with the same effect as if a signed original of the document had been duly delivered; any party may rely on that effect.

COMMENTARY

See § 173 on electronic signatures.

§ 133 Signed Definition

Signed and like terms such as sign, signing, and signature, with respect to a writing or other record (collectively, "record"), refer to executing or adopting a symbol, or carrying out a process, attached to or logically associated with the record, with the intent to adopt, accept, or authenticate the record.

COMMENTARY

This definition of *signed*, etc., is a combination of: • the definitions of *signed* and *writing* in UCC §1-201(37) and 1-201(43); and • the definitions of *electronic signature* and *electronic record* in the [U.S.] Electronic Signatures in Global and National Commerce Act ("E-SIGN"), 15 U.S.C. § 7006.

The definition also draws on the definition of *writing* in Rule 1.00(v) of the 2010 proposed amendments to the Texas Disciplinary Rules of Professional Conduct [for lawyers]. (Those proposed amendments were rejected, for unrelated reasons, in a referendum of the State Bar of Texas.)

§ 134 Software License Protocol [TO DO]

§ 135 Standby Letter of Credit *(notes only)*

A standby letter of credit (known as a "SLOC" or "L/C") can be thought of as a special type of guaranty. An L/C is issued by a bank to a third party when requested by one of the bank's customers. The L/C is, in essence, a promise, by the bank to the third party, that the *bank* will pay the third party if the bank's customer fails to meet its own payment obligation to the third party. The bank charges the customer a fee for issuing the letter of credit; the bank also requires the customer to sign an agreement to indemnify the bank (that is, reimburse the bank) if the bank is ever required to pay the third party under the L/C.

A useful teaching example can be found in Mago Int'l v. LHB AG, 833 F.3d 270 (2d Cir. 2016) (affirming summary judgment in favor of defendant bank). In that case:

- A New York-based supplier entered into an agreement to sell meats to a customer in Kosovo. As part of the agreement, the customer's bank

and a confirming bank issued a standby letter of credit to the supplier, guaranteeing payment by the customer.

- The supplier shipped twelve containers of meats to the customer. The customer, though, "stiffed" the supplier.

In its opinion, the Second Circuit explained the basic operation of standby letters of credit:

> An SLOC is an agreement by a bank to pay a beneficiary on behalf of a customer who obtains the letter, if the customer defaults on an obligation to the beneficiary.
>
> Originally devised to function in international trade, a letter of credit **reduced the risk of nonpayment** in cases where credit was extended to strangers in distant places.
>
> The issuing bank, or a bank that acts as confirming bank for the issuer, takes on **an absolute duty to pay** the amount of the credit to the beneficiary, **so long as the beneficiary complies with the terms of the letter.**
>
> However, in order to protect the issuing or confirming bank, **this absolute duty does not arise unless the terms of the letter have been complied with strictly.** Adherence to this rule ensures that banks, **dealing only in documents**, will be able to **act quickly**, enhancing the letter of credit's fluidity.
>
> Literal compliance with the credit therefore is also essential so as not to impose an obligation upon the bank that it did not undertake and **so as not to jeopardize the bank's right to indemnity from its customer.**
>
> Therefore, in determining whether to pay, **the bank looks solely at the letter and the documentation the beneficiary presents** to determine whether the documentation meets the requirements in the letter.
>
> The corollary to the rule of strict compliance is that **the requirements in letters of credit must be explicit and that all ambiguities are construed against the bank.** Since the beneficiary must comply strictly with the requirements of the letter, it must know precisely and unequivocally what those requirements are.

Id., at 272-73 (cleaned up; emphasis and extra paragraphing added). Unhappily for the meat supplier, the first time it sought payment from the bank under the L/C, it did not provide the required documentation showing that it had in fact shipped the meat to the Kosovo customer; by the time the supplier did furnish the necessary documentation, it was too late. The district court accordingly granted summary judgment in favor of the bank, and the Second Circuit affirmed. *See id.* at 5-7.

§ 136 Status Conference Requirement

§ 136.1 Why are the parties agreeing to this Requirement?

The parties want to reduce the likelihood (and potential adverse impact) of misunderstandings and other disputes. To that end, they are agreeing to confer, from time to time, about the AGREEMENT and any related subjects, as set forth in this Requirement.

COMMENTARY

This status-conference requirement recognizes that many business disputes could be mitigated, or even avoided entirely, if the parties would just *talk* with each other once in a while. Sure, this is basically just "Management 101." But it can't hurt for the contract to include a reminder.

§ 136.2 How often are status conferences required?

The parties will confer:

1. whenever reasonably requested, from time to time, by either party; and
2. whenever otherwise agreed.

COMMENTARY

It's often extremely helpful to hold such a conference immediately after — or better yet, before — a missed deadline or other potential breach.

In some situations, the parties might want to specify quarterly, monthly, or even weekly calls.

§ 136.3 Are in-person status conferences required?

No; the parties need not meet in person for status conferences unless otherwise agreed.

COMMENTARY

> Video conferences (with screen sharing) can be especially effective for status updates and are becoming extremely affordable from providers such as Amazon Chime; GoToMeeting; Skype Business; and Zoom.us.

§ 136.4 Must a party participate in status conferences?

Yes — each party is to participate in status conferences in good faith.

COMMENTARY

> A good-faith requirement can give rise to accusations of bad faith, but that likely would be an acceptable cost-benefit tradeoff in most situations.

§ 136.5 Who will make the necessary arrangements for status conferences?

The party requesting a status conference is to make any necessary arrangements for a status conference (e.g., setting up a dial-in number or providing links for video conferencing).

§ 136.6 Who will pay for status-conference expenses?

Each party is to bear its own expenses of participating in status conferences unless clearly agreed otherwise in writing.

§ 136.7 What will the parties discuss at status conferences?

The agenda for a status conference may (and typically *should*) include discussion of some or all of the following "G-PP-AA" items:

G - goals of the parties in respect of the AGREEMENT;

P - progress to date in achieving those goals;

P - problems encountered or anticipated;

A - action plans for the future, including for example plans for addressing existing or anticipated problems; and

A - assumptions being made, especially any that might prove unwarranted.

§ 137 Subject to Contract Definition

If a document states that particular discussions are "subject to contract," it thereby incorporates the Letter of Intent Protocol by reference.

§ 138 Survival Protocol

☑ The provisions of the AGREEMENT (if any) concerning the following subjects will continue in effect even if the AGREEMENT expires or is terminated for any reason:

1. Arbitration.
2. Attorney fees.
3. Confidentiality.
4. Early neutral evaluation.
5. Expense-shifting after settlement-offer rejection.
6. Forum selection (or choice of forum).
7. Governing law (or choice of law).
8. Indemnification.
9. Insurance requirements.
10. Intellectual-property ownership.
11. Limitations of liability.
12. Non-competition.
13. Non-solicitation.

14. Remedy limitations.

15. Representations and warranties.

16. Warranty disclaimers.

17. Warranty rights.

18. Other [SPECIFY]:

❑ Those provisions of this Agreement that, by their nature, should continue in effect beyond termination or expiration of this Agreement will do so.

COMMENTARY

Drafters should be careful about what rights and obligations would survive termination – see generally Jeff Gordon, Night of the Living Dead Contracts.

The unchecked alternative is pretty vague, perhaps even dangerously so; nevertheless, some contracts include language like it.

§ 139 Tax Definition

a. The term *tax* refers to any tax, assessment, charge, duty, levy, or other similar governmental charge of any nature, imposed by any government authority.

b. The term *tax* does not encompass a price charged by a government authority for (i) services rendered, or (ii) goods or other assets sold or leased, by the government authority.

c. Illustrative examples of taxes include the following, whether or not an obligation to pay the same is undisputed, and whether or not a return or report must be filed:

1. taxes on: • income; • gross receipts; • employment; • franchise; • profits; • capital gains; • capital stock; • transfer; • sales; • use; • occupation; • property; • excise; • severance; • windfall profits; • sick pay; • and disability pay;

2. ad valorem taxes; • alternative minimum taxes; • environmental taxes; • license taxes; • payroll taxes; • registration taxes; • social security (or similar) taxes; • stamp taxes; • stamp duty reserve taxes; • unemployment taxes; • value added taxes; and • withholding taxes; and

3. all other taxes; • assessments; • charges; • customs and other duties; • fees; • levies or other similar governmental charges of any kind whatsoever;

4. all estimated taxes; • deficiency assessments; • additions to tax; • fines, penalties, and interest on past-due tax payments.

COMMENTARY

This definition draws on: • the contract language quoted by the Court of Appeals of New York in Innophos, Inc. v. Rhodia, S.A., 10 N.Y.3d 25, 27-28 (2008). In that case, the state of New York's highest court upheld a summary judgment that a $20 million-plus water usage charge, levied by a Mexican government entity, was a "tax" within the meaning of the contract's laundry-list definition; and • section 3.5(e) of the Asset Purchase Agreement between Piper Jaffray Companies and UBS Financial Services, available at the SEC's EDGAR Web site and reproduced in David Zarfes & Michael L. Bloom, Contracts and Commercial Transactions (Wolters Kluwer Law & Business 2011).

See also the Taxes Protocol in the General Terms.

§ 140 Taxes Protocol

§ 140.1 What counts as a "sales" tax?

The term **sales tax** (whether or not capitalized) includes all sales taxes; use taxes; value-added taxes; excise taxes; other forms of ad valorem tax and consumption tax; and equivalent taxes.

COMMENTARY

Sales-tax provisions are common in supply agreements and services agreements. See generally: • Ad valorem tax (Wikipedia) • Consumption tax (Wikipedia) • Excise tax (IRS.gov) • Sales tax (Wikipedia) • Sales and

Local Tax Rates in 2015 (TaxFoundation.org) (extensively footnoted)
• Value-added tax (Wikipedia).

§ 140.2 Who is responsible for collecting and paying sales taxes?

a. The term **Collecting Party** refers to any party that, under the AGREEMENT, invoices another party for goods, services, or other things potentially subject to sales taxes (as defined below).

b. Unless the parties agree otherwise in writing in connection with a particular transaction, the Collecting Party will do the following, at its own expense:

1. determine what if any sales taxes must be paid to an applicable jurisdiction in connection with the transaction;
2. separately list all sales taxes in the relevant invoice; and
3. timely report and remit all sales taxes to all relevant taxing authorities anywhere in the world.

COMMENTARY

Determining just where sales taxes must be paid can be a non-trivial task. The issue has drawn major attention from taxing authorities in the age of Amazon.com and other Internet sellers. In supply- and services agreements, customers often want suppliers to take on this responsibility.

§ 140.3 What if the Collecting Party fails?

The Collecting Party must defend and indemnify:

1. each invoiced party, and
2. each member of the invoiced party's Protected Group

against any claim by a taxing authority for unpaid sales taxes.

COMMENTARY

Customers sometimes ask for sales-tax indemnity provisions in supply- and services agreements. ¶ As with any indemnity obligation, a would-be

protected party should check whether the indemnifying party has the financial assets with which to meet the obligation; if not, the protected party should consider including a requirement that the indemnifying party carry suitable insurance coverage.

§ 140.4 Who is responsible for taxes on the parties' income?

a. Each party is solely responsible for all taxes on that party's income arising from or relating to the AGREEMENT.

b. ☑ Each party will defend and indemnify each other party and the other party's Protected Group against any third-party claim that the other party failed to pay taxes for which the indemnifying party is responsible under subdivision a.

COMMENTARY

Provisions like this are not uncommon in supply- and services agreements. On the other hand, though, in some transactions the price might be "grossed up" so that the amount received by the payee, net of all taxes, is a stated amount.

§ 141 Taxing Authority Definition

The term *taxing authority* refers to any government authority exercising *de jure* or *de facto* power to impose, regulate, or administer or enforce the imposition of taxes.

COMMENTARY

In today's global economy, "offshore" companies do a great deal of manufacturing for U.S. and European firms. Those companies might not always comply with First-World standards of safety, employee treatment, and the like, which could result in adverse publicity for their U.S. and European customers.

For example:

• Apple and HP were forced to deal with news stories about worker suicides in factories owned by the giant Chinese electronics contract manufacturer Foxconn.

• Walmart and other retailers were confronted with a similar problem when a clothing factory in Bangladesh burned, killing over 100 people.

• Walgreens terminated its relationship with troubled blood-testing company Theranos (NYTimes.com).

• In 2015, the Twin Peaks restaurant organization terminated the franchise of a franchisee's restaurant in Waco, Texas, after a shootout involving rival motorcycle gangs that left nine dead. See, e.g., this news story.

• The Giuffre Hyundai, Ltd. v. Hyundai Motor America case is also relevant to termination for business-reputation risk. In that case Hyundai terminated one of its dealerships because the New York attorney general had previously obtained a court judgment against the dealership for having engaged in fraudulent and illegal business practices. Hyundai did so under a contract provision, which provided:

Longtime Subway sandwich shop pitchman Jared Fogle agreed to plead guilty to child-pornography charges, among others. Subway had previously suspended its relationship with Fogle. The case, along with the attendant bad publicity for the already-troubled Subway, is a sad reminder of the value of including an appropriate "termination for business-reputation risk" clause in a contract of that nature.

§ 142 Termination General Provisions *(in progress)*

COMMENTARY

A well-drafted termination provision:

- allows the terminating party to "fire" the other party — see, e.g., Miller-Davis Co. v. Ahrens Constr., Inc., 848 N.W.2d 95, 495 Mich. 161 (2014), where the court noted that "Miller-Davis gave Ahrens notice of default, *terminated Ahrens's right to perform the contract*, and demanded the bonding company perform under the bond." *Id.*, 848 N.W.2d at 99 (emphasis added);
- puts an end to most other *as-yet-unaccrued* rights and obligations under the agreement;
- doesn't affect claims for breach.

People routinely refer to termination *of an agreement*, but what they really (should) mean is the termination of *specific rights and obligations* under the agreement.

COMMENTARY

A California court held that an agreement terminating various contracts between the parties did not also terminate the arbitration agreement contained in some of the contracts. Oxford Prep. Academy v. Edlighten Learning Solutions, No. G055685, slip op. (Cal. App. Apr. 22, 2019) (reversing denial of motion to compel arbitration).

§ 142.1 ❑ No liability for damages for termination

Neither party will be liable for any damages arising out of the termination of the AGREEMENT in accordance with this Section 14.

§ 142.2 Termination of transaction, etc., instead of AGREEMENT

In lieu of terminating the AGREEMENT, a party authorized to so terminate may instead terminate one or more of the following specific items to the extent that they exist under the AGREEMENT:

1. transactions, for example, a purchase order;
2. grants, for example, a lease or license;
3. relationships, for example, a distributorship.

COMMENTARY

This option would give a terminating party more flexibility than an all-or-nothing right to terminate the Agreement.

§ 142.3 What if a stated reason for termination "blows up"?

IF: A party terminates the AGREEMENT or a transaction under it for a stated reason; BUT: The stated reason later is found not to have been applicable; THEN: The termination will be deemed to have been made for any other reason warranting termination.

COMMENTARY

This language provides a terminating party with a backup position in case its original reason for termination doesn't pan out. That might be handy to keep the original termination from being held to have been *itself* a breach of contract, as happened in Southland Metals, Inc. v. American Castings, LLC, 800 F.3d 452 (8th Cir. 2015) (affirming judgment on jury verdict).

§ 142.4 What effect does "termination" have?

To the extent not manifestly inconsistent with mandatory applicable law, any termination of the AGREEMENT:

1. cancels the parties' relevant, respective, post-termination rights and obligations, except to the extent (if any) that the AGREEMENT provides otherwise, for example in a survival provision;

2. cancels any right a party has to continue its performance of its relevant pre-termination obligations under the AGREEMENT;

3. does not affect any claim, by any party, for pre-termination breach of the AGREEMENT by another party; and

4. is without prejudice to any party's other rights or remedies pursuant to the AGREEMENT except to the extent, if any, that the AGREEMENT clearly provides otherwise.

COMMENTARY

People routinely refer to termination *of an agreement*, when what they really mean is the termination of *specific rights and obligations* under the agreement. This definition should help make that clear.

Subdivision 2 was inspired by Miller-Davis Co. v. Ahrens Constr., Inc., 495 Mich. 161, 848 N.W.2d 95 (2014), in which the court's recitation of facts noted that "Miller-Davis gave Ahrens notice of default, *terminated Ahrens's right to perform the contract*, and demanded the bonding company perform under the bond." *Id.*, 848 N.W.2d at 99 (emphasis added).

§ 142.5 Notice of the termination itself is required

a. For a termination to be effective, the terminating party must give the non-terminating party notice of termination (separate from notice of breach, if any).

b. The notice of termination must describe, with reasonable specificity, the basis for termination and the putative effective date of termination.

COMMENTARY

A notice of termination should be clear, because neither the terminating party nor the non-terminating party will want to have litigate whether a particular communication constituted a termination notice. That unfortunately happened in New England Carpenters Central Collection Agency v. Labonte Drywall Co., 795 F.3d 271 (1st Cir. 2015): A drywalling company had a collective bargaining agreement ("**CBA**") with a carpenter's union; the court found that a letter from the company, stating that it was no longer doing any more union work, had the effect of terminating the CBA — and with it, the union's right to audit the company's contributions to various pension funds, etc. The unfortunate part is that the parties had to litigate the issue; they might not have had to incur that expense and inconvenience if the company's letter had been more explicit.

§ 142.6 Expiration is a form of termination

a. Unless otherwise clear from the context, any expiration of the term of the AGREEMENT (or, if applicable, of a transaction, grant, or relationship under the AGREEMENT) is to be presumed to have the same effect as a termination of the same.

b. For the avoidance of doubt, for this purpose, the term *expiration* includes, without limitation, expiration due to a party's exercising a right under the AGREEMENT to opt out of an automatic-extension provision.

COMMENTARY

This is one of those "roadblock" provisions designed to forestall litigation counsel from making creative arguments to the contrary.

§ 143 Termination for Breach Protocol *(in progress)*

The Termination General Protocol is incorporated by reference.

§ 143.1 Which party or parties may terminate for breach?

Either party may terminate the AGREEMENT for breach by the other party in accordance with this Protocol.

COMMENTARY

In a contract between "Alice" and "Bob," Alice might want to specify that only she would have the right to terminate the contract for breach by Bob. Now suppose that Bob were to agree to that one-way termination right, and then later Alice herself were to breach the contract. In that situation, Bob's recourse against Alice would typically be limited to an action against Alice for *damages* or (sometimes) for *specific performance*.

§ 143.2 How much of an opportunity to cure a breach is required?

To terminate the AGREEMENT for breach, the terminating party must:

1. Give the breaching party notice of the breach;
2. Wait at least five business days; and
3. If the breaching party has not cured the breach by then: Give the breaching party notice of termination.

§ 143.3 What type of breach will permit a party to terminate?

Termination for breach is allowed only for material breach.

COMMENTARY

NOTE: A termination-for-breach provision might not even be needed, because under the law typically applicable in the U.S., if a party materially

breaches a contract, the other party may suspend its performance under the Agreement — and if the breach is incurable, the other party may terminate the Agreement.

And a would-be terminating party could just let the contract wither and die; for example, in a case involving whether a contract was a(n exclusive) requirements contract, the South Carolina supreme court noted that, if the contract did *not* create an exclusive relationship, then the contract's termination provisions would not be needed, because the customer could simply stop placing orders with the provider. *See* Stevens Aviation, Inc. v. DynCorp Int'l LLC, 407 S.C. 407, 418, 756 S.E.2d 148 (2014).

CAUTION: Not all breaches will necessarily be deemed "material" and thus entitle a party to suspend performance and/or terminate the contract. For example, in a Delaware supreme court case, a patent license agreement included a provision requiring the license terms to be kept confidential. The court held that this provision was not material, because the gravamen of the contract was the patent license, not the confidentiality requirement. As a result, when the licensee publicly disclosed the royalty terms (in violation of the license agreement), the patent owner was not entitled to terminate the license agreement for material breach. *See* Qualcomm Inc. v. Texas Instr. Inc., 875 A.2d 626, 628 (Del. 2005) (affirming holding of chancery court).

PRO TIP: Some drafters take the approach of stating, in Provision X, that failure to comply with Provision X would be a "material breach," thus giving the other party the right to terminate.)

§ 143.4 Can multiple "minor" breaches add up to a material breach?

Yes. Suppose that a party breaches the AGREEMENT several times, but none of the individual breaches is material. The *series* of breaches could amount to a material breach, even if the individual breaches are cured.

COMMENTARY

This sort of provision is often seen in long-term agreements such as real-estate leases and major service agreements. One such provision was relevant to the contract in suit in Indiana v. IBM Corp., 51 N.E.3d 150, 155 (Ind. 2016), discussed at **Error! Reference source not found.**.

§ 143.5 How long will a breaching party be allowed to try cure the breach(es)?

a. A party wishing to terminate the AGREEMENT for breach ("**Terminating Party**") must give the breaching party notice of the breach in accordance with **Error! Reference source not found.** (notices procedure). The notice of b reach must:

1. state, in reasonable detail, what the Terminating Party believes to be the breach giving rise to a right to terminate (all such breaches if more than one); and
2. state the duration of the specific cure period that the Terminating Party believes to be applicable, if any, as set forth below.

b. The cure period will be as follows, beginning upon the effective date of the notice of breach above:

1. *Nonpayment* of an amount due under the AGREEMENT: Five business days.
2. *Missed deadline* for which the AGREEMENT states that time is of the essence: No cure period.
3. *Other, curable missed deadline* stated in the AGREEMENT: Five business days.
4. *Other, curable breach:* Ten business days.
5. *Breach clearly not capable of being cured:* No cure period.

COMMENTARY

Subdivision a: This provision uses the term "Terminating Party" instead of the more-common "non-breaching party." That's because in one case, a supposedly non-breaching party was itself in breach of a different contract provision. The contract's termination-for-breach provision referred to the right of the *non-breaching* party to terminate. That, said the court, meant that the party that had purported to terminate the contract did not have the power to do so. [TO DO: Find citation]

Subdivision b: The cure periods stated here are placeholders; contract drafters and reviewers should give some thought to what would be appropriate for their particular situations.

Subdivision b.5: According to the U.S. Court of Appeals for the Second Circuit, "New York common law will not require strict compliance with a contractual notice-and-cure provision if providing an opportunity to cure would be useless, or if the breach undermines the entire contractual relationship such that it cannot be cured." Giuffre Hyundai, Ltd. v. Hyundai Motor America, 756 F.3d 204, 209-10 (2d Cir. 2014) (footnote and extensive citations omitted). **BUT**: A supposedly-"incurable" breach might prove in hindsight not to be incurable. This was illustrated in a case where a company scored an "own goal," in the form of a multi-million damage award against it, when it purported to terminate a contract for what turned out *not* to be an incurable breach — and that termination itself was held to be a breach. *See* Southland Metals, Inc. v. American Castings, LLC, 800 F.3d 452 (8th Cir. 2015) (affirming judgment on jury verdict).

§ 143.5.2 What must the breaching party do to avoid termination?

To cut off the Terminating Party's right to terminate for breach, the breaching party must do both of the following before the end of the relevant cure period:

1. cure all breaches described in the notice of breach; and
2. give notice to the Terminating Party that describes the cure with reasonable specificity.

§ 143.5.3 Is termination the terminating party's only remedy for breach?

No — although to be clear, termination for breach would not affect any applicable limitations of liability in the AGREEMENT, if any.

§ 144 Termination at Will Protocol *(in progress)*

§ 144.1 When would this Protocol apply?

This Protocol will apply only if the AGREEMENT (or the law) clearly allows a party to terminate the AGREEMENT at will (or, synonymously, for its own convenience).

COMMENTARY

In the U.S., an ongoing contract that does not include its own end date will usually be considered terminable at will: "A contract of *indefinite* duration is terminable at will upon reasonable notice to the other party after a reasonable time has passed." Glacial Plains Coop. v. Chippewa Valley Ethanol Co., LLLP, 912 N.W.2d 233, 237 (Minn. 2018) (citing cases; emphasis added).

(In that case, the state supreme court also observed that: "In general, contracts of *perpetual* duration are disfavored as a matter of public policy; thus, while we will enforce a contract that *unambiguously* expresses an intent to be of perpetual duration, we construe ambiguous language regarding duration *against* perpetual duration." *Id.* at 236 (emphasis added).)

For more citations, see Glenn West, Forever is a Long Time or No Time at All (JDSupra.com 2019), archived at https://perma.cc/8DPL-UHQY.

§ 144.2 Is termination at will restricted?

Absent a clear restriction in the AGREEMENT, a party entitled to terminate at will may do so in its sole discretion.

COMMENTARY

The AGREEMENT could restrict a party's right to terminate at will, including without limitation: • a minimum advance notice requirement; • allowing termination at will only after (i) after a certain amount of time has elapsed, or (ii) after one or another party has grossed- or netted a certain amount of revenue; and/or • requiring the terminating party to pay a buyout fee.

A party that will be making a significant investment in the parties' relationship might want to negotiate for one or more of such restrictions on the other party's right to terminate at will, so as to give the first party enough time to recoup at least some of that investment.

§ 145 Termination for Legal Violation Protocol

§ 145.1 Which party may terminate if the other party violates the law?

Any party (each, a **Terminating Party**) may terminate the AGREEMENT if another party commits any act or omission that:

1. is material to the other party's rights or responsibilities under the AGREEMENT, and
2. violates any applicable law where the violation is likely to materially and adversely affect the other party.

§ 145.2 Is a cure period required for such a termination?

a. IF: The AGREEMENT clearly and affirmatively states that violations of law may be cured; THEN: A Terminating Party may not terminate the Agreement for violation of law if both the violation and all effects of the violation are cured before the end of five business days after the violation began.

b. Otherwise, the Terminating Party may terminate the AGREEMENT under subdivision a without giving the breaching party an opportunity to cure the breach.

§ 145.3 Is there a "use it or lose it" date for legal-violation terminations?

The right to terminate under subdivision a will expire if not exercised on or before the date 90 days after the date that the Terminating Party first learns, via any source, of the most-recent act or omission giving rise to the right to terminate.

COMMENTARY

This section is a "sunset" provision will force the terminating party to fish or cut bait, and thus avoid leaving the threat of termination hanging over the other party's head.

§ 146 Termination for Bankruptcy, etc. (commentary only)

§ 146.1 Termination for bankruptcy, insolvency, etc.

Some agreements state that a party can terminate the agreement if the other party files for protection under the bankruptcy laws, etc. One such provision is found in a Honeywell purchase-order form at http://perma.cc/CUV6-NKTY:

> The solvent party may terminate this Purchase Order upon written notice if the other party becomes insolvent or if any petition is filed or proceedings commenced by or against that party relating to bankruptcy, receivership, reorganization, or assignment for the benefit of creditors.

In the U.S., however, some of these provisions will be unenforceable as so-called "ipso facto" clauses if the non-terminating party has filed a petition for protection under the bankruptcy laws. In fact, under the Bankruptcy Code, the filing of such a petition creates an automatic stay against many forms of contract termination or other action that could jeopardize the orderly reorganization or liquidation of the party seeking protection (known as the "debtor"). *See generally* Robert L. Eisenbach III, Are "Termination On Bankruptcy" Contract Clauses Enforceable? (Cooley.com 2007), at https://perma.cc/PV6N-VFTC.

§ 147 Termination for Reputation Risk Protocol *(in progress)*

§ 147.1 Which party may terminate if the other party creates a reputation risk?

Any party (each, a **Terminating Party**) may terminate the AGREEMENT if the Terminating Party reasonably determines that:

one or more Reputation Risk Actions, defined below,

when taken by (i) another signatory to the AGREEMENT or (ii) an affiliate of the other signatory,

are likely to create a not-insubstantial risk to the business reputation of (x) the Terminating Party or (y) any affiliate of the Terminating Party.

COMMENTARY

> See **Error! Reference source not found.** for an extended discussion o f why companies sometimes want provisions like this, with real-life examples where such provisions were exercised.

§ 147.2 What counts as creating a reputation risk?

The term **Reputation Risk Action** means to any action (for this purpose including omissions) or series of actions, whether related or unrelated, where the action is (i) intended by the actor, or (ii) reasonably likely, to do one or more of the following:

1. libel or slander another person;
2. put another person in a false light;
3. threaten, embarrass, harass, or invade the privacy of another;
4. impersonate another or promote, encourage, or assist in, such impersonation;
5. offend a reasonable person on racial- or ethnic grounds;

6. engage in conduct prohibited by law, including for example the U.S. Foreign Corrupt Practices Act;

7. encourage activities prohibited by law, including (for example) bribery; identity theft; child pornography; and terrorism;

8. engage in tortious conduct; and/or

9. mistreat a person, or promote, assist in, or encourage such mistreatment.

COMMENTARY

The above "laundry list" of actions is adapted from language used in a number of on-line terms of service collected by Zachary West in his blog posting, Morality clauses in domain registration (zacwe.st 2011).

§ 147.3 Will this particular right to terminate ever expire?

Yes — the right to terminate for reputation risk will expire (if not sooner exercised) at 12 midnight at the end of the day on the *earlier* of:

1. the date 90 days after the date that the Terminating Party first learns, via any source, of the most-recent Reputation Risk Action; or

2. the date six months after that most-recent Reputation Risk Action itself (i.e., regardless of when the Terminating Party first learned of it).

COMMENTARY

This "sunset" period forces the Terminating Party to make up its mind – to fish or cut bait (or fill in your own metaphor).

Subdivision 2: This separate six-month limitation has in mind that if the Terminating Party hasn't seen fit to terminate within that time — for example, because it hasn't even noticed any ill effects from a Reputation Risk Action — then the right to terminate should lapse, so that the other party won't continue to have the threat of termination hanging over its head for what has become old news.

§ 147.4 Does this reputation-risk section create any separate obligations?

No — for the avoidance of doubt:

a. This section establishes only a conditional right to terminate the AGREEMENT; in itself it does not obligate any party in any way.

b. The other party will not be liable, in damages or otherwise, for any Reputation Risk Action that does not otherwise breach the AGREEMENT.

§ 147.5 Other Termination Provisions

§ 148 Third-Party Benefits Protocol

§ 148.1 No *implied* third-party benefits are intended

a. The parties do not intend for any party other than themselves to have any legally enforceable benefit from the AGREEMENT or from any transaction or relationship resulting from it, other than:

1. to the limited extent — if any — that the AGREEMENT clearly so indicates; and/or
2. incidental beneficiaries, if any.

b. In case of doubt, though: IF: The AGREEMENT disclaims third-party benefits; BUT: The AGREEMENT also clearly provides for one or more benefits to one or more third parties; THEN: The clear provision of benefits will take precedence.

COMMENTARY

See generally, e.g., Third-Party Beneficiary (Wikipedia.org).

CAUTION: Careless drafting can result in a contract's including both an obvious third-party benefit and — contradictorily — a *disclaimer* of third-party benefits. Some courts have held that the disclaimer takes precedence; see the discussion in Glenn D. West, "Standard" Versus "Bespoke" Boilerplate—A Distinction That Can Make a Big Difference

(privateequity.weil.com 2019), archived at https://perma.cc/NXG7-JQE5. This provision is intended to forestall such a result.

§ 148.2 Third-party benefits are not assignable without consent

A third-party beneficiary of the AGREEMENT (if any) may not assign its rights under the AGREEMENT without the prior written consent of each party to the AGREEMENT; that consent may be granted or withheld in the consenting party's sole discretion.

§ 149 Time of Day Definition

A time of day refers to the exact time. *Hypothetical example:* The term "5 p.m." refers to exactly 5:00:00.00 p.m.

COMMENTARY

Why bother defining this term? Because the issue came up in two Canadian cases where this issue arose in the context of disputes whether contract bids had been timely submitted; the two courts reached opposite results:

- First was Smith Bros. & Wilson (B.C.) Ltd. v. B.C. Hydro, 30 BCLR (3d) 334, 33 CLR (2d) 64 (1997): A company's bid for a construction contract was time-stamped as having been submitted at 11:01 a.m.; the deadline was 11:00 a.m. Technical analysis indicated that the time clock was fast, and that the actual time of the bid submission was sometime between 11:00 a.m. and 11:01 a.m.. The British Colombia supreme court held that the bid was untimely.

- In contrast was Bradscot (MCL) Ltd. v. Hamilton-Wentworth Catholic District School Board, 42 O.R. (3d) 723, [1999] O.J. No. 69. In that case, the contract bids were due no later than 1 p.m. The winning bid was submitted at 1 p.m. *and 30 seconds*. The Ontario court of appeals held that the bid was timely submitted because the clock had not yet reached 1:01 p.m.

§ 150 Timely Definition

An action is timely if the action is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

COMMENTARY

"Timely" is a useful but vague term, so this definition borrows from the definition of of *seasonably* in UCC 1-205. (Many modern readers seem not to be familiar with the term *seasonably*.)

§ 151 Title of agreement (cpmmentary)t

Let's look at a hypothetical title:

Purchase and Sale Agreement
for 2012 MacBook Air Computer

This is worded:

- to make the title easier to spot in a list of documents, e.g., an index of files or a contract-management system; and
- to make the title more descriptive when referred to in other documents, e.g., another agreement, or a pleading, brief, or court opinion.

For the same reasons, it might make sense to list the parties' names in the title as well. See, for example, the merger agreement between United Airlines and Continental Airlines, whose title is:

AGREEMENT AND PLAN OF MERGER
Among
UAL Corporation
Continental Airlines, Inc.
and
JT Merger Sub Inc.
Dated as of May 2, 2010

Another title style is that seen in a real-estate purchase agreement involving Rick's Cabaret:

REAL ESTATE PURCHASE AND SALE AGREEMENT
BY AND BETWEEN
WIRE WAY, LLC,

a Texas limited liability company
("Seller")
and
RCI HOLDINGS, INC.,
a Texas corporation
("Purchaser")

Especially for companies that have lots of contracts, it can make sense to use this information-dense title style to simplify the task of contract management.

§ 152 Trademark License Protocol [TO DO]

Which party

"Innovative Litigation Services Trademarks" means all names, marks, logos, designs, trade dress and other brand designations used by Innovative Litigation Services in connection with its products and services.

In performing its obligations hereunder, Reseller may refer to the Products by the associated Innovative Litigation Services Trademarks, provided that such reference is not misleading and complies with any guidelines issued by 1LS.

Reseller is granted no right, title or license to, or interest in any Innovative Litigation Services Trademarks.

Reseller acknowledges and agrees that any use of the Innovative Litigation Services Trademarks by Reseller will inure to the sole benefit of !LS .

If Reseller acquires any rights in any Innovative Litigation Services Trademarks by operation of law or otherwise, it will immediately, at no cost or expense to ILS.

assign such rights to Innovative Litigation Services along with all associated goodwill.

Trademarks.

During the term of the AGREEMENT and within the Territory, ALT-N grants to Reseller a personal, non-exclusive, royalty-free and non-transferable license to use, reproduce, distribute and display publicly the AL T-N Marks on or in connection with the Software or Services and any packaging, labelling, promotional, advertising or other materials, including websites, relating to the Software or Services

in accordance with and subject to Reseller ensuring its compliance, and the compliance of its Sub-resellers, with:

(i) the terms of the AGREEMENT; (ii) receiving express written authorization from ALT-N each time Reseller or anyone else acting on behalf of Reseller uses AL T-N Marks; (iii) any terms and conditions including those referenced in Section 1.1 (Rights Granted); and (iv) the ALT-N Branding Guidelines.

ALT-N acknowledges that its use of the ALT-N Marks is limited to the use licensed in the AGREEMENT, that

each and every use of the ALT-N Marks requires express written authorization from ALT-N and that

Reseller has not acquired, and will not acquire, any ownership rights therein.

Reseller agrees that it will not use any ALT-N Marks in a manner likely to cause confusion with, dilute or damage the goodwill, reputation or image of ALT-N or ALT-N's Software or Services.

Reseller agrees not to use any ALT-N Marks as a feature or design element of another logo or trademark.

Upon request by ALT-N, Reseller shall supply ALT-N with specimens of its use of any ALT-N Marks and

execute or obtain execution of, the instruments that may be appropriate to register, maintain or renew the registration of any ALT-N Marks in the Territory.

The use of any ALT-N Mark by Reseller does not transfer to Reseller any further right, title, or interest in or to the ALT -N Mark and all such use and associated goodwill will inure to the benefit of ALT-N.

Reseller shall not register, attempt to register or lay common law claim to any ALT-N Mark or any mark confusingly similar with an ALT-N Mark.

Reseller hereby acknowledges that the maintenance of the reputation and quality associated with the ALT-N Marks requires the highest quality and utmost uniformity with respect to Software and Services associated with the ALT-N Marks.

ALTN reserves the right to inspect Reseller's use or display of the AL T-N Marks from time-to-time to ensure that such use or display is in accordance with the tenns of the AGREEMENT.

Reseller shall permit ALT-N or its authorized agent to inspect and monitor Reseller's goods and/or services, at ALT-N's cost, to determine and verify that the ALT -N Marks are being used in accordance with the terms of the AGREEMENT.

Should Reseller fail to comply with this provision and fail to cure such non-compliance after written notice by ALT-N, in addition to any other ren1edies that ALT-N may have, ALT-N may terminate Reseller's license to use the ALT-N Marks with immediate effect and Reseller shall immediately cease, and shall inunediately cause its Sub-resellers to cease, using all ALT-N Marks.

Licensor hereby grants to Reseller a worldwide, non-exclusive, non-sublicensable, non-transferable license to, during the Reseller Term, use and display the logos, trademarks, branding and marketing collateral Licensor provides to Reseller (the "Trademarks"), solely for the marketing, promotion and advertising of Products that conform to the Specifications and the AGREEMENT, and strictly in accordance with Licensor's then-current trademark and logo policy, as Licensor may update from time-to-time.

Licensor may modify the Trademarks or replace them upon reasonable written notice, whereupon Reseller will cease using the replaced Trademarks as soon as reasonably possible.

Licensor may modify the license grant specified in this article to eliminate one or more jurisdictions. In such case, Reseller will promptly (and in any event no later than two business days of written notice) cease all use of the Trademarks in such jurisdictions.

Reseller is granted no right, title or license to any third party trademarks, or to the Trademarks except as expressly set forth in this article, and will not: (1) challenge Licensor's ownership or use of the Trademarks; (2) attempt to register the Trademarks; or (3) incorporate the Trademarks into Reseller's trademarks, service marks, company names, internet addresses, domain names, or any other similar designations. Any and all use of the Trademarks by or for Reseller inures solely to Licensor's benefit.

If Reseller acquires any rights in the Trademarks by operation of law or otherwise, it will immediately and at no expense to Licensor, assign such rights to Licensor along with any associated goodwill, applications and registrations.

In the first graf, consider attaching then-current policy as an exhibit, and referencing it as such in the graf.

Consider expressly stating (as a "sound bite") that if the Reseller's right to resell were ever to end, then the license will automatically end without further action by Licensor.

Fourth graf: If Reseller is operating in non-U.S. jurisdictions, it might have to register as a user.

Ideally, Licensor should make it a regular, documented practice to check up on how Reseller is using the Trademarks. That's because if Licensor were to fail to police its licensees' use of the Trademarks, a non-licensee might try to claim that Licensor had thereby forfeited its rights in the Trademarks.

On a related note, you might want a sound bite in the termination section, saying that if the Reseller's rights come to an end, then the Reseller will cease holding itself out, in any way, as having any relationship with Licensor.

(I say "sound bite" because in disputes it can be handy to be able to point to explicit "Thou shalt not do X" statements — as opposed to hoping that your opponent's counsel will interpret implicitobligations in the way that you hope.)

Finally: The University of Texas system has a pretty decent form at https://www.utsystem.edu/sites/default/files/documents/intellectual-property/Trademark%20Agreements/trademarklicenseagreementtermsandconditionsv3.docx

To protect the trademark owner, I suggest including a line stating that Reseller will immediately cease any use Licensor deems objectionable upon receipt of notice from Licensor. That way, the trademark owner will retain ultimate control over how its marks are used.

I would add (either in the trademark/logo policy or in the clause above) a short and sweet sentence(s) requiring non-disparagement, use of trademark notices (TM/®), no modifications/alterations and no registering URLs.

Licensor hereby grants to Reseller a worldwide, non-exclusive, non-sublicensable, non-transferable license to, during the Reseller Term, solely within the Territory, use and display the logos, trademarks, branding and marketing collateral in the exact unmodified form that Licensor provides to Reseller (the "Trademarks"), solely for the marketing, promotion and advertising of Products that conform to the Specifications and the AGREEMENT, and strictly in accordance with applicable laws pertaining to trademarks and Licensor';s then-current trademark and logo policy, as Licensor may update from time-to-time, attached hereto as Exhibit __.

Reseller will ensure that each display of the Trademarks is accompanied by Licensor-specified trademark notices.

The foregoing license terminates automatically upon termination of the AGREEMENT for any reason, without action required by Licensor. Upon termination, Reseller will cease all use and display of the Trademarks and cease holding itself out as having any relationship with Licensor.

Reseller will not do, omit to do, or permit to be done, any act that may dilute the Trademarks or tarnish or bring into disrepute the reputation of or goodwill associated with the Trademarks, or that may invalidate or jeopardize any Trademark registration.

Upon request, Reseller will deliver to Licensor all materials, websites, and collateral in which Reseller is displaying the Trademarks, and will modify or cease any use of the Trademarks that Licensor deems objectionable, misleading, offensive, or in violation of this section, the trademark and logo policy, or applicable law.

Licensor may modify the Trademarks or replace them upon reasonable written notice, whereupon Reseller will cease using the replaced Trademarks as soon as reasonably possible.

Licensor may modify the license grant specified in this article to eliminate

one or more jurisdictions. In such case, Reseller will promptly (and in any event no later than two business days of written notice) cease all use of the Trademarks in such jurisdictions.

Reseller is granted no right, title or license to any third party trademarks, or to the Trademarks except as expressly set forth in this article, and will not: (1) challenge Licensor's ownership or use of the Trademarks; (2) attempt to register the Trademarks; or (3) incorporate the Trademarks into Reseller's trademarks, service marks, company names, internet addresses, domain names, or any other similar designations. Any and all use of the Trademarks by or for Reseller inures solely to Licensor's benefit. If Reseller acquires any rights in the Trademarks by operation of law or otherwise, it will immediately and at no expense to Licensor, assign such rights to Licensor along with any associated goodwill, applications and registrations.

§ 153 Trademarks (commentary)

The following is an edited version of a discussion in PaperCutter, Inc. v. Fay's Drug Co., Inc., 900 F.2d 558, 561-63 (2d Cir. 1990). The court's citations, internal quotation marks, and alteration marks have been omitted; emphasis, extra paragraphing, and bullet points have been added. No copyright claimed in works of the U.S. Government.

We start with a few fundamentals. Although trademarks are often referred to as a form of property, or more specifically as "intellectual property," we recently reaffirmed that there is no such thing as property in a trademark except as a right appurtenant *[that is, attached and pertaining – DCT]* to an established business or trade in connection with which the mark is employed.

Beyond preventing a mark-holder's goods from being confused with those of others and preventing trade from being diverted to competitors through the use of misleading marks, therefore, an entity has no right to appropriate a particular phrase or word for its exclusive use in the marketplace.

However difficult of definition, the courts, including ours, have basically maintained four different categories of terms with respect to trademark protection:

a. **generic terms**, which refer to the genus or class of which the product is a species, and are **not** entitled to protection **even with proof of secondary**

meaning, i.e., proof that the public has come to associate the term with a particular source;

b. **descriptive terms**, which convey an immediate idea of some characteristic or attribute of the product and **are** entitled to protection with proof of secondary meaning;

c. **suggestive terms**, which require some imagination on the part of the consumer to ascertain the nature of the product, and **are** thus distinctive enough to be entitled to protection **even without proof** of secondary meaning; and

d. **arbitrary or fanciful terms**, which are so distinctive and indicative of a product's source, rather than its qualities or attributes, that they, unlike suggestive terms, enjoy trademark protection without the need of debating whether they are "merely descriptive."

Underlying the distinctions among the four categories of terms is **an attempt to prevent consumer confusion** concerning the source of goods and to encourage businesses to invest in quality goods by protecting their generated good will and customer loyalty from would-be imitators, **but at the same time** to avoid unduly impeding the free flow of information in the marketplace that results from exclusive appropriation of terms by particular businesses.

Because terms unrelated to the characteristics or class of the product are less useful to competitors selling similar products and more likely to conjure up the source of the product, we grant trademark protection to arbitrary, fanciful, and suggestive terms, without further inquiry, but not to descriptive and generic terms.

As between descriptive and generic terms, conventional wisdom holds that generic terms, which refer to the general class or category of the product, are so useful to businesses selling the same product that **no amount of money poured** into promoting customers' association of generic terms with a particular source can justify depriving competing manufacturers of the product of the right to call an article by its name.

As to descriptive terms, a person cannot, by mere adoption and use, obtain exclusive rights in words that describe the attributes of the goods, services, or business to which the words are applied[,] for the simple reasons that prospective purchasers are likely to understand such terms in their descriptive sense rather than as an indication of source and that the terms are likely to be useful to competing manufacturers.

However, descriptive terms may, unlike generic terms, become entitled to protection if the "descriptive meaning" of a word becomes **subordinate** and

the term instead becomes **primarily** a symbol of identification, a process by which, put another way, the term acquires "secondary meaning."

These concepts, as incorporated into the Lanham Act, by which we are governed, are to the effect that no trade-mark by which the goods of the applicant may be distinguished from the goods of others shall be refused registration on the principal register on account of its nature unless it consists of a mark which when used on or in connection with the goods of the applicant is merely descriptive of them.

An exception to this, however, is when the mark used has become distinctive of the applicant's goods in commerce, i.e., when the mark has acquired secondary meaning.

... Although a certificate of registration, once issued, is prima facie evidence that the registered mark is valid, such registration does not preclude another person from proving any legal or equitable defense or defect which might have been asserted if [the] mark had not been registered. Here, the Patent and Trademark Office issued PaperCutter's trademark registration without rejecting the mark as merely descriptive and without requiring proof of secondary meaning.

Concededly, the decision of the Patent and Trademark Office to register a mark without requiring proof of secondary meaning affords a rebuttable presumption that the mark is more than merely descriptive. At the same time, the defendant may petition for cancellation of the plaintiff's registration under section 14 of the Lanham Act, either in a separate and independent action or as a counterclaim in an infringement suit, by rebutting the presumption of a plaintiff's right to exclusive use of a registered mark by a preponderance of the evidence. The presumption may be rebutted by a showing that the mark is descriptive, not suggestive.

We have no doubt that "PaperCutter" is purely descriptive of the work done by the corporation formed by Cassety and Schaefer.

- There is no suggestion that the mark is generic, since "papercutter" is not the name of the product.

- To argue, however, that the term in reference to the goods is thereby made suggestive, thus entitling it to trademark protection, is to miss the boat. Even though one would not call the product or goods a papercutter, one would refer to them as paper cuts, and the evidence was strong that this is what they were considered to be.

Descriptive terms are distinguished from suggestive terms by evaluation of what prospective purchasers perceive in terms of an indication of source, as

well as the potential impact on competitors of the appropriation of the term as a trademark by a particular seller. We have noted a useful standard for distinguishing the terms:

- A term is suggestive if it requires imagination, thought and perception to reach a conclusion as to the nature of goods.
- A term is descriptive if it forthwith conveys an immediate idea of the ingredients, qualities or characteristics of the goods.

§ 154 Training Protocol [reserved]

§ 155 Tribunal Definition

a. The term tribunal refers a panel of one or more neutral officials, where:

1. one or more parties presents evidence or legal argument or both to the panel; and
2. thereafter, the panel renders a binding legal judgment that directly affects the interests of one or more parties in the matter in question.

b. The term *tribunal* can encompass a court; an arbitration tribunal; an administrative agency; or a legislative body; all when acting as stated above.

COMMENTARY

This definition is adapted from proposed amendments to Rule 1.00(u) of the 2010 proposed amendments to the Texas Disciplinary Rules of Professional Conduct [for lawyers]. (The proposed amendments were rejected in a referendum for unrelated reasons.)

§ 156 Unilateral Amendments (commentary)

Unilateral-amendment provisions are fairly common in, e.g., Web sites' terms of service, cable- and telephone-service contracts, and the like. See, for

example, the Facebook Statement of Rights and Responsibilities § 14; Google Terms of Service (under the headline "About These Terms").

But unilateral-amendment provisions can be dangerous if not drafted properly, as discussed below.

§ 156.1 A unilaterally amendable contract *might* be deemed "illusory" absent *advance* notice and a *Halliburton* savings clause

A unilateral-amendment provision might cause some or all of a contract — for example, an arbitration provision with a class-action waiver — to be unenforceable, on grounds that the contract was illusory. That in turn might strip a provider of legal protection that the contract might otherwise have provided, in the form of, e.g., an arbitration clause with class-action waiver; a forum-selection or governing-law clause; and so forth. That's essentially what happened in the Harris v. Blockbuster, Inc. case;

- A Blockbuster customer sued the company for allegedly violating her privacy rights and sought class-action status.
- Blockbuster sought to parry the suit by moving to compel individual, case-by-case arbitration, as required in the Blockbuster on-line terms of service.
- The customer opposed this, because it would be *much* less economically attractive for her lawyers.

The court denied Blockbuster's motion, on grounds that:

1. the Blockbuster terms of service allowed Blockbuster to amend the terms of service unilaterally;
2. the unilateral-amendment right did not contain a so-called *Halliburton* exception, under which pending claims would be governed by the pre-amendment terms of service, *see* In re Halliburton Co., 80 S.W.3d 566, 568 (Tex. 2002); and
3. the terms of service were thus "illusory" and therefore unenforceable under the relevant state law.

See Harris v. Blockbuster, Inc., 622 F. Supp. 2d 396, 400 (N.D. Tex. 2009).

Much the same result occurred in Carey v. 24 Hour Fitness USA, Inc.:

- A former employee filed a lawsuit against 24 Hour Fitness. The company moved to compel arbitration, citing an arbitration provision in the company's employee handbook.
- The court held that the arbitration provision was unenforceable because (1) the company reserved the right to change the employee handbook at will, and (2) there was no *Halliburton* exception to the unilateral amendment right, which would have required existing claims to be handled under the pre-existing handbook.
- That meant that the former employee's case would be tried in court — as a class action — instead of being heard privately by an arbitrator.

See Carey v. 24 Hour Fitness USA, Inc., 669 F.3d 202 (5th Cir. 2012); *see also* Morrison v. Amway Corp.517 F.3d 248 (5th Cir. 2008) (holding that arbitration award was illusory and thus unenforceable due to lack of *Halliburton*-type savings clause).

Not quite on point: Instagram changed its terms of service and gave its users 30 days to stop using the service if they did not want to be bound by the new terms of service. One Rodriguez continued to use the service, but sued Instagram for breach of the duty of good faith and for violation of California's unfair-competition law. In March 2014 a California state court rejected the plaintiff's claims, as discussed in a post on Prof. Eric Goldman's blog.

A company's employment handbook contained an agreement to binding arbitration. The handbook also stated that "Any change to this Agreement will only be effective upon notice to Applicant/Employee and shall only apply prospectively." According to the Fifth Circuit, that wasn't enough to save the arbitration agreement from being illusory and therefore unenforceable, because the agreement didn't include the *advance* notice required for the *Halliburton* savings clause. *See* Nelson v. Watch House Int'l, LLC, 815 F.3d 190 (5th Cir. 2016) (reversing and remanding order compelling arbitration).

On the other hand, such advance notice of a unilateral amendment to a contract can help to save an arbitration provision in the contract. *See, e.g.*, Lizalde v. Vista Quality Markets, Inc., 746 F.3d 222 (5th Cir. 2014) (reversing district court's denial of employer's motion to compel arbitration of employee's claim for on-the-job injury). In that case, the arbitration agreement was terminable by the employer, but it expressly stated that the termination would be prospective only and would not be effective until the employer had given the employee ten days' notice. *See id.* at 224; *see also* Casas v. CarMax

Auto Superstores California, LLC, 224 Cal. App. 4th 1233, 169 Cal. Rptr. 3d 96 (2014) (reversing denial of motion to compel arbitration).

But an advance-notice requirement alone will not necessarily save an agreement from "illusory" status if the agreement does not also contain a savings clause. For example, citing Texas- and Fifth Circuit cases, a California court held that a 30-day advance notice provision in an employment arbitration agreement was not enough to save the agreement from being illusory, because:

> As a practical matter, few aggrieved employees could file a claim with the *[American Arbitration Association]* on one month's notice because it is an unrealistically short deadline. Nor would they be inclined to do so in light of the significantly longer statutes of limitations. And to the extent the 30 days operates as a statute of limitations, it is invalid as applied to statutory rights like those conferred by the FEHA.

Peleg v. Neiman Marcus Group, Inc., 204 Cal. App. 4th 1425,1453-54, 140 Cal. Rptr. 3d 38 (2012) (reversing order compelling arbitration and order confirming arbitration award; giving effect to employment agreement's choice of Texas law).

Some California courts have held that a unilaterally amendable contract can be rendered non-illusory by the amendment right's being constrained by the implied covenant of good faith and fair dealing. *See Peleg*, 204 Cal. App. 4th 1425 at 1463-65 (citing cases but not following them because under the parties' choice of *Texas* law, the arbitration agreement was illusory).

A federal district court in Arizona held that Twitter's terms of service were not illusory, even though Twitter could change them unilaterally, because the new terms would not apply retroactively. Brittain v. Twitter, Inc., No. CV-18-01714-PHX-DGC (D. Ariz. Jan. 4, 2019) (granting Twitter's motion to transfer in light of forum-selection provision in terms of service).

§ 156.2 Caution: Merely posting a Web-site notice of a unilateral amendment might not be enough

Just changing an agreement on the Web likely won't be enough notice of a unilateral amendment. That was the result in a case involving Talk America Inc., a long-distance telephone service provider.

- Talk America tried to enforce an arbitration clause and class-action waiver in the provider's standard on-line service contract. Talk America wanted to preclude a class-action lawsuit brought by a customer, one Joe Douglas, who was upset with certain charges on his bill.

- Talk America's standard contract form, though, was not what Mr. Douglas had agreed to with Talk America's predecessor, America OnLine. Mr. Douglas's original contract with AOL did not contain an arbitration clause, nor a class-action waiver.

- Talk America had unilaterally changed its contract form by posting the revised contract on its Web site. It claimed that Mr. Douglas had agreed to the revised contract by continuing to use the long-distance service.

The Ninth Circuit gave short shrift to Talk America's claim, saying:

> Douglas alleges that Talk America changed his service contract without notifying him. He could only have become aware of the new terms if he had visited Talk America's website and examined the contract for possible changes. ...
>
> Even if Douglas had visited the website, he would have had no reason to look at the contract posted there. **Parties to a contract have no obligation to check the terms on a periodic basis to learn whether they have been changed by the other side.**
>
> *[In footnote 1:]* **Nor would a party know when to check the website for possible changes to the contract terms** without being notified that the contract has been changed and how. Douglas would have had to check the contract every day for possible changes. Without notice, an examination would be fairly cumbersome, as Douglas would have had to compare every word of the posted contract with his existing contract in order to detect whether it had changed.

Douglas v. United States District Court ex rel. Talk America Inc., 493 F.3d 1062, 1066 & n.1 (9th Cir. 2007) (vacating district court's order compelling arbitration) (emphasis edited).

In the same vein is Rodman v. Safeway Inc., No. 11-cv-03003-JST part III-C (N.D. Cal. Feb. 12, 2015) (amended order granting class plaintiff's motion for summary judgment that Safeway had overcharged on-line customers), where the court said:

> The Safeway.com agreement did not give Safeway the power to bind its customers to unknown future contract terms, because consumers cannot assent to terms that do not yet exist. A user confronting a contract in which she purports to agree to terms in whatever form they may appear in the future cannot know to what she is are agreeing.
>
> At most, this term in the Safeway.com agreement could be read to indicate that a customer agrees to read the terms and conditions every time she makes a purchase on the website in the future. But the Court also concludes that, even in light of their agreement to the Special Terms at the time of registration, customers' assent to the revised Terms cannot be inferred from their continued use of Safeway.com when they were never given notice that the Special Terms had been altered.

Id. at part III-C (extra paragraphing added). *Epilogue:* In the *Rodman* case, Safeway ultimately got tagged for $42 million. Rodman v. Safeway Inc., 125 F. Supp. 3d 922 (N.D. Cal. 2015), *aff'd*, No. 15-17390 (9th Cir. Aug. 4, 2017) (unpublished).

§ 156.3 An employer's unilateral notice to employees can change employment-agreement terms

In Davis v. Nordstrom, Inc., the U.S. Court of Appeals for the Ninth Circuit held that an employee of Nordstrom's, the famous department store, had voluntarily given up her right to class-action litigation against the store by not opting for it when the store gave her notice that it had changed its dispute-resolution policy:

> The handbook Davis received when she began work established the ground rules of her employment, including that Davis and Nordstrom would arbitrate certain disputes. She accepted employment on this basis, so there was a binding agreement to arbitrate.
>
> Under California law, Nordstrom was permitted to unilaterally change the terms of Davis's employment, including those terms included in its employee handbook. Nordstrom was also entitled to enforce the terms of employment identified in this handbook, and any modifications made to it, as it could any other contract.

Indeed, it is settled that an employer may unilaterally alter the terms of an employment agreement, Where an employee continues in his or her employment after being given notice of the changed terms or conditions, he or she has accepted those new terms or conditions.

Davis v. Nordstrom, Inc., 755 F.3d 1089, 1093 (9th Cir. 2014) (reversing denial of Nordstrom's motion to compel arbitration; citations, footnote, and alteration marks omitted).

§ 156.4 Allowing opting out of unilateral dispute-resolution changes might be crucial

The Uber ride-sharing terms of service (Dec. 13, 2017; last visited Apr. 20, 2018): allows a party to opt out of unilateral changes by Uber to the terms of service. A similar provision is what saved an arbitration provision in a Tenth Circuit case. Alwert v. Cox Communications, Inc. (In re Cox Enterprises, Inc.), 835 F.3d 1195 at 1200 n.1 (10th Cir. 2016).

§ 156.5 Additional reading about unilateral amendments

See, e.g., Michael C. Hardy and Gabrielle D. Shirley, Do Actions Speak Louder than Words? Non-Waiver Provisions Under Attack (2011) (discussing Maryland case); Jonathan Bartley, Beware the Non-Waiver Clause (2009) (discussing English case).

§ 157 Warranty Definition

§ 157.1 What *is* a warranty?

a. The noun *warranty* (whether or not the term is capitalized) refers to a statement by a party warranting that a specified state of affairs exists (or existed or will exist at or during a specified time). The verb warrant has the corresponding meaning.

b. As a hypothetical example: *Alice warrants that the widgets, as delivered to Bob, will be substantially free of defects in materials or workmanship.*

§ 157.2 Who is entitled to benefit from a warranty?

a. A warranty will benefit only the specific individuals and organizations expressly identified in the warranty or otherwise in the AGREEMENT.

b. Illustrating with a hypothetical example: "Alice warrants *to Bob and Bob's Affiliates*."

c. If a warranty does not identify its beneficiaries, then the only beneficiary is the other party (or if more than one: all other parties) to the AGREEMENT.

COMMENTARY

A party that wants its affiliates, etc., to benefit from a warranty should make that clear in the warranty language itself.

§ 157.3 What remedies exist for a breach of warranty?

a. A warranty may state the remedies to which a warranty beneficiary is entitled in case of a breach of the warranty.

b. Unless the AGREEMENT clearly states otherwise, a warranty beneficiary's EXCLUSIVE REMEDY for a breach of the warranty would be for the warranting party to pay the beneficiary for any foreseeable damage shown to have thereby resulted to the warranty beneficiary.

c. The payment obligation of subdivision b is subject to any limitations of liability that are stated in the agreement or that apply by law (for example a damages cap and/or a disclaimer of consequential damages).

d. In case of doubt, each beneficiary of a warranty should be deemed to have relied on that warranty as part of the basis of the bargain of the agreement.

COMMENTARY

This section more or less restates the law.

Many suppliers' warranties contain express

§ 157.4 Additional commentary

§ 157.4.1 What *is* a warranty (1): Learned Hand's view

The concept of "warranty" is not necessarily an easy one to grasp. One widely held view was expressed by the legendary judge Learned Hand:

> [A warranty is] an assurance by one party to a contract of the existence of a fact upon which the other party may rely.
>
> It is intended precisely to relieve the promisee of any duty to ascertain the fact for himself[.]
>
> [I]t amounts to a promise to indemnify the promisee for any loss if the fact warranted proves untrue ….

CBS, Inc. v. Ziff-Davis Publishing Co., 75 N.Y.2d 496, 503, 553 N.E.2d 997, 1001 (1990), *quoting* Metropolitan Coal Co. v Howard, 155 F.2d 780, 784 (2d Cir 1946) (emphasis by the *Ziff-Davis* court; extra paragraphing added).

§ 157.4.2 What *is* a warranty (2): A conditional covenant

A warranty can be thought of as a *conditional covenant*, tantamount to an insurance policy: In effect, the warranting party promises that, if the warranted state of affairs turns out not to be true, then the warranting party will do as stated in the contract — or, if the contract is silent, then the warranting party will make good on any foreseeable damages that, as a result, are incurred by the party (or parties) to whom the warranty was made.

Consider a contract for Alice to sell a car (the "Car") to Bob. The contract says: *Alice warrants that the Car, when delivered, will be in good working order*. Now consider two, alternative, fork-in-the-road scenarios:

1. In Scenario 1, the contract also says: IF: Bob shows that the Car was not in good working order when delivered; THEN: AS BOB'S EXCLUSIVE REMEDY, Alice will reimburse Bob for up to $X in repair costs. This means that Alice and Bob are voluntarily sharing the risk that the Car isn't in good working order; that sharing of the risk presumably is reflected in the negotiated price of the Car.

2. In Scenario 2, the contract is silent about what Alice will do if the Car turns out not to have been in good working order when delivered. Under the law, that is equivalent to the contract's saying: *IF: Bob shows that the Car, when delivered to him, was not in good working*

> *order; AND: As a result, Bob suffers foreseeable damages; THEN: Alice will pay Bob the total amount of those damages.*

(Obviously, Alice would prefer alternative #1 above, while Bob would prefer #2.)

§ 157.4.3

Warranties carry fewer proof requirements than representations

A warranty plaintiff has an easier job than a misrepresentation plaintiff. For example:

• **The beneficiary of a warranty doesn't need to prove that the warranting party acted negligently or recklessly or intentionally** in misstating the warranted state of affairs. This is in contrast to tort-based theories of misrepresentation, where a party claiming misrepresentation must provide such proof.

• **Neither need a warranty beneficiary prove** (at least in the so-called modern [U.S.] view) that the beneficiary justifiably relied on a warranty. A leading case on point is from the Court of Appeals of New York (that state's highest court); *see* CBS, Inc. v. Ziff-Davis Publishing Co., 75 N.Y.2d 496, 503, 553 N.E.2d 997, 1001 (1990). *Cf.* Lyon Fin. Serv., Inc. v. Illinois Paper & Copier Co., 848 N.W.2d 539, 543-46 (Minn. 2014) (on certification from 7th Cir.), where Minnesota's supreme court held that proof of reliance was not required for a breach of *contract* action, but the court declined to decide whether such proof was still required for a breach of *warranty* claim (the only pleaded action in the case). *See generally* Matthew J. Duchemin, Whether Reliance on the Warranty is Required in a Common Law Action for Breach of an Express Warranty, 82 MARQ. L. REV. 689 (1999).

A different situation might be presented, however, if, before the contract was signed, a warranting party *disclosed* that a warranty was not accurate. While the law seems still to be evolving in this area, the influential U.S. Court of Appeals for the Second Circuit summarized New York law thusly:

> … a court must evaluate both the extent and the source of the buyer's knowledge about the truth of what the seller is warranting.
>
> Where a buyer closes on a contract in the full knowledge and acceptance of facts **disclosed by the seller** which would constitute a breach of warranty under the terms of

> the contract, **the buyer should be foreclosed from later asserting the breach.**
>
> In that situation, unless the buyer expressly preserves his rights under the warranties … The buyer has waived the breach.
>
> **The buyer may preserve his rights** by expressly stating that disputes regarding the accuracy of the seller's warranties are unresolved, and that by signing the agreement the buyer does not waive any rights to enforce the terms of the agreement.
>
> On the other hand, if the seller is not the source of the buyer's knowledge, e.g., if it is merely "common knowledge" that the facts warranted are false, or the buyer has been informed of the falsity of the facts by some third party, the buyer may prevail in his claim for breach of warranty.
>
> In these cases, **it is not unrealistic to assume that the buyer purchased the seller's warranty as insurance** against any future claims, and that is why he insisted on the inclusion of the warranties ….
>
> In short, where **the seller** discloses up front the inaccuracy of certain of his warranties, it cannot be said that the buyer — absent the express preservation of his rights — believed he was purchasing the seller's promise as to the truth of the warranties.
>
> Accordingly, what the buyer knew *and, most importantly, whether he got that knowledge from the seller* are the critical questions.

Rogath v. Siebenmann, 129 F. 3d 261, 264-65 (2d Cir. 1997) (vacating and remanding partial summary judgment that seller had breached contract warranty; emphasis added).

§ 157.4.4

Special case: Sales of goods under the Uniform Commercial Code

In a contract for the sale of goods, if Vendor were only to *represent* that X were true, that representation might well constitute a warranty anyway under the Uniform Commercial Code. In the Code, UCC § 2-313 provides that, if the

representation is related to the goods and forms part of the basis of the bargain, it's deemed a warranty, no matter what it's called.

§ 157.4.5 Is "represents and warrants" necessary?

A contract drafter might be tempted to write the well-known couplet *represents and warrants* as if by reflex. The two terms, though, represent (pardon the expression) distinct legal concepts, with different proof requirements and different legal effects.

Prevailing in a claim of *breach of warranty* requires proof only that:

- the defendant warranted a fact (past, present, or future) to the plaintiff;
- the warranted fact proved to be untrue; and
- the plaintiff suffered foreseeable damages from the untruth.

If the plaintiff can prove those things, then the plaintiff is entitled to benefit-of-the-bargain damages.

In contrast, for a plaintiff to prevail in a *misrepresentation* claim, the plaintiff must show:

- that the defendant represented the truth of a (past or present, usually) fact — if the representation is in the contract itself, that will be a given;
- that in making the (mis)representation, the defendant acted negligently, recklessly, or intentionally, that is, with scienter — that might or might not be difficult for the plaintiff to prove;
- that the defendant intended for the plaintiff to rely on the (mis)representation — although if the representation was made in the contract itself, then this intent might likewise be a given;
- that the plaintiff did in fact rely on the (mis)representation — this probably wouldn't be hard for the plaintiff to prove merely by testifying to it;
- that the plaintiff's reliance was reasonable — although as a practical matter it will usually be on the defendant to prove that the reliance was *un*reasonable.

If the plaintiff succeeds in proving these things, then the plaintiff might well be able to recover *punitive* damages, and/or to rescind ("unwind") the contract entirely.

See generally Tina L. Stark,[10] Nonbinding Opinion: Another view on reps and warranties, *Business Law Today*, January/February 2006; Robert J. Johannes & Thomas A. Simonis, Buyer's Pre-Closing Knowledge of Seller's Breach of Warranty, WIS. LAW. (July 2002) (surveying case law).

An English court decision highlighted the difference between representations and warranties: *See* Sycamore Bidco Ltd v Breslin & Anor [2012] EWHC 3443 (Ch) (2012), *discussed in, e.g.*, Raymond L. Sweigart and Christopher D. Gunson, 'Reps' and Warranties: One Could Cost More Than the Other Under English Contract Law (PillsburyLaw.com 2013) *and* Glenn D. West, That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined "Fraud Carve-Outs" in Acquisition Agreements, 69 BUS. LAW. 1049, 1058 n.47 (2014).

§ 157.4.6

Rule of thumb for sellers (and others): Decide which to offer

Here's a rule of thumb for anyone being asked to "represent and warrant" something, as illustrated by the following hypothetical example: Suppose that Sally wants to sell her car, and the buyer, Bob, asks Sally to represent and warrant that the car is in good condition. Sally should consider whether she prefers to *represent* the car's good condition or to *warrant* it:

• Sally might have no reason to think that the car *isn't* in good condition, but she might not want to be financially responsible if the car does turn out to need repairs after the sale. In that case, Sally should consider trying only to *represent* to Bob that the car was in good condition, without *warranting* the car's condition.

• On the other hand, Sally might have reason to doubt whether the car is in good condition, while still being willing to reimburse Bob for any necessary repairs *up to a certain amount*. In that case, Sally should consider *warranting, but not representing* to Bob, that the car is in good condition, and saying that as Bob's exclusive remedy, Sally will reimburse Bob for up to $X in repair costs for problems that existed at the time of the sale and were repaired within (say) 30 days afterwards.

[10] *Author's note:* Disclosure: Professor Stark is a friend and mentor and the author of Drafting Contracts, a well-regarded law school course book.

§ 157.4.7 Rule of thumb for buyers (and others): Ask for both!

The rule of thumb for anyone that will benefit from a representation or a warranty is very simple: Ask for both, so that if there's a problem, you can decide whether to try to prove both breach of warranty and misrepresentation.

§ 157.4.8 Be careful what you warrant

In a British Columbia case:

- A supplier sold water pipes to a customer for use in a construction project designed by the customer.
- **The pipes conformed to the customer's specifications — in other words, the supplier delivered what the customer ordered.**
- Flaws in the customer's design led to problems.
- The contract's warranty language stated that **the *supplier* warranted that the pipes were "free from all defects arising at any time *from faulty design*"** (emphasis added).
- As a result, the supplier was held liable because of its warranty, even though the problem was the customer's fault.

See Greater Vancouver Water Dist. v. North American Pipe & Steel Ltd., 2012 BCCA 337 (CanLII) (reversing trial court's judgment in favor of supplier).

§ 157.4.9 Should warranties survive the closing of the transaction?

Anyone drafting a warranty provision in a contract for the sale of assets should consider whether to specify whether, and for how long, specified warranties will survive the closing. That's because, in some circumstances, **the so-called merger doctrine can extinguish contractual warranties upon closing**.

For example: In a contract for sale of real property, the seller will generally make certain stated warranties (which are often extensively negotiated). In some jurisdictions, at the closing of the sale, all such warranties are deemed to "merge" into — and thus be extinguished by — the seller's delivery of the deed conveying the property, that is unless the contract provides otherwise. That way, "the deed is deemed to express the final and entire contract between the

parties." Ram's Gate Winery, LLC v. Roche, 235 Cal. App. 4th 1071, 1079, 185 Cal. Rptr. 3d 935 (2015) (reversing and remanding summary adjudication and holding that fact issue remained as to whether parties intended warranties to survive closing) (citations and internal quotation marks omitted).

A similar but not-identical issue can arise in corporate merger & acquisition (M&A) transactions: Careless use of the phrase "warranties will survive the closing" can create confusion: If a warranty breach allegedly occurs, it might be unclear whether the non-breaching party must merely notify the breaching party witnin a stated period of time after closing, or whether the non-breaching party must file a lawsuit or demand for arbitration within that time. *See, e.g.*, Jeffrey H. LaBarge, They don't call it a survival clause for nothing … (NixonPeabody.com 2011).

§ 157.4.10 (Study:) Disclaiming implied warranties

Overview: Many contracts include disclaimers of *implied* warranties; the idea could be paraphrased as, *whatever representations and warranties are in this contract, that's it*. For a detailed example with commentary, see the *Common Draft* disclaimer provision at https://goo.gl/uWzWES.

A disclaimer of implied warranties and representations could usefully include a disclaimer of *conditions* and of *terms of quality* to address the requirements of disclaimers under UK law as discussed below.

The word **DISCLAIMS** could be in bold-faced, all-caps type for conspicuousness (see § 4.36 to meet the special requirements for disclaimers of the implied warranty of merchantability (see https://www.law.cornell.edu/ucc/2/2-314) of goods sold (which arises automatically under the (U.S.) Uniform Commercial Code), specifically UCC § 2-316]](2) and (3) (see https://www.law.cornell.edu/ucc/2/2-316).

Effect of consumer-protection statutes on warranty disclaimers: Any company offering consumer-product warranties (in the U.S.) should carefully study the requirements of various federal- and state consumer protection laws, such as:

- the Magnuson-Moss Warranty Act, which is the federal law that governs consumer product warranties; it requires manufacturers and sellers of consumer products to provide consumers with detailed information about warranty coverage, and also affects both the rights of consumers and the obligations of warrantors under written warranties *(this paragraph is adapted from the FTC guide linked above)*; and

- state statutes such as California's Song-Beverly Act, which requires manufacturers of consumer goods sold in California to jump through various hoops (and imposes stringent requirements if the manufacturer wants to disclaim the implied warranties of merchatability and fitness).

The E-Warranty Act of 2015 requires any **written warranty for consumer products costing more than $15** to be made available before the sale, as discussed here.

In Texas and probably other jurisdictions, **homebuilders cannot disclaim the implied warranty of habitability**. *See* Centex Homes v. Buecher, 95 S.W.3d 266 (Tex. 2002).

§ 157.4.11 Warranty disclaimers for UK transactions should also disclaim "conditions" and "terms of quality"

If you're a vendor doing a sales transaction under UK law (England, Wales, Northern Ireland), be sure that your warranty disclaimer addresses not just implied warranties but also implied "conditions" and "terms of quality." An oil seller failed to do so and learned that its disclaimer didn't preclude liability. See KG Bominflot Bunkergesellschaft Für Mineralöle mbh & Co KG v. Petroplus Marketing AG, [2009] EWHC 1088 (Comm). In that case:

- The parties entered into a contract for the sale of gasoil, a type of heating oil. The contract was governed by English law.
- The contract provided that delivery was complete, and title and risk passed to the buyer, when the gasoil was loaded onto a certain ship.
- The gasoil met the contractual specifications when it was loaded.
- By the time the ship arrived at its destination, however, the gasoil no longer met the agreed specifications.
- The claimed damages were in excess of USD $3 million.

The seller took the position that all title and risk had passed, therefore the damages were the buyer's problem. The buyer, though, argued that under the Sale of Goods Act 1979, "it was an implied *condition* of the sale contract that the goods would be reasonably fit for the purpose of remaining, during their time on the vessel and for a reasonable time thereafter, within the specifications set out in the sale contract." *Id.* ¶ 7 (quoting buyer's argument; emphasis added).

The judge agreed with the buyer, holding that by failing to disclaim implied conditions as well as implied warranties, the seller had left itself open to the buyer's claim:

> 49. **If the failure to use the word "condition" renders clause 18 [the warranty disclaimer] of little or no effect, so be it.** The sellers agreed to the wording of clause 18 in the face of *Wallis v Pratt* and must live with the consequences.

(Emphasis added.)

§ 157.5 Review questions (not part of the AGREEMENT)

§ 157.5.1 Question: Warranty disclaimers in England?

FACTS: Your client, Seller, headquartered in Dallas, manufactures widgets. Seller's CEO, while on a vacation in London, had the good fortune to make friends with a prominent British industrialist; the CEO landed a big order to deliver 1 million widgets to the industrialist's company in Liverpool, and brought back a signed purchase order.

You happen to know that Seller's standard terms-of-sale document: • includes a statement of limited warranties and remedies; • includes the following statement: "ALL OTHER WARRANTIES ARE DISCLAIMED"; and • is silent about choice of law.

You don't know whether the British industrialist's company has seen Seller's standard terms-of-sale document.

1. TRUE OR FALSE: Texas law will likely apply.[11]

2. TRUE OR FALSE: If article 2 of the Texas UCC applies, Seller's disclaimer will be enough, under UCC § 2-312, to disclaim an implied warranty that Seller has the legal right to convey ownership of the widgets to the purchaser.[12]

[11] On these facts, English law will probably apply.

[12] Under UCC § 2-312(2), the implied warranty of *title* must be expressly disclaimed (or the disclaimer must be apparent from the circumstances).

3. TRUE OR FALSE: If *English* law applies, Seller's disclaimer will likely be enough to disclaim all potential liability about the widgets other than as stated in Seller's standard terms-of-sale document.[13]

§ 157.5.2 Reps and warranties strategy

FACTS: You've passed a bar exam and are a newly-licensed attorney. As a favor to a friend, you're helping the friend sell a car to a stranger. The friend says that s/he doesn't know of any mechanical problems with the car.

MORE FACTS: The buyer asks the seller to represent and warrant that the car has no problems.

QUESTION: How might you respond?[14]

TRUE OR FALSE: It'd be fine for your friend the seller to phrase the statement as, "to my personal knowledge the vehicle has no problems"?[15] *[Drafting tip: Note where the question mark is, i.e.,* outside *the quotation mark.]*

§ 157.5.3 Some multiple choice

QUESTION 1: Does a representation normally relate to *(note: there could be multiple correct answers)*:
(A) a past fact?
(B) a present fact?
(C) a future fact?
(D) all of the above?
(E) none of the above?[16]

---

[13] No - need a disclaimer of implied *conditions* and (probably) *terms of quality* as well.

[14] Perhaps by having the seller say simply, "*so far as I'm aware*, the car has no *significant* problems, but I'm not a mechanic and haven't had a mechanic check it out."

[15] That'd be a bad idea — phrased that way, the statement is likely to be taken as a definitive statement that indeed there are no problems.

[16] A and B. In rare circumstances, courts will treat C, a representation of a future fact, as a covenant or warranty (in essence, bailing out the incompetent drafter), e.g., *I represent that I will pay you Tuesday for a hamburger today*. **NOTE:** For *drafting* purposes, treat A and B as the only correct answers.

QUESTION 2: What *four extra* elements must a plaintiff typically prove to succeed in a claim for *misrepresentation*, over and above those proof elements needed for a breach of warranty claim?[17]

QUESTION 3: Should factual representations normally be included in an agreement's recitals? Why or why not?[18]

A:

§ 158 Warranties Protocol *(rough draft; in progress)*

See also the Implied Warranties Disclaimer Definition in the XXX.

With advice of counsel, drafters of the AGREEMENT could create warranties using these shorthand terms in much the same way as the famous INCOTERMS three-letter abbreviations such as EXW, DDP, and so on.

Sample language:

> ABC makes the following TANGO 2019A warranties to XYZ: *[List shorthand terms]*.

§ 158.1 Software-Related Warranties

The following shorthand terms refer to warranties made by "**Provider**" to "**Customer**" for "**Software**" specified in the AGREEMENT.

[17] A) The defendant must have intended that the plaintiff rely on the representation (or at least should have known that the plaintiff would do so. B) The plaintiff must have *actually* relied on the representation. C) The plaintiff's reliance must not have been unreasonable. D) The defendant must have acted with "scienter," i.e., negligently, recklessly, or with intent to deceive.

[18] This is a matter of convention and will depend on the supervising attorney's preference. *Author's note:* If memory serves, in some jurisdictions the courts might not treat the recitals as part of the contract. The safer thing to do would be to rework the recitals as a "1. Background" section and have the parties make whatever initial representations they're willing to make.

§ 158.1.1 Software Media Warranty

Warranty: The media on which the Software and/or its documentation are delivered will be free from material defects.

(Exclusive) remedy: Provider will replace the defective media at its own expense.

Warranty period: 90 days from date of delivery of the media.

COMMENTARY

This is an extremely common form of media warranty.

§ 158.1.2 Software Performance Warranty

Warranty: The Software, as delivered, will perform, in all material respects, in accordance with:

1. the user documentation furnished by or on behalf of Provider; and
2. any additional written specifications for the software's performance that are expressly set forth and identified as such in a written agreement signed by an authorized representative of Provider.

(Exclusive) remedy: Provider will provide the Software Performance Remedies as specified in § 158.1.4.

Warranty Period: 90 days from date of delivery of the first version of the Software that is licensed under a paid license.

(Exclusive) remedy: Provider will provide the Software Performance Remedies as specified in § 158.1.4.

COMMENTARY

A 90-day warranty period is fairly common for purchased perpetual licenses for software and will often be regarded as an "assurance-type warranty" that does not require separate revenue-recognition treatment. On the other hand, a longer warranty period could raise questions whether the longer warranty is a "performance obligation," which could complicate the provider's efforts to recognize revenue from the transaction. See, e.g., Ernst & Young, SOFTWARE — REVENUE RECOGNITION ACCOUNTING

STANDARDS CODIFICATION 985-605 (Mar. 2018), archived at https://perma.cc/R3KK-AELT; Grant Thornton, Revenue from Contract with Customers: Navigating the guidance in ASC 606 and ASC 340-40 (Jan. 2019), archived at https://perma.cc/QW26-B8CM.

§ 158.1.3 Malicious-Software Warranty

So far as Provider is aware after reasonable preventive efforts, the warranted software as delivered will not contain any virus, Trojan horse, or worm, or other software designed to permit unauthorized access to, or to erase or otherwise harm, your software, hardware, or data

§ 158.1.4 Software Performance Remedies

§ 159 Will Definition

Unless the context clearly and unmistakably requires otherwise, terms such as "Party A will take Action X" mean that Party A is *required* to take Action X; likewise, "Party B will not take Action Z" means that Party B is prohibited from taking Action Z.

COMMENTARY

Surprisingly, it might be a good idea to be clear about the meaning of the word *will*, because the term "Party A will take Action X" can mean at least two different things:

1. Party A *anticipates* taking Action X in the future; or
2. Party A *contractually commits* to taking Action X in the future.

Bad things could happen if a court were to read the term *will* in the "wrong" way. For example: In a 2014 opinion, **the Supreme Court of Texas ruled that the term will, in context, did *not* establish a contractual obligation, but merely stated the intent of one of the parties**. *See* Lubbock County Water Control & Improvement Dist. v. Church & Akin, L.L.C., 442 S.W.3d 297, 306 n.10 (Tex. 2014) (reversing court of appeals and dismissing claim for want of jurisdiction). Similar disputes might be avoided if the term *will* is defined as meaning *must*. In many cases that might well be overkill, but it also might be one of those

situations where **a few extra words can sometimes be cheap insurance against a creative trial counsel.**

Conceivably, the result in the *Lubbock County* case might have been avoided by using *shall* instead of *will* in the contract language. Professor Tina Stark (a friend and mentor to the author) thinks that contract obligations should always be signaled by *shall*, not by *will*. *See generally* Tina L. Stark, Drafting Contracts: How and Why Lawyers Do What They Do ch. 13 & 10.2.1 (2d ed. 2014). So too does Ken Adams; *see generally* his A Manual of Style for Contract Drafting; a Google search will help the reader to find Ken's various on-line postings about *shall* versus *will*.

Even so, the author still prefers sometimes using the term *will*, not *shall*, for contract obligations, because:

- Contracts should be in plain, contemporary English wherever possible; the term *shall* carries with it the faint whiff of musty, archaic legalese. (When the author reads sentences such as *Party a shall take Action X*, it reminds him of his late grandmother, who would say things such as, "I shall have a cup of tea.")
- The term *will* seems to have a more-collaborative feel to it, and less of a master/servant tone, than *shall*. That can provide just a smidgen of help in establishing a cooperative attitude among the parties, which can be important to a successful long-term relationship or even to just a one-shot transaction.
- From a sales-psychology perspective, *will* in a contract drafted by a supplier is softer and more deferential; it pays the customer the respect of (implicitly) acknowledging that the customer can walk away at any time before signature.

See also the commentary to the definition of *shall*, above.

§ 160 Willful Definition

The term *willful* and its variant spelling *wilful*, in the context of action or conduct (for example, *willful act* or *willful action* or *willful conduct* or *willful misconduct* or *willful neglect*), refer to action or conduct that would be tortious if engaged in outside the context of a contract.

COMMENTARY

This definition is based on that of New York law. **If the definition were ever to become relevant, it might well be in connection with a carve-out to a limitation of liability.** See, e.g., Metropolitan Life Ins. Co. v. Noble Lowndes Int'l, Inc., 84 N.Y.2d 430, 643 N.E.2d 504, 618 N.Y.S.2d 882 (1994), where New York's highest court looked to the doctrine of ejusdem generis in holding that, in context, the contractual term *willful acts* referred to tortious conduct, not merely to mere intentional nonperformance of the contract. Id., 84 N.Y.2d at 438.

Likewise, in Kawaauhau v. Geiger, 523 U.S. 57, 61-62 (1998), the issue arise from section 523(a)(6) of the Bankruptcy Code, which provides that debts from "willful and malicious injury" are not dischargeable in bankruptcy. The U.S. Supreme Court held that, in context, the term willful requires a showing of intent to cause injury, not merely of intent to take the action that resulted in the injury. ¶ The better practice, of course, is represented by the acronym W.I.D.D.: When In Doubt, Define.

The better practice, of course, is represented by the acronym W.I.D.D.: **When In Doubt, Define**.

§ 161 Writing Definition

a. The term *writing* refers to a tangible or electronic record of a communication or representation; *written* has a corresponding meaning.

b. *Writing* and *written* encompass, without limitation:

1. handwriting, typewriting, printing, photocopying, photography, audio or video recording, and e-mail; and

2. words, pictures, diagrams, and other forms of expression.

COMMENTARY

Subdivision b.1 of this laundry list of "written" examples is adapted from proposed amendments to Rule 1.00(v) of the 2010 proposed amendments to the Texas Disciplinary Rules of Professional Conduct [for lawyers], which added references to electronic recordings. The proposed amendments were rejected in a referendum for unrelated reasons, but the definition is still useful.

§ 162 Author's note

§ 162.1 Bibliography of reference contracts

The TANGO options for business transactions draw on ideas found in many different actual contracts, including for example the following:

- **Cisco PO:** A Cisco purchase-order form archived at https://perma.cc/SD47-YCHU
- **GE Terms of Sale:** General Electric terms-of-sale form (ES-104), archived at https://perma.cc/8LRL-PFL3
- **ISDA Master Agreement** at, e.g., https://tinyurl.com/ISDAMstrAgrmt (the SEC's EDGAR Web site)
- **Honeywell PO:** Honeywell purchase-order form, archived at https://perma.cc/CUV6-NKTY
- **Honeywell Terms of Sale:** Honeywell terms-of-sale document, archived at https://perma.cc/5MB9-H6VK)
- **UT System Patent License:** https://www.utsystem.edu/documents/docs/intellectual-property/patent-license-agreements
- **ISDA Master Agreement** https://www.sec.gov/Archives/edgar/data/1107694/000119312508091225/dex1032.htm

§ 163 APPENDIXES FOR STUDENTS

The remainder of this document is information for the author's law-school contract drafting courses.

§ 164 Course information

§ 164.1 Basic information

§ 164.1.1 The course materials are available online

The main reading material will be the following.

• This document, which is still very much a work in progress, but which I've locked down (in the student edition) for the semester. I intend to keep making it available at no charge. Students are encouraged to make suggestions and comments as the semester progresses; and

• a Supplement, consisting of several real-world contracts that I've annotated and printed to PDF. We'll study selected portions of some of these contracts.

§ 164.1.2 Course objective: An exposure to the tools of the trade

Our primary course objectives and learning outcomes are to give each student *an initial, survey-type exposure* to the following tools of the contract drafter's and reviewer's trade:

1. Techniques for drafting simple, *understandable* sentences and paragraphs to cover complex topics;
2. Important legal doctrines, e.g., laws governing interest charges, indemnities, implied warranties, etc.;
3. Crucial *business* issues that are commonly addressed in contracts;
4. Practicing spotting and fixing language ambiguities that could cause problems down the road;
5. The psychology of likely future readers such as business people, judges, and jurors;

6. Finding and harvesting useful "precedents" (past contracts);
7. Recognizing when to ask the partner or the client — and getting in the habit of *documenting* that you did so.

§ 164.1.3 What this course *won't* do

First: **Do NOT assume that we will "cover the material" in class,** because:

• We have a total of 35 hours together in class; that's not enough nearly time to do justice to all the material you'll need to be aware of in order to be a competent contract drafter or reviewer. **Possibly more than in your other courses,** you'll need to be sure to do the reading if you want to get maximum benefit from the course.

• As discussed below, the sage-on-a-stage lecture approach has been shown to be significantly less effective when it comes to comprehension and retention, so we will focus the class time on trying to make sure you understand and retain as many crucial points as possible.

Second: **This course isn't like a driver's ed class**, where completing the course will make you at least minimally competent to "go out on the road" by yourself. **Becoming a competent contract drafter will take far more time and effort than can be provided in a single three-semester-hour course.** Even after you finish this course, you likely will — and *should* — worry that you don't know what you don't know.

(You could think of this course as being **akin to a surgical-tools class** in which medical students learn the basics of using scalpels, clamps, suture needles, and other surgical tools, and practice using those tools by doing a few simple procedures on an anatomical mannequin. Completing such a class, without more, should not make a student feel "comfortable" doing any kind of surgery on a live person; that's why newly graduated doctors must still spend years in residencies to learn their trade. **Much the same would be true if you were to try drafting a contract for a real client with no other training than this course.)**

§ 164.1.4 Contract *revising* as well as *drafting*

In this course, we will practice good drafting skills — in part — by *revising* the work of others. This reflects what you're almost certain to see in practice: Contract drafters spend far less time *drafting* contracts

than they do in *reviewing and revising* others' drafts, whether a given existing draft was prepared by "the other side" or was used in a previous deal.

Even when you're the one who must prepare the first draft, **your supervising attorney will almost always tell you to find a previous form of agreement and modify it** (and perhaps will suggest one), instead of starting from scratch with a blank screen.

An analogy: When Princess Diana was killed in a car accident, the British government did not draw up her funeral plans from scratch; instead, the government modified an existing plan, code-named OPERATION TAY BRIDGE, which had been previously prepared and rehearsed for the eventual funeral of the Queen Mother. See https://goo.gl/S7U8Qr (Wikipedia.org).

§ 164.1.5 Peer review of much student work

I will of course review and provide feedback on the assigned writing projects, and I will walk around and offer real-time comments during the in-class drafting sessions. **To make it possible for you to do more practice-type exercises,** some of your drafting- and revision assignments will be "reviewed" by your colleagues in your small groups, often by comparing them with model answers that I provide.

§ 164.1.6 Spaced repetition, with (some) jumping around

Some of the short exercises and quizzes that we do will seem repetitive; they also will seem to jump around from topic to topic. **This is a feature, not a bug,** because:

- It mirrors what you'll almost certainly see in practice; and
- pedagogically it's been shown to be more effective at promoting long-term memory than lecture and repetitive reading. See generally Spaced retrieval (Wikipedia: https://goo.gl/4PRZTy).

This approach will strike some students as disorganized. Over the years, though, most students seem to have come to appreciate the value of the approach, as mentioned in some of the student comments below.

§ 164.1.7 Social proof: Past student comments (good and bad)

Following the sales-and-marketing principles of (i) using social proof, and (ii) "setting the hook," here are some student comments from official course evaluations, from virtual-whiteboard feedback at the end of various past semesters, and from the occasional email from former students:

• “I had the opportunity to redline a software agreement for the company I intern with and the Contracts Lawyer told me I did a very fine job. … The lawyer asked me how I was so well attuned to the various ways in which the software providers tried to undermine our company’s bargaining power. … I was amazed at how easily I could identify problematic language. …”

• "Great job! Loved the quizzes. Very helpful class."

• "I saw what I learned in class be used at my job, so that was great to be able to use what I learned already as a student practicing."

• "One of the best classes of my time in law school. Great progressive approach to teaching. I can only hope that UH will adopt Toedt's methodology for other classes."

• "I liked the practical approach of the course – very effective teaching technique by using repetition and in class exercises."

• "You learn piece by piece the process throughout the semester to be able to effectively draft/redline contracts."

• "His course is different from the norm and his methods are refreshing. … Professor Toedt's approach allows students to figure out the issue on their own but provides students with the tools necessary to reach an answer (which he then explains/corrects)."

• "… really enjoyed the approach to class and quizzes."

• "I like the in class exercises. Very helpful to lock in the concepts. I would recommend more of these types of exercises throughout the class. Amount of reading was reasonable."

• "Love the quizzes! They are really helpful to learn things, and the spaced repetition was excellent. Also they were a good way to test what we knew and where we were in class so we had an idea of how things were going."

• "I liked both the class and instructor and would recommend this course."

• “This was a great class, Professor Toedt's approach to teaching is clear and concise.”

• "Professor Toedt is the 'original gangster' (hereafter 'OG') of contract drafting. I'm fortunate to have taken his class. He is incredible. Thanks for your public service."

• "Professor Toedt is remarkable at contract drafting. It is a privilege to take this class with him. He does his job exceptionally well. Very respectful man."

• "Professor Toedt is great at what he does! He really knows his stuff and makes sure you know it too. I really like the approach of having different sections of a contract due as homework every week. This helped me really learn about the different sections and helped me stay on track to writing an entire contract by the end of the semester. All in all, wonderful professor!"

• "Very insightful and practical class. The professor is very effective in conveying the information in a rememberable and engaging fashion. I truly enjoyed this course and will be using what I learned in practice next year. Thank you, Professor Toedt!"

* * *

Not everyone was so enthused; here are some less-positive comments, along with my responses.

• "I also felt that we did not have enough time to complete the quizzes." *(From a different student's review:)* "Most tests/exams we are used to taking in law school last hours, not minutes. If the timing is off on a test, then that basically destroys the effectiveness of the actual test as a way to measure how students are learning."

DCT response: **By design, each quiz has too many questions.** That way, students won't have time to look up many of the answers on-the-fly, and so those who don't need to do so will get a better score.

(This practice also has a pedagogical aspect to it: **If you don't remember an answer while taking a quiz, it's better for you to be able to look it up right then and there, instead of guessing**, because that little bit of real-time review will make you somewhat more likely to remember the correct answer *next* time.)

• "The classes felt a little haphazard on a weekly basis." *(From a different student's review:)* "[T]he course is extremely unorganized …."

DCT response: The topics covered in the course are arranged in very rough order of importance (in my experience). And, as noted above, **spaced**

repetition can indeed feel like jumping around, but it's key to the approach of this course.

• "I thought some of the reading assignments were a little long. It just looks daunting and I am not motivated when one section has 20-50 subsections."

DCT response: Noted — I've redone the reading assignments to indicate more what must be read closely, versus what can be merely looked over or skimmed (so that you'll likely remember that it's there and can look it up if you ever need it in the future).

• "I felt like we spent a ton of time revising contracts and simplifying them, but I'm still not sure that I have a great grasp of all the sections of a contract." *(From a different student's review:)* "I liked that the class stressed practical knowledge and what to look out for when reviewing contracts but I do not feel like that this has translated into me feeling confident (or even semiconfident) writing or reviewing a contract in real life."

DCT response: **It's *normal* not to feel confident** until you've had a fair amount of real-world experience that didn't blow up on you. Think back to when you first drove a car by yourself.

• "To me, I think the stress of a contract for a law student is the idea of, if you're assigned to write up a contract from scratch, your thought is, where do I even begin?"

DCT response: Noted; I'm thinking about how to remedy this with some kind of step-by-step procedure — although as pointed out above, contract drafters almost never start with a clean sheet of paper or blank computer screen.

• "[W]hile I found it helpful that we started the pass-fail assignments in class and could discuss with fellow students and the instructor I would have liked more personal comments back on the finished product." *(From a different student's review:)* "Overall, I thoroughly enjoyed this class and learned a significant amount. The only change that I would be recommend *[sic]* is for the instructor to if at all possible *[sic]* decrease the amount of peer review of homework and substitute it with his own review."

DCT response: As discussed above, **peer review provides each student with more opportunities** to do short drafting assignments and get feedback; if we only did instructor feedback, we'd necessarily have fewer of these opportunities, and consequently less practice in drafting. That said, I've reworked the schedule of homework assignments and plan to do more review and commenting myself.

• "I do think you could go without any reference that might offend students. For example, I think there is a "safe sex" reference that is unnecessary …."

DCT response: "Safe sex" is a metaphor that I use as Rule 3 of my Three Rules for Protecting Trade Secrets. To make the underlying principle more memorable, I've been using the safe-sex metaphor for probably 20-plus years, in dozens of presentations to CLE audiences, business managers, entrepreneurs, law students, and business students — during that time, only this student and one business manager several years ago have ever complained the metaphor was offensive. (I also refer to "d[**]kish documents" in the Battle of the Forms discussion.) These metaphors seem to help convey the underlying concepts to adult audiences, so I anticipate that I will continue to use them.

§ 164.2 Administrative details

§ 164.2.1 Computer use; email addresses

• Computer use in class is not just encouraged but required; you will need in-class Web access for many of the in-class exercises. If this will be a problem, be sure to contact me well in advance.

(You might, however, want to rethink the extent to which you use laptops in your other classes; see, e.g., this article by a professor at the University of Michigan about how classroom laptop users not only do worse than those who take notes by hand, they also interfere with the learning of non-laptop users around them.)

• On the first day of class I will be asking for your email addresses so that I can include it in a class Google Group. Please provide an email address that you check regularly.

§ 164.2.2 Extra class time each day (to avoid needing a Friday-night makeup class)

I'm a practicing attorney and arbitrator; I normally don't have to miss class, but it has been known to happen, e.g., when I've had out-of-town commitments. There have also been times when class has been canceled due to weather. (And on the evening of Game 7 of the 2017 World Series, we canceled the evening class.)

The ABA requires 700 minutes of instruction for each credit hour; that means we need 2,100 minutes of instruction for our three-hour course. *We will achieve the needed minutes of instruction* by:

1. meeting for 80 minutes per class for 26 class meetings, vice the normal 27 scheduled class meetings, to get 2,060 instruction minutes;
2. making up the remaining 20 instruction minutes via "online" instruction in the form of emails and other discussions, as permitted by ABA rules;
3. using the resulting "spare" class #27 as a makeup day if necessary, otherwise ending the course at #26;
4. as a last resort, meeting on one of our scheduled Friday-evening makeup days (not the situation of choice).

§ 164.2.3 Recording my lectures: Go ahead if you want

I don't make audio recordings of my lectures, but I have no objection to students doing so and sharing the recordings with other UHLC students.

§ 164.2.4 Last-day agenda: Reviews, Jeopardy, pizza

The last day of class will generally include:

- Pizza for the section (6:00 p.m. or 7:30 p.m.) that has the highest average total score, including the class attendance, homework, and quizzes;
- An overview of the final exam plan;
- A collaborative review of key concepts, using the virtual whiteboards to create a master outline for each group — the virtual whiteboard (6:00 p.m. section | 7:30 p.m. section);
- A group discussion of what would make the course and/or the materials more useful to next semester's students, and what *didn't* work so well, again using the virtual whiteboard;
- Course evaluations, using the UH online system; and
- As one last review: a Jeopardy! game.

§ 164.3 General information

My contact information: I can be reached at dc@toedt.com or (713) 364-6545 (which forwards to my cell); see also my About page.

I respond pretty quickly to email questions. If I think that a question might be of interest to other students, I'm likely to copy and paste it (possibly edited, and with identifying information redacted) into an email to one or both sections.

My office hours: As an adjunct professor, I generally don't physically come to the school except to teach class. I'm happy to meet with students as follows:

HOW	WHEN	APPT. NEEDED?
In person	M or W 3:30 p.m.	Yes
In person	M or W 5:25 p.m. or 7:25 p.m.	No
Skype or Zoom video; phone	TTHF 3:00 p.m.	Yes

I strongly encourage each student to make at least one appointment during the semester to discuss any questions that they or I might have.

§ 164.4 Counseling available

Counseling and Psychological Services (CAPS) can help students who are having difficulties managing stress, adjusting to the demands of a professional program, or feeling sad and hopeless. You can reach CAPS (http://www.uh.edu/caps) by calling 713-743-5454 during and after business hours for routine appointments or if you or someone you know is in crisis. No appointment is necessary for the "Let's Talk" program, a drop-in consultation service at convenient locations and hours around campus. Go to http://www.uh.edu/caps/outreach/lets_talk.html for more information.

§ 164.5 Grading: Quizzes, final exam, etc.

The school's required average: 3.0 to 3.4: As required by law school policy for a writing class, raw grades will be adjusted proportionally to the extent necessary to make the average of the final class grades fall within the range specified in the heading of this section. (My usual practice — but not a guaranteed one — is to "move the curve" up or down as necessary so that the average is as close as practicable to the *high* end of the required range.)

Your final grade is based on 950 total possible points: Your course grade will be based on how many points you earn out of 950 total possible points, as explained below.

§ 164.5.1 Attendance "signing bonus": 100 points — *with a claw-back*

Every student starts out with the above "freebie" points for class attendance, **but can lose points for missing class,** as follows:

TOTAL CLASSES MISSED	TOTAL POINTS LOST
1	0
2	10
3	30
4	60
5 or more	all 100

This means, of course, that students who miss more than one class will have to do that much better on the final, the quizzes, and homework in order to keep up with their classmates on the school-required average.

Some absences won't lose points, however:

• I don't count absences for "official" law school travel, e.g., for moot-court competitions, etc., as long as I'm informed in advance.

• I also don't count up to two absences for illness (yours or someone for whom you need to care, e.g., a child). **If you're ill, please <u>don't</u> come to class and infect the rest of us**. Please email me if you'll be absent for illness; I'll take your word for it without a doctor's note.

Other absences, e.g., for job interviews, office visits, work trips, etc., **will be counted as missed classes** and will lose points as set forth above; please schedule accordingly.

On any given day, if I see that one or more students are missing, I will circulate an attendance sign-in sheet. If I see that everyone is present, I normally won't bother doing so.

For regular "classroom" sessions, I no longer let students attend remotely, because experience has shown that realistically, remote attenders don't participate in the small-group discussion.

Why attendance is especially important: The class attendance policy arises from the fact that we will be doing:

- a significant amount of in-class *discussion*; and
- a significant number of in-class *exercises*, in two- to four-person teams.*

Consequently, it's important for all students to attend each class, not just for their own benefit, but so that their teams won't be shorthanded.

ABA accreditation rules and school policy require attendance at 80% of the class meetings for each course. We will meet a total of 26 times; rounding to the nearest whole number of classes, a student therefore must attend at least 21 class periods to comply with the 80% rule.

§ 164.5.2

Homework: 200 points

Homework consists of short drafting assignments, mostly pass-fail; see that section for instructions and the specific assignments.

WARNING: In one past semester, a student failed the course — even though the student had a (very-low) passing grade on the final exam — *and therefore didn't graduate that semester* as the student had planned, because the student had turned in almost none of the homework assignments.

§ 164.5.3 **Mid-term quizzes: 150 points**

On four different Wednesdays (generally every third one), at the beginning of class, we will have an in-class, mid-term quiz.

The mid-term quizzes will include progressively-more review material and accordingly will count for an increasing number of points, as follows:

Quiz 1	Sept. 11	20 points
Quiz 2	Oct. 2	30 points
Quiz 3	Oct. 23	40 points
Quiz 4	Nov. 13	60 points

Each quiz will:

1. be administered either on-line via Blackboard or in hard copy;
2. be timed for *approximately* TEN MINUTES each (people with accommodations can get extra time — ask Dean Tennessee's office to let me know if you're one of those people);
3. sometimes be open-everything (book notes, Internet), but NO communicating with other students;
4. some quizzes might be closed book (I'll announced that well in advance)
5. **very likely include more questions than almost anyone could answer in the allotted time** — that's a corollary of having the quizzes be open-everything (people who spend time looking up answers won't score as well);
6. include a mix of true-false, multiple-choice, fill-in-the-blank, and/or "micro-essay" (short answer) questions;
7. cover only the following:
    - the readings assigned up through *and including* the quiz date, whether or not we discuss any particular topic in class;
    - any review questions relating to the reading;

- anything in the in-class and homework exercises that we have done to date — the quizzes themselves will thus serve as a reinforcing review that takes advantage of the testing effect;

8. be graded partly anonymously — the Blackboard software shows me students' names; I can't do anything about that, but:

   - Blackboard automatically grades the true-false, multiple-choice, and fill-in-the-blank ("FITB") questions.

   - I review any "incorrect" fill-in-the-blank answers so that I can give credit for simple misspellings, which Blackboard can't always pick up. (I program the quizzes on Blackboard to accept as many misspellings as I can think of, but you'd be surprised how … creative students can be ….).

   - If a quiz includes any micro-essays, they will not be anonymous at all.

In past quizzes, a few students have gotten the right answer to every question on every quiz. In response, one student suggested that I should "[d]esign quizzes to have a wider score distribution." I'm less interested in that than in helping *all* students to understand and retain the material.

§ 164.5.4 Final exam: 400 points

The final exam will: • be one hour in length; • consist in large part of what amounts to a mid-term quiz on steroids; • take place in the to-be-designated final-exam room; and • be open-book, open-notes, open-browser (but no communication with anyone else, whether by text, email, IM, or anything else).

What's fair game for the final exam? Anything: • in the reading materials, including the flashcards; • in the homework, quizzes, and in-class exercises.

The honor code will of course apply.

Copying and pasting from the course materials won't cut it.

§ 164.5.5 Take-home, open-book review ("Quiz 5") 100 points

This is an optional online review that you can do for extra points. NOTE: Keep in mind that your final grade will still necessarily be tied to the class average required by school policy. But still, you'll improve your chances of placing higher on the grade-distribution curve by earning more points.

§ 164.5.6 Class participation bump

As permitted by law-school policy, I reserve the right:

- to award *discretionary* increases in student grades by one-third of a grade level for excellent class participation, e.g., from a B to a B-plus, assuming that this doesn't cause the class average to exceed the maximum permitted; and
- to reduce grades for sub-standard class participation. (I've almost never done that, except for a couple of students for whom it was like pulling teeth to get them to participate even minimally.)

§ 164.6 Homework fact pattern

§ 164.6.1 Facts to start (based on an actual client project)

1. The two clients in this project are:
    a. "Gigunda Energy," a (hypothetical) global oil-and-gas company headquartered in California but with a significant campus in Houston; and
    b. (the equally-hypothetical) "Math-Whiz LLC" in Houston. Math-Whiz is headed by Mary, who is an expert in analyzing seismic data to predict where oil or natural gas deposits might be. Mary "came up" in the industry working for major oil companies, then started her own company. Her business has grown; she now employs several junior analysts, and also selectively subcontracts work to others (usually, longtime friends or colleagues of hers) to do specialized tasks.
2. Gigunda Energy expects to collect seismic data, over a period of about a year, from a potential oil field in Outer Mongolia. Gigunda wants to hire Math-Whiz to analyze the seismic data.
3. Gigunda and Math-Whiz have discussed the likely amount of work that will be involved. They have agreed that Gigunda will pay Math-Whiz a flat monthly fee of $20K for up to 200 staff hours of work per month, with additional work being billed at $150 per hour.
4. A partner in your law firm has asked you to prepare a draft contract and to help the parties negotiate it.

For each homework assignment, do two versions if necessary: One from Math-Whiz's perspective, the other from Gigunda's perspective. *(The idea is to get you thinking about what the party other than your client would want, in preparation for negotiating.)*

§ 164.6.2 Week-by-week drafting assignments

First drafts of each of these drafting assignments is due on a Wednesday at the beginning of class — be sure to read the general instructions below.

Week	**First Draft: Wednesday** (a)	**Provision (P/F?)**	**Points**
02	Aug. 28	Title and signature blocks for the agreement (P/F)	5
03	Sept. 4	Preamble and recitals (P/F)	5
04	Sept. 11	Payment terms; interest clause	10
05	Sept. 18	Math-Whiz reps and warranties (b)	10
06	Sept. 25	Rep- and warranty disclaimers	10
07	Oct. 2	Each party's indemnity obligations	20
08	Oct. 9	Assignment consent	20
09	Oct. 16	Amendments, waivers, entire agreement	20

Week	First Draft: Wednesday (a)	Provision (P/F?)	Points
10	Oct. 23	Recordkeeping; audit rights; background checks	20
11	Oct. 30	Termination rights	20
12	Nov. 6	Insurance	20
13	Nov. 13	IP rights; notices	20
14	Nov. 20	Governing law; forum selection	20
		TOTAL:	**200**

NOTES:

(a) Final drafts due no later than Sunday 12:00 noon; late submissions will have points deducted.

(b) Don't do disclaimers that will come later.

Homework will be due each Wednesday at the beginning of class. The fact pattern and specific assignments are set out below.

General instructions for the drafting homework:

1. Many drafting-assignment homework assignments will be pass-fail; any that are not pass-fail will be "flagged" as such in advance.
2. For each provision you draft, do so from the perspective of the client you're representing — but keep in mind that the client might be more interested in getting an "OK" contract to signature as soon as possible, and then going about its business, than in negotiating the absolute best possible deal for all hypothetical risks.

3. If you want to include information that isn't given in the facts, either leave a placeholder note or make something up.
4. Feel free to compare notes with your classmates.
5. Feel free to "soften" (or leave out entirely) one or more provisions that you might otherwise include, e.g., in the interest of getting to signature sooner. If you do so, then include a brief note to that effect in your homework.
6. Feel free to *briefly* explain any decisions or recommendations you make, in the same way that you might if you were sending the draft to a partner or to the client. BUT: I don't want any long essays or extensive annotations!
7. **Drafting homework is to be printed out <u>with your name</u> on it and brought to class.**
8. At the beginning of class on the due date, you'll exchange papers within your group; look over what your colleague did; and make any comments.
9. At the end of class on the due date, turn in your homework. OPTION: If you want to revise your own homework based on comments from your colleague(s), you can keep your printed-out copy and instead email me a revision.
10. I expect to provide a model answer that you should study.
11. I'll normally return marked-up homework papers the following Monday**. Don't necessarily expect a lot of individualized comments** — instead, you should study the model answer and email me with any questions you have.

§ 165 The contract drafter's mission

§ 165.1 The contract drafter's job is to *educate* and *persuade*

The author of a contract-drafting style manual once opined that, apart from the opening recitals, "in a contract you don't reason or explain. You just state rules." Ken Adams, *More Words Not to Include in a Contract—"Therefore" and Its Relatives*,

at http://www.adamsdrafting.com/therefore/ (2008). **That view would be fine if people were computers,** which do *exactly* as they're told: nothing more, nothing less.

But:

- People aren't computers.
- Even in a corporation-to-corporation contract, it's *people* who carry out obligations and exercise rights.
- People's memories are often short and can sometimes be "creative"; people sometimes need to be reminded of what they agreed to.
- A contracting party's circumstances can change after the contract is signed — by the time a dispute arises, key employees and executives of a party could have different views of what's important, and they might have forgotten (perhaps conveniently) what mattered during the contract negotiations.

Let's not forget another important group of people: Judges, jurors, and arbitrators who are asked to enforce a contract can be influenced by what they think is right and fair. Sometimes, the wording of the contract's terms can make a difference.

In sum: **People sometimes need to be educated, and even persuaded, to do things. That is the contract drafter's mission:** To (re)educate the parties — and sometimes judges and jurors — and, if necessary, to persuade them, to do what your client now wants them to do.

§ 165.2 Three crucial questions asked by judges and juries

(Just skim this section to the extent that you care to — but remember the heading.)

Most contracts stay buried in the (electronic) file drawer. The contracting parties either don't get into disputes in the first place, or they successfully resolve any disputes on their own.

But woe betide the drafter (or reviewer) who forgets that *ultimately* a contract might have to serve as Exhibit A in a lawsuit or arbitration. For such a contract, the most important reader is the judge or arbitrator — who almost certainly is very busy; who might have little or no

knowledge of the parties' business; and who would appreciate it if the contract quickly conveyed the answers to three crucial questions:

1. Exactly what — if anything — did the defendant commit to do or not do in the contract?
2. What event or events could *trigger* the defendant's commitment, and did the necessary triggering event or -events actually occur?
3. Was the defendant's commitment subject to any relevant *exceptions* or other *limitations*?

Clumsy drafting can sometimes make these three contract questions very difficult for the judge, arbitrator, or other reader to puzzle out. During negotiation, this can slow up the non-drafting party's legal review and delay getting the contract to signature, and in litigation or arbitration, it can increase the chances of an unforeseen result.

The drafters and reviewers of a contract can serve *all* future readers — not least, the business people who must read the contract — by being as clear as possible about these questions. Clarity thus helps to reduce the odds of a dispute arising in the first place.

§ 166 Preamble of a contract

Here's a preamble for a hypothetical contract:

> **Purchase and Sale Agreement**
> **for 2012 MacBook Air Computer**
>
> THIS AGREEMENT ("**Agreement**") is between (i) **Betty's Used Computers, LLC**, a limited liability company organized under the laws of the State of Texas ("**Buyer**"), with its principal place of business and its initial address for notice at 1234 Main St, Houston, Texas 77002; and (ii) **Sam Smith**, an individual residing in Houston, Harris County, Texas, whose initial address for notice is 4604 Calhoun Rd, Houston, Texas 77004 ("**Seller**"). This Agreement is effective the last date written on the signature page.

Let's look at this preamble piece by piece.

§ 166.1 "This Agreement"

Many drafters would start this preamble by repeating the title of the agreement in all-caps:

> THIS PURCHASE AND SALE AGREEMENT (this "**Agreement**") ....

But others, including your author, prefer the shorter approach shown above and reproduced just below:

> THIS AGREEMENT ("**Agreement**") ....

That's because:

- It's doubtful that anyone would be confused about what "This Agreement" refers to; and
- The shorter version reduces the risk that a future editor might (i) revise the large-type title at the very top of the document but (ii) forget to change the all-caps title in the preamble. *(This is an example of the rule of thumb: Don't Repeat Yourself, or D.R.Y.)*

In the second bullet point just above, note how the first sentence is broken up (i) with bullets, and (ii) with so-called "romanettes," that is, lower-case Roman numerals, to make the sentence easier for a contract reviewer to skim. *(This follows the maxim: Serve the Reader.)*

§ 166.2 Bold-faced defined terms

Note how our preamble defines the terms *Agreement*, *Buyer*, and *Seller*:

> THIS AGREEMENT ("**Agreement**") is between
> (i) **Betty's Used Computers, LLC**, ... ("**Buyer**") ...
> and (ii) **Sam Smith**, ... ("**Seller**").

These defined terms are not only in bold-faced type: they're also surrounded by quotation marks and parentheses. This helps to make the defined terms stand out to a reader who is skimming the document.

When drafting "in-line" defined terms like this, it's a good idea to highlight them in this way; this makes it easier for a reader to spot a desired definition quickly when scanning the document to find it. Imagine the reader running across a reference to some other defined term and starting to flip through the document, wondering to herself, "OK, what does 'Buyer' mean again?"

NOTE: If you also have a separate definitions section for defined terms, it's a good idea for that section to include cross-references to the in-line definitions as well, so that the definitions section serves as a master glossary of all defined terms in the agreement.

§ 166.3 Specific terms: "Buyer" and "Seller"

One more point about how we identify the buyer and the seller in this contract:

> THIS AGREEMENT ("**Agreement**") is between
> (i) **Betty's Used Computers, LLC**, … ("**Buyer**") …
> and (ii) **Sam Smith**, … ("**Seller**").

This preamble uses the defined terms *Buyer* and *Seller* instead of the parties' names, *Betty* and *Sam*, because:

- Doing this can make it easier on future readers … such as a judge … to keep track of who's who.
- Doing this also makes it easier for the drafter to re-use the document for another deal by just changing the names at the beginning. Sure, global search-and-replace can work, but it's often over-inclusive; for example, automatically changing all instances of *Sam* to *Sally* might result in the word *samples* being changed to *sallyples*.

§ 166.4 Agreement "between" (not "by and between") the parties

Our preamble says that the contract is *between* the parties — not *by and between* the parties, and not *among* them:

> THIS AGREEMENT ("**Agreement**") is between ….

True, many contracts say *"by and* between" instead of just "between." The former, though, sounds like legalese, and the latter works just as well.

For contracts with multiple parties, some drafters will write *among* instead of *between*; that's fine, but *between*also works.

§ 166.5 Stating details about the parties

Our preamble provides certain details about the parties:

> THIS AGREEMENT ("**Agreement**") is between (i) **Betty's Used Computers, LLC**, a limited liability company organized under the laws of the State of Texas … and (ii) **Sam Smith**, an individual ….

When a party to a contract is a corporation, LLC, or other organization, it's an excellent idea for the preamble to state both (i) the type of organization, in this case "a limited liability company," and (ii) the jurisdiction under whose laws the organization was formed, in this case "organized under the laws of the State of Texas." This has several benefits:

- It reduces the chance of confusion in case the same company name is used by different organizations in different jurisdictions … imagine how many "Acme Corporations" or "AAAAAA Dry Cleaning" there must be in various states;
- it helps to nail down at least one jurisdiction where the named party is subject to personal jurisdiction and venue, saving future trial counsel the trouble of proving it up; and
- it helps to establish whether U.S. federal courts have diversity jurisdiction (a U.S. concept that might or might not be applicable).

(A shorter version might be "Betty's Used Computers, LLC, a Texas limited liability company ….")

Including the jurisdiction of organization can simplify a litigator's task of "proving up" the necessary facts: If a contract signed by ABC Corporation recites that ABC is a *Delaware* corporation, for example, an opposing party generally won't have to prove that fact, because ABC will usually be deemed to have conceded it in advance. (See also (Study:) Acknowledgements in a contract, § 4.3 and its field notes.)

This particular hypothetical agreement is set up to be between a limited liability company, or "LLC," and an individual; in that way, the signature blocks will illustrate how organizational signature blocks should be done.

§ 166.6 Principal place of business (or residence) and initial address

Note how the preamble above states some geographical information about the parties:

- *Principal place of business:* Stating Betty's principal place of business helps trial counsel avoid having to prove up personal jurisdiction. For example, a Delaware corporation whose principal place of business was in Houston would almost certainly be subject to suit in Houston.

- *Residence:* Likewise, if a party to a contract is an individual, then stating the individual's residence helps to establish personal jurisdiction and the proper venue for a lawsuit against him or her.

- *County:* Stating the county of an individual's residence might be important if the *city* of residence extends into multiple counties. For example, Houston is the county seat of Harris County, but just because Sam lives in Houston doesn't automatically mean that he can be sued in the county's courts in downtown Houston. That's because Houston's city limits extend into Fort Bend County to the southwest and Montgomery County to the north; Sam might live in the City of Houston but in one of those other counties, and so he *might* have to be sued in his home county and not in Harris County.

- *Addresses for notice:* It's convenient to put the parties' initial addresses for notice in the preamble. That way, a later reader won't need to go paging through the agreement looking for the notice provision. Doing this also makes it easy for contract reviewer(s) to verify that the information is correct.

§ 166.7 Stating the effective date in the preamble

The preamble states the effective date; that's usually unnecessary unless the contract is to be effective as of a specified date, but many drafters like to include the effective date anyway. I prefer the "last date signed" approach that's used in the example above:

> THIS AGREEMENT ("**Agreement**") is between …. This Agreement is effective the last date written on the signature page.

Here's a different version of the last-date-signed approach:

> This Agreement is made, effective the last date signed as written below, between ....

In reviewing others' contract drafts, you're likely to see some less-good possibilities:

> This Agreement is made December 31, 20XX, between ....

> This Agreement is **dated** December 31, 20XX, between ....

Either of these can be problematic because the stated date might turn out to be inaccurate, depending on when the parties actually sign the contract.

CAUTION: **Never backdate a contract for deceptive purposes**, e.g., to be able to book a sale in an earlier fiscal period — as discussed in the Backdating entry, that practice has sent more than one corporate executive to prison, including at least one general counsel.

On the other hand**, it might be just fine to state that a contract is effective as of a different date.** EXAMPLE: Alice discloses confidential information to Bob after Bob first orally agrees to keep the information confidential; they agree to have the lawyers put together a written confidentiality agreement. That written agreement might state that it is effective as of the date of Alice's oral disclosure. The following might work if it's for non-deceptive purposes:

> This Agreement is entered into, effective December 31, 20XX, by ....

(**Alice and Bob would not want to backdate their actual signatures**, though.)

§ 166.8 Include the parties' affiliates as "parties"? *(Probably not.)*

Some agreements, in identifying the parties to the agreement on the front page, state that the parties are, say, *ABC Corporation and its Affiliates*. That's generally a bad idea unless each such affiliate actually signs the agreement as a party and therefore commits on its own to the contractual obligations.

The much-better practice is to state clearly the specific rights and obligations that (some or all) affiliates have under the contract. This is sometimes done in "master" agreements negotiated by a party on behalf of itself and its affiliates. For example, consider a negotiated master purchase agreement between a customer and a provider. The master agreement might require the provider to accept purchase orders under the master agreement from the customer's affiliates as well as from the customer itself, so that the customer's affiliates can take advantage of the pre-negotiated pricing and terms.

CAUTION: **An affiliate of a contracting party <u>might</u> be bound by the contract** if (i) the contracting party — or the individual signing the contract on behalf of that party — happens to control the affiliate, and (ii) the contract states that the contract is to benefit the affiliate. That was the result in Medicalgorithmics S.A. v. AMI Monitoring, Inc., No. 10948-CB, slip op. at 3, 52-53 (Del. Ch. Aug. 18, 2016). In that case, (i) the contract stated that a strategic alliance was being created for the contracting party and its affiliates, and (ii) the contract was signed by the president of the contracting party, who was also the sole managing member of the affiliate. The court held that the affiliate was bound by (and had violated) certain restrictions in the contract.

See also, e.g., Mark Anderson, Don't Make Affiliates parties to the agreement (2014); Ken Adams, Having a Parent Company Enter Into a Contract "On Behalf" of an Affiliate (2008).

§ 166.9 Naming the "wrong" party can screw up contract enforcement

Be sure you're naming the correct party as "the other side" — or consider negotiating a guaranty from a solvent affiliate. Failing to name the correct corporate entity could leave your client holding the bag. This seems to have happened in Northbound Group, Inc. v. Norvax, Inc., 795 F.3d 647 (7th Cir. 2015): The named party in the contract had essentially no assets (the assets were all owned by the named party's parent company). The other named party sued the parent company for breach of the contract; the Seventh Circuit affirmed summary judgment in favor of the parent company, saying:

> It goes without saying that a contract cannot bind a nonparty. … **If appellant is entitled to damages for breach of contract, [it cannot] recover them**

> **in a suit against appellee because appellee was not a party to the contract.** These are the general rules of corporate and contract law, but they come with exceptions, of course. Northbound tries to create one new exception and invokes two established ones**. We find no basis for holding Norvax liable for any alleged breach of the contract between Northbound and … the Norvax subsidiary.**

Id. at 650-51 (cleaned up; emphasis added).

§ 166.10 Does each party have *legal capacity* to contract?

Depending on the law of the jurisdiction, an unincorporated association or trust might not be legally capable of entering into contracts. *See generally* Ken Adams, Can a Trust Enter Into a Contract? (AdamsDrafting.com Dec. 2014).

If a contract is purportedly entered into by a party that doesn't have the legal capacity to do so, then conceivably the individual who signed the contract on behalf of that party might be personally liable for the party's obligations.

§ 166.11 Is country-specific information required?

Apparently, the Czech Republic and some other Central- and Eastern-European countries require contracts to include specific identifying information about the parties, e.g., the registered office, the company ID number. and the registration in the Commercial Register. See this Ken Adams blog post; also this one from 2007. Similar information can be found in this apparently-Israeli contract.

§ 167 Microsoft Word: Crucial things to know

1. The safest way to format a paragraph without corrupting the document and crashing the Word program is to **format the *style* of the paragraph**, not the individual paragraph itself.

See generally, e.g., The Styles advantage in Word (support.microsoft.com: https://goo.gl/v8Jbej); Item 3 in the

2013 list of tips to avoid crashing Word, answers.microsoft.com: https://goo.gl/VxqJKs).

NOTE: The above author's tip no. 2 is to avoid Track Changes, but I've never had a problem with it — at least so far as I know.

2. **To create a heading, use Heading styles:** Heading 1, Heading 2, etc.

3. **Headings can be automatically numbered** by using the Bullets and Numbering feature under Format.

The following apply mainly to the formatting of styles, *but can be used with caution to format individual paragraphs:*

4. On rare occasions, to adjust the line spacing within a specific paragraph, use the menu sequence: Format | Paragraph | Indents and Spacing | Spacing *(almost smack in the middle of the dialog box on a Mac)*.

5. To adjust the spacing *between* paragraphs, use the menu sequence: Format | Paragraph | Indents and Spacing menu. **Don't use a blank line to separate paragraphs — adjust the spacing instead.** See generally Practical Typography: Spacing Between Paragraphs (PracticalTypography.com: https://goo.gl/vNjeKF).

6. **To keep one paragraph on the same page with the following paragraph** (which is sometimes useful), use the menu sequence Format | Paragraph | Line and Page Breaks | Keep with Next. *(For headings, this should be done in the relevant heading style, e.g., Heading 1, etc.)*

Optional: Other Word tips

7. A table of contents can be useful in a long contract. To create a table of contents, in the References tab, use the Table of Contents dropdown box and select Custom Table of Contents.

8. Tables can sometimes be useful in contracts. To remove the borders from a table (the way Word normally creates them), first use the menu sequence: Table | Select | Table. Then use the menu sequence: Format | Borders & Shading | Borders | None.

9. **To copy and paste a short snippet from a Web page into a Microsoft Word document** without messing up the formatting of the paragraph into which you're pasting the snippet, use the menu sequence: Edit | Paste Special | Unformatted text. (Alternatively: Edit | Paste and Match Formatting.)

§ 168 Contracting mechanics

In American law schools, students learn very early that under the Statute of Frauds, many and even most business contracts must take the form of a signed writing — but also that such a writing can be enforceable in court even if it's not terribly detailed.

§ 168.1 A countersigned letter can be enough.

(Just skim this section to the extent that you care to — but remember the heading.)

Not long after the author started work as an associate at Arnold, White & Durkee, the senior name partner, Tom Arnold,[19] called me to his office. Tom asked me to draft a confidentiality agreement for a friend of his, "Bill," who was going to be disclosing a business plan to his (Bill's) friend, "Jim."

Tom instructed me *not* to draft a conventional contract. Instead, the confidentiality agreement was to take the form of a short letter along approximately the following lines, paraphrased from memory:

> Dear Jim,
>
> This confirms that I will be telling you about my plans to go into business *[raising tribbles, let's say]* so that you can evaluate whether you want to invest in the business with me.
>
> You agree that unless I say it's OK, (1) you won't disclose what I tell you about my plans to anyone else, and (2) you won't use that information yourself for any other purpose.
>
> You won't be under this obligation, though, to the extent that (A) the information in question has become public, or (B) you get the information from another source that

[19] *Author's note:* The late Tom Arnold founded the law firm Arnold, White & Durkee, which grew to become what we think was the second-largest intellectual property boutique in the United States, with some 150 lawyers in six cities. Tom was everything a lawyer should be; for many years he and his wife, the late (and aptly named) Grace, were very good to my wife Maretta and me.

> has legitimately acquired or developed the information itself.
>
> If this is agreeable, please countersign the enclosed copy of this letter and return it to me.
>
> I look forward to our working together.
>
> Sincerely yours,
>
> Bill

When I'd prepared a draft, I asked Tom, isn't this pretty sparse?

Tom replied, yes it was sparse, but:

- **The signed letter would be a binding, enforceable, workable contract,** which Bill could take to court if his friend Jim double-crossed him (which Bill judged to be very unlikely); and
- Equally important to Bill**: Jim would almost certainly sign the letter immediately** — whereas if Bill had asked Jim to sign a full-blown confidentiality agreement, **Jim likely would have asked his lawyer to review the agreement**, and that would have delayed things.

That experience was an eye-opener. It taught me that contracts aren't magical written incantations: they're just simple statements of simple things. It also was my first lesson in a fundamental truth: Business clients are often far more interested in being able to sign an "OK" contract *now* than they are in signing a supposedly-better contract weeks or in the future.

As another example, see the 2006 **letter agreement** for consulting services between Ford Motor Company and British financial wizard Sir John Bond (for USD $25,000 per day), at https://goo.gl/cXMrX5 (archive.org):

> [Letterhead for Secretary of Ford Motor Company]
>
> September 13, 2006
>
> Sir John Bond [Address redacted]
>
> Dear Sir John:

> This letter will confirm our discussions on the terms of your consultancy to Ford Motor Company:
>
> We have agreed that you will be a consultant to Ford Motor Company and William Clay Ford, Jr., generally spending the whole of the Tuesday and the morning of the Wednesday preceding each of our seven regular Board of Directors meetings in consultation with senior management of Ford Motor Credit Company and senior finance management of Ford.
>
> We will compensate you at the rate of $25,000 per day ..... *[many additional terms omitted]*
>
> If you concur in the consulting arrangement as described above, please so indicate by signing and dating this letter at the space below.
>
> [Signature blocks]

(Optional reading:) For more on this particular consulting agreement, see Rob Cox, The $25,000 Bond (TheBreakingNews.com 2006).

§ 168.2 An exchange of texts or emails might be sufficient.

In a federal-court lawsuit in Florida (decided under Delaware law), a text-message exchange served as a binding agreement to modify an existing contract — *and that agreed modification went on to cost one of the parties more than a million dollars*. In that case, an Internet advertising agency had a contract to supply online sales leads to its client, a manufacturer of electronic cigarettes. **The contract limited the client's payment obligation to 200 leads per day.** But a vice-president of marketing at the client had a text-message conversation with the account manager at the Internet ad agency; the operative part of the conversation was as follows:

> *[Account manager:]* We can do 2000 orders/day by Friday if I have your blessing
>
> *[Client VP:]* NO LIMIT
>
> *[Account manager:]* awesome!

(Emphasis added.) But then when ad agency billed the client for the higher number of sales orders, the client didn't pay, and so the ad agency sued and won a judgment for $1,240,655, because:

- The account manager's text proposing 2,000 orders per day constituted an offer to modify the contract to modify the 200-per-day limit;
- The manufacturer's vice president's "NO LIMIT" response constituted a counteroffer; and
- **The account manager accepted the counteroffer by sending the "awesome!" reply.**

The court therefore held that the text-message exchange was a binding agreement to modify the existing contract. CX Digital Media, Inc. v. Smoking Everywhere, Inc., No. 09-62020-CIV, slip op. at 8, 17-18 (S.D. Fla. Mar. 23, 2011).

§ 168.2.1 **To close more business, a GE unit streamlined its forms *(skim)***

Contract forms tend to grow by accretion, as lawyers think of issues that could arise. As a result, what a commenter said about politicians fearful of voter backlash might apply equally to contract drafters fearful of client finger-pointing: "As with mass incarceration, efforts to reform airport security are hamstrung by politicians and administrators *[read: lawyers]* **who would prefer to inflict hassle on millions than be caught making one mistake."** Henry Grabar, Terminal: How the Airport Came to Embody Our National Psychosis (Slate.com 2017).

Not surprisingly, the legal department of one General Electric business unit found that its "comprehensive" contract documents were sabotaging its ability to close sales deals:

> When GE Aviation combined its three digital businesses into a single Digital Solutions unit nearly four years ago, their salespeople were eager to speed up the growth they had seen in the years before the move. They found plenty of enthusiastic customers, but **they struggled to close their deals.**

> The reason: **Customers often needed to review and sign contracts more than 100 pages long before they could start doing business.**
>
> The new business inherited seven different contracts from the three units. **The clunky documents were loaded with legalese, redundancies, archaic words and wordy attempts to cover every imaginable legal** *[sic]*. No wonder they languished unread for months.
>
> "We would call, and **customers would say, 'I can't get through this,**'" says Karen Thompson, Digital Solutions contracts leader at GE Aviation. "And that was before they even sent it to their legal team!
>
> "**Who is going to pick up a 100-plus-page document and sort through it to find language they disagree with?** We were having trouble moving past that part to what we needed to do, which was sell our services."
>
> For those customers who did read the contract, negotiations would drag on and on.

Kristin Kloberdanz, Honey, I Shrunk The Contract: How Plain English Is Helping GE Keep Its Business Humming, (GE.com 2017) (extra paragraphing added).

What *was* a surprise was that the legal department actually did something about i. The general counsel of that GE business unit described his team's motivations in a *Harvard Business Review* article:

> … For the most part, the contracts used in business are long, poorly structured, and full of unnecessary and incomprehensible language. …
>
> **A contract should not take countless hours to negotiate. Business leaders should not have to call an attorney to interpret an agreement that they are expected to administer.**
>
> We should live in a world where contracts are written in accessible language—where potential business partners can sit down over a short lunch without their lawyers and read, truly understand, and feel comfortable signing

> a contract. A world where disputes caused by ambiguity disappear.

Shawn Burton, The Case for Plain-Language Contracts, Harv. Bus. Rev., Jan.-Feb. 2018, at 134 (extra paragraphing added).

Burton provides several examples of streamlined provisions, such as the following revision:

Before:

> Customer shall indemnify, defend, and hold Company harmless from any and all claims, suits, actions, liabilities, damages and costs, including reasonable attorneys' fees and court costs, incurred by Company arising from or based upon (a) any actual or alleged infringement of any United States patents, copyright, or other intellectual property right of a third party, attributable to Customer's use of the licensed System with other software, hardware or configuration not either provided by Company or specified in Exhibit D.3, (b) any data, information, technology, system or other Confidential Information disclosed or made available by Customer to Company under this Agreement, (c) the use, operation, maintenance, repair, safety, regulatory compliance or performance of any aircraft owned, leased, operated, or maintained by Customer of *[sic; or]*(d) any use, by Customer or by a third party to whom Customer has provided the information, of Customer's Flight Data, the System, or information generated by the System.

After:

> If an arbitrator finds that this contract was breached and losses were suffered because of that breach, the breaching party will compensate the non-breaching party for such losses or provide the remedies specified in Section 8 if Section 8 is breached.

(DCT comment: Substantively, the *After* version arguably has some minor problems, but what's of interest here is how the drafters were able to streamline the wall-of-words ("WOW") provision pretty significantly.)

§ 168.2.2 The *Pathclearer* approach uses letter agreements and business motivations *(skim)*

It's optional, but worth your time, to read a coldly-realistic article about the drawbacks of long, detailed contracts, in contrast to the benefits of the Pathclearer approach developed by in-house counsel at Scottish & Newcastle, a brewery in the UK. The Pathclearer approach involves using short letter agreements instead of long, complicated contracts, and **relying on commercial motivations** — i.e., each party's ability to walk away, coupled with the desire to retain a good business partner — and the general law to fill in any gaps that might be left. *See* Steve Weatherley, Pathclearer: A more commercial approach to drafting commercial contracts, Practical L. Co. L. Dept. Qtrly, Oct.-Dec. 2005, at 40 (emphasis added).

§ 169 Background of the Agreement

§ 169.1 Style tip: Delete "Witnesseth" and "Whereas"

(Like all purely-style tips: (1) this one isn't worth making a big deal about if you're reviewing a draft prepared by The Other Side; and (2) if your supervising partner has a preference, then do it /that way.)/

Modern drafters avoid using the archaic words "Witnesseth" and "Whereas," such as those seen in this real-estate purchase agreement. *(Don't bother reading the text below, just get a sense of how it looks.)*

> W I T N E S S E T H:
>
> WHEREAS, Seller is the owner of a certain real property consisting of approximately 4.637± acres of land, together with all rights, (excepting for mineral rights as set forth below) , title and interests of Seller in and to any and all improvements and appurtenances exclusively belonging or pertaining thereto (the "Property") located at 10557 Wire Way, Dallas (the "City"), Dallas County, Texas, which Property is more particularly described on Exhibit A attached hereto and incorporated herein by reference; and
>
> WHEREAS, contemporaneously with the execution of this Agreement, North by East Entertainment, Ltd., a

> Texas limited partnership ("North by East"), is entering into an agreement with RCI Entertainment (Northwest Highway), Inc., a Texas corporation ("RCI Entertainment"), a wholly owned subsidiary of Rick's Cabaret International, Inc., a Texas corporation ("Rick's") for the sale and purchase of the assets of the business more commonly known as "Platinum Club II" that operates from and at the Property ("Asset Purchase Agreement"); and
>
> WHEREAS, subject to and simultaneously with the closing of the Asset Purchase Agreement, Seller will enter into a lease with RCI Entertainment, as Tenant, for the Property, dated to be effective as of the closing date, as defined in the Asset Purchase Agreement (the "Lease") attached hereto as Exhibit B and incorporated herein by reference; and
>
> WHEREAS, subject to the closing of the Asset Purchase Agreement, the execution and acceptance by Seller of the Lease, and pursuant to the terms and provisions contained herein, Seller desires to sell and convey to Purchaser and Purchaser desires to purchase the Property.
>
> NOW, THEREFORE, for and in consideration of the premises and mutual covenants and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

Instead, draft background recitals … in simple, plain English. As Warren Buffett says, in his preface to the SEC's Plain English Handbook:

> When writing Berkshire Hathaway's annual report, **I pretend that I'm talking to my sisters.** I have no trouble picturing them: Though highly intelligent, they are not experts in accounting or finance. They will understand plain English, but jargon may puzzle them. **My goal is simply to give them the information I would wish them to supply me if our positions were reversed.**

> To succeed, I don't need to be Shakespeare; I must, though, have a sincere desire to inform.
>
> No siblings to write to? Borrow mine: Just begin with "Dear Doris and Bertie."

U.S. Securities and Exchange Commission, Plain English Handbook at 2 (Aug. 1998) available at https://goo.gl/DZaFyT (sec.gov) (emphasis and extra paragraphing added).

§ 169.2 Keep the background simple

The "Background" section of the contract should briefly explain to a future reader why the parties are entering into the contract, preferably in short, numbered paragraphs.

As a general proposition, the drafter should just tell the story: explain in simple terms — with short sentences and paragraphs — what the parties are doing, so as to help future readers get up to speed more quickly. The following is from a highly-publicized stock purchase agreement in the tech industry, rewritten into background-section form:

RECITALS	1.00 Background
WHEREAS, concurrently with the execution and delivery of this Agreement, Seller and Yahoo Holdings, Inc., a Delaware corporation (the "Company"), are entering into a Reorganization Agreement *substantially in* the form attached *hereto* as Exhibit A (the "Reorganization Agreement"), pursuant to which Seller and the Company will complete the Reorganization Transactions at or prior to the Closing;	1.01 Concurrently with the execution and delivery of this Agreement, Seller and Yahoo Holdings, Inc., a Delaware corporation (the "Company"), are entering into a Reorganization Agreement, *in substantially* the form attached *to this Agreement* as Exhibit A (the "Reorganization Agreement"). 1.02 Under the Reorganization Agreement, Seller and the Company are to complete certain "Reorganization Transactions" at or prior to the Closing.
WHEREAS, concurrently with the execution and delivery of this Agreement, Excalibur IP, LLC, a	1.03 Also concurrently with the execution and delivery of this Agreement, Excalibur IP, LLC, a

Delaware limited liability company ("Excalibur"), and Seller are entering into an Amended and Restated Patent License Agreement substantially in the form attached *hereto* as Exhibit D (the "License Agreement");	Delaware limited liability company ("Excalibur"), and Seller are entering into an Amended and Restated Patent License Agreement in substantially the form attached *to this Agreement* as Exhibit D (the "License Agreement").

[The remainder of the text has been omitted.]

§ 169.3 Recitals, rewritten as a "Background" section *(skim)*

The above original example is far from the worst you'll ever see. As shown above, though, it can be rewritten in a more-modern style, with:

- the recitals retitled as a (numbered) "Background" section;
- the "WHEREAS" terms deleted;
- some of the sentences shortened; and
- some of the "legalese" rephrased.

Take a look at the "redlined" version below to see the details. Strikethroughs indicate deletions; underlining indicates insertions. *(Not all revisions are so marked.)*

> 1.00 BACKGROUND
>
> 1.01 Concurrently with the execution and delivery of this Agreement, Seller and Yahoo Holdings, Inc., a Delaware corporation (the "Company"), are entering into a Reorganization Agreement in substantially the form attached as Exhibit A (the "Reorganization Agreement").
>
> 1.02 Under the Reorganization Agreement, Seller and the Company are to complete the Reorganization Transactions at or prior to the Closing.
>
> 1.03 Also concurrently with the execution and delivery of this Agreement, Excalibur IP, LLC, a Delaware

limited liability company ("Excalibur"), and Seller are entering into an Amended and Restated Patent License Agreement, in substantially the form attached as Exhibit D (the "License Agreement").

1.04 Seller now owns, and immediately prior to the Closing it will own, all of the Shares (defined below).

1.05 , Seller desires to sell the Shares to Purchaser, which likewise desires to purchase the Shares from Seller, on the terms and subject to the conditions set forth in this Agreement (the "Sale");

1.06 The board of directors of Purchaser has approved this Agreement and the transactions that it contemplates.

1.07 The board of directors of Seller has (i) approved this Agreement and the Transactions (defined below), (ii) determined that this Agreement and Sale and the Reorganization Transactions are expedient and for the best interests of Seller and its stockholders and (iii) resolved, subject to the terms of this Agreement, to recommend that the stockholders of Seller authorize the Sale and the Reorganization Transactions.

1.08 The parties enter into this Agreement in consideration of the mutual representations, warranties, covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged.

§ 169.4 Caution: Recitals might be binding

A court might give special or even binding weight to recitals in a contract. For example, California Evidence Code § 622 provides: "The facts recited in a written instrument **are conclusively presumed to be true** as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration."

§ 169.5 Special topic: Background section in *settlement* agreements

When an agreement is made to settle a dispute, it can be really advantageous for the background section of the signed agreement to document that fact. This advantage is illustrated in Pappas v. Tzolis, 20 N.Y.3d 228 (2012). In that case, the recitals in a release

- Tzolis, a businessman, owned part of a limited liability company ("LLC") along with two colleagues, Pappas and Tziolis invested $50,000 in the company, while Ifantopoulos invested $25,000. The LLC acquired a long-term lease on a building in Lower Manhattan.
- About a year later, after repeated disputes had arisen, Tzolis bought out Pappas and Ifantopoulos for 20 times (!) their respective investments.
- A few months later, Tzolis sold the building lease for $17.5 million.
- Pappas and Ifantopoulos sued Tzolis for (among other things) fraud and breach of fiduciary duty, claiming that Tzolis had arranged the sale before he bought them out, without telling them he was doing so.

New York's highest court ruled that Pappas's and Ifantopoulos's complaint should have been summarily dismissed:

Here, plaintiffs were sophisticated businessmen represented by counsel. Moreover, **plaintiffs' own allegations make it clear** that at the time of the buyout, the relationship between the parties was not one of trust, and reliance on Tzolis's representations as a fiduciary would not have been reasonable.

According to plaintiffs, there had been numerous business disputes, between Tzolis and them, concerning the sublease. Both the complaint and Pappas's affidavit opposing the motion to dismiss portray Tzolis as uncooperative and intransigent in the face of plaintiffs' preferences concerning the sublease. The relationship between plaintiffs and Tzolis had become antagonistic, to the extent that **plaintiffs could no longer reasonably regard Tzolis as trustworthy.**

Therefore, crediting plaintiffs' allegations, the release contained in the Certificate is valid, and plaintiffs cannot prevail on their cause of action alleging breach of fiduciary duty.

Id. at 233 (emphasis and extra paragraphing added).

In similar fashion, in a settlement agreement, the Background section can recite facts about the dispute between the parties. The court likely will accept those facts as true. See the commentary to (Study:) Acknowledgements in a contract, § 4.3. That can help counter what one commentator says will be the plaintiffs' lawyers' response to the *Pappas* decision, namely *not* to stipulate in their complaints that the parties had a dispute. *See* Peter Mahler, Pappas Saga Ends ... (2012).

§ 169.5.1 Drafting exercise: Background of Agreement

The following is from a real-estate purchase agreement:

> THIS REAL ESTATE PURCHASE AND SALE AGREEMENT (this "Agreement") is made and entered into by and between WIRE WAY, LLC, a Texas limited liability company ("Seller"), and RCI HOLDINGS, INC., a Texas corporation ("Purchaser"), pursuant to the terms and conditions set forth herein.
>
> W I T N E S S E T H:
>
> WHEREAS, Seller is the owner of a certain real property consisting of approximately 4.637± acres of land, together with all rights, (excepting for mineral rights as set forth below) , title and interests of Seller in and to any and all improvements and appurtenances exclusively belonging or pertaining thereto (the "Property") located at 10557 Wire Way, Dallas (the "City"), Dallas County, Texas, which Property is more particularly described on Exhibit A attached hereto and incorporated herein by reference; and
>
> WHEREAS, contemporaneously with the execution of this Agreement, North by East Entertainment, Ltd., a Texas limited partnership ("North by East"), is entering into an agreement with RCI Entertainment (Northwest Highway), Inc., a Texas corporation ("RCI Entertainment"), a wholly owned subsidiary of Rick's Cabaret International, Inc., a Texas corporation ("Rick's") for the sale and purchase of the assets of the business more commonly known as "Platinum Club II"

> that operates from and at the Property ("Asset Purchase Agreement"); and
>
> WHEREAS, subject to and simultaneously with the closing of the Asset Purchase Agreement, Seller will enter into a lease with RCI Entertainment, as Tenant, for the Property, dated to be effective as of the closing date, as defined in the Asset Purchase Agreement (the "Lease") attached hereto as Exhibit B and incorporated herein by reference; and
>
> WHEREAS, subject to the closing of the Asset Purchase Agreement, the execution and acceptance by Seller of the Lease, and pursuant to the terms and provisions contained herein, Seller desires to sell and convey to Purchaser and Purchaser desires to purchase the Property.
>
> NOW, THEREFORE, for and in consideration of the premises and mutual covenants and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

EXERCISE: Redraft this into a "Background of the Agreement" section.

- Use *short, simple* sentences and short, *single-subject* paragraphs.
- Eliminate as much legalese as you can.
- **Defined terms**
- **Some style preferences**
- The following are some personal style preferences that enhance readability (in the author's view):
- • **Put the defined term in quotes and bold-faced type** to make it stand out on the screen or page and thus make the term easier to spot while scanning through the document.
- • **Use refers to instead of means**, because the former often just sounds better in different variations.
- Before:

- Confidential Information **means** information where all of the following are true ….
- After:
- "**Confidential Information**" **refers to** information where all of the following are true ….
- **Caution: Consistency in capitalizing defined terms can be crucial**
- It's a *really* good idea to be consistent about capitalization when drafting a contract. If you define a capitalized term but then use a similar term without capitalization, that *might* give rise to an ambiguity in the language — which in turn might preclude a quick, inexpensive resolution of a lawsuit. Something like that happened in the Clinton Ass'n for a Renewed Environment case:
- The defendant asserted that the plaintiff's claim was barred by the statute of limitations and therefore should be immediately dismissed.
- The plaintiff, however, countered that the limitation period began to run much later than the defendant had said.
- The court held that inconsistency of capitalization of the term "substantial completion" precluded an immediate dismissal of the plaintiff's claim.
- *See* Clinton Ass'n for a Renewed Environment, Inc., v. Monadnock Construction, Inc., 2013 NY Slip Op 30224(U) (denying defendant's motion to dismiss on the pleadings).
- In a similar vein, a UK lawsuit over flooding of a construction project turned on whether the term "practical completion" (uncapitalized) had the same meaning as the same term capitalized. The court answered that the terms did *not* have the same meaning; as result, a sprinkler-system subcontractor was potentially liable for the flooding. *See* GB Building Solutions Ltd. v. SFS Fire Services Ltd., (2017) EWHC 1289, *discussed in* Clark Sargent, Antonia Underhill and Daniel Wood, Ensure That Defined Terms Are Used Consistently; Ambiguity Can Be Costly(Mondaq.com 2017).
- **Put the definitions at the *back* of the Agreement? Or in an exhibit or schedule?**

- A drafter can place a separate "definitions" section:
- near the *beginning* of the agreement — this is perhaps the most-common practice;
- at the back (with results that might be surprising);
- in a separate exhibit or schedule (which can be handy if using the same definitions for multiple documents in a deal).
- On his blog, IACCM founder and president Tim Cummins tells of an IACCM member whose company saved hours of negotiating time — *up to a day and a half per contract* — by moving the "definitions" section from the front of its contract form to an appendix at the back of the document. Cummins recounted that "by the time the parties reached 'Definitions', they were already comfortable with the substance of the agreement and had a shared context for the definitions. So effort was saved and substantive issues were resolved." Tim Cummins, Change does not have to be complicated (July 21, 2014).

§ 170 Backdating contracts

§ 170.1 "Transparent" backdating for non-deceptive purposes can be perfectly legitimate

Signing a contract that is "backdated" to be effective as of an earlier date might well be OK. (This is referred to in legalese as *nunc pro tunc*, or "now for then.")

The fact that parties are doing this should be made clear in the contract itself, to help forestall later accusations that one or both parties had an intent to deceive.

EXAMPLE: Suppose that Alice discloses confidential information to Bob, a potential business partner, after Bob first orally agrees to keep the information confidential. Alice might well want to enter into a written nondisclosure agreement with Bob that states the agreement and its confidentiality obligations are effective as of the date of Alice's oral disclosure.

§ 170.2 But backdating a contract could lead to prison time and/or civil liability

The former CEO of software giant Computer Associates, Sanjay Kumar, served nearly ten years in prison for securities fraud through, among other things, backdating sales contracts (NY Times). Mr. Kumar was also fined $8 million and agreed to settle civil suits by surrendering nearly $800 million (NY Times).

Kumar wasn't the only executive at Computer Associates (now known as just CA) to get in trouble for backdating. All of the following went to prison or home confinement:

- the CFO — seven months in prison, seven months home detention (NY Times)
- the general counsel — two years in prison, and also disbarred (court opinion)
- the senior vice president for business development — 10 months of home confinement (NY Times)
- the head of worldwide sales — seven years in prison (WSJ)

All of this mess came about because the Computer Associates executives orchestrated a huge accounting fraud: On occasions when the company realized that its quarterly financial numbers were going to miss projections, it "held the books open" by backdating contracts signed a few days after the close of the quarter. This practice was apparently referred to internally as the "35-day month."

According to CA, all the sales in question were legitimate and the cash had been collected (according to CA's press release). The only issue was one of the *timing* of revenue recognition. The company had booked the sales a few days earlier than was proper. But that was enough to put the sales revenue into an earlier reporting period than it should have been. That, in turn, was enough to send all those CA executives to prison. (CA press release)

Likewise, the former CFO of Media Vision Technology was sentenced to three and a half years in federal prisonbecause his company had inflated its reported revenues, in part by backdating sales contracts. Because of the inflated revenue reports, the company's stock price went up, at least until the truth came out, which eventually drove the company into bankruptcy.

Even if backdating a contract didn't land one in jail, it could can cause other problems. For example, a California court of appeals held that backdating automobile sales contracts violated the state's Automobile Sales Finance Act (although the state's supreme court later reversed). *See* Raceway Ford Cases, 229 Cal. App. 4th 1119, part IV-B, slip op. at 15-20, 28 (2014) (reversing and remanding trial court judgment in part), *reversed*, No. S222211(Cal. Dec. 15, 2016).

§ 170.3 Don't knowingly write — or accept — an incorrect date as your "date signed"

Many contracts' signature blocks include spaces in which the signers are expected to hand-write the signature date, or in which a date is already printed. To avoid later questions about possible deceptive intent:

- A signer should always hand-write the actual signature date.
- If an incorrect date is already printed in the signature block, the signer should insist that the incorrect date be changed — or perhaps manually correct the date in pen and ink and then initialing the change.

§ 170.4 An employee might get a big government payday for blowing the whistle on unlawful backdating

If a company were to backdate some of its contracts in order to "juice" its financial statements as Computer Associates did, it's unlikely that the backdating would remain hidden for long: An employee or other insider — or possibly someone who worked for another party — might secretly "rat out" the company to the (U.S.) Securities and Exchange Commission. Why? To get a very-big payday under the SEC's congressionally authorized whistleblower program.

For example, in August 2016, chemical giant Monsanto settled an SEC charge that it had falsely stated its financial results; the company paid an $80 million penalty, of which an unidentified whistleblower received a $22 million reward.

As another example of this enormous monetary incentive: Several years ago, Oracle was discovered to have violated a most-favored-customer clause in its contract with the U.S. Government; this led to Oracle's paying

the government just short of $200 million, of which $40 million went to the whistleblower.

§ 170.5 Three reasons a court might not give effect to a backdated date

Suppose that you and your counterparty agree to date a contract "to be effective as of" a past date. That doesn't mean a court will necessarily give effect to that agreed past date if, for example:

- the evidence does not indicate that the parties had agreed to the material terms of the agreement on or before the as-of date; or
- the contract language does not unambiguously state that the parties intend the agreement to have retroactive effect; or
- an unrelated third party's rights and obligations might be affected by the backdating.

See, e.g., FH Partners, LLC v. Complete Home Concepts, Inc., 378 S.W.3d 387 (Mo. App. 2012) (reversing in part and remanding summary judgment), *analyzed in* Brian Rogers, Backdating Contracts Is Tricky Business(TheContractsGuy.net 2013: https://goo.gl/tXUkua).

§ 170.6 Optional further reading about backdating contracts

Colin Riegels, Backdating Contracts And Other Documents And Instruments (Mondaq.com Apr. 2016: https://goo.gl/mhfP5H).

§ 171 Ambiguity: The bane of contract readers

§ 171.1 Introduction

Ambiguity is one of the worst sins a contract drafter can commit. A contract term is *ambiguous* if it is susceptible to two or more plausible

interpretations — and such a term can cause major difficulties for the parties. Many lawyers would agree that ambiguous language is one of the top sources of trouble for contracting parties.

In litigation, creative trial counsel, exercising 20-20 hindsight, can be quite skilled at proposing alternative meanings to language that the drafters probably thought was crystal clear.

§ 171.2 Two examples of ambiguous contract provisions

Here's a simple example of ambiguity from a hypothetical lease agreement:

> Tenant will completely vacate the Premises no later than **12 midnight on December 15**; Tenant's failure to do so will be a material breach of this Agreement.

Now suppose that, at **10:00 a.m.** on December 15, Tenant is still occupying the Premises. QUESTION: Does Tenant still have 14 hours left in which to finish moving out? Or is Tenant already in material breach?

And then: What if Landlord had re-leased the premises to a new tenant with December 15 as the agreed move-in date?

Now for a real-world example: In the *Offshore Drilling v. Gulf Copper* case, the owner of an off-shore drilling rig and a maintenance contractor disputed whether the contractor had had "control" of the rig at the time that the rig was damaged by fire and thus whether the contractor was contractually obligated to indemnify the owner. The term *control* is vague — vagueness can be thought of as a type of ambiguity, as discussed below — and so the parties had to litigate the meaning of the term. *See* Offshore Drilling Co. v. Gulf Copper & Mfg. Corp., 604 F.3d 221 (5th Cir. 2010) (affirming summary judgment in relevant part).

§ 171.3 Benefits of unambiguous contract terms

Spotting and fixing ambiguities in a contract *before* signature should be a prime goal of all contract drafters and reviewers. Unambiguous provisions are generally a Good Thing because:

- Unambiguous language tends not to lead to disputes between the parties in the first place — although that certainly isn't a universal rule.

- If a dispute *does* arise over an unambiguous provision, the judge will often decide the case quickly, e.g., on a motion to dismiss on the pleadings or a motion for summary judgment. That's because (in the U.S.) interpretation of an unambiguous contract term is generally a question of law for the court.

Ambiguities aren't necessarily fatal, because the law has rules for resolving them, as discussed below. But when a contract term is ambiguous, an expensive- and time-consuming trial is likely to be needed to determine just what the parties had in mind. To borrow a phrase from a former student (in a different context): *"That's a conversation I don't want to have."*

§ 171.4 A brief review of contract interpretation

Here's a quick recap of some basic principles of contract interpretation:

1. **A contract provision is unambiguous if it can be given a certain or definite meaning.** (A contract provision isn't necessarily ambiguous just because the parties disagree on how to interpret it.)

2. In a lawsuit, **the judge normally makes the first pass at determining the meaning of a disputed provision;** if the provision is unambiguous, then the judge will declare the provision's meaning.

3. The judge will try to figure out what the parties had in mind, *as expressed in the contract language*.

4. Context matters: **The judge will try to read contract provisions in a way that "harmonizes" them;** at a minimum, the judge will try not to read Provision A in a way that would make Provision B meaningless.

5. **The judge will give contract terms their plain, common, or generally accepted meaning** — unless, that is, the contract shows that the parties used particular terms in a technical or different sense.

6. **If all else fails** — if the usual contract-interpretation principles don't produce a definitive answer for what a contract provision means — then the judge will rule that provision is ambiguous**; in that situation, the case will have to be tried, and the trier of fact (usually, the jury) will decide what the parties seem**

to have had in mind — often by looking to extrinsic evidence under the parol evidence rule.

See, e.g., Plains Explor. & Prod. Co. v. Torch Energy Advisors Inc., 473 S.W.3d 296, 305 (Tex. 2015); Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983).

Courts often look to specific rules of interpretation such as:

- Specific terms normally take precedence over the general.
- A term stated earlier in a contract is given priority over later terms.
- Under the principle of *ejusdem generis*, "if a law refers to automobiles, trucks, tractors, motorcycles, and other motor-powered vehicles, a court might use *ejusdem generis* to hold that such vehicles would not include airplanes, because the list included only land-based transportation." Nolo's Plain-English Law Dictionary (law.cornell.edu).
- The rule of the last antecedent: A federal criminal statute included a mandatory ten-year minimum sentence in cases where the defendant had previously been convicted of "aggravated sexual abuse, sexual abuse, or abusive sexual conduct involving a minor or ward." The Supreme Court held that the minor-or-ward qualifier applied only to abusive sexual conduct, not to sexual abuse — as a result, a defendant was subject to the ten-year mandatory minimum sentence for sexual abuse against an adult. Lockhart v. United States, 577 U.S. xxx, No. 14–8358, slip op. at part II-A (U.S. March 1, 2016).
- But see the series-qualifier principle: Dissenting in *Lockhart*, Justice Kagan argued: "Imagine a friend told you that she hoped to meet 'an actor, director, or producer involved with the new Star Wars movie.' You would know immediately that she wanted to meet an actor from the Star Wars cast—not an actor in, for example, the latest Zoolander." *Id.* (Kagan, J., dissenting).
- **Other things being equal, under the contra proferentem principle, ambiguous provisions will often be construed against the drafting party.**

See generally, e.g., Vincent R. Martorana, A Guide to Contract Interpretation (ACC.com 2014); James J. Sienicki and Mike Yates, Contract interpretation: how courts resolve ambiguities in contract documents (Lexology.com 2012: https://goo.gl/ZGkwJu).

§ 171.4.1 Vagueness is a type of ambiguity

As one type of ambiguity, a term is *vague* if its precise meaning is uncertain. As a silly example, consider this provision in a contract for a home caregiver:

> Nurse will visit Patient's house each day, check her vital signs, **and give her cat food**.

The sentence above is **ambiguous**, in that conceivably it might take on any of three meanings:

1. Nurse is to put a bowl of food down for Patient's cat each day.
2. Nurse is to bring cat food with her when s/he visits Patient.
3. Nurse is to feed cat food to Patient. *(OK, this one is might not be plausible.)*

The sentence above might also be **vague** if it turned out that Patient had more than one cat.

And the first two meanings listed above are vague in another sense as well: The term *cat food* encompasses wet food, dry food, etc.

§ 171.4.2 What should you *do* about ambiguity?

What do you *do* if you spot an ambiguity in a draft contract draft? The answer might depend on the circumstances:

- If your side drafted the ambiguous language, then you'll definitely want to fix the ambiguity: under the doctrine of *contra proferentem,* court might resolve the ambiguity in favor of the other side.
- On the other hand, if the other side drafted the ambiguous language, then you might not want to say anything about it, in the hope that *contra proferentem* will result in an interpretation favorable to your client.
- BUT: If you notice but fail to point out an ambiguity created by the other side's drafter, the other side might argue that you *waived* application of *contra proferentem* by "laying behind the log."

The safest approach might be some combination of:

- Ask the partner or the client — and document that you did so; and/or
- **A.T.A.R.I. - Avoid the Argument: Rewrite It.**

§ 171.4.3 Optional further reading about ambiguity

Some amusing examples of ambiguity can be read at the Wikipedia article on Syntactic ambiguity, at https://goo.gl/6zmrH5

See also numerous categorized case citations by KPMG in-house attorney Vince Martorana, at https://goo.gl/kQax4T.

§ 172 Signatures

§ 172.1 Signature & delivery mechanics (commentary)

§ 172.1.1 How contracts are signed (usually)

At least in the U.S., a contract between two parties (Alice and Bob) will typically be signed and delivered in one of several different ways:

1. **Old school (1):** Alice and Bob meet to sign the contract; think of the treaty-signing ceremonies that you've probably seen on TV. Alice signs multiple physical copies of the contract; Bob likewise signs the same physical copies. Alice and Bob each keep (at least) one fully signed "original."
2. **Old school (2):** Alice, sitting in her office (or wherever), signs two hard copies of the contract and mails them to Bob. Bob countersigns the hard copies, keeps one of them, and mails the other fully signed hard copy back to Alice for her files.
3. **Exchanging signed counterparts:** Alice signs two hard copies ("counterparts") of the complete contract and sends just one of the signed hard copies to Bob. Bob does exactly the same thing. So, each party ends up with two, signed, hard copies of the contract, but each hard copy has been signed by just one of the parties.
4. **Delivering signed signature pages only:** In the era of electronic communication, the following is increasingly common: The final

contract draft is agreed to, typically going back and forth by email and phone. Alice, in her office, signs a hard copy of the final agreed draft; Bob, in his office, does likewise. Each party scans his or her signed signature page to a PDF file, then emails the PDF to the other party as an attachment.

5. **Round-robin signing of the signature page only:** A variation on #4 is: Alice emails Bob a PDF of her signed signature page. Bob prints out Alice's signed signature page; countersigns it himself; scans the fully signed signature page; and emails it back to Alice.

6. **Electronic signatures:** More and more contracts are getting "signed" electronically, using various commercial services.

§ 172.1.2 Separate signature pages?

Sometimes drafters put signatures on a separate page to make it easier to FAX just the signed signature pages back and forth (see the next section). That can give rise to a couple of problems, but those can be addressed with some advance planning.

Include a running header with version date: If signatures are on a separate page, then someday The Other Side might claim that it signed a different version of the contract than the one you claim it signed. One way to try to forestall such a claim would be to include, at the top of every page of every draft, a running header with a version date and time, such as that shown at the top right of this page. (Don't use Microsoft Word's automatic date fields – you don't want the date field automatically updating itself every time the document is printed.)

Include a "Page X of Y" running footer: Microsoft Word's PAGE and NUMPAGES fields can be used to create a running footer that automatically says, for example, "Page 5 of 11."

Eliminate blank space on the penultimate page: If you leave significant blank space on the last page before the signature page (the "Penultimate Page"), then a fraudster might be tempted to fill that blank space with additional provisions and then claim that the added provisions were part of the signed contract. One way to guard against that is to include — on a separate line just after the final text on the Penultimate Page — a parenthetical note such as, "(Signature page follows)" or "(Remainder of page intentionally left blank)" to signal that any additional text was not agreed to.

§ 172.1.3 Counsel normally won't want to sign contracts for clients

A lawyer for a party entering into a contract normally won't want to be the one to sign the contract on behalf of her client, because:

- Doing so could raise questions whether, in the negotiations leading up to the contract, the lawyer was acting as a lawyer or as a business person. This could be an important distinction: in the latter case, the lawyer's communications with her client might not be protected by the attorney-client privilege and thus might be subject to discovery by third parties.
- If the lawyer's signature is on the contract, the lawyer is almost certain to be deposed in the event of a lawsuit or arbitration about the contract. This might lead to disqualification not only of the lawyer herself but also of her entire firm — and her litigation partners would not be happy about that.
- From a client-relations perspective: If the contract later "goes south," the lawyer won't want her client's business people pointing the finger at her for having made what they claim — in hindsight was a bad *business* decision.

§ 172.1.4 Pro tip: Be sure a company title is in your client's signature block

If your client is a company, some individual human, typically an officer or manager of the company, will be signing on behalf of the client. In that situation, the client's signature block in the contract should normally state that it's the company, not the individual human in his or her personal capacity, that is signing the document. [LINK]

If your client is the company and not the human signer, then technically you're under no professional obligation to make sure that the human signer is protected from personal liability. But it's *normally* not a conflict of interest for you to simultaneously look out for the human signer as well as for the company.

(Reminder: A lawyer might find herself dealing with an employee of a client company in a situation where the interests of the employee and the company diverge or even conflict. One example might be an investigation of possible criminal conduct such as fraudulent backdating of a contract signature (see § 3.4). In circumstances such as those, the lawyer may want to consider whether she should affirmatively advise the employee,

preferably in writing, that she's *not* the employee's lawyer; conceivably, the lawyer might even have an ethical obligation to do so.)

§ 172.1.5 Pro tip: Hang on to *fully signed* originals

A party that wants to rely on a contract, but can't produce a copy signed by the other side, might not be completely out of luck, but it definitely will have more burden and expense at trial.

For example: In a 2014 case, a wife sued her husband for divorce. The husband moved to enforce a pre-nuptial agreement. Unfortunately for him, the only copy he had *was not signed by his wife*. The wife claimed that she didn't recall signing the agreement, that she never possessed a signed original, and even if she did sign it, she did so under duress.

The husband had to take his case had to go all the way to the state supreme court. That court held that the husband was entitled to introduce secondary evidence to try to persuade the factfinder that the pre-nup existed. In re Serodio & Perkins, 101 A.3d 1069, 1072-73 (N.H. Aug. 22, 2014).

The husband would have had much smoother sailing if he had just made sure to keep a fully signed copy of the pre-nup agreement.

§ 173 Electronic signatures (skim)

§ 173.1.1 Electronic signatures are largely authorized by statute

It's becoming increasingly common for parties to sign their contracts electronically; U.S. law explicitly law supports it:

- See generally the federal Electronic Signatures in Global and National Commerce Act (E-SIGN Act), 15 U.S.C. § 7001 et seq., which provides in part (subject to certain stated exceptions) that, for transactions "in or affecting interstate or foreign commerce," electronic contracts and electronic signatures may not be denied legal effect solely because they are in electronic form.

- At the U.S. state level, 47 states, the District of Columbia, and Puerto Rico, and the U.S. Virgin Islands have adopted the Uniform Electronic Transactions Act (UETA).

- The remaining three states — Illinois, New York, and Washington — have adopted their own statutes validating electronic signatures.

- Courts now routinely honor electronic "signatures; see, e.g., Naldi v. Grundberg, 80 A.D.3d 1, 908 N.Y.S.2d 639 (N.Y. App. Div. 2010).

§ 173.1.2 Electronic signatures can create surprising binding agreements

Here are a couple of hypothetical examples of possible electronic signatures — imagine that Alice, an executive of Alpha Corporation, and Bob, an executive of Bravo LLC, have been exchanging drafts of an agreement:

- Alice sends Bob an email or text message saying, "Your last draft looks fine — we agree and are eager to get started!"

- Bob posts a draft at the Web site of an electronic-signature service and sends Alice an email asking her to sign it; Alice goes to the Web site and clicks on an "Agreed" button.

  (For a now-dated list of electronic-signature services *[use at your own risk, of course]*, see Tabby McFarland, 10 Electronic Signature Options and Why You Should Use Them (SmallBizTrends.com June 2015) (hat tip: Brian Rogers a.k.a. @theContractsGuy).)

- Alice pulls up Bob's latest draft in Microsoft Word. She types in her name in the "Signed" space of the signature block for Alpha Corporation and saves the document. Finally, she emails the document back to Bob with an email that says, "Here you go!"

Each of these "signatures" is likely enough to form a binding contract — which might be a surprise to Alice and Bob.

§ 173.1.3 Pro tip: Be able to prove up electronic signatures

In Ruiz v. Moss Bros. Auto Group, Inc., 181 Cal. Rptr.3d 781, 232 Cal. App. 4th 836, 844-45 (Cal. App. 2014), a California appeals court affirmed denial of an employer's petition to compel arbitration of a wage-and-hour claim by one of its employees. The arbitration agreement had an electronic signature, but according to the court, the employer had not sufficiently proved that the purported electronic signature on the arbitration agreement was in fact that of the employee. The court seems to have given guidance about what would suffice to prove up an electronic signature:

> *[The employer's business manager]* Main never explained how Ruiz's printed electronic signature, or the date and time printed next to the signature, came to be placed on the 2011 agreement.
>
> More specifically, Main did not explain how she ascertained that the electronic signature on the 2011 agreement was "the act of" Ruiz. This left a critical gap in the evidence supporting the petition.
>
> Indeed, Main did not explain[:]
>
> - that an electronic signature in the name of "Ernesto Zamora Ruiz" could only have been placed on the 2011 agreement (i.e., on the Employee Acknowledgement form) by a person using Ruiz's "unique login ID and password";
> - that the date and time printed next to the electronic signature indicated the date and time the electronic signature was made;
> - that all Moss Bros. employees were required to use their unique login ID and password when they logged into the HR system and signed electronic forms and agreements;
> - and the electronic signature on the 2011 agreement was, therefore, apparently made by Ruiz on September 21, 2011, at 11:47 a.m.
>
> Rather than offer this or any other explanation of how she inferred the electronic signature on the 2011 agreement was the act of Ruiz, Main only offered her unsupported assertion that Ruiz was the person who electronically signed the 2011 agreement.

Id., 232 Cal. App.4th at 844 (extra paragraphing and bullets added, citation omitted).

§ 173.1.4 An electronic signature won't always work

In SN4, LLC v. Anchor Bank, FSB, 848 N.W.2d 559 (Minn. App. 2014), two related companies wanted to buy an apartment building from the bank that

had acquired title through foreclosure. The resulting email exchanges made it clear that the parties contemplated hand-signed, "wet ink" signatures on the purchase contract. The bank never hand-signed any contract draft, and ultimately decided not to sell to the buyers. The buyers sued the bank, claiming that the email exchanges themselves amounted to binding contracts. The court disagreed and granted summary judgment for the bank. Citing the Minnesota version of the UETA, an appeals court affirmed, holding:

> Here, there was no express agreement between the buyers and the bank to electronically subscribe to the purported agreement. Moreover, their conduct does not evidence an implied agreement to do so.
>
> The buyers hand-signed the initial version of the purchase agreement that was first sent to the bank on July 13. The buyers also hand-signed the purported final agreement.
>
> Berg *[the bank's attorney]* and Puklich *[the buyers' attorney]* both stated a desire for "execution" or "fully executed" copies. And Berg wanted "'hard copies' signed."
>
> Significantly, after July 26 — the date that the buyers claim that the bank had electronically signed the purported agreement — Puklich, in numerous e-mails, continued to ask the bank to sign the agreement and to have it sent back to him by e-mail or hard-copy mail.
>
> In fact, on July 28, Puklich specifically requested a scanned copy of the signed agreement to be return by e-mail, supporting that the buyers intended that the agreement be hand-signed.
>
> Based on these communications, we conclude that no reasonable factfinder could determine that the buyers and the bank intended to subscribe to the July 18th agreement by electronic means.

Id., 848 N.W.2d at 567 (extra paragraphing added, citations omitted).

§ 173.1.5 Electronic-signature vendors

For a list of electronic-signature companies, see Tabby McFarland, 10 Electronic Signature Options and Why You Should Use Them (SmallBizTrends.com June 2015) (hat tip: Brian Rogers a.k.a. @theContractsGuy).

§ 173.1.6 Caution: An email might create a binding contract (skim)

It's not unknown for parties to argue that an email with a signature block had the effect of "signing" a contract. For examples of cases in which counsel made such arguments, see Jeffrey Neuburger, Meeting of the Minds at the Inbox: Some Pitfalls of Contracting via Email (Proskauer.com June 2015) (hat tip: Brian Rogers a.k.a. @theContractsGuy).

The author's own email signature block includes a disclaimer that (as of August 2019) states as follows: Unless expressly stated otherwise, this message is not intended to serve as assent to an agreement or other document, whether or not attached to this message.

A contract's general provisions could include such a disclaimer, although conceivably a party might argue that the disclaimer had been implicitly waived. Here's one possibility:

A signature in a document is not to be considered assent or agreement to any other document unless clearly and unmistakably indicated in the document containing the signature. EXAMPLE: Suppose that a party sends a draft of this Agreement as an attachment to an email, and that the email contains a signature block. In that situation, the email's signature block is not to be considered as assent to the draft unless the email clearly and unmistakably so indicates.

§ 173.1.7 The "from" field in an email *might* suffice as a signature

Emails normally include a "from" field that typically includes both the name and the email address of the sender. Some courts have held that this information can suffice as a signature and satisfy the Statute of Frauds; other courts, though, have reached the opposite result. For an extensive discussion of authority on this point, *see* Khoury v. Tomlinson, 518 S.W.3d 568, 575-77 (Tex. App. [1st Dist.] 2017, no pet.) (holding that "from" field sufficed as a signature, but reversing and remanding on other grounds).

One court held that a "from" field can suffice as a signature, but also held that on the facts of that case, the "from" field in an email did not act as a signature for an attached document (and also that the parties had not agreed to transact their business electronically). *See* SN4, LLC v. Anchor Bank, FSB, 848 N.W.2d 559 (Minn. App. 2014).

§ 173.1.8 Pro tip for electronic transmission: Circulate a "master" PDF with all signatures

After a contract is signed, consider:

- adding all signed pages to a PDF file of the entire Agreement;
- emailing the PDF file to all parties (or their counsel); and
- in the body of the email, explaining what you've done.

That will leave an email "paper trail" (so to speak) in the files of all concerned; that in turn should reduce the risk of a future dispute about which version the parties thought they were signing.

§ 173.1.9 A court *might* hold that a contract *must* be signed to be enforceable — or not …

In a 2016 case, the Seventh Circuit affirmed summary judgment that — one party's arguments notwithstanding — a draft contract never became enforceable because it was never signed. C.G. Schmidt, Inc. v. Permasteelisa North America, 825 F.3d 801, 806 (7th Cir. 2016).

On the other hand, a *drafting* party might be bound by its draft contract if the other side signs it *and* the parties at least partially perform, even if the drafting party itself never signed the draft. See, e.g., Baker Hughes Inc. v. S&S Chemical, LLC, 836 F.3d 554, 561-62 (6th Cir. 2016). The court noted that the result might have been different if the draft contract itself had expressly stated that Alice's offer in the draft was conditioned on both parties' signing the document. *See id.* at 562.

There are three kinds of situations where an unsigned contract might be enforced:

1. The statute of frauds doesn't apply;
2. A contract isn't the only way to become bound by legal duties;
3. The parties "agreed" via some other written communication(s).

The following types of non-"contract" written communication might bind the parties to an unsigned contract:

1. Email
2. Text message
3. IM / Slack / other chat
4. Social media
5. Inadvertently binding LOI.

§ 173.2 Signature authority

§ 173.2.1 Be sure the other side's signer has authority to agree

A contract signed by an individual who doesn't have authority to commit his principal might be worthless. EXAMPLE: Liberty Ammunition, Inc. v. United States, 835 F.3d 1388 (Fed. Cir. 2016):

- Liberty Ammunition signed several nondisclosure agreements (NDAs) with the U.S. Government.
- Under the applicable regulations, the specific individuals who signed those NDAs on behalf of the government did not have authority to bind the government.

The court majority held that the government was not bound by some of the NDAs — and thus the government was not liable for its disclosure and use of Liberty Ammunition's purportedly-secret technology. *See id.* at 1401-02. (In dissent, Judge Newman argued that the senior Army officer who signed a particular NDA had at least *apparent* authority and therefore the government should have been bound by the NDA. *See id.* at 1403-05; see also the discussion of apparent authority below.)

Here's another example from the Illinois supreme court in 1550 MP Road LLC v. Teamsters Local No. 700, 2019 IL 123046: A landlord sued its defaulting tenant, a union local. **The landlord won a $2.3 million judgment against the union in the trial court, only to see the award thrown out in the state supreme court.** Why? Because in signing the lease, the union official had not complied with the requirements of a state statute that authorized an unincorporated association to lease or purchase real estate in its own name.

§ 173.2.2 Job-title rules of thumb for signature authority

The person signing a contract for The Other Side should have a title that leaves no doubt that she has authority to make binding commitments on behalf of her company. If there's going to be a problem on that score, far better to find out now, instead of when The Other Side tries to get out of its contractual obligations. Here are a few rules of thumb:

- The president of a company almost certainly has authority to commit the company to a contract.
- A vice president, "director" (not the same as a member of the board of directors, discussed below), or "manager" is very likely to have authority to commit the company in matters within their stated domains, but that might not be the case if they go outside their areas. For example, the director of marketing communications might not have authority to sign a big sales contract.
- Any other job title or purported authority should be scrutinized carefully. (Some companies seem to delight in strange titles; for example, Jerry Yang, co-founder and former CEO of Yahoo, was once called the company's "Chief Yahoo.")
- For corporations, a member of the board of directors might, *but often will not*, have authority to commit the company, at least not without a special authorization by the board.

§ 173.2.3 The gold standard: A secretary's certificate of a board resolution

The gold standard of corporate signature authority is probably a certificate, signed by the secretary of the corporation, that the corporation's board of directors has granted the signature authority. You've probably seen paperwork that includes such a certificate if you've ever opened a corporate bank account. The language, which is invariably drafted by the bank's lawyers, normally says something to the effect that the company is authorized to open a bank account with the bank in question and to sign the necessary paperwork, along with many other things the bank wants to have carved in stone. See this example.

§ 173.2.4 Apparent authority to sign

A person with "apparent authority" can bind a company to a contract, unless the other side has reason to know otherwise. So the question is: Would "a reasonable person" think the signer for The Other Side had authority to commit that company to the contract? For more information, see the Wikipedia entry on apparent authority.

Normally, a company officer will have at least apparent authority to commit the company, especially if the officer's title indicates he or she is responsible for a relevant area of the company's business. See, for example, Digital Ally, Inc., v. Z3 Tech., LLC, 754 F.3d 802, 812-14 (10th Cir. 2014). In that case:

- Digital Ally signed a contract with Z3, under which Z3 would design and manufacture circuit-board modules, which Digital Ally would then incorporate in its own products.
- The contract was actually signed by one Robert Haler, whose title at Digital Ally was *executive vice president of engineering and production*.
- Things did not go entirely as planned, and a lawsuit ensued.
- Digital Ally claimed that it was not bound by the contract because, under the company's *internal* signature-authority policies, Haler did not have authority to sign a contract of that type.

Digital Ally's argument didn't fly: the district court granted, and the appeals court affirmed, partial summary judgment that Haler did have at least apparent authority to sign the contract.

§ 173.2.5 Asking for a written *representation* of signature authority can help to smoke out problems

Suppose that "Alice" is designated to sign a contract on behalf of a party, but Alice balks at having the contract include a *personal* representation by Alice that she has authority to sign the contract. That might be a sign that the *other* party should investigate whether Alice really does have authority to sign.

CAUTION: Even if a signer were to make a written representation that s/he had signature authority, that might not be enough — because legally the other side might be "on notice" that the signer does *not* have authority, as discussed in the next section.

§ 173.2.6 Special case: Who can sign for an LLC?

By statute, a contract with an LLC might not be enforceable, even if signed by a "manager." That could be the case if the articles of organization (which are usually publicly available) expressly deprive the manager of such authority.

This happened in a Utah case where one manager of a two-manager LLC signed an agreement granting, to a tenant, a 99-year lease on a recreational-vehicle pad and lot. But there was a problem: The LLC's publicly filed articles of organization stated that neither of the two company's managers had authority to act on behalf of the LLC without the other manager's approval. Therefore, said the court, the tenant was on notice of the one manager's lack of authority to grant the lease on just his own signature alone — and so the lease was invalid. (The court remanded the case for trial as to whether the LLC subsequently ratified the lease agreement.) Zions Gate RV Resort, LLC v. Oliphant, 2014 UT App 98, 326 P.3d 118, 121 ¶ 8, 122-23.

§ 173.3 Signature blocks (commentary)

§ 173.3.1 "Agreed"

It's helpful to start out a signature block with the word "AGREED:" in all-caps and followed by a colon, as shown in the examples below, thusly:

> AGREED: BUYER
> Betty's Used Computers, LLC, by:
>
> _____
> Betty Boop, Manager
>
> _____
> Date signed

§ 173.3.2 Use a concluding paragraph? *(No.)*

The author prefers <u>not</u> to use an entire concluding *paragraph* such as the following:

> To evidence the parties' agreement to this Agreement, each party has executed and delivered it on the date indicated under that party's signature.

First, that kind of concluding paragraph is overkill. There are other ways of proving up that The Other Side in fact delivered a signed contract to you … for starters, the copy in your possession that bears The Other Side's signature.

Second, at the instant of signature, a *past-tense* statement that each party "has delivered" the signed contract is technically inaccurate — even more so at the moment when the first signer affixes his (or her) signature.

§ 173.3.3 Blank space for date signed

Look again at the signature block above for Betty's Used Computers, LLC. It's a good idea to include, as part of each signature block, a blank space in which the signer can hand-write the date signed. The last date signed is often used to establish the effective date of the contract, and for certain sales contracts the date the agreement is completed might be necessary to establish when the seller can recognize revenue. [TODO]

§ 173.3.4 What should an organization's signature block look like?

Look again at the signature block above for Betty's Used Computers, LLC. In addition to AGREED and a date-signed blank space, an organization's signature block should include:

- the organization's name (or its abbreviation, e.g., "Seller," if an abbreviation has been defined);
- the word "by," followed by a colon; and
- the signer's title, to establish that the signer has at least apparent authority. If the employee's title includes the word "president," "vice president," "manager," or "director," that might well be enough for apparent authority. Consider also including a representation by the signer that s/he has such authority.

If you don't know the name or title of the individual who will be signing, include blank lines for that information to be filled in:

> AGREED: BUYER
> Betty's Used Computers, LLC, by:

_____
Signature

_____
Printed Name

_____
Title

_____
Date signed

§ 173.3.5 Signature by an attorney-in-fact

Using a suitably-worded power of attorney, the signing organization could designate an individual or organization as its attorney-in-fact to sign the contract on its behalf. (NOTE: Whoever signs the power of attorney should be – and possibly might *have* to be — someone who could sign the contract itself.)

AGREED: BUYER
Betty's Used Computers, LLC, by:

_____
Jimmy John,
Attorney-in-fact

_____
Date signed

Caution: A party's counsel normally won't want to sign a contract on behalf of his or her client, as discussed in XXX.

§ 173.3.6 Special case: Signature block for an LLC

Look again at the signature block above for Betty's Used Computers, LLC. When a signatory party is a limited-liability company ("LLC"), check whether the LLC is member-managed or manager-managed. In the latter case, a "mere" member, *acting in that capacity*, might not have authority to sign on behalf of the LLC.

§ 173.3.7 Special case: Signature block for a limited partnership

In many U.S. jurisdictions, a limited partnership might be able to act only through a general partner, in which case a signature block for the limited partnership might need to include the general partner's name. And the general partner of a limited partnership might very well be a corporation or LLC; in that case, the signature block would be something like the following:

> AGREED: ABC LP, by:
> ABC LLC, a Texas corporation,
> general partner, by:
>
> _____
> Ron Roe, Manager
>
> _____
> Date signed

On the other hand, in some jurisdictions, a limited partnership might be able to act through its own officers; for example, Delaware's limited-partnership statute gives general partners the power "to delegate to agents, officers and employees of the general partner *or the limited partnership* …." Del. Code § 17-403© (emphasis added). In such cases, the signature block of a limited partnership might look like the signature block of a corporation or LLC, above (link).

CAUTION: A limited partner that, *acting in that capacity*, signed a contract on behalf of the limited partnership could be exposing itself to claims that it should be held jointly and severally liable as a general partner. (Of course, some general partners also hold limited-partnership interests and thus are limited partners in addition to being general partners.)

§ 173.3.8 Signature blocks for individuals

If an individual is a party to the contract, the signature block can be just the individual's name under an underscored blank space:

Example:

> AGREED:
>
> _____
> Jane Doe

_____
Date signed

But you might not know the signer's name in advance, in which case you could use the following format:

AGREED:

_____
Signature

_____
Printed name

_____
Date signed

§ 173.3.9 Keeping signature blocks on the same page

The author prefers to keep all of the text of a signature block together on the same page (which might or might have other text on it). That looks more professional, in my view, than having a signature block spill over from one page onto the next. This can be done using Microsoft Word's paragraph formatting option, "Keep with Next."

§ 174 May vs. might (commentary)

To avoid possible confusion:

- Use *may* to indicate *permission*.
- Use *might* to indicate *possibility*.

Example: Consider the two possible meanings of the following statement: *Consultant may not send the invoice before December 31.*

§ 175 Splitting Up Walls of Words

§ 175.1 Introduction

One of the chief impediments to getting deals done is the time it takes to review and revise draft contracts during negotiation. Much of this delay can be attributed to lazy or arrogant drafting (L.O.A.D.) that results in hard-to-read "wall of words" (W.O.W.) provisions. This practice note offers step-by-step suggestions for breaking up such walls of words to make them easier for your client and the other side to read and edit and thus get to signature more quickly.

§ 175.2 Split up multiple-*sentence* paragraphs

Before:

> The Premises as furnished by Landlord consist of the improvements as they exist as of the Effective Date and Landlord shall have no obligation for construction work or improvements on or to any portion of the Premises. Prior to entering into this Lease, Tenant has made a thorough and independent examination of the Premises and all matters related to Tenant's decision to enter into this Lease. Tenant is thoroughly familiar with all aspects of the Premises and is satisfied that it is in an acceptable condition and meet Tenant's needs. ….

After:

> (a) The Premises as furnished by Landlord consist of the improvements as they exist as of the Effective Date.
>
> (b) Landlord shall have no obligation for construction work or improvements on or to any portion of the Premises.
>
> (c) Prior to entering into this Lease, Tenant has made a thorough and independent examination of the Premises and all matters related to Tenant's decision to enter into this Lease.

> (d) Tenant is thoroughly familiar with all aspects of the Premises and is satisfied that it is in an acceptable condition and meet Tenant's needs. …

§ 175.3 One subject per paragraph, please

Before:

> The Premises as furnished by Landlord consist of the improvements as they exist as of the Effective Date and Landlord shall have no obligation for construction work or improvements on or to any portion of the Premises.

After:

> (a) The Premises as furnished by Landlord consist of the improvements as they exist as of the Effective Date.
>
> (b) Landlord shall have no obligation for construction work or improvements on[,] or to any portion of[,] the Premises.

§ 175.4 Watch out for bloat in the form of parentheticals and "provided that …"

Too many long contract provisions include terms that gets stuffed into parentheticals or appended as "provided that …" afterthoughts. (This might be a holdover from the days of dictating.)

Before:

> The number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be equal to the product (*rounded up to the nearest whole share unless otherwise agreed by Seller and Purchaser)* of (A) the number of shares of Seller Common Stock subject to the corresponding Seller RSU Award immediately prior to the Closing and (B) the Purchaser Ratio ….

After:

> (a) The number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be

> equal to the product of (A) the number of shares of Seller Common Stock subject to the corresponding Seller RSU Award immediately prior to the Closing and (B) the Purchaser Ratio ….

(b) The number of shares computed in accordance with subdivision (a) is to be rounded up ….

§ 175.5 Include the word "then" (to help guide the reader's eye)

Before:

> 15.5 Landlord's Right to Cure. If Tenant shall fail or neglect to do or perform any covenant or condition required under this Lease and such failure shall not be cured within any applicable grace period, Landlord may, on five (5) business days written notice to Tenant, but shall not be required to, make any payment ….

After:

> 15.5 Landlord's Right to Cure. <u>If</u> Tenant shall fail or neglect to do or perform any covenant or condition required under this Lease and such failure shall not be cured within any applicable grace period, <u>then</u> Landlord may ….

Better still:

> 15.5 Landlord's Right to Cure. IF: Tenant shall fail or neglect to do or perform any covenant or condition required under this Lease; AND: Such failure is not cured within any applicable grace period; THEN: Landlord may, on five business days written notice to Tenant, ….

§ 175.6 Spin off long "if" conditions into a preamble

Before:

> 15.5 Landlord's Right to Cure. If Tenant shall fail or neglect to do or perform any covenant or condition required under this Lease and such failure shall not be

> cured within any applicable grace period, Landlord may, on five (5) business days written notice to Tenant, but shall not be required to, make any payment payable by Tenant hereunder, discharge any lien, take out, pay for and maintain any insurance required hereunder, or do or perform or cause to be done or performed any such other act or thing (entering upon the Premises for such purposes, if Landlord shall so elect), and Landlord shall not be or be held liable or in any way responsible for any loss, disturbance, inconvenience, annoyance or damage resulting to Tenant on account thereof.

After:

> 15.5 Landlord's Right to Cure. IF: Tenant (i) fails to do anything required by this Agreement and (ii) does not cure the failure within the applicable grace period; THEN: The following will apply:—
>
> (a) Landlord may, without limitation:
>
> (1) make any payment payable by Tenant under this Agreement: …

§ 175.7 Spin off "laundry lists" and lengthy exceptions

Consider spinning off a long laundry list into separate subdivisions — possibly as a defined term.

Before:

> Tenant does not rely on, and Landlord does not make, any express or implied representations or warranties as to any matters including, without limitation, (a) the physical condition of the Premises including without limitation *the structural components of any improvements or any building systems within or serving the improvements (including without limitation indoor air quality)*, (b) the existence, quality, adequacy or availability of utilities serving the Premises or any portion thereof, (c) the use, habitability, merchantability, fitness or suitability of the Premises for Tenant's intended use, ….

After:

> Tenant does not rely on, and Landlord does not make, any express or implied representations or warranties as to any matters including, without limitation, the following:
>
> *(1) the structural components of any improvements or* any building systems within or serving the improvements (including without limitation indoor air quality); …

The same is true for lengthy exceptions:

Before:

> 15.6 Landlord's Default. Landlord shall be in default under this Lease if Landlord fails to perform obligations required of Landlord within thirty (30) days after written notice by Tenant to Landlord and to the holder of any first mortgage or deed of trust covering the Premises whose name and address shall have heretofore been furnished to Tenant in writing, specifying wherein Landlord has failed to perform such obligations; provided, however, that if the nature of Landlord's obligations is such that more than thirty (30) days are required for performance, then Landlord shall not be in default if Landlord commences performance within such thirty (30) day period and thereafter diligently prosecutes the same to completion. Tenant shall be entitled to actual (but not consequential) damages in the event of an uncured default by Landlord, but the provisions of Article 17 shall apply to any Landlord default and Tenant shall not have the right to terminate this Lease as a result of a Landlord default.

After:

> 15.6 Landlord's Default.
>
> (a) Except as provided in subdivision (c), Landlord will be in default under this Lease Agreement if Landlord fails to perform its obligations within 30 days after written notice by Tenant to Landlord.
>
> (b) Any notice under subdivision (a) must provide reasonable detail about Landlord's failure to perform. …

§ 176 General writing rules

Contract-drafting students should memorize the rules in this chapter.

In a few places, this chapter "steals" — don't worry, it's legal — from the following sources:

- The U.S. Securities and Exchange Commission's Plain English Handbook (Aug. 1998) at https://goo.gl/DZaFyT (sec.gov)
- The PlainLanguage.gov Web site at https://goo.gl/FcvL (PlainLanguage.gov), maintained by "a group of federal employees from many different agencies and specialties who support the use of clear communication in government writing."
- The U.S. Air Force's writing guide, The Tongue and Quill (rev. Nov. 2015), available at https://goo.gl/1y1b0j (static.e-publishing.af.mil)

This "theft" is legal because under 17 U.S.C. § 105, copyright is not available for works that were created by officers or employees of the U.S. Government in the course of their official duties; see generally the Wikipedia article Copyright status of work by the U.S. government.

§ 176.1 D.R.Y. (Don't Repeat Yourself): Avoid the $693,000 proofreading error

Stating information more than once in a contract can cause severe problems if (i) the information is revised during negotiation, and (ii) the revision is not made *everywhere* in the contract documents. Just this type of mistake once cost a bank $693,000:

- The bank sued to recover $1.7 million from defaulting borrowers and their guarantor. In the lower court, the bank won a summary judgment.
- Unfortunately for the bank, the loan documents referred to the amount borrowed as "one million *seven thousand* and no/100 ($1,700,000.00) dollars" (capitalization modified, emphasis added).

- The appeals court held that, under standard interpretation principles, **the words, not the numbers, controlled,** and so the amount guaranteed was only $1.007 million, not $1.7 million.

See Charles R. Tips Family Trust v. PB Commercial LLC, 459 S.W.3d 147 (Tex. App.–Houston [1st Dist.] 2015) (reversing and remanding summary judgment).

Here's an example:

Before:

> Bob will pay Alice one hundred thousand dollars ($100,000.00) for the House, with 50% due upon signing of this Agreement.

After:

> Bob will pay Alice $100,000 for the House, …. *(Notice how the ".00" is omitted.)*

And another:

Before:

> Alice will sell the house at 1234 Main Street to Bob. … *[and later in the document:]* Alice will not alter the house at 1234 Main Street before the Closing.

After:

> Alice will sell the house at 1234 Main Street (the "**House**") to Bob. … Alice will not alter the House before the Closing.

Sometimes, though, repetition can be used (cautiously) to emphasize a point; the mission, after all, is to educate and persuade (see § 4.49.1), not to slavishly follow rules.

§ 176.2 Avoid "false imperatives"

A false imperative exists when a contract purports to impose an obligation, but without specifying who is responsible for carrying it out. "Let there be [whatever]"

To help identify a false imperative, ask: *If this doesn't happen, who could be sued?* Or, to adapt a tired business cliché: *Whose throat do I choke?*

Here's a before-and-after example:

Before:

> The apartment shall be regularly serviced by a professional pest-control service. *[So whose job is it?]*

After:

> Tenant *[or, perhaps, Landlord?]* is to cause the apartment to be serviced, at least once per calendar quarter, by a professional pest-control service.

For a discussion of false imperatives in the context of legislative drafting, see generally Jery Payne, The False Imperative, in *The Legislative Lawyer* (Dec. 2010).

§ 176.3 Write short, *single-subject* sentences and paragraphs

You'll normally get a contract to signature sooner if you draft it as a series of short, single-issue sentences and paragraphs, because:

- Short paragraphs and sentences can be reviewed more quickly.
- Short paragraphs and sentences are easier to save for re-use, and later to snap into a new contract draft like Lego blocks, without inadvertently messing up some other contract section.
- Short paragraphs and sentences are easier to edit during drafting and/or negotiation.
- Short paragraphs and sentences reduce the temptation for the other side's reviewer to tweak more language than necessary — and that's a good thing, because language tweaks take time to negotiate, which in turn causes business people to get impatient and to blame "Legal" for delaying yet another done deal.

So: If a sentence or paragraph starts running long, seriously consider breaking it up.

Oh, and *one major topic per paragraph, please*. Too many contract drafters are guilty of mixing a variety of topics into a single paragraph (often with topics separated by "provided, that ...."). That just makes the paragraph all the harder for the other side's legal reviewer, which in turn will slow up getting the agreement to signature.

§ 176.4 Subdivisions can help

Here's an example from the PlainLanguage.gov site, slightly modified:

Before:

> Except when this part provides for the granting, approval, or enforcement of leases and permits, the provisions in this part that authorize or require us to take certain actions extend to any tribe or tribal organization that is administering relevant programs or providing specific services under a contract or self-governance compact entered into under the Indian Self-Determination and Education Assistance Act (25 U.S.C. § 450f et seq.).

After:

> Any tribe or tribal organization that is administering programs or services under 25 CFR part 900:
> (a) may administer the provisions in this part that authorize or require us to take certain actions; and
> (b) may not administer the provisions of this part relating to the granting, approval, or enforcement of leases and permits.

Subdivisions can be internal to a paragraph, as seen in this slightly-modified example from the PlainLanguage.gov site:

Before:

> If any member of the board retires, the company, at the discretion of the board, and after notice from the chairman of the board to all the members of the board at least 30 days before executing this option, may buy, and the retiring member must sell, the member's interest in the company.

After:

> A retiring board member must sell his or her interest in the company to the company if (i) the chairman of the board gives notice to all board members at least 30 days in advance of the sale, and (ii) the board, in its discretion, approves the sale.

§ 176.5 Use active voice — mostly

Active voice gets to the point by *putting the actor first*. Look at the following before-and-after examples:

Before:

> A song was sung by her.

After:

> She sang a song.

Before:

> The part must have been broken by the handlers.

After:

> The handlers must have broken the part.

But **sometimes passive voice is better,** for example if the doer or actor of the action is unknown, unimportant, obvious, or better left unnamed:

- The part is to be shipped on 1 June. (If the actor is unclear or unimportant.)
- Presidents are elected every four years. (The actors are obvious.)
- Christmas has been scheduled as a workday. (The actor is better left unsaid.)

And clear, forceful, active-voice language might be inappropriate in diplomacy; in political negotiations — or in contract negotiations. *[DCT comment: The original USAF sentence said "…* may *be inappropriate," but it's better to stick with "might be."]*

§ 176.6 Streamline your sentences

It's easy to let a sentence get fat and sloppy. Here are a few examples:

Before:

> They made the decision to give their approval.

After:

> They decided to approve it.

Better *(possibly?)*:

> They approved it.

Before:

> The team held a meeting
> to give consideration to the issue.

After:

> The team met to consider the issue.

Better *(possibly?)*:

> They considered the issue.

Before:

> We will make a distribution of shares.

After:

> We will distribute shares.

Before:

> We will provide appropriate information
> to shareholders.

After:

> We will inform shareholders.

Before:

> We will have no stock ownership of the company.

After:

> We will not own the company's stock.

Before:

> There is the possibility of prior Board approval of these
> investments.

After:

> The Board might approve these investments in advance.

Before:

> The settlement of travel claims involves the examination of orders.

After:

> Settling travel claims involves examining orders.

Before:

> Use 1.5 line spacing for the preparation of your contract draft.

After:

> Use 1.5 line spacing to prepare your contract draft.

Better:

> Use 1.5 line spacing for your draft.

§ 176.7 Follow the rules for numbers, currencies, percentages

§ 176.7.1 General rules for numbers

• **Spell out** the numbers one to ten.

• **Use numbers** for 11, 12, 13, etc.

• **Both in the same sentence?** Consider using just numbers. There will be four students per negotiating team. There are 21 students in the class. The quiz will contain between 8 and 12 questions.

• **Don't start a sentence with numerals;** either spell out the numerals in words or (preferably) rewrite the sentence.

Before:

> 42 was Douglas Adams's answer to The Ultimate Question of Life, the Universe, and Everything.

After:

> According to the late novelist Douglas Adams, the answer to The Ultimate Question of Life, the Universe, and Everything is … 42.

§ 176.7.2 Large numbers

Spell out million, billion, trillion — but not thousand.

Before:

> More than 300,000,000 people live in the United States.

After:

> More than 300 million people live in the United States.

§ 176.7.3 Don't use both words and digits

Don't spell out a number in words and then restate the number in numerals — there's too much danger of changing one but not the other.

Before:

> More than three hundred million (300,000,000) people live in the United States.

After:

> More than 300 million people live in the United States.

Before:

> Guarantor will pay Bank USD one million seven thousand dollars ($1,700,000.00).

After:

> (In a lawsuit Bank lost the difference, i.e., $693,000.)

§ 176.7.4 Currency rules

"United States dollars": For domestic contracts, there's usually no need to say, "in United States dollars." (You can put that in the Definitions & Usages section if you want.)

In international contracts, use ISO 4217 currency abbreviations such as *USD*, as in, "Buyer will pay **USD** $30 million." (The USD abbreviation goes where indicated, not after the numbers.)

It's OK to spell out dollar amounts, but it's customary to just use the numbers.

Before:

> Twenty million dollars

After:

> $20,000,000

Better still:

> $20 million

Omit zero cents unless relevant.

Before:

> Alice will pay Bob $5,000.00.

After:

> Alice will pay Bob $5,000.

Not:

> Alice will pay Bob $5 thousand

Spell out a percentage if it's at the beginning of a sentence — or just use numbers and rewrite the sentence to avoid starting with the percentage

Before:

> 30% of the proceeds will be donated to charity.

After:

> Thirty percent of the proceeds will be donated to charity.

Or:

> Of the proceeds, 30% will be donated to charity.

Not:

> Thirty percent (30%) of the proceeds will be donated to charity.

§ 176.8 Parallelism in lists: Be consistent

Use a consistent pattern when making a list.

Before:

> The security policeman told us to observe the speed limit and we should dim our lights.

After:

> The security policeman told us to observe the speed limit and to dim our lights.

Before:

> The functions of a military staff are to advise the commander, transmit instructions, and *implementation* of decisions. *["Advise" and "transmit" are verbs, while "implementation" is a noun.]*

After:

> The functions of a military staff are to advise the commander, transmit instructions, and implement decisions. *[The verb "implement" is stronger than the noun "implementation."]*

Before:

> *The functions of a military staff are* to advise the commander, transmit instructions, and implement decisions. *[Also: Passive voice.]*

After:

> A military staff advises the commander; transmits his instructions; and implements his decisions.

Before:

> Universal military values include *that we should act with* integrity, dedication to duty, the belief that freedom is worth dying for and service before self.

After:

> Universal military values include *commitment to* integrity, dedication to duty, service before self, and the belief that freedom is worth dying for.

If one of the items in a list can't be written in the same grammatical structure, then consider placing it at the end of the sentence. In the last row above, beginning with "Universal military values," the phrase "the belief that freedom is worth dying for" doesn't match the three-word construction of the other items; placing that phrase at the end of the sentence improves overall readability.

If your sentence contains a series of items separated by commas *[DCT comment: Or by semicolons]*, keep the grammatical construction similar—if two out of three items begin with a verb, then make the third item begin with a verb too.

Don't mix things and actions, statements and questions, or active and passive instructions.

Make ideas of equal importance look equal.

Here's another example, from the SEC's Plain English Handbook (at 34), slightly edited:

Before:

> If you want to buy shares in Fund X by mail, **fill out** and **sign** the Account Application form, **making** your check payable to "The X Fund," and put your social security or taxpayer identification number on your check.

After: *(with semicolons separating the clauses instead of commas)*

> If you want to buy shares in Fund X by mail, **fill out** and **sign** the Account Application form; **make** your check payable to "The X Fund"; and put your social security or taxpayer identification number on your check.

And one more, from the same source:

Before:

> We invest the Fund's assets in short-term money market securities to **provide** you with

liquidity, **protection** of your investment, and **high** current income.

After: We invest in short-term money market securities to **provide** you with liquidity; **protect** your investment, and **generate** high current income.

For this last example, the SEC Handbook points out that the *Before* sentence "is unparallel because its series is made up of two nouns and an adjective before the third noun. It's also awkward because the verb provide is too closely paired with the nominalization protection." The *After* sentence uses verbs throughout, and also uses semicolons instead of commas.

§ 176.9 Use industry-standard terminology

When you're drafting a contract, you'll want to try to **avoid coining your own non-standard words or phrases** to express technical or financial concepts. If there's an industry-standard term that fits what you're trying to say, use that term if you can.

First, someday you might have to litigate the contract. You'll want **to make it as easy as possible for the judge (and his or her law clerk) and the jurors** to see the world the way your client does. In part, that means making it as easy as possible for them to understand the contract language.

The odds are that **the witnesses who testify in deposition or at trial likely will use industry-standard terminology**. So the chances are that the judge and jurors will have an easier time if the contract language is consistent with the terminology that the witnesses use—that is, if the contract "speaks" the same language as the witnesses.

Second — and perhaps equally important — the business people on both sides are likely to be more comfortable with the contract if it uses familiar language, which could help make the negotiation go a bit more smoothly.

§ 176.10 Omit *needless* words — but remember your mission

"Omit needless words" is a famous quotation from Strunk & White's The Elements of Style. Here are some examples of possibly-needless words, from the SEC's Plain English Handbook (slightly edited):

- in order to : to
- in the event that : if
- subsequent to : after
- prior to : before
- despite the fact that : although
- because of the fact that : because; since
- in light of : ditto
- owing to the fact that : ditto

But remember your mission: To educate, and possibly persuade, readers. That's why it can sometimes be helpful to (judiciously) record reasons and explanations in a contract, to educate later readers about *why* the negotiators agreed to certain things.

Certainly **brevity in a contract is a virtue, but it's far from the only one or even the most important one**. Sometimes a few words of explanation or clarification (possibly in footnotes) can be cheap insurance.

§ 176.11 And: Do what your supervising partner prefers

The above rules aren't ethical mandates. A new lawyer might find that her supervising partner prefers to write, for example, *one million seven hundred thousand dollars ($1,700,000.00)* instead of the simple *$1.7 million* recommended above. **Don't fight the partner over it** — for purely-stylistic matters, just do it the way that the partner prefers. There'll be plenty of time to adjust your style as you get more experienced and more trusted to handle things on your own.

(In the meantime, of course, **you'll have to be extra-careful** not to make the kind of mistakes that can result from some of these stylistic practices, as discussed above.)

§ 176.12 Bonus: Tips for plainer English

§ 176.12.1 Improve the "flow" of the words

Before:

> … in a writing **signed** by the party sought to be bound …

After: … in a writing **that is signed** by the party sought to be bound ….

§ 176.12.2 Modifier order might matter

Place modifiers correctly–"we want only the best" not "we only want the best."

§ 176.12.3 Be careful when using a verb that doubles as a noun

Let's look again at an example from the SEC's Plain English Handbook (at 32). The word *supplements* can be a verb, but it can also be a noun, as in, dietary supplements. That can interrupt the flow of the sentence and slow down the reader's comprehension.

Before:

> The following description of the particular terms of the Notes offered hereby (referred to in the accompanying Prospectus as the "Debt Securities") **supplements**, and to the extent inconsistent therewith replaces, the description of the general terms and provisions of the Debt Securities set forth in the Prospectus, to which description reference is hereby made.

After:

> This document describes the terms of these notes in greater detail than our prospectus. It might provide information that differs from our prospectus. If the information in this document does differ from our prospectus, please rely on the information in this document.

§ 176.12.4 Avoid gobbledygook

Adapted from the PlainLanguage.gov site:

Before:

> Consultation from respondents was obtained to determine the estimated burden.

After:

> We consulted with respondents to estimate the burden.

Before:

> The amount of expenses reimbursed to a claimant under this subpart shall be reduced by any amount that the claimant receives from a collateral source in connection with the same act of international terrorism. In cases in which a claimant receives reimbursement under this subpart for expenses that also will or may be reimbursed from another source, the claimant shall subrogate the United States to the claim for payment from the collateral source up to the amount for which the claimant was reimbursed under this subpart.

After:

> If another source pays you, then we will reduce our payment by that amount.
>
> If we pay you, and another source also pays you for the same expenses, then you must repay us the amount that we paid you.
>
> *[Note how the After version is now in <u>two</u> paragraphs.]*

Before:

> When a filing is prescribed to be filed with more than one of the foregoing, the filing shall be deemed filed as of the day the last one actually receives the same.

After:

> A document is considered "filed" only when all parties that are supposed to receive the document have actually received it.

§ 177 Defined terms

§ 177.1 Some style preferences

The following are some personal style preferences that enhance readability (in the author's view):

• **Put the defined term in quotes and bold-faced type** to make it stand out on the screen or page and thus make the term easier to spot while scanning through the document.

• **Use refers to instead of means**, because the former often just sounds better in different variations.

Before:

> Confidential Information **means** information where all of the following are true ….

After:

> "**Confidential Information**" **refers to** information where all of the following are true ….

§ 177.2 Caution: Consistency in capitalizing defined terms can be crucial

It's a *really* good idea to be consistent about capitalization when drafting a contract. If you define a capitalized term but then use a similar term without capitalization, that *might* give rise to an ambiguity in the language — which in turn might preclude a quick, inexpensive resolution of a lawsuit. Something like that happened in the Clinton Ass'n for a Renewed Environment case:

- The defendant asserted that the plaintiff's claim was barred by the statute of limitations and therefore should be immediately dismissed.
- The plaintiff, however, countered that the limitation period began to run much later than the defendant had said.
- The court held that inconsistency of capitalization of the term "substantial completion" precluded an immediate dismissal of the plaintiff's claim.

See Clinton Ass'n for a Renewed Environment, Inc., v. Monadnock Construction, Inc., 2013 NY Slip Op 30224(U) (denying defendant's motion to dismiss on the pleadings).

In a similar vein, a UK lawsuit over flooding of a construction project turned on whether the term "practical completion" (uncapitalized) had the same meaning as the same term capitalized. The court answered that the terms did *not* have the same meaning; as result, a sprinkler-system subcontractor was potentially liable for the flooding. *See* GB Building Solutions Ltd. v. SFS Fire Services Ltd., (2017) EWHC 1289, *discussed in* Clark Sargent, Antonia Underhill and Daniel Wood, Ensure That Defined Terms Are Used Consistently; Ambiguity Can Be Costly(Mondaq.com 2017).

§ 177.3 Put the definitions at the *back* of the Agreement? Or in an exhibit or schedule?

A drafter can place a separate "definitions" section:

- near the *beginning* of the agreement — this is perhaps the most-common practice;
- at the back (with results that might be surprising);
- in a separate exhibit or schedule (which can be handy if using the same definitions for multiple documents in a deal).

On his blog, IACCM founder and president Tim Cummins tells of an IACCM member whose company saved hours of negotiating time — *up to a day and a half per contract* — by moving the "definitions" section from the front of its contract form to an appendix at the back of the document. Cummins recounted that "by the time the parties reached 'Definitions', they were already comfortable with the substance of the agreement and had a shared context for the definitions. So effort was saved and substantive issues were resolved." Tim Cummins, Change does not have to be complicated (July 21, 2014).

§ 178 Battle of the Forms

§ 178.1 Business background: D[**]kish documents

When a corporate buyer makes a significant purchase, it's quite common for the buyer's procurement people to send the seller a purchase order. Typically, if the seller wants to get paid, it must quote the purchase-order number on the invoice, otherwise the buyer's accounts-payable department simply won't pay the bill. This is a routine internal-controls measure implemented by buyers to help prevent fraud.

Many buyers, however, try to use their purchase-order forms, not just for fraud prevention, but to impose legal terms and conditions on the seller. These buyers put a lot of fine print on the backs of their purchase-order forms; the terms of the fine print typically include 1) detailed — and often onerous — terms for the purchase, including for example expansive indemnity requirements; and 2) language to the effect of, *our terms and conditions are the only ones that will apply; yours don't count, no matter what you do*.

Sellers aren't always innocent parties in this little mating ritual, either: It's not uncommon for a seller's quotation to state that all customer orders are subject to acceptance in writing by the seller. Then, the seller's written acceptance takes the form of an "order confirmation" that itself contains detailed terms and conditions — some of which might directly conflict with the buyer's purchase order.

This is known as the "Battle of the Forms," of the kind contemplated by UCC § 2-207 and sometimes experienced in common-law situations as well.

In a sense, such purchase-order and sales-confirmation forms are "d[**]kish," in that they try to displace rival terms and conditions, in much the same way that natural selection supposedly has favored human male genitalia that are sized and shaped to displace rival semen from a female. See, e.g., Gordon G. Gallup and Rebecca L. Burch, Semen Displacement as a Sperm Competition Strategy in Humans, 2 EVOL. PSYCH. 12 (2004). *(My wife, a lawyer herself, raised her eyebrows disapprovingly about this paragraph, but the metaphor strikes me as quite apt.)*

§ 178.2 How the UCC handles the Battle of the Forms

The (U.S.) Uniform Commercial Code expressly provides ground rules for the Battle of the Forms.

To illustrate, let's consider a hypothetical example in which 1) Customer sends Supplier a purchase order for widgets; 2) **Customer's purchase order states that Customer's payment is due net 120 days** from the date of Customer's receipt of a correct invoice; it also states that **Customer rejects any additional or different terms that Supplier might propose;** and 3) After receiving the purchase order, Supplier ships the requested widgets *together with* a written order confirmation that objects to Customer's purchase order terms and states that **Customer's payment is due net 10 days from the date of the invoice.**

Under **UCC § 2-207(3), the two conflicting net-days payment terms would drop** out — you can think of them as killing each other off — and unless the parties agreed otherwise, **the payment terms would be set by the UCC's relevant gap-filling provision**, if any. On the subject of payment terms, UCC § 2-310 requires payment at the time and place at which Customer receives the goods, which might be the place of shipment, unless the parties agree otherwise.

As an example, see Northrop Corp. v. Litronic Industries, 29 F.3d 1173 (7th Cir. 1994) (Posner, J.): This was a case where:

- **the *buyer's* purchase order stated that the seller's warranty provision was of unlimited duration;**
- **the *seller's* acknowledgement form stated that the seller's warranty lasted only 90 days;**
- **the trial court held, the appellate court agreed, that *both* of those provisions dropped out of the contract, and therefore the buyer was left with an implied warranty of "reasonable" duration**.

§ 178.3 4.24.3 Pro tip for sellers

Sellers should never sign a buyer's purchase-order form — nor fill an order in response to a purchase order — without carefully reading its terms and sending an order confirmation with suitably-worded terms of sale.

§ 178.4 Caution: The UN CISG relies on the "mirror image" (or "last shot") rule

Analysis of the Battle of the Forms is different under the UN Convention on Contracts for the International Sale of Goods. *See generally, e.g.*, VLM Food Trading Int'l, Inc. v. Illinois Trading Co. 811 F.3d 247 (7th Cir. 2016), where the appeals court affirmed a judgment below that, "because Illinois Trading never expressly assented to the attorney's fees provision in VLM's trailing invoices, under the Convention that term did not become a part of the parties' contracts." *Id.* at 250. The appeals court explained:

> **[T]he Convention departs dramatically from the UCC** by using the common-law "mirror image" rule (sometimes called the "last shot" rule) to resolve "battles of the forms." With respect to the battle of the forms, the determinative factor under the Convention is when the contract was formed. **The terms of the contract are those embodied in the last offer (or counteroffer) made prior to a contract being formed.** Under the mirror-image rule, as expressed in Article 19(1) of the Convention, "[a] reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer."

Id. at 251 (cleaned up, emphasis added).

§ 178.4.1 CAUTION: Filling a purchase order might well mean that the buyer's T&Cs apply

Remember that in U.S. jurisdictions, a customer's sending of a purchase order might count as an offer to enter into a contract, *which could be accepted by performance*, i.e., by filling the purchase order. Consider the following actual examples:

- The following is from a Honeywell purchase-order form archived at http://perma.cc/CUV6-NKTY, § 1 "This Purchase Order is deemed accepted when Supplier returns the acknowledgment copy of this Purchase Order **or begins performing**, whichever is earlier." (Emphasis added.)

- From a General Electric purchase-order form § 1: "This Order shall be irrevocably accepted by Supplier upon the earlier of: (a) Supplier's issuing any acceptance or acknowledgement of this Order; or (b) **Supplier's commencement of the work** called for by this Order in any manner." (Emphasis added.)

- From a Cisco purchase-order form § 1: "Supplier's electronic acceptance, acknowledgement of this Purchase Order, **or commencement of performance** constitutes Supplier's acceptance of these terms and conditions." (Emphasis added.)

§ 178.5 A "master" agreement *should* preclude a Battle of the Forms

In a New Jersey case, UPS and a GE subsidiary entered into a master agreement, which contained a provision stating that the master agreement would take precedence over any bill of lading or other shipment document:

> E. To the extent that any bills of lading, or other shipment documents used in connection with transportation services provided pursuant to the contract are inconsistent with the terms and conditions of this contract (including the terms and conditions of Appendices or Exhibits incorporated by reference), the terms and conditions of this Contract (and any incorporated Appendices and Exhibits) shall govern.

Indem. Ins. Co. of N. Am. v. UPS Ground Freight, Inc., No. 13-3726, slip op. at 3 (D.N.J. Mar. 31, 2016). UPS claimed that its bill of lading limited its liability for damage to some $15,000. In contrast, the GE subsidiary claimed that the bill of lading was inapplicable, and that consequently UPS should be held liable for the full value (some $1 million) of the shipment in question. The court declined to decide the issue on summary judgment.

§ 178.6 Additional reading (optional)

See generally:

- Brian Rogers, Battle of the Forms Explained (Using a Few Short Words) (blog entry March 1, 2012).

- Marc S. Friedman and Eric D. Wong, TKO'ing the UCC's 'Knock-Out Rule', in the Metropolitan Corporate Counsel, Nov. 2008, at 47.

§ 179 Street smarts

§ 180 Security interests, liens, etc.

§ 181 4.94.1 Introduction

Overly simplified: Contracts often require one party, the "debtor," to pay money to another party, the "creditor." As a Plan B, the creditor might want to have the debtor, and/or a guarantor (section 4.67), grant the creditor a "security interest" in saleable property, referred to as "collateral." Assuming that the i's are dotted and the t's crossed, when the debtor doesn't pay, the creditor — after jumping through various hoops — can foreclose on the collateral (that is, seize and sell it) and use the sale proceeds to pay down the debt, with any remaining proceeds going to the collateral's former owner.

In the U.S., depending on the type of collateral, a security interest or other lien can be created:

- For a variety of tangible goods and intangible rights: By signing a security agreement governed by article 9of the Uniform Commercial Code (Cornell.edu: https://goo.gl/SNEsB1);
- For real estate, depending on the jurisdiction: By signing a deed of trust (Wikipedia: https://goo.gl/UZaxuX) or a mortgage (Wikipedia: https://goo.gl/LOmOrS);
- For certain goods being purchased under article 2 of the Uniform Commercial Code (see https://goo.gl/q2FMQ4), a security interest might well arise as a matter of law under any of UCC sections 2-401, 2-505, or 2-711;
- In some cases, by possession (and, possibly, *only* by possession) of the collateral; and
- As a matter of law, for example in the case of tax liens (Wikipedia: https://goo.gl/hqYv6V) or so-called mechanic and materialman's liens, a.k.a. M&M liens or supplier liens (Wikipedia: https://goo.gl/6JWk9P).

For other "hidden liens" that can arise as a matter of state- or federal law in California — and might have counterparts in other jurisdictions — see generally the Hidden Liens Report of the Commercial Transactions Committee, Business Law Section, State Bar of California, at https://goo.gl/LgzPH8. *Disclosure:* I drafted two small portions of the report while serving on the Commercial Transactions Committee, which I later co-chaired.

§ 182 4.94.2 Caution: Must the security interest be "perfected"?

Just because Creditor A acquires a security interest (or other lien) doesn't automatically mean that Creditor A would get to seize and sell the collateral if the debtor didn't pay. Either intentionally or inadvertently, the debtor might grant a different Creditor B a security interest *in the same collateral* without telling either creditor about the conflicting security interests. That might well trigger a dispute over which creditor — each having a legitimate claim to the collateral or its proceeds — was entitled to priority. (We won't address here the rules for resolving such a dispute.)

• *Perfection by public notice:* Creditor A might well be able to cut off claims of later creditors by timely filing a public notice of Creditor A's security interest or other lien. That way, by law, future creditors won't be able to claim that they had no reason to know of Creditor A's security interest because the future creditors could and should have searched the appropriate public records as part of their due diligence.

In many cases, such a public notice will take the form of a UCC-1 financing statement, filed by Creditor A with the state secretary of state (or, for some types of collateral, in county records). See generally the Wikipedia article UCC-1, at https://goo.gl/goFnIg.

• *"Perfection" by possession:* Some security interests and liens can be "perfected" by taking possession of the collateral (and, in the case of mony, only that way): Under UCC § 9-313, "a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 8-301." A practical implication is that a creditor, seeking to take a security interest in such collateral, might insist on seeing the collateral to confirm that it wasn't in someone else's possession under a prior, perfected security interest.

§ 183 4.94.3 Pro tips for taking security interests in collateral

When drafting a contract that calls for your client to take a security interest in collateral of another party, consider the following:

- For collateral consisting of negotiable documents, goods, instruments, money, or tangible chattel paper (see above), confirm that the collateral is not in the possession of some other creditor and thus would presumably be already subject to that creditor's security interest;
- Check the appropriate public records to find out whether any existing security interests or liens might impair your client's ability to claim proceeds from the collateral;
- In the contract, expressly prohibit the debtor (i) from granting any other security interest or lien in the collateral, or (ii) from allowing a lien to attach as a matter of law, e.g., through the debtor's failure to pay taxes or other amounts owed;
- File a UCC-1 financing statement in the appropriate location (or locations?) to put future creditors on notice of your client's claim to the collateral;
- Get a representation [LINK NEEDED], and/or a warranty, that no other security interests or liens have been granted except as expressly disclosed;

§ 183.1 Round-trip sales transactions

Round-trip sales transactions are those in which, in essence, one company says to another, *You'll buy my stuff, but I'll buy enough of yours to cover your cost*. (It's sometimes referred to as "buying revenue.") This type of deal can be a species of securities fraud, and can get companies and individuals sued by the SEC and/or by securities plaintiffs.

The SEC explained the basics of round-trip transactions in a 2005 press release charging Time Warner (then AOL) with the practice, a charge that eventually cost Time Warner nearly $3 billion (extra paragraphing has been added for readability):

[AOL] effectively funded its own online advertising revenue by giving the counterparties the means to pay for advertising that they would not otherwise have purchased.

To conceal the true nature of the transactions, the company typically structured and documented round-trips as if they were two or more separate, bona fide transactions, conducted at arm's length and reflecting each party's independent business purpose. The company delivered mostly untargeted, less desirable, remnant online advertising to the round-trip advertisers, and the round-trip advertisers often had little or no ability to control the quantity, quality, and sometimes even the content of the online advertising they received. Because the round-trip customers effectively were paying for the online advertising with the company's funds, the customers seldom, if ever, complained.

AOL / Time Warner almost immediately settled with the SEC for $300 million; in 2009 it settled a related class-action lawsuit for $2.65 billion.

§ 183.2 Association membership rules might not be binding

An association's rules might not count as a binding contract. From a Fifth Circuit case:

> Dr. Barrash claims that because he was a member of the AANS, the association's bylaws formed a contract between them. The bylaws include the disciplinary procedures to be followed by the PCC. Dr. Barrash argues that the AANS breached the bylaws when it censured him because the PCC did not strictly comply with its own procedures. He claims that this breach caused damages because he lost income opportunities as an expert witness following publication of the censure.
>
> To date, no Texas court has allowed a plaintiff to challenge a professional organization's internal disciplinary procedures under a breach of contract theory.

> Based on Texas precedent and the doctrine of judicial non-intervention, we find that Dr. Barrash has failed to state a plausible breach of contract claim.

Barrash v. American Association of Neurological Surgeons, Inc., 812 F.3d 416, (5th Cir. 2016) (affirming dismissal for failure to state a claim upon which relief can be granted) (citations omitted).

§ 183.3 Due diligence on your counterparty can pay off

It can be worthwhile to do some homework on a counterparty that your client doesn't really know. Here are two not-atypical stories about **a contractor that was hired to remediate Hurricane Harvey flood damage in Houston but that didn't do the work**:

- August 2018: Titan Foundation & Elevation given 30 days to complete stalled projects on flood-damaged homes
- In a tweet from an ABC 13 reporter: "Houston City Council considering 4 new home elevation contracts to replace a previous last failed contractor. **Titan Foundation failed to do work. Homeowners still waiting.** Council considering yet another delay."

§ 183.4 "Roadblock" soundbite language in contract saves Mercedes-Benz from $100M punitive-damages verdict

Sometimes extra "roadblock" soundbite verbiage in contracts can pay off: The Texas supreme court rendered a take-nothing judgment, reversing a $100M jury verdict for punitive damages against Mercedes-Benz USA, because the plaintiff's fraudulent-inducement claim was conclusively negated by the contract's express terms, which explicitly ruled out just the assertion on which the plaintiff claimed to have relied. *See* Mercedes-Benz USA, LLC v. Carduco, Inc., No. 16-0644 (Tex. Mar. 1, 2019) (reversing court of appeals and rendering take-nothing judgment).

§ 184 Contract Drafting Course Notes

§ 184.1 Ambiguity exercises

§ 184.1.1 Schrödinger's yoga teacher

From a yoga teacher at the end of class: "If you don't know me, my name is Elizabeth …." QUESTION: What's her name if you *do* know her?

§ 184.1.2 An obituary: Going to heaven surrounded by family

From an obituary: "Pamela went to heaven surrounded by family whom she loved …." QUESTION: What questions does this line evoke in your minds? Discuss with your neighbors.

§ 184.1.3 Right of access to property

SBA Towers II LLC v. Wireless Holdings, LLC, No. 325 WDA 2018 (Pa. Super. Mar. 19, 2019) involved the following contract language:

> [Appellant] shall have *at all times* during the initial term or renewal term *the right of access to and from the Leased Space* and all utility installations servicing the Lease Space *on a 24 hours per day/7 days per week basis*, on foot or by motor vehicle, including trucks, and for the installation and maintenance of utility wires, cables, conduits and pipes over, under and along the right- of-way extending from nearest accessible public right-of-way.

Id., slip op. at 1-2. The question was: Did this language allow the landlord to impose "reasonable" security restrictions such as: • requiring the tenant to call ahead before accessing the space, and • requiring the tenant to obtain background checks on its personnel wo would access the space?

- The majority agreed with the trial court that this language was ambiguous: "Noting that the interpretation of a contract is a question of law, the trial court interpreted the Lease as allowing for reasonable security." *Id.*at 2.

- A dissent said that the parties' silence about access restrictions did not create an ambiguity:

> Notably, Paragraph 18 does not set forth any restrictions on Appellant's access to the property, and it is silent as to whether Appellees may, in the future, impose any restrictions. While the Majority interprets this silence as an ambiguity as to whether Appellant's access may be restricted, the silence, in my view, clearly evinces the parties' intent **NOT** to restrict Appellant's access. Thus, I would conclude that Paragraph 18 is free of any latent or patent ambiguity.

Murray, J., dissenting, slip op. at 4.

QUESTION: How could the drafter(s) have avoided this dispute, and would it have been worth the trouble?

QUESTION: In what other type(s) of provision have we seen analogs to access restrictions?

§ 184.2 Drafting screw-ups

§ 184.2.1 Call in the Seabees ....

In a Delaware case, the contract in suit required immediate cure of incurable breaches; the court remarked that "FetchIT and Shodogg show up the more modest claim on the Seabees Memorial: 'The difficult we do at once, the impossible takes a bit longer.'" Fetch Interactive Television LLC v. Touchstream Technologies Inc., No. 2017-0637-SG, slip op. at 10 n.41.

§ 184.2.2 D.R.Y. fail

A contract allowed termination if a breach wasn't cured within "fifteen (30) days" after notice of breach. The court held that termination was allowed in 15 days. Fetch Interactive Television LLC v. Touchstream Technologies Inc., No. 2017-0637-SG, slip op. at 52-53.

§ 184.2.3 Clients don't always fill in the blanks

Whoever prepared this purported letter of intent naïvely assumed that clients will just naturally fill in whatever blanks you leave for them:

Provided you are in agreement with these terms, please countersign this LOI in the space provided below and return a copy to my attention. We look forward to your timely response.

Very truly yours,

TRUM[illegible] ACQU[illegible]SIT[illegible]ON, LLC

By: _____
Name:
Title:

THE ABOVE IS ACKNOWLEDGED, CONSENTED TO AND AGREED TO BY:

I.C. EXPERT INVESTMENT COMPANY

By: _____
Andrey Rozov
CEO

§ 185 Side letters (commentary)

Key takeaway: Signing a side letter agreement, *and then concealing the side letter from the company's accountants*, can lead to a prison sentence for securities fraud.

In this context, a "side letter" is, in essence a secret annex to a sales contract, allowing the buyer to cancel the transaction. That means the deal is a sham, because the seller does not have a binding contract and cannot enforce a right to payment. If the seller reports the revenue as part of its periodic financial reporting, it likely will constitute securities fraud, and both the vendor and the customer can get in serious trouble for it. Here are some examples from the news:

- The former CEO of McKesson Corporation was sentenced to ten years in prison for concealing side letters, as well as for backdating contracts (SFGate.com: https://goo.gl/vcy4eM).
- A Kansas City bank president was convicted of bank fraud for signing a side letter in connection with a questionable loan to a real-

estate developer, but then concealing the side letter from bank examiners. *See*Feingold v. United States, 49 F.3d 437 (8th Cir. 1995) (affirming conviction).

- In one case, the SEC didn't just go after a vendor that used a secret side letter, it also filed a civil lawsuit against an executive of a customer that made a sham $7 million purchase. According to the SEC's complaint, the customer executive not only knew that the vendor planned to fraudulently misstate its financial results, he even advised the vendor's sales people how to conceal the cancellation right from the vendor's finance department (SEC.gov: https://goo.gl/8sfMWL).

For additional information, see What to Do When You Find the Side Letter… (BorisFeldman.com 2001), athttps://goo.gl/ehJbzm, archived at https://perma.cc/NG3H-R7UW.

And see also

§ 186 Flip insurance (commentary)

Flip insurance is (the author's term for) a type of clause sometimes seen in, for example, asset-sale agreements. Such a clause provides that if the buyer sells the purchased asset at a higher price within a stated period of time (often one year), then the seller is entitled to a share of the difference.

> HYPOTHETICAL EXAMPLE: Buyer pays Seller $100 for an asset. Their contract contains a flip-insurance clause stating that Seller is entitled to 50% of Buyer's profit if Buyer sells the asset within one year after the closing of Buyer's purchase from Seller.

Other terms for this type of clause are *jerk insurance* and *schmuck insurance* — see Peter Mahler, "Jerk Insurance" Takes on New Meaning in Buyout Dispute (NYBusinessDivorce 2015).

In one example of a badly drafted flip-insurance clause, a federal district court held that Seller was entitled to 20% of *the entire proceeds* of Buyer's flip sale, not just to 20% of Buyer's *profit* on the flip sale. See Charron v. Sallyport Global Holdings, Inc., No. 12cv6837, part III (S.D.N.Y. Dec. 10, 2014) (setting forth findings of fact and conclusions of law after bench trial), *aff'd*, No. 15-256 (2d Cir. Mar. 1, 2016) (summary order).

§ 187 Fraud allegations (commentary)

§ 187.1 Motivation: "They lied!" is a go-to phrase for trial counsel

When a big contract fails, trial counsel will pretty much always try hard to find opportunities to accuse the other side of having misrepresented facts. Why? Because it can work, sometimes spectacularly well. Jurors and even judges might not understand the nuances of the dispute, but they will definitely understand the accusation that "they lied!"

Consequently, every contract drafter should be mindful of the possibility that if a serious dispute were ever to arise concerning the contract, the other side might claim that the drafter's client engaged in fraudulent behavior. We see this in the civil complaint filed by the state of Oregon against Oracle, in which the second paragraph said, in its entirety (with extra paragraphing added for readability):

> Oracle lied to the State about the "Oracle Solution."
>
> Oracle lied when it said the "Oracle Solution" could meet both of the State's needs with Oracle products that worked "out-of-the-box."
>
> Oracle lied when it said its products were "flexible," "integrated," worked "easily" with other programs, required little customization and could be set up quickly.
>
> Oracle lied when it claimed it had "the most comprehensive and secure solution with regards to the total functionality necessary for Oregon."

(The *Oregon v. Oracle* case was later settled, with Oracle agreeing to pay Oregon $25 million in cash and to provide technology worth another $75 million.)

As another example, consider BSkyB Ltd. v. HP Enterprise Services UK Ltd., [2010] EWHC 86 (TCC). In that case:

- British Sky Broadcasting ("Sky") contracted with EDS to develop a customer relationship management (CRM) software system.
- Things didn't go as planned, and Sky eventually filed suit.

- In the (non-jury) trial, the judge concluded that EDS had made fraudulent misrepresentations when one of EDS's senior UK executives, wanting very much to get Sky's business, lied to Sky about EDS's analysis of the amount of elapsed time needed to complete the initial delivery and go-live of the system. *See id.* at ¶ 2331 and ¶¶ 194-196.

- The judge also concluded that during subsequent talks to modify the contract, EDS made additional misstatements that didn't rise to the level of fraud, but still qualified as negligent misrepresentations. *See id.* at ¶ 2336.

- A limitation-of-liability clause in the EDS-Sky contract capped the potential damage award at £30 million.

- By its terms, though, that limitation did not apply to fraudulent misrepresentations; the judge held that the limitation didn't apply to negligent misrepresentations either. *See id.* at ¶¶ 372-389.

(One of the most interesting aspect of the judge's opinion is its detailed exposition of the facts, which illustrate the 'sausage factory' by which technology deals sometimes get made — and how even just one vendor representative can make a deal go terribly wrong for his employer.)

In early June 2010, EDS reportedly agreed to pay Sky some US$460 million — *more than four times the value of the original contract* — to settle the case. See Jaikumar Vijayan, EDS settles lawsuit over botched CRM project for $460M, Computerworld, June 9, 2010.

Still another example is Waste Management, Inc.'s lawsuit against SAP over a failed enterprise resource planning (ERP) software implementation, reported to have settled for an undisclosed sum. At the heart of Waste Management's case was its allegation, not just that SAP had breached the contract, but that it was guilty of fraudulent inducement, fraud, and negligent misrepresentation. *See* Chris Kanaracus, SAP, Waste Management settle lawsuit, Computerworld, May 3, 2010.

§ 187.2 The threat of punitive damages and rescission raises the stakes

If a customer's lawyers can prove fraud by a vendor, then the customer may be able to recover not just 'benefit of the bargain' contract damages, but possibly punitive damages as well. This is important because "punis"

ordinarily aren't available in garden-variety contract cases. For that reason, even when evidence of fraud is weak, the mere threat of punitive damages can give the customer more leverage in making settlement demands.

A fraud claim also raises the specter of rescission, that is, unwinding the transaction and putting the parties back at Square One, which conceivably could be equally scary to the claim's target.

§ 187.3 Fraud claims can be expensive to defend against

A fraud claim might well be more expensive to defend against than would a garden-variety breach-of-contract claim. That's because the defendant's intent is relevant to the fraud inquiry, which opens up all kinds of possibilities for requests by the claimant for costly discovery.

§ 187.4 In California, mere negligent misrepresentation counts as "fraud"

"Under California law, negligent misrepresentation is a species of actual fraud and a form of deceit." Wong v. Stoler, No. A138270, part III-B(2), slip op. at 12 (Cal. App. May 26, 2015) (designated as not for publication; citing cases).

§ 188 Appendix: Exercises

§ 188.1 Drafting exercises

§ 188.1.1 Drafting exercise: Selling your laptop

FACTS:

You are a new lawyer, licensed to practice in Texas.

Here in Houston, "Alice"* is selling her 2012 Macbook Air laptop computer to "Bob" for USD $ 500.

You represent Bob, who has asked you to draw up a contract for the sale.

* In the tech world, communications protocols are often illustrated by using fictional characters Alice, Bob, Carol, Dave, Eve, Fred, etc.)

EXERCISE: In your groups, using the virtual whiteboard (6:00 p.m. section | 7:30 p.m. section), draft the simplest bare-bones contract you can think of for this transaction that would be reasonably likely: • to be understood and complied with by the parties; • to cover the essential business issues; and • to get Bob to a jury — i.e., past a motion to dismiss for failure to state a claim — if Alice defaults.

§ 188.1.2 Signatures: The Addams family in Hawai'i

FACTS:

Your client is Addams Investments, L.P., a "family" limited partnership of the very-wealthy Addams clan in Galveston. The sole general partner of the limited partnership is Addams Operations, Inc.

It's 12:00 noon Houston time on March 31. The president of Addams Operations, Ms. Wednesday Addams, is on the phone. It's a bad connection, but she wants to talk about a contract that you and she have been negotiating for Addams Investments, L.P.

Under the contract, will buy a large quantity of widgets from Widgets, Inc., a Houston company that recently went public. (Family patriarch Gomez Addams is convinced the family will make a killing in the widget market.)

Wednesday Addams says that she has talked by phone with her opposite number at Widgets, Inc.; she reports that Widgets, Inc., has agreed to the last contract draft that you sent over, and that everyone is ready to sign.

The Widgets, Inc. people really, *really* want to get the contract signed and delivered today, March 31. They've told Wednesday Addams that they're willing to make significant pricing concessions to make that happen.

There's a problem, though: As you learn from Wednesday Addams over the bad phone connection, she and the rest of the Addams family are at the end of a rugged backpacking vacation on a small, primitive island in Hawai'i. The island has no Internet service and barely has cell phone service.

The family has just emerged from the back country. The plan is for everyone, smelly as they are, to take a private plane from a dirt landing strip on the island to the Honolulu airport. A shuttle bus will take them to a nearby hotel for a quick shower and change of clothes. The family will then board a United Airlines "redeye" overnight flight that will land in Houston on the morning of April 1.

One more thing, she says: In the interest of traveling as light as possible, no one in the group brought a laptop.

QUESTION: How should the contract signature block for Adams Investments, L.P., be written? INSTRUCTIONS: Develop a consensus, then post your version on the virtual whiteboard (6:00 p.m. section | 7:30 p.m. section).

QUESTION: Why might the Widgets sales rep be so eager to get the contract signed on March 31? (*Hint:* It has to do with the fact that Widgets, Inc. is a newly-public company.)

QUESTION: What about just signing it on April 1 when the family gets back to Houston?

QUESTION: Is it physically possible for you to "make it happen" for the contract to be signed and delivered to Widgets, Inc. today, March 31? If so, how might you go about it?

QUESTION: If Wednesday Addams asks *you* to sign it as the company's lawyer, how should you respond?

§ 188.1.3 Exercise: Preamble questions (Rick's Cabaret)

The provision below, at https://goo.gl/DRbLRw (edgar.sec.gov), is from a 2008 real-estate purchase agreement involving the parent company of "gentleman's club" Rick's Cabaret:

> THIS REAL ESTATE PURCHASE AND SALE AGREEMENT (this "Agreement") is made and entered into by and between WIRE WAY, LLC, a Texas limited liability company ("Seller"), and RCI HOLDINGS, INC., a Texas corporation ("Purchaser"), pursuant to the terms and conditions set forth herein.

QUESTION: What if any other information might you want to include in this preamble?

§ 188.1.4 Exercise: Title and preamble (consulting agreement)

The provision below comes from an agreement form used by a company in the oil and gas business:

Consulting Services Agreement

> This Consulting Services Contract (the "Agreement") dated [omitted] is entered into by and between [omitted], a Delaware corporation, *and its affiliate companies* (collectively "Company") and [omitted], a Texas corporation ("Consultant"), sometimes referred to herein individually as a "Party" or collectively as "Parties". This Agreement shall be effective on the earlier of the date that the services commence or the date that both Parties have executed the Agreement (the "Effective Date"). This agreement is entered into solely between the Company and Consultant, and no third party beneficiaries are created, except as expressly otherwise provided herein. *[Emphasis added.]*

QUESTIONS FOR CLASS DISCUSSION:

What if any other information might you want to include in the preamble?

Any thoughts about "and its affiliate companies"?

At the end of the first sentence, is the period where it should be for U.S. usage?

§ 188.1.5 Long paragraphs: From the SEC Plain English Handbook

From the SEC's Plain English Handbook (at 30):

> NLR Insured Mortgage Association, Inc., a Delaware corporation ("NLR MAE"), which is an actively managed, infinite life, New York Stock Exchange-listed real estate investment trust ("REIT"), and PAL Liquidating REIT, Inc., a newly formed, finite life, self-liquidating Delaware corporation which intends to qualify as a REIT ("PAL Liquidating REIT"), hereby jointly offer, upon the terms and subject to the conditions set forth herein and in the related Letters of Transmittal (collectively, the "Offer"), to exchange (i) shares of NLR MAE's Common Stock, par value $.01 per share ("NLR MAE Shares"), or, at the option of Unitholders, shares of PAL Liquidating REIT's Common Stock, par value $.01 per share ("PAL Liquidating REIT Shares"), and (ii) the right to receive cash payable 60

> days after closing on the first of any Acquisitions (as defined below) but in no event later than 270 days (nine months) following consummation of the Offer (the "Deferred Cash Payment"), for all outstanding Limited Partnership Interests and Depository Units of Limited Partnership Interest (collectively, "Units") in each of PAL Insured Mortgage Investors, a California limited partnership ("PAL 84"), PAL Insured Mortgage Investors - Series 85, A California Limited Partnership, a California limited partnership ("PAL 85"), and PAL Insured Mortgage Investors L.P. - Series 86, a Delaware limited partnership ("PAL 86").

EXERCISE: Rewrite this into shorter sentences and paragraphs. Don't change the substance of the provisions.

§ 188.1.6 Streamlining the sentence: The team meeting

In your small groups, discuss how to trim out the "fat" from the following sentence:—

> The team held a meeting to give consideration to the quarterback issue.

§ 188.1.7 Drafting problems with a contract (1)

From a contract drafted by The Other Side of a deal *(sanitized)*:

> Within thirty (60) days of the close of previous quarter term, ABC shall provide XYZ with a revenue report that provides a total amount of Data Revenue and Software Revenue obtained by ABC during the referenced quarter term, minus any associated costs or expenses and customer returns or refunds ("Revenue Report").

QUESTIONS:

Any drafting problems with this?

Ignoring the substance, how might this be otherwise improved to make it more readable?

ANSWERS: (DCT to show his version)

§ 188.1.8 Shareholder information

Consider the following sentence — discuss in your groups:

> We will provide appropriate information to the company's shareholders.

§ 188.1.9 "Flow" exercise: Carbolic acid and Queen Victoria

From this NPR piece:

> [Joseph] Lister was the closest surgeon to [Queen Victoria's] residence in Scotland, Fitzharris says, so she directed Lister to come drain a large abscess growing under her armpit. *Before the surgery, Lister's assistant sprayed carbolic acid with a machine Lister invented called the donkey engine all over the operation area,* sterilizing it but also accidentally spraying the queen in the face.

QUESTION: How could the italicized text be rewritten to "flow" better? (Hint: Consider rewriting it so that it would sound more-natural if read aloud — which isn't bad advice for any writing.)

§ 188.1.10 Exercise: Prior board approval

How could the following be streamlined?

> There is the possibility of prior Board approval of these investments.

§ 188.1.11 Grammar fail: Homosexuality and the Texas GOP's platform (2016)

From the Texas GOP platform of 2016:

> Homosexuality is a chosen behavior that is contrary to the fundamental unchanging truths that **has** been ordained by God in the Bible, recognized by our nations founders, **and shared by the majority of Texans**.

See, e.g., the NPR story.

§ 188.1.12 Redrafting the recitals (Rick's Cabaret)

The provision below, at https://goo.gl/DRbLRw (edgar.sec.gov), is from a 2008 real-estate purchase agreement involving the parent company of "gentleman's club" Rick's Cabaret:

You're to redraft the "Whereas" clauses below (from an actual contract). First, some background about the transaction and the contract:

Wire Way LLC owned land and a building, in Dallas, that was home to an "adult entertainment club" (that is to say, a strip club) known as "Platinum Club II."

The club was apparently operated by another company, North by East Entertainment, Ltd.; it's not clear what relationship existed between North by East and Wire Way LLC, the owner of the land and building.

Rick's Cabaret wanted to buy out the club; under the agreement, it would do so with a semi-complicated transaction:

In a related transaction, North by East (the operator of the club) would sell the assets of the club business to RCI Entertainment (Northwest Highway) Inc. ("RCI Entertainment"), which was *[and is]* a subsidiary of Rick's Cabaret International ("Rick's") *[now named RCI Hospitality Holdings Inc.]*;

In another related transaction, Wire Way LLC would lease the land and building to RCI Entertainment; and

In the agreement we're studying now, Wire Way LLC would sell the land and building to RCI Holdings, Inc., which also was *[and is]* a subsidiary of Rick's.

IN-CLASS ASSIGNMENT: Rewrite the "Whereas" provisions below as a "Background" section **in plain English**. Tell the story — not *too* informally, but not in a stilted, legalese-y manner either.

WHEREAS, Seller is the owner of a certain real property consisting of approximately 4.637± acres of land, together with all rights, (excepting for mineral rights as set forth below), title and interests of Seller in and to any and all improvements and appurtenances exclusively belonging or pertaining thereto (the "Property") located at 10557 Wire Way, Dallas (the "City"), Dallas County, Texas, which Property is more particularly described on Exhibit A attached hereto and incorporated herein by reference; and

WHEREAS, contemporaneously with the execution of this Agreement, North by East Entertainment, Ltd., a Texas limited partnership ("North by East"), is entering into an agreement with RCI Entertainment (Northwest Highway), Inc., a Texas corporation ("RCI Entertainment"), a wholly owned subsidiary of Rick's Cabaret International, Inc., a Texas corporation ("Rick's") for the sale and purchase of the assets of the business more commonly known as "Platinum Club II" that operates from and at the Property ("Asset Purchase Agreement"); and

WHEREAS, subject to and simultaneously with the closing of the Asset Purchase Agreement, Seller will enter into a lease with RCI Entertainment, as Tenant, for the Property, dated to be effective as of the closing date, as defined in the Asset Purchase Agreement (the "Lease") attached hereto as Exhibit B and incorporated herein by reference; and

WHEREAS, subject to the closing of the Asset Purchase Agreement, the execution and acceptance by Seller of the Lease, and pursuant to the terms and provisions contained herein, Seller desires to sell and convey to Purchaser and Purchaser desires to purchase the Property.

NOW, THEREFORE, for and in consideration of the premises and mutual covenants and conditions contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

§ 188.1.13 **Yahoo-Verizon real-estate reps and warranties**

In class, we'll rewrite section 2.15(a) of the Verizon-Yahoo stock purchase agreement; this is a set of reps and warranties about real estate. *We won't do any more than subdivision (a).*

DCT's version follows. NOTE: I numbered the paragraphs as "(a1)" etc., for easier back-and-forth comparison with the original. A better way would have been (a), (b), etc. — or, perhaps even better still, as (1), (2), etc.

§ 188.1.14 2.15 Real Property

(a1) Except as provided below, the term "**Lease**" refers to a material lease (or a material sublease*) under which Seller —* to the extent related to the Business — or any of the Business Subsidiaries leases or subleases real property (the "**Leased Real Property**").

[Alternative: "Except as provided below, the term "**Lease**" refers to a material lease (or a material sublease*) under which real property (the "**Leased Real Property**") is leased or subleased* by Seller —* to the extent related to the Business — or any of the Business Subsidiaries."

(a2) The term "Lease" does not include leases or subleases for data centers.

(a3) The term "**Default**" refers to (i) a default under a contract or other obligation; and/or* (ii) the occurrence of one or more conditions or events that, after notice or the lapse of time or both, would constitute such a default.

(a4) The "**Material Default**" refers to any Default **other than** one or more Defaults that, individually or in the aggregate, would not reasonably be expected to have a Business Material Adverse Effect.

(a5) Each Lease is in full force and effect.

(a6) Seller or the applicable Business Subsidiary (each, a "**Seller Tenant**") has good and valid leasehold title in each parcel of the Leased Real Property pursuant to the relevant Lease or Leases.

(a7) Each Seller Tenant's leasehold title* is free and clear of all Encumbrances other than Permitted Encumbrances, except in each case where such failure would not, individually or in the aggregate, reasonably be expected to have a Business Material Adverse Effect.

(a8) There are no Material Defaults by Seller, nor by any Business Subsidiary, under any Lease.

(a9) To the Knowledge of Seller,* there are no Material Defaults, under any Lease,* by any other party to that Lease.

(b1) Seller and/or* the Business Subsidiaries have good and marketable title to all of the real property owned in fee by Seller (to the extent related to the Business) or any of the Business Subsidiaries (the "Owned Real Property").

(b2) Each real-property title referred to in subdivision (b)(1) is free and clear of any Encumbrances other than Permitted Encumbrances.

(b3) There are no leases, licenses or occupancy agreements pursuant to which any third party is granted the right to use the Owned Real Property.

(b4) There are no outstanding options or rights of first refusal to purchase the Owned Real Property, except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Business Material Adverse Effect.

(b5) Neither Seller nor any of the Business Subsidiaries has received written notice of any default,* under any restrictive covenants affecting the Owned Real Property and the Leased Real Property, that remains uncured.

(b6) No event has occurred that, after notice or the lapse of time or both, would constitute a default referred to in subdivision (b5), except, in each case, as would not, individually or in the aggregate, reasonably be expected to have a Business Material Adverse Effect.

(c1) Section 2.15(c) of the Disclosure Schedules contains a complete and correct list of[:] ~~the~~(i) [the] Owned Real Property[;] and (ii) [the] Leases.

(c2) Seller has made available to Purchaser a true, correct* and complete copy of each Lease with respect thereto* (including all material amendments, modifications and supplements thereto).

§ 188.1.15 BLUF exercise: Doctor practice bylaws

EXERCISE: Break up the following provision — and put the bottom line up front (BLUF) — from Lynd v. Marshall County Pediatrics, P.C., 263 So.3d 1041, 1044-45 (Ala. 2018):

> If any shareholder of the corporation for any reason ceases to be duly licensed to practice medicine in the state of Alabama, accepts employment that, pursuant to law, places restrictions or limitations upon his continued rendering of professional services as a physician, or upon the death or adjudication of incompetency of a stockholder or upon the severance of a stockholder as an officer, agent, or employee of the corporation, or in the event any shareholder of the corporation, without first obtaining the written consent of all other shareholders of the corporation shall become a shareholder or an officer, director, agent or employee of another professional service corporation authorized to practice medicine in the State of Alabama, or if any shareholder makes an assignment for the

> benefit of creditors, or files a voluntary petition in bankruptcy or becomes the subject of an involuntary petition in bankruptcy, or attempts to sell, transfer, hypothecate, or pledge any shares of this corporation to any person or in any manner prohibited by law or by the By-Laws of the corporation or if any lien of any kind is imposed upon the shares of any shareholder and such lien is not removed within thirty days after its imposition, or upon the occurrence, with respect to a shareholder, of any other event hereafter provided for by amendment to the Certificates of Incorporation or these By-Laws, then and in any such event, the shares of this [c]orporation of such shareholder shall then and thereafter have no voting rights of any kind, and shall not be entitled to any dividend or rights to purchase shares of any kind which may be declared thereafter by the corporation and shall be forthwith transferred, sold, and purchased or redeemed pursuant to the agreement of the stockholders in [e]ffect at the time of such occurrence. The initial agreement of the stockholders is attached hereto and incorporated herein by reference[;] however, said agreement may from time to time be changed or amended by the stockholders without amendment of these By-Laws. The method provided in said agreement for the valuation of the shares of a deceased, retired or bankrupt stockholder shall be in lieu of the provisions of Title 10, Chapter 4, Section 228 of the Code of Alabama of 1975.

DCT's first pass: (to show on his computer)

§ 188.1.16 Rewriting exercise: Assignment provision, etc.

The provision below comes from an agreement form used by a company in the oil and gas business:

> **16. Consultant's Engagement Team** - Consultant shall not, without the prior written consent of Company, engage any subcontractor for performance of the Services or assign any rights arising under this Agreement, including but not limited to assignment of monies payable under this Agreement. In the event Company consents to the assignment of this Agreement

> or Consultant's use of a subcontractor, Consultant shall continue to be responsible for all obligations and liabilities under this Agreement. For a period of one (1) year from the date that a Consultant employee or subcontractor stops providing services to the Company under this agreement, neither the Company nor its affiliates or subsidiaries shall hire or solicit said individual without paying to Consultant a fee equal to the annual salary or annualized subcontractor revenue of such individual. The restrictions on solicitation or hiring set forth in this Section will not apply to any employee or subcontractor whose Consultant employment is terminated prior to solicitation by the Company, its affiliates or subsidiaries.

EXERCISE: Break up this provision.

QUESTION: If you were representing *Consultant*, what portions of this section (if any) might concern you?

§ 188.1.17 Rewriting exercise: Indemnity provision

FACTS: 1) You represent Seller, which is selling equipment to Buyer, which in turn is engaging Contractor to do some work (think: drilling an oil well) that is being financed by multiple Lenders. ¶ 2) Buyer wants Seller to sign a sales contract that contains the following indemnity language:

> 10.1. General Indemnity. Seller shall INDEMNIFY, DEFEND, RELEASE AND HOLD HARMLESS Buyer (and its affiliates, co-owners, co-venturers, and partners), its respective shareholders, officers, directors, administrators, managers, employees, servants and agents, successors and assigns, Contractor and Lenders (each, a "Buyer Indemnified Party") from and against any and all damages (whether ordinary, direct, indirect, incidental, special, consequential, or exemplary), judgments, liabilities, fines, penalties, losses, obligations, settlements, claims, actions, demands, suits, costs and expenses (including, without limitation, reasonable attorneys' fees, court, mediation and arbitration costs, and other costs of investigation or defense) (collectively, "Losses") directly or indirectly arising from or relating to this Agreement (or any

> breach hereof by Seller), the Services (if any), or any Equipment or other personal property (whether rented, sold or incorporated) delivered or made available by Seller hereunder, including, without limitation, any such Losses arising from or relating to (a) the breach or violation of any applicable laws by Seller (or any of Seller's subcontractors of any tier, or any of its or their employees, agents, consultants or representatives ("Seller's Contractor Group")), (b) any alleged infringement or violation of a third party's patent, trade secret, copyright, trademark or intellectual property right, or (c) the negligence, willful misconduct or other breach or violation of this Agreement by Seller or any of Seller's Contractor Group, REGARDLESS OF WHETHER ANY SUCH LOSSES ARE ATTRIBUTABLE (IN WHOLE OR IN PART) TO THE SOLE, JOINT OR CONCURRENT NEGLIGENCE (WHETHER ACTIVE, PASSIVE, SIMPLE OR GROSS NEGLIGENCE), STRICT LIABILITY OR ANY OTHER LEGAL FAULT OR RESPONSIBILITY OF BUYER, SELLER OR ANY OTHER PERSON, OR IMPERFECTION OF ANY MATERIALS; PROVIDED, HOWEVER, THAT SELLER SHALL NOT BE LIABLE FOR THE INDEMINFICATION OBLIGATIONS SET FORTH HEREIN FOR CLAIMS CAUSED BY THE SOLE NEGLIGENCE OR WILLFUL MISCONDUCT OF THE BUYER INDEMNIFIED PARTY.

EXERCISE:

Break up this provision.

In your groups, discuss:

- what you might advise Seller about the possible risks of agreeing to this provision;
- what if any changes you might ask Buyer to agree to; and
- how Seller might arrange its business affairs to support this provision if "forced" to agree to it.

§ 188.1.18 Drafting exercise: Assignment provision

The following comes from a software-development agreement in an arbitration case that I once heard (as the arbitrator):

> 9.7 Assignment. No Party may sell, transfer, assign, assume or subcontract any right nor obligation set forth in this Agreement by contract, operation of law or otherwise, except as expressly provided herein, without the prior written consent of the other Party; provided, however, upon providing the other Party written notice, any Party may without the consent of the other Party: (a) (i) assign any or all of its rights and interests hereunder to one or more of its Affiliates or (ii) designate one or more of its Affiliates to perform its obligations hereunder, in each case, so long as the assigning Party is not relieved of any liability hereunder and so long as any such Affiliate remains such Party's Affiliate; provided, however, that such Affiliate assignee(s) provide the other Party with written acknowledgement of and agreement to the assigning Party's obligations under the Agreement that were assigned to it; or (b) assign or transfer this Agreement as a whole to any Person that succeeds to all or substantially all of the business or assets of such Party related to the subject matter of this Agreement.

EXERCISE: Break this up into shorter, one-subject paragraphs.

§ 188.1.19 Grammar fail: Professor Goodenough's prospects

From the Houston Chronicle:

> Feeling behind in school wasn't new for Goodenough when he started his physics Ph.D. at the University of Chicago. As a child, his dyslexia went undiagnosed. But it still stung when, *after serving in World War II, an administrator told him* he wouldn't make it as a physicist because he had started too late. He was in his 20s.

QUESTION (discuss in your groups): What's wrong with the italicized portion?

§ 188.2 Ambiguity exercises

§ 188.2.1 Ambiguity exercise: Success

From a Facebook posting: "A man's success has a lot to do with the kind of woman he chooses to have in his life. (Pass this on to all great women.)"

QUESTION: What's a different interpretation of this quote?

§ 188.2.2 Ambiguity exercise: An elephant takes a selfie?

From this tweet: "Man trampled to death by elephant trying to take a SELFIE"

EXERCISE: Rewrite.

§ 188.2.3 Ambiguity and traffic signs

See this sign.

§ 188.2.4 Ambiguity exercise: Success

From a Facebook posting: "A man's success has a lot to do with the kind of woman he chooses to have in his life. (Pass this on to all great women.)"

QUESTION: What's a different interpretation of this quote?

§ 188.2.5 Ambiguity exercise: Lola, by The Kinks

From The Kinks' famous song Lola (YouTube):

Well I'm not the world's most masculine man
But I know what I am and I'm glad I'm a man
And so is Lohhh-lahhh
Lo lo lo lo Lohhh-lahhh. Lo lo lo lo Lohhh-lahhhh

(Emphasis added.)

QUESTION: When the artists sing, "And so is Lola," *what* exactly is Lola?

EXERCISE: In your small groups, discuss how this could be clarified (don't worry about rhyme or meter).

§ 188.2.6 Ambiguity exercise: Plush carpets

From Martin Parker, Why we should bulldoze the business school, The Guardian, Apr. 27, 2018 (https://perma.cc/F5N6-46RE):

> There will be plush lecture theatres with thick carpet, perhaps named after companies or personal donors.

QUESTION: *What*, exactly, is named after companies or personal donors?

QUESTION: How could this sentence be rewritten to clarify it?

§ 188.2.7 Ambiguity exercise: Hillary's email server

SOURCE: A Politico piece titled FBI could leak Clinton email investigation, Grassley warns.

TEXT: "A hypothetical leak could occur, he said, if officials believed Clinton was *not being prosecuted for political reasons*." (Emphasis added.)

EXERCISE: There are two possible meanings of the italicized portion of the above sentence.

Go to your small group's the virtual whiteboard (6:00 p.m. section | 7:30 p.m. section).

Each student is to rewrite the sentence **twice**, once for each meaning, to make that meaning clear. (Don't put your names on the rewrites; see #4 below.)

Then, within your small groups, critique your rewrites.

Finally, the whole class will briefly look at each small group's rewrites.

§ 188.2.8 Exercise: Shall, will, must, etc.

QUESTION: Which of the following does Professor Toedt think is *not* a good choice:

A. Bob will pay Alice $1,000 no later than December 24.
B. Bob shall pay Alice $1,000 no later than December 24.

C. Bob must pay Alice $1,000 no later than December 24.
D. Bob is to pay Alice $1,000 no later than December 24.[20]

§ 188.2.9 Ambiguity: Pricing term extension

FACTS: (1) A supply contract between Provider and Customer includes a price schedule that is to be effective for one year, expiring December 1 (the "Pricing Term"), but Customer can extend the Pricing Term once, for one more year. (2) The extension provision says: *Written notice of extension of the Pricing Term must be given no later than 30 days before its then-current expiration date*. The contract does not contain any other relevant notice provision. (3) On October 31, Customer mails Provider a written notice of extension by certified mail, return receipt requested. A week later, Customer receives back the "green card" from the U.S. Postal Service confirming receipt by Provider on November 2. (4) Provider later tells Customer that the Pricing Term expired and that Provider's prices will increase to Provider's published list prices.

QUESTION: Has Customer effectively extended the Pricing Term? Why or why not?[21]

A:

Exercise: Rewrite the Pricing Term extension provision to clarify it.[22] *(The same issues can come up with terms such as, for example,* submit *for bids — is a bid "submitted" when sent, or when received?)*

§ 188.2.10 Ambiguity: Vacating the premises

CLAUSE: Tenant will completely vacate the Premises no later than 12 midnight on December 15, 20x0; Tenant's failure to do so will be a material breach of this Agreement.

EXERCISE: Rewrite this to make it clear that if Tenant remains on the premises at 10:00 a.m. on December 15, it will be in breach.

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[20] B (but do it the way your supervising attorney wants).

[21] Arguably not; it depends on whether notice is "given" when *mailed* or when *received*.

[22] The extension provision could be rewritten to say, e.g., *To extend the Pricing Term, Customer must give Provider written notice of extension, which must be effective no later than 30 days before its then-current expiration date.*

§ 188.2.11 Ambiguity: Rodney Dangerfield

Here's the "Quotation of the day" from the NY Times morning-briefing email of August 2, 2017:

"His mother convinced him to open a savings account one summer so he could save up for a football uniform. Then she stole his money." *— Joan Dangerfield, the widow of the comedian Rodney Dangerfield, who was honored with a plaque in Kew Gardens, Queens, 13 years after his death. His childhood in the neighborhood prepared him for a lifetime of getting no respect.*

QUESTION: Who was honored — Joan Dangerfield, or Rodney?

EXERCISE: Rewrite the sentence that begins, "Joan Dangerfield" to clarify it.

§ 188.2.12 Ambiguity: From the "Mutts" comic strip

See the strip of July 13, 2017.

EXERCISE: Rewrite.

§ 188.2.13 Ambiguity: From the "B.C." comic strip

See the strip of July 17, 2017.

EXERCISE: Rewrite.

§ 188.2.14 Ambiguity and a trademark license termination clause

From General Nutrition Investment Co. v. Holland & Barrett Int'l Ltd (Rev 1) [2017] EWHC 746 (Ch), ¶ 15:

5.2 The Licensor may terminate this Agreement *[sic]* immediately by notice in writing if:

(a) The Licensee *[i]* materially breaches this Agreement or any other member with the H&B Group commits an act which would amount to a material breach of this Agreement or *[ii]* (without prejudice to the Licensor's other rights to terminate under this Agreement) otherwise infringes the Licensor's rights under the Trade Marks *[iii]* to an extent likely to cause material lost to the Licensor; or ...

(Bracketed romanettes added; hat tip: IP Draughts.)

QUESTION 1: Does the materiality qualifier in clause iii apply to both clause i and clause ii or just to clause ii? EXERCISE: Rewrite to clarify.

QUESTION 2: Why does this quotation include "*[sic]*" after "terminate this Agreement"?

§ 188.2.15 Ambiguity and progressive resistance to President Trump

TEXT: "The temptation for progressives to resist pushing their own concrete policy agenda is compelling, especially since **doing so** gives the other side ammunition for criticism …." (From Joel Berg, It's Policy, Stupid — Why progressives need real solutions to real problems, Washington Monthly, Apr. 10, 2017.) QUESTION: In the quotation, the bold-faced "doing so" refers to what, exactly — *pushing* a policy agenda, or *resisting* pushing an agenda? EXERCISE: Rewrite to clarify.

§ 188.2.16 Ambiguity and Fukushima

TEXT – from the New York Times: "… Carl Pillitteri, who was working as a field engineer on the Fukushima Daiichi nuclear generating station in Japan when a devastating earthquake and tsunami hit the island in 2011, resulting in the worst nuclear disaster since Chernobyl; it left some 18,490 people dead or missing …."

QUESTION: What left some 18,490 people dead or missing — the earthquake, the tsunami, or the nuclear disaster? EXERCISE: Rewrite to clarify.

§ 188.2.17 Ambiguity from President Trump

From a presidential tweet of April 3, 2017: "Such amazing reporting on unmasking and the crooked scheme against us by @foxandfriends. …" (Hat tip: Chris Richardson.)

§ 188.2.18 Ambiguity and lawyer ethics rules

TEXT: This was the title of an article in the April 2017 ABA Journal: "Lawyers should tread carefully before quitting a troublesome client to comply with ethics rules"

QUESTION: What action should lawyers take to comply with ethics rules? A) Quitting a troublesome client. B) Treading carefully before quitting a troublesome client.

QUESTION: How could this be rewritten to make it clear that the intended meaning is B) above?

§ 188.2.19 Ambiguity and traffic signs

See this sign (and this one).

§ 188.2.20 Ambiguity and Vladimir Putin

TEXT: "WASHINGTON (AP) – A Russian billionaire close to President Vladimir Putin said Tuesday he is willing to take part in U.S. congressional hearings to discuss his past business relationship with President Donald Trump's former campaign chairman, Paul Manafort." (AP.com)

QUESTIONS: 1) Who exactly is willing to take part in U.S. congressional hearings? 2) How could this be clarified?

§ 188.2.21 Ambiguity and the $10 million [missing] comma

TEXT: From O'Connor v. Oakhurst Dairy, No. 16-1901 (Mar. 13, 2017) (reversing grant of partial summary judgment to Oakhurst):

"Specifically, Exemption F *[of Maine's overtime law]* states that **the protection of the overtime law does not apply** to: ¶ The canning, processing, preserving, freezing, drying, marketing, storing, **packing for shipment or distribution of:** ¶ (1) Agricultural produce; ¶ (2) Meat and fish products; and ¶ (3) Perishable foods." *Id.*, slip op. at 4 (emphasis added, paragraphing and indentations omitted).

"We conclude, however, that **Exemption F is ambiguous, even after we take account** of the relevant interpretive aids and the law's purpose and legislative history. For that reason, we conclude that, under Maine law, we must construe the exemption in the narrow manner that the drivers favor, as doing so furthers the overtime law's remedial purposes." *Id.* at 7-8.

(The opinion goes on for 20 more pages elaborating on the reasoning that's summarized in the above excerpts.)

This reinforces the need for drafters to try to spot these issues—and write around them—on the front end, so as to avoid having these awkward and expensive conversations later.

§ 188.2.22 Ambiguity in "if applicable" parentheticals

TEXT: Except as provided in sections 5 and 6 (if applicable) ...

QUESTION: Does that imply that neither of sections 5 and 6 might be applicable – that is, that both of them might be not-applicable?

EXERCISE: Rewrite so that it's clear that only section 6 might not be applicable.

§ 188.2.23 Ambiguity and the New York City nuns

From Matt A.V. Chaban, Down to One Resident in 15,600 Square Feet, a Missionary Sisterhood's Home Is for Sale (NYTimes.com June 2016):

The Missionary Sisters of the Immaculate Heart of Mary **was established in New York** almost by accident. **It was founded in 1897** by Mother Marie Louise De Meester, **who was visiting during World War I** *[???]* following a missionary trip to St. Croix. During her stay, she realized a residence in the city might not only ease the order's work in the Western Hemisphere, but also improve recruitment.

EXERCISE: Rewrite the second and third sentences so as not to suggest that World War I was going on in 1897.

§ 188.2.24 Ambiguity and Jewish grandmothers

From Joshua Rothman in The New Yorker: "My grandmother is ninety-three and, **to my knowledge**, has never kept kosher."

QUESTION: What are two plausible intepretations of the bold-faced phrase?

EXERCISE: Rewrite to clarify.

§ 188.2.25 Ambiguity exercise: Iron fish

From Philippa Roxby, Why an iron fish can make you stronger (BBC.com 2015): "... participants started using water from wells after a few months, because of drought, which was contaminated by arsenic."

QUESTION: What exactly was contaminated by arsenic?

EXERCISE: Rewrite to clarify.

§ 188.2.26 Ambiguity exercise: Litigation threats

TEXT: No litigation against Borrower is pending or threatened to Borrower's knowledge.

QUESTION 1: What are two possible meanings?

QUESTION 2: How might a court resolve the ambiguity? (Hint: Consider the contra proferentem principle.)

EXERCISE: Rewrite to clarify.

§ 188.2.27 Ambiguity exercise: Restricted trust funds

TEXT: The Trust may donate funds only to charitable and educational institutions.

QUESTION: May the Trust donate funds to an institution that is charitable but not educational? How about vice versa?

EXERCISE: Rewrite to clarify.

§ 188.2.28 Ambiguity examples: Prostitutes and the Pope

Prostitutes appeal to Pope

I can't tell you how much I enjoyed meeting your husband.

§ 188.2.29 Ambiguity exercise: A gift to a married couple

TEXT: I will give you and your husband $1 million.

QUESTION: How much total will the couple get — $1 million, or $2 million?

EXERCISE: Rewrite to clarify.

§ 188.2.30 Ambiguity exercise: The electric chair

TEXT: The judge sentenced the killer to die in the electric chair for the second time.

EXERCISE: Rewrite to clarify.

§ 188.2.31 Ambiguity exercise: Bid deadline

TEXT: Bids may be submitted until March 1.

EXERCISE: Rewrite to clarify

§ 188.2.32 Ambiguity and the Midnight Hour

TEXT: "Tenant will vacate the Premises no later than 12 midnight on December 15, 2020; Tenant's failure to do so will be a material breach of this Agreement."

FACTS: At 10:00 a.m. on December 15, Tenant is still occupying the Premises.

QUESTION: Is Tenant in material breach?

EXERCISE: Rewrite.

§ 188.2.33 Ambiguity and Early Retirement

TEXT: From this headline: "Houston Technology Center CEO To Retire Early Next Year" (He'll retire Feb. 1, 2017 after serving for ten years.)

QUESTION: Will the CEO retire, and the retirement will take place early next year? Or will he retire next year, which will be earlier than had been expected?

EXERCISE: Rewrite to clarify

§ 188.2.34 Ambiguity and Olivia Pope

TEXT: "Wait for me to do *what I do best*." (Spoken by Kerry Washington as Olivia Pope in an episode of *Scandal* aired April 7, 2016.)

QUESTION: What are the two possible meanings of this sentence?

EXERCISE: Rewrite the line of dialogue to be clear which version you think Olivia meant — and try to make it sound "natural" and not lawyer-like.

§ 188.2.35 Ambiguity and IRS Form 1099

TEXT: "*As we tend to receive the most questions related to Form 1099-MISC*, we would like to provide you with some general guidelines and resources in order to assist you with the accurate and timely filing of Form 1099-MISC." (From Christie A. Gricius, CPA, Client Alert: 1099-MISC Reporting Guidelines (Jan. 2016) (emphasis added).)

QUESTION: What are the two possible meanings of the italicized text?

EXERCISE: Rewrite the italicized portion **twice**, once for each meaning.

§ 188.2.36 Ambiguity: Report of Rubio's concession speech

TEXT: A tweet by Vox.com's Ezra Klein: If the upshot of this speech is "and I'll support the guy who did all these terrible things I'm talking about in the general [election]"...

QUESTION: When "the guy" did "all the terrible things": (i) in the general election, or (ii) in some other context?

EXERCISE: Rewrite.

§ 188.2.37 Ambiguity: Arenas awash in pleasure

TEXT: From a Maureen Dowd column in the NY Times, March 5, 2016: "Like Bill Clinton, Trump talks and talks to crowds. They feed his narcissism, and in turn, *he creates an intimacy even in an arena that leaves both sides awash in pleasure*." (Emphasis added.)

DISCUSSION: The italicized part of this quotation arguably has two meanings: Both sides are left awash in pleasure by —

An arena.

The intimacy that Trump creates even in an arena.

EXERCISE: Rewrite the italicized portion of the Dowd quote to be clear that she intended the second meaning.

§ 188.2.38 Ambiguity and Obama's veto

TEXT: From the Washington Post: "The House GOP effort to override Obama's veto of a bill to repeal Obamacare and defund Planned Parenthood failed to get two-thirds, as expected."

ASSIGNMENT: Rewrite this to eliminate the ambiguity in the "as expected" part.

§ 188.2.39 Ambiguity: Inept phonies in politics

TEXT: From a Maureen Dowd column in the NY Times, March 5, 2016: "Trump was right about Romney. *When you lose a race that you should have won by being an inept phony*, you can't call this year's front-runner an inept phony." (Emphasis added.)

COMMENT: The italicized part of this quotation arguably has two meanings:

Romney could have won the 2012 presidential race *by being* an inept phony (says Dowd).

Romney lost the 2012 presidential race *because he was* an inept phony (ditto).

EXERCISE: Rewrite the italicized portion of the Dowd quote to be clear that she intended the second meaning. *Extra points*:* Keep something of the same rhythm or structure to the sentence.

§ 188.2.40 Ambiguity: Overseas trips

TEXT — from a parent's letter of recommendation for a prospective Eagle Scout: "We've taken a number of family trips, *including trips to China, the Netherlands, and Italy this past year.*"

Rewrite to be clear that only the trip to Italy was in the previous year.

Rewrite to be clear that all trips were taken in the previous year.

§ 188.2.41 Ambiguity at the rodeo

From Joey Guerra, Chris Young in fine voice at RodeoHouston, *Houston Chronicle*, Mar. 3, 2016, p. A8: "Nothing was ever too brash or too loud."

QUESTION: Did the writer think that Chris Young was, or wasn't, brash and loud?

§ 188.2.42 Ambiguity in the (White Sox) Clubhouse

From Ken Hoffman's column in the Houston Chronicle, March 22, 2016, p. D2, col. 1:

> White Sox management announced this week that the LaRoche matter was closed — and the right decision was made by all parties involved.

QUESTION: Was Hoffman —

- *reporting that* the right decision was made, or
- *opining that* the right decision was made?

§ 188.2.43 Ambiguity: Less and less people

From Mark Kleiman, The Current Crime Debate Isn't Doing Hillary Justice (WashingtonMonthly.com Feb. 2016):

> When the prison population is small, it consists mostly of serious, high-rate offenders, because prosecutors and judges try to single them out. Therefore, when the population grows, it grows mostly by adding **less and less dangerous people.**

(Emphasis added.)

QUESTIONS:

Is the bold-faced portion ambiguous? If so, what are the two (or more) possible meanings?

Would "fewer and fewer dangerous people" be a better fit here?

Might hyphens be useful here? (See the *Grammarist* notes on phrasal adjectives.)

Could the bold-faced portion be improved? If so, revise it.

§ 188.2.44 Ambiguity: Book of Common Prayer (in class only)

From the Book of Common Prayer (1979) of the Episcopal Church, pp. 361, 377 (Eucharistic Prayer A with the Proper Preface for Lent):

> It is right, and a good and joyful thing, always and everywhere to give thanks to you, Father Almighty, Creator of heaven and earth. Through Jesus Christ our Lord; who was tempted in every way as we are, yet did not sin ....

QUESTION: Ignoring the theology and christology, to what does the phrase "Through Jesus Christ our Lord" refer to:
(A) The people giving thanks through Jesus; or
(B) the Father Almighty creating heaven and earth through Jesus?

ASSIGNMENT: In the chat room, Revise the second sentence so that the passage refers clearly to Choice A above. *(Hint: Adding three words to the beginning would be one way to do it.)*

§ 188.2.45 Ambiguity: Medical report

"The young man had involuntary seminal fluid emission when he engaged in foreplay for several weeks." From an example given by Steven Pinker, The Sense of Style: The Thinking Person's Guide to Writing in the 21st Century (2014).

§ 188.2.46 Ambiguity and the want ads

"Wanted: Man to take care of cow that does not smoke or drink." From an example given by Steven Pinker, The Sense of Style: The Thinking Person's Guide to Writing in the 21st Century (2014).

§ 188.2.47 Ambiguity exercise: The job recommendation

TEXT: "I enthusiastically recommend this candidate with no qualifications whatsoever." From an example given by Steven Pinker, The Sense of Style: The Thinking Person's Guide to Writing in the 21st Century (2014).

§ 188.2.48 Ambiguity exercise: Superman and Wonder Woman

From a tweet by SCOTX justice Don Willett: "My heroes are my parents, Superman and Wonder Woman."

EXERCISE: Rewrite twice – once for each meaning.

§ 188.2.49 Ambiguity exercise: Merle Haggard in Same-Sex Marriage?

Rewrite to eliminate the ambiguity:

> Among those interviewed were his two ex-wives, Kris Kristofferson and Robert Duvall.

(In http://nielsenhayden.com/makinglight/archives/012652.html and quoted in https://en.wikipedia.org/wiki/Serial_comma#Unresolved_ambiguity)

§ 188.2.50 Ambiguity exercise: Sex and the Supreme Pontiff

Rewrite this headline to eliminate the ambiguity:

> Prostitutes Appeal to Pope

(Adapted from http://grammar.about.com/od/terms/g/ambiguity.htm)

§ 188.2.51 Ambiguity exercise: What to bring?

State at least two three possibilities for what the writer below will bring to a party:

> I'll bring wine or beer and dessert.

(Adapted from http://www.literarydevices.com/ambiguity)

§ 188.2.52 Ambiguity exercise: Quack quack?

Rewrite to eliminate the ambiguity:

> I saw her duck.

(Adapted from http://literarydevices.net/ambiguity/)

§ 188.2.53 Ambiguity exercise: Dog bite

Use *one character* to eliminate the ambiguity:

> Passerby helps dog bite victim.

(Adapted from http://literarydevices.net/ambiguity)

§ 188.2.54 Ambiguity exercise: Umbrella strikes

Rewrite this headline to eliminate the ambiguity:

> She hit the man with an umbrella.

(Adapted from http://literarydevices.net/ambiguity)

§ 188.2.55 Ambiguity exercise: Going to Oregon

Consider the following sentence:

> The family went to Oregon with Betty, a maid,
> and a cook.

Rewrite the sentence (consider using parentheses and dashes, too) to be clear that the family went to Oregon with: • one person • two persons • three persons. (Adapted from https://en.wikipedia.org/wiki/Serial_comma#Unresolved_ambiguity)

§ 188.2.56 Ambiguity exercise: The Affordable Care Act

TEXT: (Adapted from a comment by a guest on the first hour of the Diane Rehm Show, Apr. 12, 2016): Before the Affordable Care Act, "if you had a pre-existing condition such as breast cancer, you could not be covered."

QUESTION: Does this mean that before the ACA, if you had a pre-existing condition insurance carriers: (A) were *not permitted* to offer coverage, or (B) might *choose to deny* coverage?

EXERCISE: Rewrite to make it clear that the intended meaning was (B).

§ 188.2.57 Ambiguity exercise: Meow

Rewrite to eliminate the ambiguity: "He gave her cat food."

(Adapted from http://literarydevices.net/ambiguity)

§ 188.2.58 Ambiguity exercise: Texas Democrats

TEXT: "[In the 1930s, some] of Texas's wealthiest families could not abide the new breed of Texas Democrats who found hope in the New Deal and wanted the federal government to do even more." (Adapted from Mary Beth Rogers, *Turning Texas Blue – What It Will Take to Break the GOP Grip on America's Reddest State*, at 49 (New York: St. Martin's Press 2016))

QUESTION: Who wanted the federal government to do more — (A) the new breed of Texas Democrats, or (B) some of Texas's wealthiest families?

EXERCISE: Rewrite to make it clear that the intended meaning was (A).

NOTE: This sentence correctly uses "Texas's" as the possessive, with the s-apostrophe-s and not merely s-apostrophe. (A generally recognized exception to this rule is the possessive of Jesus of Nazareth, e.g., *the centurions divided Jesus' robe among them*.)

§ 188.2.59 Ambiguity exercise: NCAA Finals

REWRITE: "They reached the tournament finals for the seventh time this year."

§ 188.2.60 Ambiguity exercise: Louis C.K.

This example is from a NY Times piece about how streaming-TV episodes are getting too long, but noting how exceptions exist, such as Louis C.K.'s *Horace and Pete*:

> Its third episode — essentially *a long* dramatic monologue about infidelity by Laurie Metcalf — is 43 minutes of regret and catharsis, the camera holding tight to Ms. Metcalf's face. I did not look at my watch once.

The italicized portion has two possible meanings:

1. a long dramatic monologue *about Laurie Metcalf's infidelity*; and

2. a long dramatic monologue, *about infidelity*, *by Laurie Metcalf*. [Note the commas.]

In case #2, it'd be simpler just to rearrange the sentence, thusly: "a long dramatic monologue by Laurie Metcalf about infidelity."

§ 188.2.61 Ambiguity exercise: The daughter of Poseidon

Heard on The Ezra Klein Show, a podcast on Vox.com, when he interviewed his Vox co-founder Melissa Bell: she said, "*I was raised by the ocean in San Diego*." Klein immediately responded: "*I had a privileged upbringing: Poseidon was my father … I control the waves*."

EXERCISE: Rewrite to eliminate the ambiguity.

§ 188.2.62 Ambiguity exercise: The burglars and the bystander

From the Houston Chronicle, Aug. 22, 2016 "*Police apprehended two men accused of burglarizing two homes on the North Side with the help of a civilian who chased them Monday afternoon.*"

QUESTION: Did the citizen *help* the police, or the burglars?

QUESTION: Did the citizen *chase* the burglars, or the police?

EXERCISE: Rewrite to clarify.

§ 188.2.63 Ambiguity exercise: Making babies

From a spring-2016 student: Mice Breeding Chinese Scientists Say Making Babies in Space Is Possible (Inverse.com). The student's comment: "TL;DR: Hyphens are important, yo."

§ 188.2.64 Ambiguity exercise: SCOTUS and a sexual-crimes statute

FACTS:

A federal criminal statute requires a 10-year mandatory sentence enhancement in certain cases where the defendant had previously been convicted of crimes "*relating to aggravated sexual abuse, sexual abuse, or abusive sexual conduct involving a minor or ward*."

A convicted defendant argues that the qualifier, "involving a minor or ward," applies not just to the third-listed item (abusive sexual conduct), but also to the first two (aggravated sexual abuse and (plain?) sexual abuse).

The Supreme Court disagrees. *See* Lockhart v. United States, No. 14-8358 (U.S. March 1, 2016) (affirming Second Circuit and rejecting Eighth Circuit's contrary view).

EXERCISE: Tweak the italicized statutory language to reduce the chances of a circuit split. *[Notice that I didn't say "eliminate" the ambiguity – one doesn't want to overpromise ....]*

§ 188.2.65 Ambiguity exercise: Milk, eggs, and computer programmers

Check out this Facebook picture. The salient sentence is: "Honey, please go to the market and buy 1 [sic] bottle of milk. If they have eggs, bring 6 [sic]."

EXERCISE: Rewrite the second sentence to clarify the intended meaning.

§ 188.2.66 Ambiguity in the obituaries

From an obituary (paraphrased): "Doris is survived by her loving husband Mark of 15 years."

QUESTION: Were Doris and Mark married for 20 years? Or is Mark 15 years old? How could this be clarified?

COMMA QUESTION: Is it possible that Doris had more than one husband? How could this be clarified?

§ 188.2.67 Ambiguities and vagueness 1

St. Arnold's will ship 1,000 cases of Lawnmower to Labatt's in Ontario for $5 per case.

St. Arnold's will ship 1,000 cases of beer to Labatt's in Ontario for $5 per case.

I can't tell you how much I enjoyed meeting your husband.

§ 188.2.68 Ambiguities and vagueness 2

No litigation against Borrower is pending or threatened to Borrower's knowledge.

The Trust may donate funds only to charitable and educational institutions.

§ 188.2.69 Ambiguities and vagueness 3

I will give you and your husband $1 million.

The judge sentenced the killer to die in the electric chair for the second time.

§ 188.2.70 Ambiguity in deadlines

EXERCISE: Rewrite the following to eliminate the ambiguities:

> Bids may be submitted until March 1.
>
> The lease expires at 12:00 a.m. on March 1.

§ 188.2.71 Ambiguity and lawyer spin

TEXT: From this comment (by a brilliant lawyer) in an on-line forum: "A classic lawyering tactic is to use the most favorable (to your side) characterization of something you can justify."

EXERCISE: Rewrite this to make it clear that the term "you can justify" applies to *characterization* and not to *something*.

§ 188.2.72 Ambiguity and Memorial Day

TEXT: From Hillary Clinton's foreign-policy speech, June 2, 2016: "We honor the sacrifice of **those who died for our country in many ways** – by living our values, by making this a stronger and fairer nation, and by carrying out a smart and principled foreign policy.

EXERCISE: Rewrite.

§ 188.2.73 Ambiguity and the Midnight Hour

TEXT: "Tenant will vacate the Premises no later than 12 midnight on December 15, 2020; Tenant's failure to do so will be a material breach of this Agreement."

FACTS: At 10:00 a.m. on December 15, Tenant is still occupying the Premises.

QUESTION: Is Tenant in material breach?

EXERCISE: Rewrite.

§ 188.2.74 Ambiguity in an obituary

From the obituary of Inez Neill Winton, who died at age 97, in the Houston Chronicle, Sept. 26, 2018, at B8.

> In early 1942, when American's *[sic]* of Japanese ancestry were taken from their homes and relocated to internment camps, Inez went to the camp at Amache, Colorado to teach the children and open a library. *She still received Christmas cards from several of the children she taught well into the 1960s* including two who fought in the 442nd Infantry Regiment Brigade *[sic]*.

QUESTION: What are two possible interpretations of the italicized portion? How could this be rewritten to clarify?

QUESTION: What is the ambiguity in the "From the obituary of ..." sentence above? How could it be fixed?

§ 188.2.75 Ambiguity: Dear Abby and a name change

From Dear Abby, Sept. 24, 2018:

> DEAR ABBY: My mom owns two successful women's clothing stores near my hometown that she's had for more than 10 years. The problem is, she named them after me, and *I hate it!* [Emphasis added.]

QUESTION: *What*, exactly, does Angry Daughter hate?

§ 188.2.76 Ambiguity: Mortgage-backed securities

TEXT: From David Dayen, Trump's Regulators Want to Kill a Key Financial Rule That Even Republicans Support, (newrepublic.com Jan. 23, 2018):

> ... the [banks' financial] assets are counted differently according to the risk they hold. This can prove disastrous if the "low-risk" assets are actually

dangerous—as *mortgage-backed securities were considered to be* during the housing bubble.

QUESTION: What exactly were mortgage-backed securities considered to be during the housing bubble — were they considered dangerous, or were they considered low-risk?

QUESTION: How could this problem be fixed?

§ 188.3 "Flashcards"

§ 188.3.1 When the effective date is to be different

QUESTION: According to Professor Toedt, in most circumstances, the best way to state the effective date of a contract that is different from the date(s) that the contract is signed is:

A. In the preamble: "This Agreement is entered into on [DATE]."

B. In the preamble: "This Agreement is entered into on the latest date signed as written in the signature blocks below, to be effective as of [DATE]."

C: In the preamble: "This Agreement is entered into on [DATE]."

D. None of the above.[23]

§ 188.3.2 Affiliates as parties

FACTS:

Your client ABC Inc. has asked you to review a contract drafted by XYZ Corporation.

The preamble of the contract states that the parties are (i) ABC Inc. and (ii) XYZ Corporation and its Affiliates.

In the definitions section, the contract defines the term Affiliate.

[23] B. It's best for an agreement to accurately state the specific dates that the agreement is signed by the different parties—although as seen in this example, the effective date can always be defined as the last-date-signed as handwritten in the signature blocks.

TRUE OR FALSE: This contract structure is unobjectionable.[24]

§ 188.3.3 Affiliates placing orders

FACTS: (1) Customer Corporation negotiates a master purchase agreement with Vendor Inc. The agreement specifies the pricing that Vendor will honor, during the agreement term, for Customer's orders for particular goods and/or services.

2. Customer wants its various "Affiliates" (defined in the agreement) to be able to place orders at the specified pricing.

QUESTION: To accommodate Customer's desire, which of the following would be the best drafting approach?

A. In the preamble, recite that the parties are "(i) Vendor Inc. … and (ii) Customer Corporation … and its Affiliates (defined below)."

B. In the preamble, recite that the parties are Vendor Inc. and Customer Corporation, but state in the body of the agreement that Customer's Affiliates are entitled to place orders at the agreed pricing.

C: Both of the above.

D. Neither of the above.[25]

§ 188.3.4 Agreement date: The best way

QUESTION: According to Professor Toedt, in most circumstances, the best way to state the date of a contract is:

A. In the preamble: "This Agreement is entered into on [DATE]."

B. In the preamble: "This Agreement is entered into on the latest date signed as written in the signature blocks below."

C: In or just before the signature blocks: "Date: [DATE]."

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[24] False. For a variety of reasons, affiliates of a signatory party normally should not be listed as parties themselves unless (i) their rights and obligations are clearly spelled out, and (ii) they also sign the agreement.

[25] B

D. None of the above.[26]

§ 188.3.5 Two-way vs. one-way NDAs

FACTS:

1. Your client Alice has been asked to sign a confidentiality agreement ("NDA") that was prepared by Bob ("The Other Side").

2. Neither Alice nor you have any past history with Bob.

3. The NDA's terms apply equally to the confidential information of both Alice and Bob, not just to the confidential information of only one party or the other.

4. Alice is in a hurry and asks if it's OK to just sign the NDA, given point 3 above.

TRUE OR FALSE: You can probably go ahead and tell Alice "yes, it's OK to sign this."[27]

§ 188.3.6 Injunctive relief: Stipulation of irreparable harm

FACTS: A draft NDA, prepared by the disclosing party, includes a injunctive-relief provision that states that if the receiving party breaches the NDA, then the disclosing party will be irreparably harmed and will be entitled to injunctive relief. You are reviewing the draft NDA for your client, which will be the receiving party.

TRUE OR FALSE: In these circumstances, there's probably no need to try to revise or delete this provision.[28]

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[26] B. This option reduces the chances of the parties' either leaving the date blank or failing to update the date to reflect the actual date of signature.

[27] False. Just because a contract treats both sides equally does not mean that the contract doesn't favor the party that drafted the contract, which almost certainly knew which role it would play in the contractual relationship.

[28] False. A receiving party that agreed to this would stipulate away a major element of the disclosing party's burden of proof in a lawsuit.

§ 188.3.7 Injunctive relief: Bond-waiver request

FACTS: A draft NDA, prepared by the disclosing party, includes a injunctive-relief provision that states that the receiving party waives any requirement for the posting of a bond as a prerequisite to the granting of injunctive relief. You are reviewing the draft NDA for your client, which will be the receiving party.

TRUE OR FALSE: In these circumstances, it'd be worthwhile to try to revise or delete this provision.[29]

§ 188.3.8 What constitutes a warranty

TRUE OR FALSE: A contract provision can amount to a warranty even if the provision doesn't use the word warranty.[30]

§ 188.3.9 Must a warranty specify a remedy?

FACTS: A contract states that "Alice warrants that the car is in good condition," but it is otherwise silent about what will happen if the car isn't in good condition.

TRUE OR FALSE: This contract provision isn't really a warranty because it doesn't specify a remedy if the warranty were to be breached.[31]

§ 188.3.10 Notices by regular mail

FACTS: Alice and Bob are entering into a contract, being drafted by Bob's lawyers. The "Notices" provision in the draft contract states: "Any notice required or permitted by this Agreement will be effective three days after

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[29] True. Suppose that (i) a receiving party were to agree to this; (ii) the disclosing party accused the receiving party of breach and was able to get a preliminary injunction; (iii) it turned out that the receiving party didn't breach after all; (iv) the preliminary injunction caused significant harm to the receiving party; but (v) the disclosing party-plaintiff didn't have money to pay a damage award for wrongful injunction. In that case, the receiving party might be stuck bearing the costs of the wrongful injunction.

[30] True. See UCC § 2-313(2) (which applies only to the sale of goods).

[31] False. The standard remedies for breach of warranty are normally those specified by law, generally damages. Within limits, though, the parties can (i) agree on specific 'Plan B' remedies, and (ii) exclude other remedies.

being deposited in the U.S. Mail in a sealed envelope that has first-class postage affixed and is addressed to the notified party's address for notice as stated in this Agreement."

TRUE OR FALSE: In these circumstances, it'd be worthwhile to try to revise or delete this provision.[32]

§ 188.3.11 Notarizing a document for recordation

FACTS:

1. The other side's lawyer has drafted a real-estate-related document for her client to sign and deliver to your client, which will then want you to have the document filed for recording in the deed records of a Texas county.

2. The notary certificate after the signature line reads: "Sworn and subscribed to before me, the undersigned authority," with a blank line for the notary to fill in the date.

TRUE OR FALSE: In these circumstances, it'd be worthwhile to try to revise or delete this provision.[33]

§ 188.3.12 Material breach — "takesies"?

FACTS:

1. A contract states that breach of a certain obligation will be considered a "material" breach that will allow the other party to terminate the contract by notice.

2. The obligated party breaches the obligation, whereupon the other party duly terminates the contract and sues for damages.

3. In court, the obligated party admits its breach, but it claims that the breach wasn't material and so the other party shouldn't have terminated the contract.

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[32] True. Mail can go astray — in business-to-business contracts, notices should be by certified mail, overnight delivery, or other means that can provide proof of receipt.

[33] True. The quoted language in the text would be for a jurat, whereas recordation of the document will normally require an acknowledgment.

TRUE OR FALSE: The breaching party might have a very difficult time persuading a court that the breach wasn't material.[34]

§ 188.3.13 A breach that that isn't designated as "material"

FACTS: Alice and Bob are negotiating a contract. One provision in the draft contract obligates Alice to take Action A, but it doesn't state that Alice's obligation is "material."

TRUE OR FALSE: In a lawsuit arising out of the contract, Bob could still try to prove that Alice's obligation to take Action A was in fact "material" and thus that her failure to take Action A constituted a "material breach."[35]

§ 188.3.14 Strategy for non-warranting parties

TRUE OR FALSE: IF: You're drafting a contract for your client Alice; AND: As part of the deal, Bob is to warrant something to Alice; THEN: You'll normally want to use the phrase "Bob represents and warrants," instead of just "Bob represents."[36]

Answer:

§ 188.3.15 Representations: Language

FACTS: Alice wants to sell her car to Bob. Bob wants the contract to include a representation by Alice that the car has no significant defects.

QUESTION: In most circumstances, which language below for the representation would Alice prefer?

---

[34] True. The material-breach statement referred to in the facts might have the same effect as an acknowledgement.

[35] True. Materiality can generally be proved up with parol evidence, so the lack of an acknowledgment of materiality in the contract itself shouldn't be fatal to Bob's materiality case, but such an acknowledgment *would* save some billable time for Bob's trial counsel.

[36] True. A party that will benefit from another party's warranty will pretty much always want to ask for both a representation and a warranty.

A. Alice represents that, so far as she is aware, without any particular investigation, the car has no significant defects.

B. Alice represents that, to her knowledge, the car has no significant defects.[37]

§ 188.3.16 Time is of the essence: Injunctive relief?

FACTS:

1. Alice and Bob enter into a contract that requires Bob to deliver 1 million widgets (a generic product available from a wide variety of vendors) to Alice for a stated price at a specified time. The contract also states that time is of the essence for the delivery.

2. Bob fails to deliver the widgets on time and tells Alice he just can't do it.

3. Alice duly files suit against Bob, in a court having jurisdiction, and moves for a preliminary injunction ordering Bob to deliver the widgets.

TRUE OR FALSE: Even if Alice can prove up irreparable harm and a balance of the equities in her favor, the court is unlikely to grant Alice's motion.[38]

§ 188.3.17 Termination of Agreement: What's left?

FACTS: You are reviewing a contract (the "Agreement") that contains a section on termination of the Agreement.

QUESTION: You should consider whether the Agreement should also include a | an [BLANK] provision to keep alive any provisions that your client might want to continue in effect even after termination of the Agreement, such as (for example) choice of forum, disclaimers of implied warranties, and limitations of liability.[39]

---

[37] A. If Alice were to make a no-significant-defects representation "to her knowledge," then later on an aggressive trial counsel for Bob might try to argue that Alice had implicitly represented that she was in fact knowledgeable about the car's condition.

[38] True. Only in special circumstances will a court grant anything resembling injunctive relief on a contract claim, on the theory that normally such claims can be adequately remedied by an award of monetary damages.

[39] Survival.

§ 188.3.18 Employment agreement salary amount

QUESTION: In an employment agreement for an executive, the exective's annual salary is preferably stated as follows:

A. $X per year.

B. A rate of $X per year.

C. Something else.[40]

§ 188.3.19 Interest at 5%

FACTS:

1. You're reviewing a draft contract for a client, Alice. The contract was drafted by Bob's lawyer. Alice is in a hurry to get the contract signed.

2. Among other things, the contract requires Alice to pay Bob for consulting services, with interest on past-due amounts at 5% until paid.

TRUE OR FALSE: In these circumstances, it'd be worthwhile to try to revise or delete this provision.[41]

§ 188.3.20 Dry-erase pens

FACTS:

1. Alice sends Bob — both in Texas — a purchase order for dry-erase pens; the purchase order states in part that Alice has all rights and remedies available by law in case of any defect in the pens.

2. Bob doesn't sign the purchase order, but he returns a confirmation of the order, which says in part that all implied warranties are disclaimed, including the implied warranties of merchantability and fitness for particular purpose.

---

[40] B. Stating the salary as an annual RATE makes it less likely that the executive could claim he or she was owed an entire year's salary for working only part of a year.

[41] True. Some points to consider: 1. Alice should be consulted about this to get her sign-off. 2. The provision is ambiguous as to the interest rate: is it per-year or per-month? If the latter, it's likely to be usurious in many jurisdictions. 3. Given that Bob drafted the contract, chances are it'd be interpreted against him under *contra proferentem*, and also to construe the contract so that it's *not* usurious.

3. Bob ships what are supposedly dry-erase pens, together with an invoice; Alice timely pays the invoice.

4. Shortly thereafter, Alice discovers that the pens have been mislabeled and are actually permanent markers that ruin Alice's expensive whiteboard.

5. Alice sues Bob for breach of the implied warranty of merchantability.

6. Bob moves to dismiss, citing the implied-warranty disclaimer in his order confirmation.

QUESTION: How will the court likely rule on Bob's motion?

A. Granted, because under the last-shot rule, Bob's order confirmation knocked out Alice's purchase-order terms.

B. Denied, because both parties are "merchants" and Alice sent the first document.

C: Denied, because the conflicting terms in the parties' documents will drop out under the "knock-out rule."

D. Something else.[42]

§ 188.3.21 **Negotiation in good faith**

FACTS:

1. Alice and Bob, both living and working in the U.S., are negotiating a contract. They've agreed on all the major terms, but they can't quite reach agreement on the interest rate that is to be charged on past-due payments. They decide to "kick the can down the road" by stating in the contract that, starting 90 days later, each party will negotiate in good faith to attempt to reach agreement on the interest rate.

2. When the 90-day period is over, Bob contacts Alice to reopen negotiations about the interest rate, but Alice adamantly refuses even to discuss the matter, even after Bob threatens her with a lawsuit.

[42] C. There's a conflict between (i) the disclaimer of implied warranties in Bob's order-confirmation document , and (ii) the all-rights-and-remedies language in Alice's purchase order. Bob's disclaimer will therefore drop out — but Alice's all-rights-and-remedies language will stay because it simply states the law.

TRUE OR FALSE: Bob can recover his foreseeable, non-speculative damages resulting from Alice's breach of her agreement to negotiate in good faith.[43]

§ 188.3.22 Agreements to agree

TRUE OR FALSE: In the U.S., an agreement to agree on something in the future will generally be enforceable.[44]

§ 188.3.23 Letters of intent

QUESTION: In the U.S., which portions of a signed letter of intent ("LOI") will be binding — if any?

A. None

B. Only those provisions that the LOI clearly specifies are binding

C: Possibly the entire LOI if the LOI does not clearly state otherwise

D. Something else.[45]

§ 188.3.24 Conditions precedent

QUESTION: [BLANK] is a colloquial, one-word synonym for "condition precedent":[46]

[43] True. In the U.S., *an agreement to negotiate in good faith* is generally enforceable — although breach might be tricky to prove. (Contrast this with *an agreement to agree*, which in the U.S. will generally *not* be enforceable.)

[44] False. (Contrast this with an agreement to negotiate in good faith, which in the U.S. will indeed generally be enforceable.)

[45] **C.** The parties might also bind themselves by their post-LOI actions, as the jury found in the *Energy Transfer Partners v. Enterprise Product Partners* case (later reversed by an intermediate appellate court).

[46] Prerequisite**.**

§ 188.3.25 Conditions subsequent

QUESTION: [BLANK] is a colloquial, one-word synonym for "condition subsequent":[47]

§ 188.3.26 Conspicuousness options

QUESTION: In the eyes of a court, for a long contract provision, which of the following might NOT suffice to satisfy a legal requirement that the provision be "conspicuous"?

A. The provision is rendered in all-caps.

B. The entire contract is only one page long, the provision is in bold-faced type, and the provision is relatively short.

C: The parties' lawyers negotiated the provision in question.[48]

§ 188.3.27 Indemnity financial support

FACTS: Alice is hiring Bob to do some work in her factory. Her draft of the contract requires Bob to indemnify Alice for any harm that might occur to any of his employees while at Alice's factory.

FILL IN THE BLANK: Alice should also consider inserting a [BLANK] provision requiring Bob to enter into and maintain this type of ancillary contract to make sure there is a pot of money available in case it's needed to support Bob's indemnity obligation.[49]

§ 188.3.28 It's late, it's late, it's late, but not too late (RIP Freddie Mercury)

FACTS:

1. It's Wednesday, Sept. 9, 2019. Your client Alice emails you the (unprotected) Word document of a draft contract that has been prepared by Bob's lawyer. Alice says that on Wednesday, Sept. 2, she and Bob agreed

[47] Exception (or, escape clause).

[48] A. At least one judge has warned that all-caps might not be enough for conspicuousness if the provision in question is buried in a sea of all-caps.

[49] Insurance.

to the major "deal points" in the draft contract. She has looked over the draft and is satisfied that those deal points are accurately set forth, but she's not sure about certain other provisions in the draft contract. She asks if she and Bob can meet in your office late this afternoon to sign the contract.

2. The signature blocks of the contract include the term, "Date: Sept. 2, 2019"; otherwise, you see no changes worth holding up the deal for.

QUESTION: Which of the following actions would you recommend to Alice as the MOST sensible for you to take to get the contract signed TODAY?

A. Contact Bob's lawyer and ask that he change the date-signed term and resend the Word document to you.

B. Open the Word document; change the date-signed term to Sept. 9; print out hard copies for signature; and email Bob's lawyer to advise that you changed the date-signed term.

C: Print out hard copies of Bob's Word document and make a pen-and-ink change to the date-signed term, then have Alice and Bob each initial and date the change.

D. Have Alice sign the document with the Sept. 2 date-signed term. [50]

§ 188.3.29 Baby, it's you: Most favored customer

FACTS:

1. You represent Alice, a product vendor. Alice is negotiating a long-term sales agreement with Bob, a large customer—think, Tilman Fertitta in the TV show "Billion Dollar Buyer."

2. Bob's draft of the sales agreement includes a provision that: (i) represents and warrants that Alice has not given any other customer any better terms than those of the draft sales agreement, and (ii) requires Alice (x) to report to Bob any future deals in which she gives another customer better terms and (y) to give Bob, on a going-forward basis, the benefit of those better terms.

[50] B. Any of these options would work in a pinch, but the question was which one would be the *most* sensible.

TRUE OR FALSE: In these circumstances, there's probably no need to try to revise or delete this provision.[51]

§ 188.3.30 When is reasonable reliance a required element of proof?

FACTS: Alice bought $1 million of widgets from Bob. She is suing him for breach of warranty and for misrepresentation because he allegedly statements about the widgets that allegedly turned out not to be true.

QUESTION: Of the following causes of action, which (if any) require Alice to prove that she reasonably relied on Bob's alleged statements?

A. Breach of warranty.

B. Misrepresentation.

C: Both A and B.

D. Neither A nor B.[52]

§ 188.3.31 Notice timing

Adapted from language in an actual contract: "Seller will notify Buyer at least 30 (THIRTY) days before the effective date of any price increase."

TRUE OR FALSE: This is an acceptable drafting style.[53]

§ 188.3.32 Who is a merchant?

TRUE OR FALSE: Under the Uniform Commercial Code, both buyers and sellers can be "merchants."[54]

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[51] False. Most-favored-customer clauses can be both burdensome and dangerous.

[52] B.

[53] False. Use just the digits — and, incidentally, it's really unusual to put the words in parentheses.

[54] True.

§ 188.3.33 Attorney malpractice insurance: What type?

QUESTION: Attorney malpractice insurance is an example of a type of coverage that, in the business-insurance context, is normally referred to by this name:

A. Client liability coverage

B. Professional liability coverage

C: Commercial General Liability coverage

D. Umbrella coverage[55]

§ 188.3.34 Indemnitor reliability

FACTS: You represent Alice and are drafting a contract that she and Bob will enter into. The contract is to include an obligation for Bob to defend and indemnify Alice against certain third-party claims.

FILL IN THE BLANK: should also consider including, in the contract, a requirement that Bob acquire and maintain [BLANK] to increase the chances that enough money will be available to pay for Alice's defense and indemnity.[56]

§ 188.3.35 Indemnity: You expect me to cover THAT?

QUESTION: Under the law in Texas (and some other places), if a contract provision requires Alice to indemnify Bob against the consequences of Bob's own negligence, that provision must be each of these two things or it will be unenforceable:[57]

[55] B. Professional liability coverage is sometimes referred to as Errors and Omissions, or "E&O."

[56] Insurance.

[57] Express and conspicuous.

§ 188.3.36 Amending a contract by substituting new text

QUESTION: An agreement can be amended by setting out the entire agreement anew, as modified; this is referred to as a|an [BLANK] agreement.[58]

§ 188.3.37 Employment offer letters: Binding?

TRUE OR FALSE: A company's offer letter to a prospective employee could become a binding contract, depending on how the letter was worded.[59]

§ 188.3.38 Employment offer letters: Bad form?

TRUE OR FALSE: Most lawyers prefer to draft *employment* agreements in the form of a conventional-style contract; such lawyers regard letter agreements as being somewhat "bad form."[60]

§ 188.3.39 Employment offer letters: Specific requirements?

QUESTION: In most U.S. jurisdictions, a contract drafted in the form of a letter agreement will be binding only if it meets certain specific requirements that don't apply to conventional-style contracts.[61]

§ 188.3.40 Letter agreements

QUESTION: A contract could be drafted in the form of a signed letter from one party to the other, to be countersigned by the other party.[62]

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[58] Amended and restated.

[59] True.

[60] False; for example, the Sheryl Sandberg employment agreement is drafted in the form of a letter agreement.

[61] False.

[62] True.

§ 188.3.41 **Material breach – calling it out**

QUESTION: For a contract provision to be considered "material," the contract normally must so state.[63]

§ 188.3.42 **"Acknowledge" language in a contract**

FACTS: A contract between Alice and Bob states that Alice "acknowledges" Bob's Assertion X.

QUESTION: In court, Alice might not be allowed to contest Assertion X.[64]

§ 188.3.43 **Notarizing: Two types**

QUESTION: Name the two basic forms of "notarizing" a document in the U.S.[65]

§ 188.3.44 **Notarizing an affidavit**

QUESTION: An affidavit to be used in court will normally require an acknowledgement certificate signed by a notary public or other authorized officer.[66]

§ 188.3.45 **Notary self-help**

QUESTION: A notary public ordinarily is allowed to "notarize" a document in which he or she is also the signer of the document.[67]

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[63] False.

[64] True.

[65] Acknowledgment and jurat. (Someday it might be important to know the difference between the two.)

[66] False. An affidavit would normally require a jurat, not an acknowledgement.

[67] False. Certainly in Texas and probably in other jurisdictions, a notary public is not allowed to notarize anything in which the notary has an interest.

§ 188.3.46 **Contract signature by outside counsel?**

QUESTION: Professor Toedt thinks it would normally be OK for outside counsel to sign contracts on behalf of a client.[68]

§ 188.3.47 **Limited partnership signature by general partner?**

QUESTION: A general partner of a limited partnership has actual authority to sign a contract on behalf of the limited partnership. [69]

§ 188.3.48 **Limited partnership signature by limited partner?**

QUESTION: A limited partner of a limited partnership, acting in that capacity, has actual authority to sign a contract on behalf of the limited partnership. [70]

§ 188.3.49 **Limited partnership signature through power of attorney?**

QUESTION: An individual of legal age who holds a written power of attorney from a limited partnership, authorizing that individual to sign a specific contract (or contracts generally) on behalf of the limited partnership, has actual authority to bind the limited partnership to that contract.[71]

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[68] False. In a dispute about the contract, the signers will often be deposed, and an outside counsel won't want to have that happen — not least because it might preclude her and her firm from representing the client in the dispute, which might really displease the client and open the door for the replacement counsel to take over even more work from the client.

[69] True.

[70] False. Not only does the limited partner not have authority to bind the limited partnership: signing the contract could be evidence that the limited partner was in fact functioning as a general partner by being involved in the management of the limited partnership.

[71] True.

§ 188.3.50 Limited partnership signature by all limited partners?

QUESTION: A power of attorney, giving someone the authority to sign a contract on behalf of a limited partnership, can be signed by all of the limited partners in lieu of being signed by a general partner.[72]

§ 188.3.51 Limited partnership officers

QUESTION: Under Texas law, a limited partnership can have one or more officers, who might have at least apparent authority to bind the limited partnership to a contract.[73]

§ 188.3.52 Limited partner as limited-partnership officer

QUESTION: An officer of a limited partnership who also owns a limited-partnership interest in the limited partnership can sign a contract on behalf of the limited partnership.[74]

§ 188.3.53 Contract signature by inside counsel

QUESTION: Professor Toedt thinks it would normally be OK for an in-house counsel in a company's legal department to sign a contract on behalf of another department in the company.[75]

§ 188.3.54 Reps and warranties: Synonyms?

QUESTION: The terms warranty and representation are basically synonyms.[76]

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[72] False.

[73] True.

[74] True. The officer will want to be explicitly clear, in his or her title in the signature block, that he or she is signing as an officer and NOT as a limited partner.

[75] False. This might well be OK for legal department contracts such as Westlaw- or Lexis-Nexis subscriptions, but for company-politics purposes, an in-house counsel will want someone from the appropriate department to be the signer for that department's contracts.

[76] False. The two terms are somewhat similar but can have very distinct proof requirements and legal consequences.

§ 188.3.55 **Strategy for warranting parties**

FACTS: You're drafting a contract for your client Alice; AND: As part of the deal, Alice is to warrant something to Bob.

TRUE OR FALSE: You'll normally want to use the phrase, "Alice represents and warrants," instead of just, "Alice represents."[77]

§ 188.3.56 **Warranties: *Ipsissimis verbis*?**

QUESTION: A contract provision can have the same legal effect as a warranty even if the provision doesn't use the word warranty.[78]

§ 188.3.57 **Passive voice problem**

QUESTION: An apartment lease agreement states (in part): "The apartment shall be regularly serviced by a professional pest-control service." This is an example of a | an [TWO WORDS] (not "passive voice"):[79]

§ 188.3.58 **Employment agreement salary frequency**

FACTS: You're drafting an employment agreement for a salaried employee. The parties have agreed on the starting salary, and you've been instructed to put that starting salary into the agreement.

QUESTION: You'll want to state that the salary will be paid:

A. Monthly

B. Biweekly

C: Per the company's standard payroll procedures[80]

---

[77] False. A party being asked to warrant something will pretty much always want to consider carefully, on a case-by-case basis, whether to represent it or to warrant it.

[78] True. See UCC § 2-313(2).

[79] : False imperative

[80] C. The company won't want to have to make special arrangements to pay just one employee; that would be burdensome and might result in extra expense.

§ 188.3.59 **Employment duration**

QUESTION: In nearly all U.S. jurisdictions — unless the employer and employee agree otherwise, or a statute provides otherwise — an employee's employment by a company will be:

A. at will

B. month-to-month[81]

§ 188.3.60 **You get what you ...**

QUESTION: You get what you [BLANK], not what you expect.[82]

§ 188.3.61 **Do, or do not; there is no try**

QUESTION: This category of contract provision is a promise or commitment to do something, or possibly not to do something.[83]

§ 188.3.62 **If I'm wrong about this ....**

QUESTION: This category of contract provision is a promise to pay the other party's damages (or take other specified action) if a statement about a past-, present-, or future fact proves incorrect.[84]

§ 188.3.63 **Hold harmless means what?**

QUESTION: In most U.S. jurisdictions "hold harmless" is treated as a synonym for this type of contract term.[85]

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[81] A.

[82] INspect.

[83] Covenant

[84] Warranty

[85] Indemnify or indemnity

§ 188.3.64 **Background section displaces this**

QUESTION: This archaic introductory section of a contract has been replaced, in modern drafting, by the "Background" section.[86]

§ 188.3.65 **Maybe you can be one of us ....**

QUESTION: This three-word phrase can be used to cause an external document to be treated as part of a contract.[87]

§ 188.3.66 **Attorney fees in Texas: Who d'ya gotta be?**

QUESTION: Under Texas law, when a plaintiff successfully asserts a contract claim against a defendant, if the plaintiff wishes to recover its attorney fees under Tex. Civ. Prac. & Rem. Code sec. 38.001, the defendant must be a[n] [BLANK] or a[n] [BLANK].[88]

§ 188.3.67 **Attorney fees: The American Rule**

QUESTION: Under the so-called "American rule," this party can recover its attorney fees if it prevails in contract-related litigation if the contract does not say otherwise:[89]

§ 188.3.68 **Covenant, or condition, or something else?**

QUESTION: Other things being equal: If a contract provision could be construed as either a covenant or a condition, a U.S. court will normally prefer to construe the provision:

A. As a covenant

B. As a condition

---

[86] Whereas clauses.

[87] Incorporate by reference

[88] Individual or corporation

[89] Neither party.

C: No preference between covenant and condition—whichever is supported by the parol evidence[90]

§ 188.3.69 Contract interpretation: Evidence

QUESTION: Testimony and documents concerning the parties' course of dealing, offered in court to support a party's preferred interpretation of a contract provision, would be considered [BLANK] evidence.[91]

§ 188.3.70 Parol evidence: When is it relevant?

QUESTION: In the U.S., courts generally will look to parol evidence to interpret a contract provision only if the provision is [BLANK]:[92]

§ 188.3.71 Arising out of vs. relating to

QUESTION: Which version of this forum-selection language would be the broadest?

A. Any litigation arising out of this Agreement is to be brought in Houston, Texas.

B. Any litigation arising out or relating to this Agreement is to be brought in Houston, Texas.

C: Any litigation arising out of or relating to this Agreement or any transaction or relationship resulting from it is to be brought in Houston, Texas.[93]

§ 188.3.72 Termination upon bankruptcy

FACTS: On behalf of your client Alice, you are reviewing a draft contract prepared by the attorney representing Bob. The draft includes the following

[90] A

[91] Parol

[92] Ambiguous

[93] C

provision: "Bob may terminate this Agreement if Alice files for protection under the bankruptcy laws."

QUESTION: This provision will generally not be enforceable in the United States.[94]

§ 188.3.73 Mediation of disputes – binding?

QUESTION: Unless the parties agree otherwise, mediation is normally binding.[95]

§ 188.3.74 Arbitration of disputes – binding?

QUESTION: Unless the parties agree otherwise, arbitration is normally binding.[96]

§ 188.3.75 Mnemonic: A.T.A.R.I.

QUESTION: What does Professor Toedt mean by "A.T.A.R.I."?[97]

§ 188.3.76 Mnemonic: R.O.O.F.

QUESTION: What does Professor Toedt mean by "R.O.O.F."?[98]

§ 188.3.77 Mnemonic: W.I.D.D.

QUESTION: What does Professor Toedt mean by "W.I.D.D."?[99]

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[94] True. A bankruptcy court might allow Bob to terminate the agreement, but normally such "ipso facto clauses" are unenforceable under U.S. bankruptcy law.

[95] False. Contrast this with arbitration, which normally is binding unless the parties agree otherwise.

[96] True. Contrast this with meditaion, which normally is not binding unless the parties agree otherwise.

[97] Avoid The Argument — Rewrite It!

[98] Root Out Opportunities for F...ups

[99] When In Doubt, Define!

§ 188.3.78 **An unrestricted right to unilaterally amend**

QUESTION: If a contract provision gives Alice the right to unilaterally amend the contract but does not put certain limits on that right, then the entire contract might be unenforceable because it is "ill" in this way:[100]

§ 188.3.79 **Can liability for fraud be disclaimed?**

QUESTION: An entire-agreement provision, by itself, won't preclude an aggrieved party from claiming misrepresentation unless the entire-agreement provision includes a disclaimer of this:[101]

§ 188.3.80 **Specifying the location for litigation**

QUESTION: A drafter whose client didn't have superior bargaining power might not want to include this type of provision, stating where any litigation may (or must) take place:[102]

§ 188.3.81 **Promises to reimburse**

QUESTION: This type of contract provision is a promise to reimburse a person for any harm the person might suffer from a stated event.[103]

§ 188.3.82 **Limitation of liability**

QUESTION: If a drafter had his or her "thinking cap" on, he or she could draft this type of limitation of liability (A) as "one size fits all," or (B) as separate limitations for different categories of events.[104]

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[100] Illusory.

[101] Reliance

[102] Forum selection

[103] Indemnity obligation

[104] Damages cap

§ 188.3.83 Excluded damages: Cover charges

QUESTION: In some vendors' contract forms, the list of excluded damages will sometimes include (that is, exclude) this category of damages, of which one of the examples in UCC art. 2-715 is "commercially reasonable charges, expenses or commissions in connection with effecting cover ...."[105]

§ 188.3.84 Representations in time

QUESTION: A representation is a statement about facts in this time frame:

A. Past only

B. Present only

C. Future only

D. Past or present but not future

E. Past, present, or future

F. Present or future but not past

G. Past or future but not present[106]

§ 188.3.85 Reps and warranties: Who on earth would want both?

QUESTION: In a normal purchase-and-sale contract, this party will normally want to think about whether a particular statement should be a representation or a warranty (the other party will want it to be both).[107]

§ 188.3.86 Semi-unique remedies for misrepresentation

QUESTION: In a contract case, if Alice successfully proves the elements of misrepresentation, she might be entitled to one or both of these two remedies that might not otherwise be available to her:[108]

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[105] Incidental

[106] D

[107] Seller

[108] Punitive damages and rescission

§ 188.3.87 **Remedies: Unwinding the deal**

QUESTION: This remedy for breach of contract — seldom granted unless the contract itself provides for it — basically "unwinds the deal."[109]

§ 188.3.88 **The 35-day month**

QUESTION: The former CEO of software giant Computer Associates spent nearly ten years in federal prison for engaging in this "35-day month" contract-signing practice to falsify quarterly financial statements.[110]

§ 188.3.89 **Interpretation: Tie goes to the non-drafter**

QUESTION: Under the rule of contract interpretation known by this Latin phrase, an ambiguity in a provision is resolved against the party that drafted the provision — IF other rules of interpretation don't provide a resolution.[111]

§ 188.3.90 **Apples, peaches, and pears, oh my!**

QUESTION: Under the rule of contract interpretation known by this Latin phrase, if a contract term says "food, including apples, peaches, and pears" then a court might limit the term "food" to fruits.[112]

§ 188.3.91 **Reaction to a bad contract provision**

FACTS: For a client, you're reviewing a contract drafted by The Other Side. Your client does not have much bargaining power and would really like to see this contract signed. You see a provision that outrages you.

QUESTION: What should be your first action?

A. Delete the provision.

---

[109] Rescission

[110] Backdating

[111] Contra proferentem

[112] Ejusdem generis

B. Put yourself in The Other Side's shoes and ask what problem they were trying to solve.

C: Revise the provision to make it acceptable to your client.

D. Accept the provision and advise your client about it.[113]

§ 188.3.92 **Facebook and the Winklevii**

QUESTION: What connection does / did the Winklevoss twins have for Facebook?

A. One of the twins is a member of Facebook's board of directors.

B. They were the first two computer programmers hired by Facebook.

C: They're connected to Google, not Facebook.

D. Facebook paid them USD $65 million to settle their claim that company founder Mark Zuckerberg stole their ConnectU idea while all were students at Harvard.[114]

§ 188.3.93 **Insurance-policy types**

FACTS: Alice buys a professional-liability insurance policy for her new consulting business. Unfortunately she is unable to attract enough work to support herself, so a few months later she shuts down the business; allows her insurance policy to lapse by not paying premiums; and takes a full-time job working for a company.

Months later, but still within the relevant statute-of-limitations period, she is sued for malpractice by one of her former clients. The former client's claim would clearly have been covered by Alice's insurance policy if Alice had not allowed the policy to lapse.

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[113] B. If you think about why The Other Side included the provision, it might give you insight into possible changes that The Other Side would go along with.

[114] D. The lesson here is that startup-company founders should carefully consider whether any individuals or other companies might be able to claim an ownership interest in the company itself or its intellectual property.

QUESTION: Of the two types of insurance policy — claims-made and occurrence — which would cover the claim against Alice even after cancellation of the policy?

A. Only a claims-made policy.

B. Only an occurrence policy.

C: Neither.

D. Both.[115]

§ 188.3.94 Clause phrasing

You are drafting a contract between

1. your client Alice, and

2. Bob, who owns a sole-proprietorship yard maintenance company that employs a number of workers. Under the contract, Bob's workers are to replace the sod in Alice' front yard, but Bob won't be personally doing any of that work — and the contract will be between Alice and Bob, not Alice and Bob's workers.

QUESTION: How can you phrase this obligation so that it's clear that Bob is responsible for making this happen, without making it a false imperative?[116]

§ 188.3.95 Nickname for a "this is acceptable" provision

A lease agreement states that

1. Tenant must pay the rent by a means reasonably acceptable to Landlord, and

2. Venmo is to be conclusively deemed an acceptable means of payment.

QUESTION: Subdivision (2) is an example of a xxxx-yyyyyy provision.[117]

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[115] B

[116] Have the contract say something along the lines of: Bob will cause Alice's sod to be replaced ....

[117] Safe-harbor; see https://en.wikipedia.org/wiki/Safe_harbor_(law)

§ 188.3.96 **Partnership creation**

QUESTION: A partnership can be created without the partners even knowing it.[118]

§ 188.3.97 **Termination for convenience**

You are negotiating a contract for your client Alice. The contract states that the other party, Bob, may terminate the contract for convenience.

QUESTION: Name at least three kinds of fences that you might want to try to put around Bob's right to terminate for convenience.[119]

§ 188.3.98 **Condition subsequent**

QUESTION: What is a two-word colloquial synonym for "condition subsequent"?[120]

§ 188.3.99 **"Provided that ..."**

A contract contains the following provision: "Alice will pay Bob USD $100 no later than December 25; provided, however, that if Alice pays Bob no later than December 21, the amount to be paid will be $75."

QUESTION: Professor Toedt regards the "provided ..." as an acceptable form.[121]

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[118] True; see https://www.statutes.legis.state.tx.us/Docs/BO/htm/BO.152.htm#152.051

[119] 1) Earliest termination date; 2) latest termination date; 3) Bob may not terminate before Alice has achieved specified

120: Escape clause (or, exception). "A condition subsequent is a condition referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition." Community Health Sys. Prof. Servs. Corp. v. Hansen, No. 14-1033, slip op. at 11 (Tex. June 16, 2017) (citation and internal quotation marks omitted).

[121] False. The term "provided that ...." is commonly used in wall-of-text provisions but should be avoided in favor of breaking up the sentence and even the paragraph. ¶ This clause could be turned into a table, but it's short enough not to be worth bothering. ¶ Another approach would be to rewrite the sentence with numbers or romanettes "Alice will pay Bob

§ 188.3.100 Use of other contract provisions in interpretation

TRUE OR FALSE: Parol evidence for interpreting Provision A of a contract can include the text of Provision B of the same contract.[122]

§ 188.3.101 Termination with or without cause

FACTS:

A contract between Alice and Bob allows Alice to terminate both (i) for cause and (ii) only during a specified time frame, without cause.

Alice must give Bob written notice of either form of termination.

Texas law applies.

TRUE OR FALSE: In the above contract, Alice must still have a good-faith reason for terminating *without* cause, otherwise she will be in breach of contract if she so terminates.[123]

§ 188.3.102 Assignment of agreement w/ state agencies

TRUE OR FALSE: In contracts between state-government entities and their contractors, it's not unusual for a contract to prohibit the contractor from assigning the contract without the prior written consent of the government entity.[124]

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as follows: (1) If no later than December 21: USD $75. (2) If no later than December 25: $100."

[122] False. This isn't parol evidence, which is generally considered to be evidence outside the four corners of the contract itself — which of course could include attachments, exhibits, and the like as well as any documents incorporated by reference.

[123] False — under Texas law: "When a contract provides expressly that it is subject to termination upon notice, the general rule is that each party to the contract has the legal right to cancel the contract. The parties bargained for the flexibility of terminating the contract upon tender of the requisite notice. Neither party should be denied the benefit of its bargain." Community Health Sys. Prof. Servs. Corp. v. Hansen, No. 14-1033, slip op. at 14-15 (Tex. June 16, 2017) (cleaned up), *quoting* Juliette Fowler Homes, Inc. v. Welch Associates, Inc., 793 S.W.2d 660, 665 (Tex. 1990).

[124] True.

§ 188.3.103 Assignment of agreement: Statutes

FILL IN THE BLANK: Name one state that has a statute prohibiting contractors from assigning their agreements with state agencies without the agency's consent.[125]

§ 188.3.104 Assignment of agreement: Mergers, etc.

FACTS:

Your client, a small corporation, previously entered into a contract that prohibits each party from assigning the contract without the other party's consent.

Your client is about to be acquired by one of its larger competitors; the acquisition could take place either as an asset acquisition or by a statutory merger of your client and a newly-created subsidiary of the larger competitor.

QUESTION: Name two factors that might affect whether the "roll-up" should take the form of (i) an asset purchase, or (ii) a merger?[126]

§ 188.3.105 Assignment consent: Protection

FACTS:

You represent Alice's company and are reviewing a contract prepared by Bob's attorney.

The draft agreement precludes Alice's company from assigning the agreement without Bob's prior written consent.

You're aware that Alice's company might be seeking venture-capital financing in the near future.

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[125] New York State Finance Law § 138 (link)

[126] That might depend on: the applicable state law — in some jurisdictions, a merger is deemed to cause a transfer of assets to the surviving company, which would trigger the consent requirement; and whether the contract specifically states that a merger or change of control of your client requires consent to the same extent as an assignment.

QUESTION: Name at least two ways — other than just saying "no" — in which you might reduce Alice's business risk from the assignment-consent provision.[127]

§ 188.3.106 **Signing a contract**

FACTS:

(A) Morticia Addams is a limited partner of Addams Investments, L.P., a "family" limited partnership (the "Partnership").

(B) The Partnership is entering into a contract with a new investment advisor so that the advisor can manage some of the Partnership's financial portfolio.

(C) Morticia is in town, but the rest of the family is in Europe for a wedding.

TRUE OR FALSE: From the Partnership's perspective, there'd be little legal risk associated with having Morticia sign the contract on behalf of the Partnership in her capacity as a limited partner.[128]

TRUE OR FALSE: As attorney *for the Partnership*, you should not concern yourself with whether Morticia's signing the contract would be a good idea from her perspective.[129]

§ 188.3.107 **Signing a contract**

FACTS:

(A) Alice Alpha, a lawyer, signs a contract on behalf of her client Allen Able, who is out of the country on an extended business trip.

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[127] In negotiating the contract, you could ask: for an exception in the case of a transfer of all assets of Alice's company's business to which the contract is related; and/or for a requirement that the consent not be unreasonably withheld, together with a fast-track arbitration provision.

[128] False: Morticia should not sign in her capacity as a limited partner.

[129] Technically you represent the Partnership only, but in this type of situation, as long as there's no conflict of interest, it's a good idea to keep an eye out for the interests of the partners as well.

(B) Before Allen left, he signed and gave Alice a written power of attorney designating Alice as Allen's attorney-in-fact for purposes of signing the contract.

(C) In the contract, Alice's signature block reads as follows: "Allen Able, by Alice Alpha, attorney-in-fact."

TRUE OR FALSE: Under these circumstances, this is a sensible way for Allen and Alice to do the needful.[130]

TRUE OR FALSE: Alice should attach a copy of the power of attorney to the contract.[131]

TRUE OR FALSE: Alice should keep a copy of her power of attorney.[132]

§ 188.3.108 Contract interpretation

TRUE OR FALSE: Parol evidence can be used to show that a seemingly unambiguous contract is in fact ambiguous.[133]

FACTS: (A) Alice sues Bob for breach of contract. (B) The facts are not in dispute; what *is* in dispute is the meaning of a particular term in the contract. (C) The court rules that the disputed term unambiguously means what *Bob* says it means. TRUE OR FALSE: Summary judgment in Bob's favor is appropriate.[134]

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[130] This would work, but Alice probably would prefer not to sign on behalf of Allen (let the client sign it and take whatever heat might come later).

[131] Not mandatory, but might be a good idea.

[132] Absolutely.

[133] False. "An unambiguous contract will be enforced as written, and parol evidence will not be received for the purpose of creating an ambiguity or to give the contract a meaning different from that which its language imports." David J. Sacks, P.C. v. Haden, 266 S.W.3d 447, 450 (Tex. 2008), quoted in Community Health Sys. Prof. Servs. Corp. v. Hansen, No. 14-1033, slip op. at 9 (Tex. June 16, 2017).

[134] True. See, e.g., Lopez v. Munoz, Hockema & Reed, L.L.P., 22 S.W.3d 857, 862 (Tex. 2000), quoted in Community Health Sys. Prof. Servs. Corp. v. Hansen, No. 14-1033, slip op. at 9.

§ 188.3.109 Termination of employment agreement

TRUE OR FALSE: A contract can provide that it is terminable without cause during one time period and is only terminable for cause at another time.

FACTS: A contract between Alice and Bob allows Alice to terminate both for cause and (only during a specified time frame) without cause; either form of termination written notice. TRUE OR FALSE: If Alice wants to terminate *without* cause, her notice of termination must state the reason for termination, so as to be clear that the termination was not for cause.[135]

TRUE OR FALSE: In the above contract, Alice must still have a good-faith reason for terminating without cause, otherwise she will be in breach of contract if she so terminates.[136]

§ 188.3.110 Contract formation

FACTS:

(A) Seller regularly sells generic widgets. Buyer regularly buys widgets and incorporates them into, among other products, the pottery wheels that are manufactured and sold in Buyer's factory.

(B) Buyer sends Sally Sales Rep a purchase order for 10,000 widgets at stated price- and delivery terms.

(C) The P.O. contains a lot of detailed fine print — including a provision in which the seller warrants that the seller's goods will be fit for the purpose for which Buyer's *customers* use *Buyer's* goods; the P.O. doesn't identify those goods and Seller doesn't know that Buyer has pottery wheels in mind.

(D) On the front, the P.O. says, in big bold letters, that the seller must sign the P.O. and return it with the ordered goods; the P.O. also says (i) that shipment constitutes acceptance of the terms, and (ii) that Buyer rejects any additional or inconsistent terms in any sales confirmation or other document that Seller provides.

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[135] False. "[W]hen a party properly terminates a contract pursuant to a without-cause provision, the reason for the termination is irrelevant." Community Health Sys. Prof. Servs. Corp. v. Hansen, No. 14-1033, slip op. at 13 n.6 (Tex. June 16, 2017) (extensive citations omitted).

[136] False, at least under Texas law.

(E) Sally sends a copy of the P.O. to Seller's fulfillment department and tells them to ship the 10,000 widgets as specified in the P.O., but Sally doesn't sign or return the P.O.; Seller invoices Buyer for the stated price.

QUESTION: Was a binding contract formed? Why or why not?[137]

QUESTION: If a binding contract *was* formed, is the fit-for-Buyer's-customer's purpose warranty provision part of the contract? *(Hint: This is Contract Law 101.)*[138]

ALTERNATIVE FACTS: Seller doesn't ship the widgets, but instead sends back a "sales confirmation" form with Seller's own version of detailed fine print, including a conspicuous, legally-adequate disclaimer of all warranties, express and implied. Buyer then cancels the order, which shocks and disappoints Seller.

QUESTION: Was a binding contract formed? Why or why not? If yes, is the fit-for-purpose warranty provision part of the contract? *(Hint: This is Contract Law 101.)*[139]

ALTERNATIVE FACTS: Seller ships the widgets and includes with the shipment the sales confirmation form mentioned in the previous paragraph, but Seller does not sign or return the purchase order.

QUESTION: Was a binding contract formed? Why or why not? If yes, what are the warranty terms of the contract? (*Hint:* See Battle of the Forms.)[140]

ALTERNATIVE FACTS: Seller signs and returns the purchase order.

QUESTION: Was a binding contract formed? Why or why not? If yes, what are the warranty terms of the contract?[141]

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[137] Yes: The P.O. was an offer that could be — and was — accepted by performance. (Hint: This is Contract Law 101.)

[138] Probably, for the same reason as above.

[139] No: This is a Battle-of-the-Forms situation; Seller's sales-confirmation form materially altered the terms, and the parties didn't conduct themselves in a manner that recognized the existence of a contract, so no contract. See UCC § 2-207.

[140] A contract hasn't been formed yet; it depends on whether Buyer accepts the widgets (and, possibly, on whether Buyer pays Seller's invoice). See UCC § 2-207.

[141] A contract has indeed been formed; the warranty terms are those in Buyer's P.O. form.

§ 188.3.111 **Exercise: Shall, will, must, etc.**

QUESTION: In your small groups, discuss which of the following Professor Toedt thinks is *not* a good choice:

A. Bob will pay Alice $1,000 no later than December 24.

B. Bob shall pay Alice $1,000 no later than December 24.

C. Bob must pay Alice $1,000 no later than December 24.

D. Bob is to pay Alice $1,000 no later than December 24.[142]

§ 188.3.112 **Ambiguity: Pricing term extension**

FACTS:

1. A supply contract between Provider and Customer includes a price schedule that is to be effective for one year, expiring December 1 (the "Pricing Term"), but Customer can extend the Pricing Term once, for one more year.

2. The extension provision says: Written notice of extension of the Pricing Term must be given no later than 30 days before its then-current expiration date. The contract does not contain any other relevant notice provision.

3. On October 31, Customer mails Provider a written notice of extension by certified mail, return receipt requested. A week later, Customer receives back the "green card" from the U.S. Postal Service confirming receipt by Provider on November 2.

4. Provider later tells Customer that the Pricing Term expired and that Provider's prices will increase to Provider's published list prices.

QUESTION: Has Customer effectively extended the Pricing Term? Why or why not?[143]

[142] B. In some English-speaking countries, *shall* might be regarded as optional or permissive; moreover, *will* is friendlier sounding.

[143] Arguably not; it depends on whether notice is "given" when mailed or when received.

§ 188.3.113 Ambiguity: Vacating the premises

CLAUSE: Tenant will completely vacate the Premises no later than 12 midnight on December 15, 20x0; Tenant's failure to do so will be a material breach of this Agreement.

EXERCISE: Rewrite this to make it clear that if Tenant remains on the premises at 10:00 a.m. on December 15, it will be in breach.[144]

§ 188.3.114 CPI choice

FACTS:

You represent Buyer in negotiating a long-term master purchase agreement with Seller.

You draft a price-increase clause that limits Seller's permissible price increases to no more than the increase in CPI (and no more than once a year as well).

A year later, Seller says it is increasing its price by the percentage stated in a particular CPI published by the U.S. Government for the specific industry in which Seller and Buyer operate. You hadn't known there even was such a thing.

Your client Buyer angrily tells you that Seller's price increase must be limited to the (much-lower) increase in the "regular" CPI, namely CPI-U, US City Average, All Items, 1982–1984=100.

QUESTION: On these facts, how might a court rule on Buyer's claim that Seller's price increases must be limited to the increase in CPI-U and not to the increase in the special CPI?[145]

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[144] Tenant will completely vacate the Premises no later than 12 midnight at the beginning of December 15, 20x0; Tenant's failure to do so will be a material breach of this Agreement.

[145] Chances are that the court would rule in favor of Seller, because you (on behalf of Buyer) drafted the price-increase provision.

§ 188.3.115 Indemnity: Basic questions

QUESTION 1: How does an *indemnity* relate to a *warranty*?[146]

QUESTION 2: IF FALSE, EXPLAIN WHY: IF: Alice agrees to indemnify Bob against damage arising from occurrence of Event X; THEN: This reduces the risk to the parties associated with the (possible) occurrence of Event X. *(CAUTION: Read this carefully.)*[147]

QUESTION 3: IF FALSE, EXPLAIN WHY: An indemnity obligation allocates at least some of the financial risk of Event X.[148]

QUESTION 4. IF FALSE, EXPLAIN WHY: The following is an acceptable conventional phrasing: *Alice **hereby indemnifies** Bob against any damage Bob might incur if it rains tomorrow.*[149]

§ 188.3.116 Indemnities: Duty to defend

FACTS: Suppose that:

You draft an indemnity obligation that does not expressly require the subcontractor to defend your client, the general contractor, from claims, but merely obligates the subcontractor to indemnify the general contractor.

An employee of the subcontractor writes a letter to the general contractor, asserting a claim. Assume for this purpose that the employee's claim comes within the scope of the subcontractor's indemnity obligation.

The general contractor forwards the employee's letter to the subcontractor and demands that the subcontractor engage outside counsel to investigate the claim.

Texas law applies.

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[146] An indemnity is a reimbursement; a warranty is a promise to reimburse (i.e., indemnify) someone if a warranted state of affairs turns out not to be true.

[147] False — it doesn't reduce the risk, it allocates the risk.

[148] True.

[149] False — it should be "Alice will indemnify Bob [i.e., future tense] …."

QUESTION 1: Must the subcontractor engage outside counsel for your client the general contractor?[150]

QUESTION 2: Would your answer be different if all of this were taking place in Los Angeles instead of Houston and California law applied? Cite the relevant authority.[151]

§ 188.3.117

Exercise: Defense against indemnified claims

FACTS:

1. Alice's contract with Bob obligates her to reimburse Bob for his attorney fees and expenses in defending against certain third-party claims.

2. A third party, Carol, brings such a claim against Bob.

3. Bob hires Skadden Arps *(a top NYC firm)* to defend him against Carol's claim.

4. Alice has plenty of money to pay legal bills.

QUESTION: Speculate about what incentives might motivate Skadden in conducting Bob's defense. [152]

Decide on your answer and be prepared to explain it.

QUESTION: Name two ways that Alice, during negotiation of her contract with Bob, could have limited her financial exposure to Bob's cost of defending against Carol's claim.[153]

MORE FACTS:

5. Alice's contract with Bob also requires her to *indemnify* Bob against any monetary awards resulting from such third-party claims.

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[150] No, at least not technically; see this discussion. (But it might behoove the subcontractor to do so anyway — why?)

[151] Yes — a California statute (Cal. Civ. Code § 2278(3)) states that a contractual duty to indemnify another party includes a duty to defend unless the contract specifies otherwise.

[152] Skadden might be tempted to mount a gold-plated defense for its client Bob, knowing that it wouldn't be Bob who'd be paying the bills.

[153] Alice could have: (i) insisted that she would control the defense, including hiring counsel of her choice; and/or (ii) capped her monetary liability for providing a defense.

6. Bob neglects to mention to either Alice or Skadden that Carol had filed her third-party claim weeks before, and that when Bob failed to file a timely answer, Carol moved for and obtained a default judgment for a large amount of money.

QUESTION: Name two ways that Alice, during negotiation of her contract with Bob, could have limited her exposure to Bob's screw-up.[154]

ALTERNATE FACTS:

7. Alice's contract with Bob requires her to *provide* Bob with a defense, as opposed to reimbursing Bob for his defense expenses.

8. Alice engages her regular lawyer, Andy, to conduct Bob's defense against Carol's claim.

9. Bob finds that he and Andy don't get along so well.

QUESTION: During negotiation of the contract, what sort of clause could Bob have asked to be included in the contract to protect him against this uncomfortable situation?[155]

ALTERNATE FACTS:

10. It turns out that Alice can't afford to pay Bob's legal bills for defending against Carol's claim.

QUESTION: What if anything might Bob have done during contract negotiation to mitigate this problem?[156]

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[154] Alice could have asked for the defense-and-indemnity provision to require Bob to give her notice of any indemnifiable event within X days after the event, failing which: (i) Alice would not be responsible for any harm resulting from the delay in notification, or even (ii) Alice would be entirely released from the defense-and-indemnity obligation.

[155] Bob could have asked for the defense-and-indemnity provision: to allow him to hire separate monitoring counsel at his own expense, along with requiring Alice's counsel Andy to cooperate with Bob's monitoring counsel; and/or to allow Bob to hire his own counsel to take over the defense in case of a conflict of interest or a fundamental disagreement about strategy — but then Alice would want to say, fine, but I'm off the hook if your lawyer loses the case.

[156] Bob could have asked for the contract to require Alice to maintain insurance to cover the defense costs.

§ 188.3.118 Affiliate status

FACTS: ABC-Mexico S.A. owns 25% of the shares of voting stock of ABC-USA Inc.; the remaining shares are owned by various investors.

QUESTION 1: Under the TANGO definition, does ABC-Mexico qualify as an *Affiliate* of ABC-USA?[157]

(But the parties' agreement might contain other definitions of *Affiliate*.)

MORE FACTS: ABC-Mexico, which owns 25% of the voting stock of ABC-USA Inc., enters into voting agreements with the holders of an additional 28% of the voting stock of ABC-USA Inc.; under each voting agreement, ABC-Mexico is given an irrevocable proxy to vote the holders' shares of ABC-USA's stock.

QUESTION 2: Under the TANGO definition, does ABC-Mexico now qualify as an *Affiliate* of ABC-USA?[158]

§ 188.3.119 Contra proferentem prerequisite

QUESTION: What is the basic prerequisite for applying the principle of *contra proferentem* to resolve an ambiguity in a contract?[159]

§ 188.3.120 When the effective date should be different

QUESTION: According to Professor Toedt, in most circumstances, the best way to state the effective date of a contract that is different from the date(s) that the contract is signed is:

A. In the preamble: "This Agreement is entered into on [DATE]."

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[157] No — under the linked definition, Affiliatestatus depends on "control," and the Minimum Voting Percentage required for control is 50%. This means that ABC-Mexico doesn't own enough stock to control ABC-USA or vice versa — and, in turn, In turn, under this definition the two companies are not Affiliates.

[158] Yes: The voting proxies, plus ABC-Mexico's own stock ownership, give ABC-Mexico enough voting control to qualify as an Affiliate of ABC-USA. That situation could change, however, if the proxies were to expire at some point — most proxies do — and were not renewed, extended, or replaced.

[159] Other methods of interpreting the agreement must have failed to resolve the ambiguity.

B. In the preamble: "This Agreement is entered into on the latest date signed as written in the signature blocks below, to be effective as of [DATE]."

C: In the preamble: "This Agreement is entered into on [DATE]."

D. None of the above[160].

[160] B. It's best for an agreement to state the specific dates that the agreement is signed by the different parties—although as seen in this example, the effective date can always be defined as the last-date-signed.