The Tango Terms: Ground rules for productive business dealings

Like a *Robert's Rules of Order*, for contract engagements *

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Chapter 1: Tango Terms Adoption Rule

This rulebook is designed for flexible use and also tries to avoid legalese. Suppose that “Alice” and “Bob” adopt the Tango Terms in an agreement, which we’ll call the “*Contract*.” That should result in a sensible, legally-binding contract. (Alice and Bob would want to check with their respective legal counsels to be sure.)

> Comment: In some places, this rulebook uses the names “Alice” and “Bob” as placeholders for party names. This follows a common convention devised by renowned computer scientists Ron Rivest, Adi Shamir, and Leonard Adleman, inventors of the eponymous RSA public-key encryption; see generally the Wikipedia entry https://en.wikipedia.org/wiki/Alice_and_Bob.

§ 1.01. Option 1: Just say “Tango Terms”

Probably the easiest way for Alice and Bob to use the Tango Terms would be for them simply to agree, either orally or in writing, what their deal is and say the phrase “Tango Terms.” This could be done in an email exchange; a letter agreement; a term sheet; or any other form of agreement, whether written or oral. (Alice and Bob would want to check with their legal counsels about whether an *oral* agreement would be enforceable under the law known as the Statute of Frauds.)

EXAMPLE: Consider the following exchange of text messages to set up a confidentiality agreement (also known as an “NDA”):

> *Alice*: “Bob, want to send you some information about our upcoming product release, but need you to keep it confidential. Tango Terms. OK?”

Bob: “Fine.”

Alice: “Great — info on the way.”

In this situation, Alice and Bob’s exchange of text messages will very likely create a binding NDA (at least in the U.S.), because:

– text messages can create binding contracts (see the commentary at § 12.04.5), and

– the content of Alice and Bob’s text-message exchange makes it clear that they adopted the Tango Terms, i.e., incorporated those terms by reference.

But which specific Tango Terms rules will apply in Alice and Bob’s newly-created NDA? *Will Alice and Bob need to read the entire Tango Terms rulebook?* **No**; here are the Tango Terms that will apply:

1. The Confidentiality Rule, § 2.02, will apply, because Alice and Bob’s text-message exchange talks about confidentiality; and

2. In addition, the following provisions will always apply:

Chapter 6: General Provisions

Chapter 7: Disagreement Rules

Chapter 8: Termination Rules

Chapter 9: Definitions and Usages (general)

§ 1.02. Option 2: Build your own, save time

Suppose that Alice is an experienced contract drafter. She could create a custom NDA for her and Bob to sign by selecting specific Tango Terms rules to be incorporated by reference. Doing so would get the parties to signature sooner than the old-fashioned approach to drafting, because:

– Alice wouldn't have to hunt up an old NDA form and customize it;

– If Bob had previously reviewed a Tango Terms NDA, he'd save time reviewing Alice's draft, because he'd have seen much of it before.

– Because the Tango Terms "fair play" rules are designed to be workable for both Alice and Bob, their negotiation should take less time.

§ 1.03. A party can opt out of certain terms

In Chapter 7: "Disagreement Rules," a few of the rule titles end with "[opt-out]." What does that mean?

– Suppose that after agreeing to their NDA, Alice and Bob disagree about something relating to the NDA, and that Bob gives Alice notice (§ 6.12) that he is invoking the Internal Escalation Rule (§ 7.02).

– In that situation, Alice is allowed to unilaterally decide that one or more of the rules labeled as "[opt-out]" will *not* apply to that particular disagreement.

> Comment: This opt-out feature is included because when the parties are negotiating the Contract, Alice might be reluctant to agree *in advance* to some of the less-conventional Tango Terms dealing with disagreements. This includes, for example, those designed to promote early settlements, such as the jury-trial waiver in § 7.03 and the baseball-arbitration provision in § 7.08.

– To do this, Alice must give Bob notice (§ 6.12) to that effect; *her* notice must be effective: (i) no *sooner* than the effective date of

Bob's notice invoking the Internal Escalation Rule; and (ii) no *later* than five business days after that invocation notice date.

> The no-*sooner* time limit on Alice's opt-out decision is intended to keep Alice from deciding to kill the opt-rules entirely until she and Bob have a specific disagreement that must be resolved.

§ 1.04. Opt-*in* terms must be specifically agreed

The Tango Terms provisions try to take a minimalist approach, so as to reduce the amount of text that must be reviewed. But some parties might need or want more than that. To make it easier for drafters to build more-detailed custom agreements, some Tango Terms titles end with the label "[opt-in]," or they specify that the provision is an "Option."

Let's return to our hypothetical text-message exchange between Alice and Bob, but this time we'll change it up a bit:

> *Alice*: "Bob, want to send you some information about our upcoming product release, but need you to keep it confidential. Tango Terms. OK?"
>
> *Bob*: "Fine*, but we'd need the M&A Disclosure Option."*
>
> *Alice*: "Sounds good — info is on the way."

In this case, Alice and Bob's NDA includes not only the "standard" Tango Terms, but also the option allowing Bob to disclose Alice's confidential information in certain circumstances involving mergers or acquisitions, in § 2.02.4–9.

§ 1.05. Commentary is nonbinding

This rulebook includes a considerable amount of explanatory commentary. This includes, for example, citations to statutes and court cases, as well as discussions of why different parties sometimes want things to be done in certain ways.

The commentary:

– can be recognized because it's in a different, smaller font, as can be seen in the examples below; and

– is ***not*** a binding part of a Contract.

Comment: Here's some commentary that is not a binding part of this Rule.

§ 1.05.1. Another example of nonbinding commentary

Here's another example of commentary that is not part of this Rule.

§ 1.06. Commentary: Author's note

For a number of years I've used the materials in this rulebook and its predecessors (the COMMON DRAFT provisions) in the contract-drafting classes that I teach as an adjunct professor at the University of Houston Law Center and in my law practice representing tech companies.

Why do I call this rulebook "the Tango Terms"? I looked for names that suggested coordinated action, such as in aviation (FORMATION or RENDEZVOUS); singing (DUETS or CHORUS); 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 fairly well, because tango, the dance, is made up of defined basic steps that (so I'm told): • beginners can perform gracefully, and also • experienced performers can add flair and sophistication.

Chapter 2: Rules for Preliminaries

Before Alice and Bob sign a “main” agreement, they might well enter into some kind of preliminary agreement such as a confidentiality agreement (a.k.a. nondisclosure agreement or “NDA”) and/or a letter of intent (a.k.a. “LOI”).

§ 2.01. Confidentiality of Dealings Rule

§ 2.01.1. The setting: Alice doesn’t want Bob talking about their dealings together (and/or vice versa)

This Rule applies if the Contract between Alice and Bob says that the parties are to keep their dealings confidential, or words to that effect.

> Template adoption language: “The parties will keep their dealings confidential per the Confidentiality of Dealings Rule (Tango Terms 2020A).”

§ 2.01.2. The Rule

a. *Affected parties:* While this Rule refers to *Bob’s* obligations, the same obligations would apply to Alice unless the Contract clearly said otherwise.

b. *Confidentiality requirement:* Bob will preserve in confidence (defined below) all nonpublic information about the fact, and the terms, of their dealings under the Contract.

c. *Definition:* For this purpose, “preserved in confidence” means that Bob will not disclose (nor confirm) the fact or terms of his dealings with Alice: (1) to any third party; nor (2) except on a need-to-know basis to any of Bob's or Alice's officers, directors, employees, or agents.

d. *No expiration:* The confidentiality obligation of this Rule will not expire as to particular information unless and until the information becomes public.

> ALTERNATIVE: "The parties' confidentiality obligation under the Tango Terms Confidentiality of Dealings Rules will expire at exactly 12 midnight at the end of [FILL IN DATE]."

§ 2.01.3. Additional commentary

§ 2.01.3–1 Introduction: Business motivations

Parties might not want anyone to know even that they are having business discussions, let alone the details of their business dealings. That can present some tricky issues, though, especially in an employment-related agreement.

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).

§ 2.01.3–2 Confidentiality of dealings, not 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.

§ 2.01.3–3 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).

§ 2.01.3–4 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).

§ 2.01.3–5 Employers: 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.)

§ 2.02. Confidentiality Rule

§ 2.02.1. The setting: Bob wants to disclose information to Alice in confidence

This Rule applies if the Contract between Alice and Bob states that Bob will disclose certain information in confidence to Alice (and/or vice versa), or words to that effect.

> Comment: See also the opt-in terms at § 2.02.3.
>
> Template adoption language: "Each party will preserve in confidence the confidential information of each other party (Tango Terms 2020A: Confidentiality Rule)."
>
> 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.

§ 2.02.2. The Rule

§ 2.02.2–1 For the disclosing party: Dos and don'ts

a. *Proof of Confidential Information eligibility:* For Bob's information to be protected under this Rule ("*Confidential Information*"), Bob must be able to show that the information meets the prerequisites below in this subdivision.

> CAUTION: In drafting a confidentiality provision, one of the first issues the drafter likely will confront is whether the agreement should protect just one party's Confidential Information, or that of each party. **Two-way confidentiality agreements,** protecting each party's information, are usually a better idea, for the reasons discussed in the additional commentary at § 2.02.3–2. Still, some

parties might want to limit protection so that it covers only the information of one specified party.

CAUTION: Drafters representing disclosing parties should be sure that each prospective receiving party has actually agreed in writing to be bound by the confidentiality obligations. A Bob might not have any recourse against someone who hasn't signed on to those obligations; this happened in Knight Capital Partners Corp. v. Henkel AG, 930 F.3d 775 (6th Cir. 2019).

NOTE: "Bob's information" encompasses third-party information as discussed in § 2.02.2–1e

1. *Secrecy measures:* Bob must have taken and be taking — at a minimum — reasonable measures to keep his information secret.

Comment: This secrecy requirement tracks the general law in the United States, notably in the Uniform Trade Secrets Act; see, e.g., Cal. Civ. Code § 3426.1(d)(2); Tex. Civ. Practice & Rem. Code § 134A.002(6)(B).

Fort-Knox security measures for Confidential Information aren't necessary (usually); in many circumstances, less-strict security measures may well suffice. As one appeals 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. … Whether these [specific] 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).

But some secrecy efforts for confidential information are pretty much mandatory, and 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).

2. *Timing:* Bob must have initially made the information available to Alice — in hard copy; electronically; by oral disclosure; by

demonstration; or any other manner — during the term of the Contract (i.e., not before and not after).

Comment: Bob might want to have the confidentiality agreement expressly state that the agreement's confidentiality obligations apply to one or more *earlier* disclosures. This could happen if business people exchanged information under *oral* promises to keep the information confidential and then wanted to follow up with a *written* confidentiality agreement.

b. *Marking:* Except as provided below in this subdivision, Bob must be able to show that his information, as initially disclosed to Alice, was marked as confidential in a reasonably-prominent, human-readable form — if so, then the information will be presumed to be Confidential Information until shown otherwise.

CAUTION: Agreeing to a hard-and-fast marking requirement, *but then failing to comply with the requirement*, can be fatal to Bob's rights. The computer manufacturer Compaq (now part of Hewlett-Packard) once defeated a claim of trade-secret misappropriation concerning hard-disk technology because the owner of the putative trade-secret information did not follow its *oral* disclosures with *written* summaries as required by the parties' agreement. See Convolve, Inc. v. Compaq Computer Corp., No. 2012-1074, slip op. at part II.A.2 (Fed. Cir. July 1, 2013) (affirming summary judgment in pertinent part).

1. *Recognizably-confidential:* Bob's information can still qualify as Confidential Information, even without being marked as such, if Bob shows that the information is of a type that reasonable people in the business would readily recognize as likely to be confidential.

Comment: Under this section, marking of Confidential Information is optional, although doing so is a very good idea. (A different rule applies to trade secrets, discussed below.)

An absolute requirement to mark Confidential Information would be burdensome and, too often, would "honored in the breach." Hence, information that is timely marked as confidential is *presumed* to be Confidential Information until shown otherwise. This represents a compromise between • the interests of disclosing parties (which generally don't want to have to mark information at all) and • the interests of receiving parties (which generally want carte blanche to do whatever they want with unmarked information).

2. *Access to internal files access:* Bob's information can still qualify as Confidential Information, even if it is not marked as such, if Bob shows that he made the information available to Alice (directly or indirectly) by allowing Alice to have access to Bob's internal files (hard copy, electronic, or whatever), as long as Bob did not give Alice permission to make and take away copies of the information; and/or

Comment: In some situations, Bob might allow Alice — for example, an employee or a contractor — to have access to Bob's internal files; in such a situation, it would be quite reasonable for Bob to want not to have to make sure that every single confidential document was marked as such.

3. *Catch-up marking:* Bob's information can still qualify as Confidential Information if Bob shows that: (i) he initially made the information available to Alice (directly or indirectly) in an unmarked form or a non-written form — for example, in an oral disclosure or a demonstration — and then (ii) he followed up that initial, unmarked disclosure with a written summary, in reasonable detail, that was marked as confidential, and (iii) he gave Alice notice (§ 6.12) to formally document the fact that he had sent the follow-up summary.

Comment: A belated claim of confidentiality after an unmarked initial disclosure is a significant enough event that it should be memorialized with a formal written notice.

c. *Must not be excluded:* Bob's information will not be considered Confidential Information if Alice shows that the information comes within one or more of this Rule's exclusions from Confidential Information status (§ 2.02.2–2k).

d. *Written advice of trade-secret claims:* If Bob wants his Confidential Information to qualify as a trade secret under this Rule — and so to have longer protection under § 2.02.2–2i.2 — then the following will apply:

> Comment: **A key distinction** between "Confidential Information" and "trade secret" here is that "mere" Confidential Information will in time lose its confidentiality status; see § 2.02.2–2i.2 below.

1. Bob must be able to show that the information in question (i) has independent economic value, actual or potential, (ii) from not being generally known to, and not being readily ascertainable through proper means by, (iii) another person who can obtain economic value from the disclosure or use of the information.

> Comment: This section simply adopts, essentially verbatim, the definition of *trade secret* in the (U.S.) Defend Trade Secrets Act, 18 U.S.C. § 1839(3). That statute defines "*proper* means" by inference: it defines improper means as: "(A) [including] theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means; and (B) [not including] reverse engineering, independent derivation, or any other lawful means of acquisition ...." 18 U.S.C. § 1839(6).
>
> The Judicial Council of California Civil Jury Instructions, 2017 edition, includes a list of factors that jurors may take into account in determining whether particular information has independent economic value, with extensive citations.

2. Bob must clearly advise Alice, in writing, that he is claiming the Confidential Information as a trade secret; this writing must be reasonably prominent and contain reasonable identifying details.

> Comment: Unlike in the definition of "mere" Confidential Information, this subdivision requires Bob to advise Alice in writing that the information is claimed as a trade secret. This means that trade-secret information will (putatively) continue to be protected by an agreement for an indefinite time; in contrast, "mere" Confidential Information would automatically lose its protection under an agreement after a time under § 2.02.2–2i.2 below.
>
> This requirement that trade secrets be explicitly claimed in writing is part of a compromise: • it encourages parties to mark all of their confidential information as such; but • it does not ***require*** marking for garden-variety confidential information that does *not* qualify as a trade secret (for example, because the information lacks independent economic value).
>
> The written-claim requirement comports with the *litigation* requirement in some states that a party claiming misappropriation of a trade secrets must identify the alleged trade secret with particularity. See Steven D. Gordon, Pre-Discovery Trade Secret Identification Under The DTSA (2019) (reviewing case law), archived at https://perma.cc/2KQV-VZAE; Jacob W.S. Schneider and Taylor Han, Exploring the Pre-Discovery Trade Secret Identification Requirement in Massachusetts and Across the Country (2018) (reviewing California case law), archived at https://perma.cc/7JLU-4ZSG.

3. Bob's written trade-secret claim under subdivision 2 may take the form, without limitation, of a reasonably prominent, human-readable marking — on the copy of information that Bob initially provides to Alice — that the information is a trade secret (and not merely Confidential Information).

4. Bob's written trade-secret claim under subdivision 2 must be received by Alice before Alice's confidential obligations would

otherwise end as to that information (so as to avoid unfair surprise to Alice).

e. *Bob's responsibilities for third-party confidential information:* Suppose that Bob provides Alice with confidential information of a third party, Tim. In that case:

1. Bob represents and warrants to Alice that Bob is authorized to make Tim's information available to Alice; and

2. Bob must defend and indemnify Alice and its Protected Group (§ 9.42), in accordance with the Indemnity and Defense Rule (§ 5.06.3), against any claim by Tim that Bob was not authorized to make Tim's information available to Alice.

§ 2.02.2–2 **For receiving parties: Dos and don'ts**

a. *Required secrecy measures:* Alice must take at least prudent measures to keep Bob's Confidential Information secret; these measures must include, without limitation, the same secrecy measures that Alice takes with respect to her own confidential information of comparable significance.

> Comment: This prudent-measures requirement is somewhat stricter than the "commercially reasonable" requirement that is often used. In many situations, the "normal" precautions are likely to satisfy Bob's desires, but for some types of Confidential Information, Bob might want to insist on special measures.

> CAUTION: Bob should always insist on imposing confidentiality obligations on Alice; otherwise, a court is likely to hold that Bob had failed to make reasonable efforts to protect its confidential information, as discussed in the commentary to the definition of "Confidential Information" above.

b. *Restricted use of Confidential Information by Alice:* During the term of the Contract (and only then), Alice may use Bob's Confidential

Information to the extent – and only to the extent — reasonably necessary for one or more of the following:

> Comment: If this Rule is adopted as part of a larger agreement that covers more than just confidentiality, then conceivably Bob might want to cut off Alice's right to use and disclose Confidential Information *before* the end of the term of the Contract.

1. performing her obligations under the Contract;

2. exercising her rights under the Contract;

3. assessing whether to enter into another agreement with Bob; and/or

4. any other use expressly agreed to in writing by Bob.

> Comment: Many confidential-information clause templates do not specify any preauthorized uses or disclosures of Confidential Information; typically, the parties end up negotiating some fairly-standard categories of authorized use. To save negotiation time, this provision simply goes ahead and pre-authorizes some of those particular categories of use and disclosures.
>
> Alice might want to state explicitly that that certain specific uses are pre-authorized.

c. *Restricted routine disclosures of Confidential Information:* During the term of the Contract (and only then), Alice may disclose Bob's Confidential Information — to the extent not prohibited by law — as follows:

1. to her own employees, officers, and directors to the extent that those individuals have a legitimate "need to know" in connection with an authorized use of the information and are bound by suitable obligations of confidence; and

> PRO TIP: Drafters should also consider the extent — if any — to which Alice's **contractors**, affiliates, etc., should be permitted to receive Confidential Information. This will be especially true if Alice's workforce might include so-called **leased employees** or

> other individuals working long-term in independent-contractor status.

2. to others, if Bob approves in writing.

d. *Prerequisites for routine disclosures:* Before Alice makes any disclosure of Bob's Confidential Information under subdivision c, Alice must first:

1. confirm that the intended recipient is bound by the confidentiality obligations of the Contract; and

2. cause the recipient to be specifically instructed and/or reminded that he or she is obliged to abide by those confidentiality obligations.

e. *Disclosure under subpoena, etc.:* Alice would not break this Rule if she were to disclose Bob's Confidential Information to the minimum extent required by law in response to subpoenas and other compulsory legal demands, if she satisfies all of the following prerequisites:

> Comment: This section is phrased as an exception to the prohibition against disclosure, not as immediately excluding the requested information from Confidential-Information status (which would be both a terrible idea and usually unnecessary).

1. Alice must give Bob as much advance notice of the impending disclosure as is allowed by law;

> CAUTION: If Alice is served with a search warrant or similar criminal investigative demand, the law might prohibit Alice from telling Bob about it.

2. Alice must provide reasonable cooperation with any effort by Bob to limit the disclosure in response to the demand; and

3. Alice must disclose only so much Confidential Information as, in the opinion of Alice's counsel, is required by the demand.

f. *Legally-immune disclosures:* Alice would not break this Rule if she were to disclose Bob's Confidential Information to the minimum extent that disclosure is IMMUNE from liability under Title 18, Section 1833(b) of the United States Code.

NOTE: Alice is STRONGLY ENCOURAGED, but is not required, to advise Bob in advance of any such contemplated disclosure.

> Comment: 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.

g. *Disclosures authorized by labor law:* Alice would not break this Rule if she were to disclose Bob's Confidential Information 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.

> Comment: The (U.S.) National Labor Relations Board has been hostile to confidentiality restrictions that purport to limit 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).

> CAUTION: The National Labor Relations Board might regard this "it's not a violation" carve-out as insufficiently explaining to employees their right to engage in concerted action under the NLRA. See the

NLRB general counsel's Advice Memorandum dated November 13, 2019, in Case No. 14-CA-227644, concerning a non-disparagement clause in an employment agreement required by the Strange Law Firm, discussed in this law firm memo.

h. *Restricted copying of Confidential Information:* Alice may reproduce Bob's Confidential Information only as reasonably necessary for a use or disclosure authorized by the Contract.

i. *Duration of Alice's obligations:* Alice's confidentiality obligations under this Rule will remain in effect as follows:

1. *For Confidential Information other than trade secrets:* Through the end of the calendar day on the date five years after the effective date of the Contract, or until the information no longer qualifies as Confidential Information, whichever comes first;

Comment: Under this Rule, Alice's confidentiality obligations as to *trade secret*s last indefinitely (think of the Coca-Cola formula, for example), whereas the protection for "mere" Confidential Information expires after a fixed time. This represents another compromise between two competing interests:

– Bobs will normally be reluctant to agree to a fixed confidentiality period. That's because doing so can result in destruction of Bob's rights in its confidential information after the end of the confidentiality period.

– In contrast, Alices generally prefer to have fixed expiration dates for confidentiality obligations as a safe harbor: After X years have gone by, it might well take time and energy for Alice to figure out (1) which information of Bob is still confidential, and (2) whether Alice might be using or disclosing confidential information in violation of a confidentiality agreement. Alice likely would prefer instead to have a bright-line "sunset," after which Alice can do whatever it wants without having to incur the burden of analyzing the facts and circumstances.

An alternative expiration date for Confidential Information might be stated as follows: "For other Confidential Information: Through the end of the calendar day on the date X years from the date that this

Agreement expires or is terminated" or "… the date that all copies of the information are returned or destroyed."

2. *For trade secrets:* Until such time, if any, as the information no longer qualifies as a trade secret;

3. *For information is required by law (for example, privacy law) to be preserved in confidence:* Until such time, if any, as that requirement no longer applies.

j. *Specific examples of Confidential Information:* Alice's obligations under this Rule extend, without limitation, to the following categories of information that otherwise qualifies as Confidential Information:

1. analyses; compilations; forecasts; interpretations; notes; reports; studies; summaries; and similar materials, prepared by (or for, or on behalf of) Alice;

Comment: For those who *really* want to include illustrative examples of Confidential Information, consider selecting from the following list, harvested from various agreement forms: Algorithms. Audit reports. Biological materials. Business plans. Business records. Circuit records. Commercial information. Compounds. Computer programs. Contracts. Construction records. Data-center designs. Designs. Diagrams. Documents. Draft publications. Drawings. Engineering records. Financial information. Financial projections. Financial statements. Forecasts. Formulas. Hardware items. Ideas. Interpretations. Invention disclosures. Leases. Machine-readable data. Maps. Market projections. Marketing information. Methods. Offers. Operational data. Opinions. Patent applications (when unpublished). Plans. Pricing information. Procedures. Processes. Product development plans. Product information programs. Projections. Proposals. Research data. Research plans. Samples. Server-configuration designs. Source code for computer programs. Specifications. Strategies. Tax bills. Technical information. Technical reports. Technological developments. Test data. Title reports.

2. "secret sauce" selections and/or combinations of specific items of information, even if some or all of those items of information, taken individually, would not qualify as Confidential Information;

> Secret sauce: It's well-established in U.S. law that when a party makes a specific selection or combination of one or more particular items of 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); • Integrated Cash Mgmt. Servs., Inc. v. Digital Transactions, Inc., 920 F.2d 171, 174 (2d Cir. 1990) ("winning combination" of generic software programs).

3. the fact of Bob's use of particular nonconfidential information; and

4. third-party information in Bob's possession.

k. *Proving exclusion from Confidential Information status:* Alice might want to be free to use or disclose particular information of Bob's because she didn't think it was confidential. In that situation, Alice must be able to show that, at the relevant time or times, the information in question fell into one or more of the following exclusion categories:

> CAUTION: Just because this Rule does not protect particular excluded information would not mean that the information was fair game for Alice to use or disclose. Both 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).

NOTE: Under this Rule, *subpoenaed* information does not automatically lose its confidentiality status. That's because it might well be possible to get a court to order limitations on what the party issuing the subpoena is allowed to do with the information.

1. The information was generally known to persons within the circles that normally deal with that kind of information — other than by disclosure, in violation of an agreement, by Alice or by others to whom Alice provided the information;

Comment: The "generally known to persons within the circles …" language is a mashup of section 1(4)(i) of the U.S. Uniform Trade Secret Act, https://perma.cc/XK9G-CLJA at 5, as well as 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), https://perma.cc/PHT8-DQFJ.

2. The information was readily ascertainable, using proper means, by the persons described in subdivision 1;

Comment: See the definition of trade secret (§ 2.02.2–1d) and its commentary.

3. A third party made the information available to Alice, without restriction, and in doing so, the third party did not breach an obligation of confidence to Bob;

4. Alice already knew the information when Bob first gave her access to it (but Alice must provide reasonable corroboration of any self-interested testimony);

Comment — corroboration requirement: A receiving party might claim that it already knew Confidential Information before receiving the information from Bob, or that it developed the information independently. Under this Rule, any self-interested testimony in support of such a claim ("sure, we already knew that!") must be supported with reasonable corroboration.

CAUTION: Bob will sometimes propose an even-stiffer corroboration requirement, namely that Alice must prove any exclusion from confidentiality with documentary evidence. This might raise the bar in litigation to a greater extent than Alice would like.

5. Alice developed the information, or someone did it on her behalf, without using information of Bob that was not itself excluded from the definition of Confidential Information (here again, reasonable corroboration of any self-interested testimony is required); and/or

Comment: A party accused of misappropriating confidential information might have a hard time convincing a judge or jury that it independently developed the allegedly misappropriated information on its own. 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 a confidentiality agreement. (Disclosure: The author was part of Rockwell's trial team in that case.)

6. Bob disclosed the information to a third party but didn't require the third party to agree to confidentiality obligations comparable to those of this Rule.

Comment: Disclosure of information to a third party without restriction will normally kill any claim that the information was confidential. See, e.g.: • Southwest Stainless, LP v. Sappington, 582 F.3d 1176, 1189-90 (10th Cir. 2009) (reversing judgment of misappropriation of trade secrets: supplier gave specific price-quote information to a customer without any sort of confidentiality obligation); • 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."

l. *Other restrictions:* If Alice's confidentiality obligations under the Contract were to come to an end, that would not affect Bob's ability to enforce any other intellectual-property rights he might have by law (for example, copyrights and patents) against Alice except to the extent, if any, that Alice and Bob expressly agreed otherwise in writing.

§ 2.02.2–3 Survival of Confidential Information provisions

Even if the Contract were to come to an end, Alice's confidentiality obligations concerning Bob's Confidential Information would remain in effect, no matter what other of its provisions might also deal with the survival of the Contract's terms.

§ 2.02.3. Additional commentary

§ 2.02.3–1 Introduction

The law will protect just about any information that (i) is kept confidential and (ii) provides a competitive advantage to its "owner." This is seen in the definition of trade secret in the (U.S.) Defend Trade Secrets Act, 18 U.S.C. § 1839(3):

> … all forms and types of financial, business, scientific, technical, economic, or engineering information, including patterns, plans, compilations, program devices, formulas, designs, prototypes, methods, techniques, processes, procedures, programs, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialized physically, electronically, graphically, photographically, or in writing if—
>
> (A) the owner thereof has taken reasonable measures to keep such information secret; and
>
> (B) the information derives independent economic value, actual or potential, from not being generally known to, and not being readily

> ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information[.]

A similar definition can be found in section 1(4)(i) of the U.S. Uniform Trade Secret Act, archived at https://perma.cc/XK9G-CLJA at 5. See also 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), at https://perma.cc/PHT8-DQFJ.

These definitions largely codify common-law principles, as summarized in section 757 of the Restatement of Torts:

> 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).

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, emphasis and extra paragraphing added).

§ 2.02.3–2 Protecting *each party's* information is usually a good idea

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).

– *Faster signature:* 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 Rawlsian "*I cut, you choose*" principle — because each negotiator must keep 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.)

– *Greater safety:* 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 protected only the *defendant’s* information. Consequently, said the court, the *plaintiff’s* afterthought disclosures of its own confidential information were unprotected.

– *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 are 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.

§ 2.02.3–3 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.

Ultimately, 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, and your chances.

§ 2.02.3–4 Caution: NDAs and prospective BigCo dealings

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.)

§ 2.02.3–5 Review questions for students

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.]

§ 2.02.4. Confidentiality: Opt-in terms

The following terms apply only to the extent, if any, that the Contract clearly so states.

§ 2.02.4–1 Recipient's Indemnity Option

a. This Option, if agreed to, would apply if both of the following things were true:

1. A third party makes any kind of claim *against Bob* and/or any member of his Protected Group (§ 9.42); and

2. The third party's claim arises from: (i) Alice's use of Bob's Confidential Information, and/or (ii) Alice's disclosure of the Confidential Information to other parties.

b. In such a situation, Alice must defend and indemnify Bob and his Protected Group against the claim, in accordance with the Indemnity and Defense Rule (§ 5.06.3).

> Comment: As with any indemnity obligation, Bob should consider (i) whether Alice has the financial wherewithal to meet this obligation; and (ii) whether to ask Alice also to agree to maintain appropriate insurance coverage. [TO DO: LINK].

§ 2.02.4–2 Recipient's Compliance Responsibility Option

a. The parties wish to plan for the possibility that a third party, "*Tom*," might — legitimately or otherwise — obtain or otherwise access Bob's Confidential Information in question as a result of Tom's relationship with Alice.

b. IF: Tom uses, discloses, and/or copies Alice's Confidential Information in a manner not permitted by the Contract; THEN: Alice will be liable to Bob for any resulting harm to Bob or his interests, to the same extent as if the damage had been caused by Alice's own use, disclosure, or copying of the Confidential Information.

c. For this purpose, the term *third party* includes, without limitation, any employee of Alice.

§ 2.02.4–3 **Recipient Assignment Consent Option**

Alice may not assign the Contract without Bob's written consent in accordance with the Assignment Consent Rule (§ 5.02).

§ 2.02.4–4 **Copies of Confidentiality Agreements Option**

a. If Bob so requests, Alice will provide Bob with a copy of the written confidentiality agreement between Alice and each individual or organization to which Alice provides Bob's Confidential Information.

> Comment: This agreement-production requirement might be burdensome for Alice, but sometimes Bob might have a legitimate need for it.

b. Alice may, if she wishes, have such copies redacted so that Bob will not get to see confidential information of Alice and/or the individual or organization in question.

§ 2.02.4–5 Confidential Information Segregation Option

Alice must keep Bob's Confidential Information segregated from other information, to speed up any necessary return or destruction of the Confidential Information.

> Comment: See also the return-or-destruction provisions, below. This segregation requirement could well be unduly burdensome; on the other hand, such a 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.

§ 2.02.4–6 Confidentiality Compliance Inspection Option

a. At any time that Alice has Bob's Confidential Information in her possession, Bob may cause reasonable inspections of her relevant properties and premises to be conducted, to confirm that she is complying with her confidentiality obligations under the Contract.

> Comment: Receiving parties are highly likely to balk at this Option; in some cases, though, Bob might feel it was necessary.

b. Any such inspection must be upon written notice, far enough in advance to be reasonable under the circumstances.

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 Alice's possession, custody, or control.

§ 2.02.4–7 **Cooperation Against Misappropriation Option**

If Bob asks, Alice must provide reasonable cooperation (at Bob's expense) with any efforts by Bob to take action: (i) to protect Confidential Information against misappropriation, and/or (ii) to redress such misappropriation.

§ 2.02.4–8 **Confidential Information Return or Destruction Option**

a. Except as stated below in this Option: If Bob so requests in writing after termination or expiration of the Contract, then Alice must either (i) turn over to Bob, or (ii) destroy, all copies and other tangible embodiments of Confidential Information (collectively, "copies") in Alice's possession, custody, or control.

> CAUTION 1: In many situations, an obligation to return or destroy Confidential Information might not be practical. For example, it might be a huge, expensive burden to try to purge Confidential Information from phones, tablets, personal computers, etc. Ditto if Confidential Information were embodied in a deliverable (for example, custom-developed computer software, or a physical object) that Alice will have the right to keep on using. (This sort of situation is sometimes seen in services agreements.)
>
> CAUTION 2: Sometimes both parties forget about return-or-destruction obligations. So Bob will want to follow up to be sure that the return-or-destruction requirement is actually complied with; if Bob were to fail to do so, Alice (or a third party) could try to use that as evidence that Bob did not take reasonable precautions to preserve the secrecy of its confidential information. Likewise, if Alice were to forget to comply with her return-or-destruction obligations, then Bob might use that fact to bash Alice in front of a judge or jury.
>
> PRO TIP: To make it easier for Alice to comply with this return-or-destruction obligation, drafters could consider the segregation option (§ 2.02.4–5). Of course, Alice could elect to segregate Confidential Information on her own initiative, even without a specific contractual requirement.

b. Before destroying copies of Bob's Confidential Information, Alice must advise Bob in writing, by any reasonable means (including without limitation email), at least five business days in advance. If Bob so requests as to particular information, Alice will turn over the copies to Bob instead of destroying the copies.

> Comment: This requirement has in mind the situation in which Bob doesn't himself have a copy of Confidential Information to be destroyed. That might occur if, say, (i) Alice had developed particular information that, under the Contract, was Bob's property, but (ii) Alice hadn't yet provided any copies of the information to Bob.

c. Except as provided in subdivision e, Alice need not return or destroy electronic copies of Bob's Confidential Information to the extent that it would be unduly burdensome or costly for her to do so; specific examples that need not be returned or destroyed would be Confidential Information in email attachments and system-backup media.

> Comment: Alice might find it to be tremendously burdensome — and expensive — to try to return or destroy all copies of Bob's confidential information, even those in emails, backup systems, etc.

d. Except as provided in subdivision e, Alice may keep archive copies of Bob's Confidential Information in accordance with the Archive Copies Rule (§ 3.10.9).

e. If Alice is an employee of Bob — for this purpose, the term "employee" includes, without limitation, an individual contractor — then Alice must not retain copies of Confidential Information except solely for the purpose of imminent disclosure subject to one of the exceptions above (response to subpoenas, legally-immune disclosures, etc.).

f. Alice's confidentiality obligations under the Contract will continue in effect by their terms for all copies of Bob's Confidential Information that are not returned or destroyed under this Option.

g. IF: Bob so requests in writing within a reasonable time after the return-or-destruction requirements of this Agreement become applicable; THEN: Alice will promptly provide Bob with a written certificate of her compliance with those requirements. The certificate must:

1. be signed by Alice (if an individual) or by an officer of Alice (if an organization) who is 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 Contract (unless doing so is prohibited by applicable law, for example because Alice is cooperating with law-enforcement authorities).

> Comment: Requiring Alice to certify her compliance with the return-or-destruction requirements would: • make it easier for Bob to manage his contract rights; • give Alice 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 Bob with an opening to make a "they lied!" accusation (see the commentary at § 7.07.2) in case it turned out that some specimens of Confidential Information were not returned or destroyed.

§ 2.02.4–9 **M&A Disclosure Option**

a. Alice may, without Bob's consent, disclose Bob's Confidential Information to a prospective acquirer, "*Mary*," of:

1. substantially all shares (or equivalent ownership interest under applicable law) of Alice (if an organization); or

2. substantially all of the assets of Alice's business specifically associated with the Contract.

> Comment: 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

b. Mary must agree in writing to abide by Alice's obligations concerning Bob's Confidential Information.

c. Any disclosure under this Option must be done (i) in one or more secure physical data rooms and/or (ii) via a secure online data room.

d. Alice must not allow Mary to keep copies of Bob's Confidential Information without Bob's prior written consent.

§ 2.02.4–10 **Public-Filing Disclosure Option**

a. Alice may include Bob's Confidential Information in a submission to a regulatory agency or other governmental body, but only if all of the prerequisites in this Option are met.

b. 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 (§ 2.02.2–2e).

c. Alice must first consult with Bob a sufficient time in advance to give Bob a reasonable opportunity to seek a protective order or other relief.

d. Alice must disclose only so much Confidential Information as is required to comply with the law.

e. Alice must provide reasonable cooperation with any efforts by Bob 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.

> Comment: A receiving party that is publicly traded (or wants to be) might feel it must disclose Confidential Information in its public filings. **Such public disclosure, though, would almost certainly destroy the confidentiality 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).
>
> Example: This 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 Vulcan's confidential information in a public filing with the Securities and Exchange Commission.

§ 2.02.4–11 General Experience Exclusion Option

a. The Contract's restrictions on Alice's use of Bob's Confidential Information do not limit the ability of Alice's personnel to utilize their general knowledge, skills, and experience in the general field(s) of the Confidential Information, even if improved by exposure to such information.

> Comment: This option is inspired by 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 Bob because of the difficulty of determining when it did or didn't apply.

§ 2.02.4–12 **Residuals Rights Option**

a. The term "*residuals*" refers to ideas, concepts, know-how, techniques, and similar information that may be retained in the unaided memory of Alice's personnel who did not intentionally memorize the information for that purpose.

b. Alice may use residuals as it sees fit without obligation to Bob — this subdivision, however, does not negate any restriction of an agreement on Alice's disclosure of Bob's Confidential Information to third parties.

> Comment: Some receiving parties (cough, Microsoft) have tried to include provisions granting them "residual rights" along these lines.
>
> CAUTION: The danger is that granting residuals rights of this kind could later result in he-said-she-said disputes about whether Alice's personnel were in fact relying on their unaided memories — and that same uncertainty might well tempt Alice to treat this language as a get-out-of-jail-free card to do whatever it wanted with Bob's confidential information. For that reason, Bob likely will push back strongly against any request for residuals rights.
>
> On a related 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).
>
> PRO TIP: If pressured to agree to this provision, Bob might also try to exclude particular receiving-party personnel or departments from being able to exercise residual rights.

c. For the avoidance of doubt, any use of residuals by Alice will be subject to any applicable patent rights, copyrights, trademark rights, or other intellectual-property rights owned or assertable by Bob.

> Optional additional reading: 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).

§ 2.02.4–13 **General Skills Exclusion Option**

The term *Confidential Information* does not include general skills and experience developed by Alice's personnel as a result of working with Bob's Confidential Information.

> Comment: This exclusion can present difficult line-drawing problems but is sometimes requested by receiving parties.

§ 2.02.4–14 **Toolkit Exclusion Option**

The term *Confidential Information* does not include any concept, idea, invention, strategy, procedure, architecture, or other work, THAT: (1) is, in whole or in part, created by Alice as a result of working with Bob's Confidential Information, but (2) is not specific, and/or is not unique, to Bob and its business, and (3) does not include Bob's Confidential Information.

§ 2.03. Letter of Intent Rule

a. *Applicability:* This Rule applies if an agreed term sheet or other agreement (the "*LOI*"):

1. adopts this Rule (thus incorporating it by reference); and/or

2. adopts the Tango Terms and states that the LOI is a "letter of intent," a "memorandum of understanding," or similar document.

b. *Background:* 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 final, definitive written agreement (a "*Final Agreement*") that: (i) sets forth final, agreed terms of the Arrangement; and (ii) is signed and delivered by all relevant parties.

> Comment: 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).

c. *Intent:* The parties are agreeing to the LOI to serve as an interim agreement, but they intend for the LOI to be partly nonbinding, with the following purposes:

> CAUTION: The consequences of parties' entering into a "non-binding" letter of intent can be significant if a court finds that the parties in fact 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 $27 billion in 2019 dollars, for interfering with what the jury

> and the courts found to be Pennzoil's binding memorandum of understanding with Getty Oil.

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 with a convenient working outline of the potential Arrangement as they are currently contemplating it; and

3. to set out agreed ground rules for the parties' anticipated discussions about the potential Arrangement.

d. *Materiality of this Rule:* Each party acknowledges that without that party's agreement to this Rule, the other party would not go forward with discussions about the potential Arrangement.

e. *Only limited binding provisions:* The parties intend for only the following terms in the LOI to be binding unless and until the parties enter into a Final Agreement:

1. this Rule; and

2. any other terms in the LOI that the parties have clearly agreed in writing will be binding.

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; this is true regardless whether the purported right or obligation supposedly arises in contract; tort; strict liability; *quantum meruit*; quasi-contract; unjust enrichment; or otherwise.

> Comment: 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 (in 1983 dollars) 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).

f. *Discussions and messages not binding:* In case of doubt, the parties intend that their discussions and other messages concerning the potential Arrangement, in any form or medium, before their formal entry into the Final Agreement, will not be binding on either party. This is true:

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 message exchanges occur about the potential Arrangement.

Comment: "Any form, any medium": This encompasses, for example, emails; text messages; Internet chat messages; and hard-copy letters, memos, and notes.

Discussions, texts, etc.: 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.

g. *No effect of early start:* IF: A party begins taking action concerning the potential Arrangement before a Final Agreement has been fully signed and delivered; THEN:

1. That party 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 constitutes or evidences (i) agreement to the Final Agreement, nor (ii) the formation of a partnership, joint venture, or other kind of relationship.

Comment: This section tries to forestall a particular type of finding: That a 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.

Moreover, **under state law a partnership can arise even without a contract:** According to a Texas jury — whose verdict was subsequently overturned on appeal and is now being appealed even further — two parties formed a *de facto* partnership, even though they had signed an LOI disclaiming any such intent, because (said the plaintiff and the jury) the parties had *conducted* themselves as though they were partners. See Energy Transfer Partners, L.P. v. Enterprise Products Partners, 529 S.W.3d 531 (Tex. App.—Dallas 2017). At this writing, in early January 2020, a further appeal has been filed at the Supreme Court of Texas; the parties' briefs on the merits, as well as amici briefs, are available at the supreme court's Website under docket number 17-0862.)

h. *Confidentiality:* 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. (The parties do not intend for this Rule to otherwise limit or expand any confidentiality agreement that would otherwise apply.)

> Comment: 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 section takes the latter possibility into account.
>
> Parties can consider also agreeing to the Tango Confidentiality Rule and/or to the Confidentiality of Dealings Rule.

i. *No exclusivity unless expressly agreed:* Until such time (if any) as the parties enter into a Final Agreement, each party remains free — in that party's sole and unfettered discretion — to seek, discuss, negotiate, and/or enter into arrangements, of any kind, with other parties. This is true even if, as a result of other discussions, it would no longer be possible for one or more of the parties to enter into a Final Agreement.

> Comment: In some LOIs, one or both parties might insist on an exclusivity provision, but any such provision should be negotiated carefully.

j. *Withdrawal from discussions:* Any party may withdraw from discussion of the potential Arrangement and negotiation (if any) of a Final Agreement:

1. 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 that party's own interests and desires; and

3. without obligation or liability of any kind, under any legal- or equitable theory, to any other party.

k. *No claim of bad-faith withdrawal:* Each party agrees not to claim, under any circumstances, that another party's withdrawal under subdivision j was done in bad faith; any obligation to negotiate a Final Agreement in good faith is to be conclusively deemed satisfied.

> Comment: This section 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 here: These subdivisions 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.

Chapter 3: Rules for principal operations

The rules in this chapter will apply to the extent that the Contract indicates that the associated operations are to occur. EXAMPLE: If the Contract indicates that one party is to deliver goods to another, then the Order Fulfillment Rule will apply.

§ 3.01. Services Rule

§ 3.01.1. The Rule

§ 3.01.1–1 Definitions: Provider; Customer

In this Rule, "*Provider*" refers to a party that, under the Contract, is to perform services for (or at the behest of) another party, referred to as "*Customer*."

§ 3.01.1–2 Statements of work

a. *Written statements of work strongly preferred:* Services under the Contract (and the compensation for them) should be specified in one or more agreed, written, statements of work, signed by each party.

> Comment: It's extremely common — and a very good idea — for services agreements to separate the "technical" details of a services contract into a written statement of work (a.k.a. a "work order" or a "scope of work").
>
> Note: This Rule states a strong preference for *written* statements of work but does not *require* them, because parties don't always do business that way — see below for special requirements for oral statements of work.
>
> ALTERNATIVE: "Provider will not be obligated to provide services under the Agreement, nor will Customer be obligated to pay for

them, except as set forth in a written statement of work, signed by the party sought to be bound; no party is to assert otherwise." COMMENT: The no-assertion language is intended to make it a breach of contract for a party to contend otherwise, with the compensable damages including 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 writing requirement, as discussed in the commentary to § 6.01).

CAUTION: Don't assume legal review of statements of work won't be necessary. Some contract reviewers make the mistake of ignoring statements of work, 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 statement of work, because: (i) the reviewer will be better able to negotiate the terms and conditions if she has some idea of the technical details; and (ii) perhaps unconsciously — or perhaps deliberately — the other side's drafter might have included important "legal"-type terms and conditions in the statement of work, in the hope that the contract reviewer might overlook them.

Optional reading: For a useful overview of statements of work, a.k.a. "work orders," see generally, e.g., Stephen F. Pinson, Negotiating a work order: Key Terms (ScottAndScottLLP.com 2016), archived at https://perma.cc/8JYJ-KEJT.

b. *Modification of statements of work:* If Bob signs a change order for a statement of work, then Alice may enforce the change order even if she did not herself sign it.

CAUTION: In some jurisdictions, courts might not honor a contractual requirement that amendments and waivers must be in writing; see the commentary at § 6.01.

The language "signed by the party against which enforcement of the change order is sought" is based on the (U.S.) Uniform Commercial Code's statute of frauds provision, which requires only that a contract be signed "by the party against whom enforcement is sought ...." UCC § 2-201.

§ 3.01.1–3 Licenses and permits

a. *Licenses and permits for services performance:* Provider is to see to the timely procurement of the following:

1. any permits and licenses needed for Provider's performance of services generally — for example, building permits, contractor- and occupational licenses, etc.; and

Comment: 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:

– 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 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, might 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), where the appeals court reversed a $220,000-plus judgment in favor of a subcontractor, on grounds that the 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; see, e.g., The Fifth Day, LLC v. Bolotin, 72 Cal. App. 4th 939 (2d Dist. 2009).

– California courts have looked to Cal. Lab. Code § 2750.5 to hold that if an unlicensed subcontractor fails to pay wages, withholding, and worker's compensation premiums for its employees, then the prime contractor that used the unlicensed subcontractor is responsible for those amounts; see generally this Pillsbury Winthrop memo.

2. any special authorizations for performance of the services that go beyond what would normally be required in Provider's general line of work.

b. *Licenses and permits for use of deliverables:* Customer is responsible for obtaining any licenses or permits needed for use of deliverables.

> CAUTION: A services customer might need to obtain authorizations to use deliverables produced by services. For example, the customer might require a government permit or a patent license to use the deliverables.
>
> Perhaps the parties' agreement includes a warranty by the service provider 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 the customer's use of the deliverables infringes the third party's IP rights, e.g., by infringing a patent or copyright.
>
> It can be a big mistake for a customer to fail to establish clear lines of responsibility about who will obtain any third-party authorizations that might be needed. A California customer received an expensive lesson on that subject when he hired a Web developer to revamp his company'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 customer — 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).

c. *Licenses and permits — disagreements:* IF: Provider and Customer disagree in writing about the need for a particular third-party authorization; THEN: Provider will not be in breach of an agreement or the statement of work if, by notice to Customer, Provider suspends the relevant work pending resolution of the disagreement.

> Comment: Disagreements over permits and licenses have 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, you don't need no stinkin' permit; get to work.* In such a situation, the provider — not wanting to become liable for violating the law, 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.

d. *Licenses and permits — indemnity obligation:* IF: Alice is responsible under the Contract for obtaining a permit or license; AND: Alice fails to do so, and as a result a third party makes a claim against Bob arising from that failure; THEN: Alice will defend and indemnify Bob and his Protected Group (§ 9.42) against all damages and losses they incurred as a result of the claim.

Comment: Some illustrative examples of 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.

Indemnity: 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.

§ 3.01.1–4 Performance of services

a. *Qualifications for individual service personnel:* Provider is to 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;

Comment: 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 possibility: 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, whereas on the other hand it might be obvious that the Provider employee trying to perform the work clearly doesn't know what he or she is doing.

2. are bound by confidentiality- and invention-assignment obligations to Provider sufficient to support any corresponding obligations that Provider has to Customer under an agreement;

3. are legally able to be employed in any jurisdiction where those personnel are to be physically present; and

4. meet any specific qualifications set forth in the statement of work.

b. *Performance standard:* Provider is to see to it that all services are performed:

Comment: These performance requirements are phrased as a *covenant*, that is, promises, and *not* as representations or warranties – although a warranty is 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.

1. safely; and

2. in a "workmanlike" manner — that is to say, (i) *by personnel* who have the knowledge, training, or experience necessary for the successful practice of the relevant trade or occupation; and (ii) *in a manner* that is generally considered proficient by those capable of judging such work.

Comment: This definition of *workmanlike* 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 term *workmanlike* seems widely used in court decisions, sometimes as "skillful and workmanlike" (which is arguably redundant). See generally Fed. Ins. Co. v. Winter, 354 S.W.3d 287, 292-93 (Tenn. 2011) (extensively reviewing case law and treatises).

> In this definition, the language "necessary for the successful practice …" calls for judging Provider's performance according to a pragmatic, real-world standard — but that would likely require (expensive) expert testimony in the event of a dispute and thus might make a relatively-quick summary judgment unlikely.
>
> Some service providers might fear that "workmanlike" could be vague; they might prefer *in accordance with the specifications* or perhaps *competent and diligent*. But any of these terms would likely require factual determinations in litigation or arbitration, too.
>
> ALTERNATIVE: "Provider will see to it that all services are performed in a first-class manner —namely, (i) by personnel who have the knowledge, training, or experience necessary for the successful practice of the relevant trade or occupation, (ii) in a manner generally considered excellent to outstanding (but not necessarily flawless) by those capable of judging such work." COMMENT: Customer might want to require "first-class" performance, but if Provider has bargaining power, then it might charge more; Customer might well prefer to pay for simple "workmanlike" performance.

c. *Performance of all individual tasks:* Provider is to see to 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.

> Comment: 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 the provider is supposed to do. In that case, the presence or absence of this all-individual-tasks language seems unlikely to make a difference either way. • So, if the all-individual-tasks language gives the customer some comfort, why not include it; doing so can help to remove a potential delay on the path to signature.

d. *Option for background check:* IF: The statement of work clearly so states; THEN: Provider will cause background checks to be performed, per the Background Checks Rule (§ 5.04), on all non-Customer personnel who, under the statement of work, (i) provide services while physically on-site at Customer's site, or (ii) have access to Customer's computer network.

e. *Furnishing of all materials:* Provider is to see to 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.

> Comment: 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.

f. *Furnishing of all safety equipment:* Provider is to see to 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).

> Comment: 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.

g. *Supervision:* Provider is to see to all supervision and, to the extent necessary, training of all individuals engaging in the services.

h. *Control of 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.

> Comment: 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 § 6.09 (independent-contractor status).

i. *Customer's responsibility:* 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.

> Comment: This provision should be unobjectionable — and it did draw an objection from a customer, that would be a red flag: • that the customer might be a "problem child," and/or • that the customer wanted the provider to "just take care of it and send me the bill when you're done."

> NOTE: 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.

§ 3.01.1–5 **Defects in services or deliverables**

Provider is to proceed in accordance with XXX in any case of defective performance of services and/or delivery of defective deliverables.

> Comment: 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 XXX).

> OPTIONAL: "This is the EXCLUSIVE REMEDY for defects in performance of services and/or in deliverables."

§ 3.01.1–6 Customer right to use deliverables

a. Provider consents to Customer's use, as Customer sees fit, of any and all deliverables resulting from services under the Contract.

> Comment: The "Provider consents" phrasing is used because Provider might not have the power to "authorize" Customer's use of deliverables — because Customer use might also be limited by, e.g., (i) third-party intellectual property rights, and/or (ii) applicable law such as export- or privacy law. (Of course, an agreement might include warranties by Provider on such subjects, e.g., warranties of noninfringement of selected third-party IP rights.)
>
> OPTION: "Customer may not use deliverables under an agreement, either as delivered or as later modified, for *service bureau use*, which refers to the providing of services to or for third parties, where performance of the services includes (without limitation) functions performed by one or more of such deliverables." COMMENT: 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 or expose Provider to additional risk of liability. (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?)
>
> ALTERNATIVE OPTION: "Customer may use deliverables for service-bureau use, but only within the following limits: *[SPECIFY]*."

b. The consent of subdivision a extends any and all intellectual-property rights or other exclusionary rights that are owned or otherwise assertable by Provider.

§ 3.01.1–7 Continued development of deliverables by Customer

a. *Right to further develop:* Customer may: (i) modify or otherwise continue development of deliverables, and/or (ii) have the same done by others on behalf of Customer.

> OPTION: "To help protect Provider's trade secrets and other confidential information, Customer may not have deliverables modified by competitors of Provider."
>
> ALTERNATIVE: "Customer may not modify or otherwise continue development of deliverables, nor have the same done by others." COMMENT: Just because Customer paid for the deliverable does not mean that Customer necessarily has the right to further develop it. For example, if the deliverable is a copyrighted work of authorship such as computer software, then Provider might have the right, under copyright law, 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 continue development of the deliverable as it wished. This was the case in, for example, Effects Resellers, Inc. v. Cohen, 908 F.2d 555, 558-59 (9th Cir. 1990). But it might require extended and expensive litigation for Customer to win such a 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).

b. *Development support limitations:* 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.

> Comment: Declining to support others' modifications: Providers will often be reluctant to take on any responsibility for deliverables that anyone else has "messed with."

c. *Development compliance:* Any permitted deliverable-related modification- or development activity, by or on behalf of Customer, must not violate:

1. applicable law such as export-controls laws; nor

2. any unrelated IP rights assertable by Provider, if any, nor
3. any additional restrictions specified in the Contract.

§ 3.01.1–8 **Payment for services**

a. *Invoicing:* Provider is to send Customer one or more invoices for services, and for reimbursable expenses, if applicable, as follows:

1. on the schedule specified in the statement of work, if any;
2. otherwise, one-half upon agreement to the statement of work and the balance upon completion and acceptance of the services.

> Comment: 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 (§ 5.02) if the service provider will be billing on anything other than a flat-fee, all-inclusive fee.
>
> Comment: 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.

b. *Payment terms:* Customer is pay for services as stated in the statement of work and in the payment terms of the Contract.

> Comment: See the payment terms in § 3.01 and the optional additional terms in § 3.10.15.
>
> OPTION: "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." COMMENT: A services provider, desirous of getting paid, might seek to include this provision out of concern 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.
> ¶ A customer, however, likely would object to such a provision,

perhaps objecting that a minor payment dispute should not call into question the customer's right to use the deliverable(s) and possibly even disrupt an M&A transaction. ¶ In the U.S., as a compromise the provider might want: • to take a security interest (XXX) in the customer's right to use the deliverable(s), using a clause provision such as [TO DO]; and • to "perfect" the security interest by filing a UCC-1 financing statement.

§ 3.01.1–9 Expense reimbursement

If the statement of work so states, Customer will reimburse Provider for reasonable out-of-pocket expenses actually incurred in providing services in accordance with the Expense Reimbursement Rule (§ 4.05).

§ 3.01.1–10 Suspension of services for nonpayment

a. IF: Customer does not pay Provider an amount due under the Contract within seven days following the original payment due date; AND: The nonpayment is clearly 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 the effective date of Provider's notice to Customer of upcoming suspension; and

2. Any such suspension will be without prejudice to Provider's other remedies for the nonpayment.

Comment: This language is modeled on an American Institute of Architects contract form that was litigated in U.W. Marx, Inc. v. Koko Contracting, Inc., 124 A.D. 3d 1121 (N.Y. App. 2015).

ALTERNATIVE 1: "In no event may Provider suspend or terminate performance of the services because of a payment dispute." This alternative is modeled on § 2.5 of a 2008 outsourcing agreement between Boise Cascade, L.L.C., and Boise Paper Holdings, L.L.C.

ALTERNATIVE 2: "In no event may Provider suspend or terminate performance of the services except as expressly provided in this Agreement or in the relevant statement of work." This 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.

OPTION: IF: Provider suspends performance of the services due to nonpayment, but then resumes performance; THEN: 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: (1) any resulting delay; and (2) redeployment of personnel- and material resources in connection with (i) the suspension of work and (ii) any resumption of work. COMMENT: Drafters should consider providing for an independent expert to oversee and, if necessary, to decide the pricing adjustment. See also the Baseball Arbitration Rule (§ 7.08).

§ 3.01.1–11 **Termination of statement of work for breach**

a. Either party may terminate a statement of work for material breach by the other party, effective immediately upon notice of termination to the other party, if both of the following prerequisites are satisfied:

Comment: These provisions draw on terms found in various services-agreement forms.

Termination by *Provider*: In many cases, the most-significant breach Customer will likely commit is failing to pay Provider's invoices. ALTERNATIVE: "Provider may not terminate a statement of work for breach by Customer unless clearly so stated in the statement of work or otherwise agreed in writing"

1. the terminating party gives the breaching party notice that specifies the breach in reasonable detail; and

2. the breach is not cured, and the breaching party gives the terminating party notice of the cure (with reasonable supporting evidence) within five business days after the breaching party's receipt of the notice of breach.

§ 3.01.1–12 **Specific events of breach by Provider**

a. Except as otherwise agreed, any one or more of the following events would allow Customer to terminate a statement of work for breach as provided above:

> Comment: This is provided mainly as a "comfort clause" for Customer.

1. Provider does not timely start to perform the services, if the parties have agreed in writing that a specific start time is material;

2. Provider is clearly shown to have permanently abandoned performance;

> Comment: This subdivision and the next one allow Customer to terminate a statement of work if Provider (i) abandons, or (ii) in certain circumstances, suspends performance of the work. Either must be clearly shown, to reduce the chances of premature- or bad-faith terminations by Customer.

3. Provider is clearly shown to have temporarily suspended performance if the Contract 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 Contract and/or the statement of work, if the parties have agreed in writing that timeliness is material (for example, by stating that time is of the essence).

§ 3.01.1–13 Termination of statement of work at will by Customer

a. Unless the Contract or the statement of work clearly indicates otherwise, Customer — but not Provider — may unilaterally terminate a statement of work at will in accordance with (i) the Termination at Will Rule (§ 5.05) and (ii) the wrap-up provisions of this Rule (§ 3.01.1–14).

> Comment: A customer might well want the right to "pull the plug," i.e., terminate a statement of work, at will. That should normally be fine with the provider — but only if the provider will be compensated for (i) the work it has done and expenses it has incurred to date, and (ii) any costs incidental to the termination, for example, costs of finding new paying work for employees dedicated to the customer's project.
>
> The "default value" of this provision does not allow Provider to terminate a statement of work at will, because Customer likely would not want Provider to be able to walk away and leave Customer in the lurch.
>
> 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.
>
> OPTION: "A termination at will of a statement of work by Customer will not be effective earlier than six months after the effective date of Customer's notice to Provider of termination at will." COMMENT: This 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.

OPTION: "Any termination at will by Customer that complies with the express requirements of the Agreement (including but not limited to the termination-at-will provisions of this Rule) is to be conclusively deemed to satisfy any applicable standard of good faith and fair dealing. COMMENT: This good-faith conclusive presumption is intended to roadblock aggressive trial counsel from trying to gum up a dispute by accusations of bad faith."

OPTION: "Customer will not be liable for any harm suffered by Provider as a result of termination at will by Customer."

OPTION: "A termination at will of a statement of work by Customer before [SPECIFY TIME] will not become effective until Customer pays Provider — as alternative performance and not as liquidated damages — an early-termination fee, in the amount of [SPECIFY AMOUNT] or as stated in the statement of work, at the same time as giving notice of termination." PRO TIP: The amount of the early-termination fee could be reduced as time goes on and Provider presumably recoups more of its investment in the project. COMMENT: The "alternative performance" term 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.

OPTION: "Customer may not terminate a statement of work at will until the specified milestones in the Agreement or statement of work have been achieved."

OPTION: "A notice of termination at will by Customer will not take effect as a notice before [SPECIFY TIME] or in the statement of work, whichever is later. (In case of doubt, this is a different issue than when the termination itself will take effect.)"

ALTERNATIVE: "Customer may not terminate a statement of work at will."

§ 3.01.1–14 **Post-termination wrap-up**

a. *Post-termination deliveries:* Promptly after any termination of a statement of work, Provider is to cause the "**Termination**

Deliverables,” namely the following, to be delivered to Customer or to Customer’s designee:

> Comment: The “or to Customer’s designee” language has in mind that, if Customer is pulling the plug on a statement of work, then Customer might want Provider to turn over any work-in-progress to another service provider to finish up the work. (See also § 11.07.2 concerning performance bonds.) See generally Blaine Green and Michael Murphy, Lessons from Litigating Technology Services Agreements(PillsburyLaw.com 2014).

1. all completed deliverables and work-in-progress for that statement of work — those, however, 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;

3. any Customer-owned data that was provided by or on behalf of Customer; and

4. any Customer-owned data that was generated by or on behalf of Provider, in connection with that statement of work.

b. *Final invoice(s) after termination:* 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.

> Comment: After any termination of a statement of work, getting paid will doubtless be a high priority for Provider. That might involve an awkward discussion if Customer claims that Provider failed to meet its obligations under the statement of work. And *that’s* especially likely if it’s 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, such as invoices from subcontractors and/or providers of matériel).

c. *Final payments upon termination:* Unless otherwise agreed in writing: Promptly upon any termination of a statement of work, Customer is to pay:

1. all then-pending Provider invoices; and

2. Provider's subsequent final invoice(s) for previously unbilled services and/or reimbursable expenses — to the extent consistent with any payment prerequisites in the statement of work (e.g., requiring achievement of particular milestones as a prerequisite for payment).

d. *Termination not Customer's sole remedy for Provider breach:* Customer's right to terminate a statement of work for breach by Provider would be in addition to any other recourse available to Customer under an agreement, the statement of work, or the law (subject to any agreed limitations of liability).

> ALTERNATIVE: "Customer's right to terminate a statement of work for breach by Provider would be Customer's **EXCLUSIVE REMEDY** for the breach(es) that gave rise to Customer's right to terminate."

e. *Continuance of confidentiality obligations:* Upon termination of a statement of work, each party must continue to honor any applicable confidentiality obligations stated in an agreement and/or in the statement of work.

§ 3.01.2. Additional opt-in services terms

The terms below apply in the Contract only to the extent (if any) that the Contract clearly so states.

§ 3.01.2–1 Mitigation of Schedule Slips Option

IF: A statement of work clearly states that a particular milestone (i) is material, and (ii) must be completed by a specified date; AND: The milestone is not completed by that 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.

> Comment: 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.
>
> Depending on the circumstances, Provider's efforts might or might not need to be at Provider's sole expense in order to be reasonable.

§ 3.01.2–2 Prohibited Use of Deliverables by Others Option

OPTION: "Customer may not allow others (for example, Customer's other contractors) to use deliverables under an agreement, not even for Customer's business purposes."

§ 3.01.2–3 Customer Ownership of Deliverables IP Rights Option

a. As between Provider and Customer, Customer will own all intellectual-property rights (if any) in and to any deliverables created in the performance of Provider's obligations under a statement of work, by one or more employees of Provider (and/or of Provider's subcontractors, if any).

Comment: Consider also XXX (IP ownership protocol).

CAUTION: 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. [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."

– Giving the customer ownership of the IP rights would likely mean that the provider would not have standing to sue third parties 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 associated IP for any and all purposes.

The above compromise would not be ideal for the provider, but it could be an acceptable business risk.

b. Provider will seasonably disclose to Customer — in writing, and in as much detail as Customer reasonably requests — all technology and other intellectual property that the statement of work calls for to be owned by Customer.

Comment: Under UCC § 1-205, an *action is taken seasonably if the action is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.*

§ 3.01.2–4 **Loss of Deliverables Rights for Nonpayment Option**

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.

Comment: A services provider, concerned about the possibility of not getting paid, might seek to include this provision in the Contract. This might be a particular concern if the provider suspected that the customer could file for bankruptcy protection — in which case the customer might continue to enjoy rights in the deliverable(s) while possibly paying the provider no more than pennies on the dollar.

Of course, a customer likely would object to this a provision like this one. 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.

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.

> The provider could also look at other options for ensuring that it will be paid, such as a guaranty (§ 4.06), a standby letter of credit (§ 11.12), and/or a payment bond (§ 11.07.1).

§ 3.01.2–5 Post-Termination Deliveries Delay Option

IF: Provider's already-sent invoices — for any statement of work — are past due when a statement of work is terminated; THEN: Provider may delay delivery of the Termination Deliverables until all such invoices are paid in full.

> Comment: "For any statement of work": In some situations, Customer might terminate (let's say) statement of work #2 but hasn't paid the invoices for statement of work #3. In that situation, Provider might legitimately want to hold off on delivering the Termination Deliverables for statement of work #2 until the invoices for statement of work #3 are paid as well.
>
> ALTERNATIVE: "Provider must deliver the Termination Deliverables to Customer whether or not Customer has fully paid Provider's outstanding invoice(s) and/or final invoice(s)."

§ 3.01.2–6 Provider Post-Termination Compliance Option

Upon termination of a statement of work, Customer need not pay Provider's final invoice(s) for then-unbilled services, if any, until Provider has complied with its applicable post-termination obligations.

§ 3.01.2–7 Adjustment of Final Payment for Material Breach Option

If a statement of work is terminated for material breach by Provider, then Customer's final payment obligation is to be adjusted appropriately as agreed by the parties or as determined by a tribunal of competent jurisdiction.

> Comment: : This option is likely to be important if Customer "pulled the plug" because of (alleged) poor performance by Provider.
>
> PRO TIP: 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.

§ 3.01.2–8 **Expiration as Termination Option**

Unless clearly agreed otherwise in writing, an expiration of a statement of work is to be considered a form of termination.

> Comment: 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.

§ 3.02. Resale Rule

§ 3.02.1. The setting

This Rule applies when, under a resale arrangement specified in the Contract, a party ("*Reseller*") is to deal in products, services, and/or other offerings of another party ("*Supplier*").

§ 3.02.2. The Rule

§ 3.02.2–1 **Term sheet template**

The following terms are placeholders for discussion and legal review; these terms will apply unless the Contract clearly specifies otherwise.

a. *Territory:* The "*Territory*" in which Reseller may deal in Offerings during the Reseller Relationship is: Worldwide, in all market segments (whether now or later existing).

b. *Term:* The Reseller Relationship will last for two years from the effective date of the Contract and will be automatically extended for successive two-year extension terms [IF COPIED: in accordance with the Tango Terms Evergreen Extension Rule] (§ 5.05).

c. *No exclusivity:* The Reseller Relationship is non-exclusive [IF COPIED: per the Tango Terms Exclusivity Definition] (§ 9.24).

> Comment: If the Reseller Relationship will be exclusive, be sure to review the exclusivity definition cited above.

d. *Authorized resale offerings:* 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.

> Comment: Supplier might want to consider limiting the authorized Offerings to those for which Reseller has been suitably trained. Parties might also want to negotiate different Offerings for different time periods and/or different territories.

e. *Discount:* Reseller's discount for Offerings is: 0.01%.

> Comment: The 0.01% discount is of course a placeholder number.

f. *No agency:* Reseller is not Supplier's agent and will conduct itself accordingly at all times.

> Comment: 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.

§ 3.02.2–2 Reseller performance obligations

a. *Required sales-promotion efforts:* During the Reseller Relationship, Reseller must make commercially-reasonable efforts to promote sales of the Offerings within the Territory.

> Comment: See the definition of commercially reasonable at XXX and in the extended commentary at XXX.
>
> Supplier might want 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 • translate Supplier's sales- and marketing materials for foreign markets — although that's something that Supplier might want to do itself for quality-control purposes.
>
> ALTERNATIVE: "During the Reseller Relationship, Reseller must use its best efforts to promote sales of the Offerings within the Territory." See the discussion of *best efforts* in the footnotes and in the extended commentary at XXX. COMMENT: A best-efforts commitment would normally go hand-in-hand with exclusivity [CITE NEEDED].
>
> ALTERNATIVE: "During the Reseller Relationship, Reseller must achieve the following performance targets: [FILL IN]. If Reseller does not achieve those targets, then [FILL IN CONSEQUENCES]." COMMENT: 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 (KPI). COMMENT: Consequences for missing targets could include loss of exclusivity and conversion to month-to-month status — possibly as Supplier's exclusive remedy. BUT: 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.

§ 3.02.2–3 Identification of Reseller Relationship

a. *Reseller identification 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.

b. *Reseller use of Supplier's logos (with restrictions):* During the term of the Reseller Relationship, Reseller's identification of itself as a Supplier channel associate (per § 3.02.2–3a) may include commercially reasonable use of Supplier's logos for the relevant Offerings.

1. Any such use of Supplier's logos must conform to § 5.12 (trademark use).
2. Reseller must promptly stop using Supplier's logos if requested in writing by Supplier.

c. *Supplier identification of 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 § 3.02.2–3a and § 3.02.2–3b (substituting "Reseller" for "Supplier" and vice versa).

§ 3.02.2–4 Fulfillment of orders for Offerings

a. *Reseller's customers ordering directly from Supplier:* Supplier may fill any orders for Offerings that it receives directly from Reseller's customers.

b. *Reseller ordering from Supplier:* The parties anticipate that *Reseller* will order Offerings from Supplier or its designee.

> Comment: 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.

c. *Order handling:* Orders for Offerings are to be handled in accordance with the Order Fulfillment Rule (§ 3.01).

§ 3.02.2–5 Pricing for Offerings

a. *Pricing for orders by Reseller:* During the Reseller Relationship, Reseller will be entitled to pay for Offerings at Supplier's then-standard list pricing, less Reseller's discount (§ 3.02.2–1e).

> ALTERNATIVE: "… Reseller *will* pay for Offerings …." (emphasis added). COMMENT: This alternative has 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.

b. *Pricing for orders by Reseller's customers:* During the Reseller Relationship, any customer that (i) was referred to Supplier by Reseller, and (ii) did not have a prior relationship with Supplier, will be entitled to pay for Offerings:

1. at Supplier's then-standard list pricing, less the Reseller discount; or

2. at the customer's option, at pricing as agreed by Supplier and the customer.

> Comment: In contrast to subdivision a, this subdivision 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.

c. *No Supplier control over resale pricing:* As between Reseller and Supplier, Supplier has no authority to determine the prices that Reseller charges to Reseller's customers.

> Comment: 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.

§ 3.02.2–6 **Payment for Offerings**

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.

§ 3.02.2–7 **Warranties, etc., for Offerings**

a. Supplier will honor the same Offering warranty terms for Reseller's customers as it does for its own customers of the same Offering(s).

b. Supplier will defend and indemnify the Protected Group of Reseller 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.

c. Reseller will not purport to make (and has no authority to make), *on behalf of Supplier*, any commitment to any customer of Reseller except:

1. with Supplier's express, prior, written consent; and/or
2. 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.

d. Supplier does not object to Reseller's offering warranties or other commitments to Reseller's customers that are more favorable to customers than those offered by Supplier, but:

1. If Reseller does so, it is at Reseller's own risk;
2. Reseller must make it clear to its customers that Supplier is not liable for Reseller's commitments; and
3. Reseller must defend and indemnify Supplier against any third-party claim against Supplier arising from or relating to any Reseller-offered warranty.

ALTERNATIVE: "Reseller may not offer warranties or other commitments to its customers that are more favorable than those offered by Supplier." COMMENT: 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.

§ 3.02.2–8 Changes to content of Offerings

a. *Reserved right:* Supplier reserves the right — at any time and from time to time, in Supplier's sole discretion:

1. to add to or delete from Supplier's line of offerings;*
2. to modify any particular item in its line of offerings; and
3. 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.

b. *Consultation about Offering changes:* 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 a. Supplier is not obligated 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.

c. *No Reseller modification of Offerings:* 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), *without Supplier's advance written permission*:

1. If any part of an Offering comes in a sealed package — e.g., a software license-code envelope — then Reseller must not open the package.

2. If any Offering comes in separable components, Reseller must not separate the components.

3. 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.

§ 3.02.2–9 Offering-related support

a. *Support responsibilities:* Customer support (defined in more detail below) for Offerings will be provided to Reseller's customers as follows:

– Level 1 support by: Reseller.

– Level 2 support by: Supplier.

– Level 3 support by: Supplier.

1. *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.

2. *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.

3. *Level 3 support* refers to advanced efforts to identify and/or correct a defect in a product or an error in a service.

b. *Compliance with Supplier 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 an agreement).

c. *Flagging of 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.

§ 3.02.2–10 **After the Reseller Relationship ends**

a. *Cessation of promotion by Reseller:* 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, except to the extent otherwise provided by an agreement.

> Comment: 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.

b. *Close-out of pending transactions:* Reseller may close out pending transactions in accordance with the Close-Out Rule (XXX), with a Close-Out Period of ten business days.

c. *No retroactive effect:* 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.

> Comment: 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.

d. *Protection of Reseller's customers' rights:* The ending of the Reseller Relationship will not affect any then-established rights or obligations of Reseller's customers concerning Offerings.

§ 3.02.2–11 Software-related resale 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.

a. *Software provisioning 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.

> ALTERNATIVE: "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."

b. *License terms:*

1. 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.

2. 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.

c. *Software updates 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.

d. *Reseller use of Supplier's software:* 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.

1. All such use must comply with the applicable end-user license agreement and/or terms of service and privacy policy.

2. In conjunction with such use, Reseller may make a reasonable number of backup copies in accordance with Reseller's normal backup procedures.

3. 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.

e. *Suspicion of 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:

1. promptly advise Supplier;

2. provide Supplier with all relevant information reasonably requested by Supplier about the unauthorized activities;

3. provide reasonable cooperation with any efforts by Supplier to prevent or stop the unauthorized activities ("Policing Efforts"); and

4. not make any Policing Efforts itself without Supplier's prior written approval.

Comment: Subdivision 2: The "reasonably requested by Supplier" is a way of deferring the question: Who pays?

> Subdivision 4: 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.

§ 3.02.2–12 **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 § 3.02.2–12, "feedback" refers to any and all suggestions, comments, opinions, ideas, or other input.

§ 3.02.2–13 Product recalls

a. *Reseller's responsibilities:* Reseller will provide reasonable cooperation with Supplier and its designees in connection with any recall of Offerings.

b. *Reseller's expenses:* At Reseller's request, Supplier will reimburse Reseller, in accordance with **Error! Reference source not found.**, for c ertain expenses — when actually incurred by Reseller in providing the cooperation required by a — as follows:

1. ☑ reasonable out-of-pocket external expenses such as (without limitation) shipping charges by carriers for returning physical Offerings

2. □ reasonable compensation for internal expenses, e.g., wages and salaries for Reseller personnel involved in the cooperation.

> Comment: "Internal" expenses such as wages and overhead are capable of being "gamed"; consequently, this provision does not make such expenses reimbursable.

c. *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.

> Comment: 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.

§ 3.02.2–14 Reseller's servicing of Offerings

This section applies if Reseller engages in repair or other servicing of Offerings for its customers.

a. *Parts:* Reseller must use parts of equal or better quality than the original parts in the Offering.

> ALTERNATIVE: "In servicing Offerings, Reseller may not use parts not previously approved in writing by Supplier."

b. *Labeling:* Reseller may not offer or provide as "new" any Offering that Reseller has repaired after return by a customer.

§ 3.02.2–15 Resale-Relationship miscellany

a. *Reseller indemnity obligation:* Reseller must defend Supplier and Supplier's Protected Group from and against any and all claims by any third party arising out of Reseller's activities under an agreement.

b. *No other Reseller rights granted:* Supplier reserves all rights not specifically granted by an agreement; this reservation includes (without limitation) copyrights, patent rights, trademark and service mark rights, trade secret rights and other intellectual property rights.

c. *No implied franchise- or business-opportunity relationship:* This § 3.02.2–15c applies unless the Contract clearly and unmistakably provides otherwise.

1. No party intends, by entering into the Reseller Relationship, to create a relationship that would be subject to laws governing franchises and/or business opportunities.

2. Each party **WAIVES**, to the fullest extent not prohibited by law, any rights or claims, arising out of or relating to the Reseller Relationship, under laws governing franchises and business opportunities or similar laws.

d. *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.

§ 3.02.3. Additional opt-in terms

The terms below do not apply in the Contract except to the extent (if any) that the Contract clearly so states.

§ 3.02.3–1 Reseller's marketing obligations [fill in]

Without limiting Reseller's other obligations under the Contract, Reseller will engage in the specific marketing efforts set forth in Schedule [FILL IN NUMBER].

> Comment: 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.

§ 3.02.3–2 Reseller Marketing Consultation Rule [opt-in]

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.

§ 3.02.3–3 No Non-Supplier Trademarks Rule [opt-in]

Reseller must not promote or offer Offerings under any brand name other than those authorized in advance by Supplier.

§ 3.02.3–4 Additional Territory-related restrictions [opt-in]

> Comment: One or more of the following could be copied and pasted into the Contract.

❑ Reseller must not solicit or support any customer for Offerings if the customer has significant operations outside the Territory.

❑ Reseller must not establish or maintain facilities specifically for supporting customers' use of Offerings if such use is reasonably likely to occur outside the Territory.

❑ Reseller must not make any Offering available to any individual or organization if Reseller knows, or should know, that the Offering will be taken, installed, or used outside the Territory.

§ 3.02.3–5 No Competing Offerings Rule [opt-in]

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.

> Comment: CAUTION: Restrictions on Reseller's other activities could have implications under antitrust- and/or competition law.

§ 3.02.3–6 Reseller inventory obligation options [opt-in]

> Comment: One or more of the following could be copied and pasted into the Contract.

❑ Reseller must keep a minimum quantity of Offerings in inventory as follows: [DESCRIBE*]*.

❑ Reseller must not keep more than [AMOUNT] of Offerings in inventory without Supplier's prior written consent.

§ 3.02.3–7 Reseller retail sale options [opt-in]

> Comment: One or more of the following could be copied and pasted into the Contract.

❑ Reseller may offer or sell Offerings from physical premises (for example, in stores).

❑ Reseller must not offer or sell Offerings from physical premises (for example, in stores) without Supplier's prior written consent

§ 3.02.3–8 Reseller Delivery to Its Customers Rule [opt-in]

Reseller will acquire any physical Offerings and — at its own expense and risk — arrange for all storage and/or delivery to Reseller's customers.

> ALTERNATIVE: "Supplier will arrange for delivery of Offerings to customers at Reseller's written direction." COMMENT: This alternative is sometimes referred to generically as "drop-shipping."

§ 3.02.3–9 Subreseller Rule [opt-in]

a. *Applicability:* This Rule applies only if the Contract clearly says so.

b. *Reseller appointment of Subresellers:* Reseller may appoint one or more "*Subresellers*" to help carry out Reseller's obligations and exercise Reseller's rights under the Contract, BUT only as stated in this Rule.

c. *Supplier consent:* Reseller must obtain Supplier's written consent before appointing a Subreseller; Supplier may grant, withhold, or condition its consent to appointment of a Subreseller in its sole discretion.

> ALTERNATIVE: "Reseller need not obtain Supplier's written consent before appointing a Subreseller."

> ALTERNATIVE: "Supplier will not unreasonably withhold, delay, or condition its consent to the appointment of a Subreseller."

d. *Information about potential Subresellers:* Before appointing a prospective Subreseller (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 Subreseller 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.

e. *Subreseller agreements:* Each Subreseller must enter into an agreement (a "*Subreseller Agreement*"); at a minimum, each such agreement must:

1. impose at least the same restrictions and obligations on the Subreseller as this Rule does on Reseller;

2. clearly state that Supplier will have no liability to the Subreseller in connection with the Subreseller Agreement or the Subreseller's dealing in Offerings);

3. prohibit the Subreseller from appointing sub-Subresellers without Supplier's prior written consent, which may be granted or withheld in Supplier's sole discretion;

4. terminate automatically at the end of the Reseller Relationship; and

5. clearly indicate that Supplier is a third-party beneficiary of the Subreseller Agreement.

f. *Reseller responsibility for Subreseller actions:* Reseller must defend and indemnity Supplier's Protected Group against any claim by a third party if the claim arises out of acts or omissions of a Subreseller relating to Subreseller Agreement.

§ 3.02.3–10 **No Other Offering Sources Rule [opt-in]**

Reseller must not acquire Offerings from sources other than Supplier.

> CAUTION: Depending on the jurisdiction, restricting Reseller's right to acquire or dispose of products elsewhere might trigger legal complications.

§ 3.02.3–11 **No Offerings to Non-End-Customers Rule [opt-in]**

Reseller must not provide Offerings to others for resale or redistribution.

§ 3.02.3–12 Data About Reseller Customers Rule [opt-in]

a. *Information about Reseller 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.

b. *Compliance with privacy laws:* Each party is to follow any restrictions, imposed by applicable law, on the use and/or disclosure of customer data provided by Reseller.

§ 3.03. Referral Commissions Rule

This Rule will apply if, under a commission arrangement specified in the Contract, a party ("*Company*") is to pay commissions to another party ("*Associate*") for certain referrals of customers.

> Comment: This Rule 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.

§ 3.03.1. The Rule

§ 3.03.1–1 Term sheet template

The following terms are placeholders for discussion and legal review; they will apply unless the Contract clearly specifies otherwise.

a. *Commission entitlement:* Company will pay Associate a commission on sales by Company to qualified customers referred by Associate, [*IF COPIED*: in accordance with the Tango Terms Referrals Commissions Rule 2020A,] with details as follows.

b. *Eligibility:* Associate will be eligible for a commission only for referrals that lead to sales by Company of:

> CAUTION: Be careful about using terms such as "consummated" sales — that led to a presumably-expensive lawsuit over a finder's fee in Fed Cetera, LLC v. Nat'l Credit Servs., Inc., 938 F.3d 466 (3d Cir. 2019) (reversing summary judgment; finder's-fee agreement did not require resulting federal contract to be "performed" in order for the transaction to be "consummated" and thus for the finder's fee to be owed).

any Company products and/or services ("*Offerings*"),

> Comment: Company might want to consider limiting the authorized Offerings to those for which Associate has been suitably trained. Parties might also want to negotiate different commission-eligible Offerings for different time periods and/or different territories.

anywhere in the world (the "*Geographic Territory*"),

in any market segment (the "*Market Segment*"),

during the period ending on the date two years after the date of the Contract (the "*Commission Term*"), which will be automatically extended in accordance with the Tango Terms Evergreen Extension Rule (§ 5.05).

> Comment: 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.

c. *No exclusivity:* The commission arrangement is non-exclusive [IF COPIED: as stated in the Tango Terms Exclusivity Definition] (§ 9.24).

Comment: If the commission arrangement will be exclusive, be sure to review the exclusivity definition cited above.

d. *Commission amount:* The amount of each commission will be: 0.001% of Company's collected invoiced sale amounts (with certain exclusions defined in the Tango Terms protocol), without deduction of Company expenses.

Comment: The 0.001% commission rate is of course a placeholder number.

ALTERNATIVE: "The amount of the commission will be as follows: 1. [FILL IN AMOUNT] for each referral of a lead that results in a sale, for which full payment is collected, 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." COMMENT: In this 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.

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).

§ 3.03.1–2 Other commission-eligibility criteria

a. *Eligible prospects:* Associate will be eligible for commissions only on Company's sales of Offerings to customers that Associate refers to Company (each, a "*Prospect*"), where each Prospect meets all of the following qualifications:

1. The Prospect must have substantial operations in the Market Segment within the Geographic Territory; Company's

determination of that question will be final and binding unless Associate shows that the determination was clearly arbitrary and capricious.

> Comment: Company will have an economic incentive not to be ungenerous in determining whether a Prospect has "substantial" operations, lest Associate be unmotivated to pursue sales for Company.

2. The Prospect must not be barred by law from acquiring the Offering(s) in the Geographic Territory.

> Comment: A given customer might be prohibited by law from acquiring Offerings in the Geographic Territory. The prohibition might arise from, e.g., export control laws or other governmental trade policy. Ideally, Company's diligence processes will catch such situations before they result in an illegal sale, but if that doesn't happen, then Associate shouldn't be paid a commission for referring the illegal sale.

3. The Prospect must not be a competitor of Company (unless Company gives its prior written consent).

> Comment: 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.

4. The Prospect must not have had a previous connection with Company at the time of Associate's initial referral; Company's determination of that point will be final and binding unless Associate shows that the determination was clearly arbitrary and capricious.

> Comment: Company might be reluctant to pay commissions for sales it thinks it would have made even without Associate's involvement. But Company would 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.

> OPTION: "Sales to the following specific customers are not eligible for commissions: [LIST]." COMMENT: 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.

b. *"Stale" referrals:* For any given customer, Associate will not be eligible for commissions unless Company's first sale of an Offering to that customer is closed on or before the date one year after Associate's written communication to Company of suitable contact information for the customer. (Whether contact information is suitable is a matter for Company to decide in its sole judgment.)

> Comment: 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.

c. *Commission cutoff date:* For any given customer, Associate will not be eligible for commissions for sales occurring later than one year after the date of Company's first closed sale to that customer or the end of the Commission Term (defined above), whichever comes later.

> Comment: 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.

d. *Exclusions:* 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, so long as the policy is not shown to be clearly arbitrary or capricious.

> Comment: This is a pretty-standard exclusion; subdivision 2 recognizes the economic realities of customer returns.

§ 3.03.1–3 Commission administration

a. *Commission payments:* Company will pay Associate its commissions within 30 days after the end of the fiscal quarter in which Company collects the associated invoiced price.

> Comment: 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).

b. *Reporting:* With each commission payment, Company will provide Associate with a written statement of the amount due, with reasonable supporting detail.

> OPTION: "Associate may audit Company's commission reports to confirm the commission amounts due in accordance with the Tango Terms Audit Rule."

§ 3.03.1–4 Other commission terms and conditions

a. *Alpha's participation in sales negotiations:* Alpha's role (if any) in Company's sales negotiations with Prospects will be determined exclusively by Company in Company's sole discretion; Associate must follow Company's lawful directions in that regard and must not attempt to insert Associate'sself into any such negotiation without Company's prior approval.

b. *Company's responsibility for third-party claims:* 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:

1. provide Associate with a defense against the claim in accordance with the Indemnity and Defense Rule (§ 5.06.3); and

2. pay any monetary award that is entered against Associate resulting from the claim (§ 5.07.1.j).

c. *Associate's responsibility for Associate's business:* IF: A third party makes a claim against *Company* because of what the third party asserts was some fault on Associate's part; THEN: Associate must:

1. provide Company with a defense against the claim in accordance with the Indemnity and Defense Rule (§ 5.06.3); and

2. pay any monetary award that is entered against Company resulting from the claim (§ 5.07.1.j).

d. *Confidentiality:*

1. Each party will keep the details of these commission arrangements confidential, but they may disclose to others the fact that they have entered into a commission agreement.

> Comment: In some circumstances, it might be appropriate and even necessary for one or both parties to disclose the fact that Company will be paying commissions to Associate, but the amounts, territory, etc., might be more sensitive.

2. You must treat Company's Confidential Information in accordance with § 2.02; Company's Confidential Information includes, without limitation, the fact and status of Company's discussions and/or dealings with any particular customer.

3. Company need not treat Associate's information as confidential unless agreed otherwise in writing.

e. *Termination for breach:* Either party may terminate the commission arrangement for breach in accordance with § 8.02.

f. *Termination at will:* Either party may terminate the commission arrangement at will upon 30 days' notice in accordance with § 5.11.

§ 3.03.2. Additional commentary

[To come]

§ 3.04. Order Fulfillment Rule

§ 3.04.1. The Rule

§ 3.04.1–1 **Applicability**

a. This Rule applies apply when under the Contract, parties (referred to as "**Customer**" and "**Supplier**" respectively) can agree to conduct specific transactions such as, for example, (i) a sale or other delivery of tangible- or nontangible goods or equipment or other deliverables, and/or (ii) the performance of services. Each such transaction agreement is referred to as an "**Order**."

b. In case of doubt: Unless otherwise specified in an agreement, "Customer" might not be an end-customer, but instead might be a reseller, a distributor, etc.

§ 3.04.1–2 Order submission

a. *Required information in an Order:* Supplier may decide from time to time what information is to be included in an Order.

> Comment: Allowing Supplier to decide what information must be included in an Order should ordinarily be workable — as a practical matter, Supplier probably won't be unreasonable, because Customer will (usually) have the choice whether or not to place the Order.
>
> ALTERNATIVE: "Orders are to include the following specific information: [SPECIFY]." COMMENT: As an example, section 2 of a Honeywell terms-of-sale document, at https://perma.cc/5MB9-H6VK, 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."

b. *Order submission method:* Supplier may decide, from time to time, how orders are to be submitted, for example via hard copy, Web-based system, etc.

> Comment: Again, Supplier is not likely to be unreasonable about making Customer jump through hoops.
>
> ALTERNATIVE: "Orders are to be submitted as follows: [DESCRIBE]."

c. *Orders as separate agreements:* Each Order is to be considered a separate agreement that incorporates the Contract, including but not limited to this Rule, by reference (whether or not the incorporation is explicit) unless the Order clearly says otherwise.

> ALTERNATIVE: "Each Order is to be considered an addition to this Agreement and not as a separate agreement." COMMENT: Language along the lines of this alternative is seen in some contracts where "netting out" of multiple transactions is desired, such as, e.g., the ISDA Master Agreement [TO DO: LINK].
>
> For standalone commercial transactions, the above alternative 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 Contract," then that amount would grow over time as more statements of work were completed; Customer might like that, but Supplier wouldn't be wild about it

§ 3.04.1–3 Supplier quotations, catalogs, price lists

a. *Quotation as offer:* IF: Supplier sends Customer a quotation for a proposed sale or other transaction; THEN: That quotation 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. *Acceptance of quotation:* IF: Customer accepts a Supplier quotation — including but not limited to by sending a purchase order; THEN: the quotation becomes an Order.

> Comment: See also the Entire Agreement clause concerning the effect of additional terms in purchase orders, etc.

c. *Quotation 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.

d. *Quotation modification or withdrawal:* 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.

e. *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.

> Comment: The idea for this section comes from section 1 of a Honeywell terms-of-sale document archived at https://perma.cc/5MB9-H6VK.

§ 3.04.1–4 **Order modification**

a. Changes to Orders ("*change orders*") should be agreed to in writing, but a writing is not strictly necessary.

> Comment: Oral modifications to Orders are allowed here because that's how it often happens in the real world. ALTERNATIVE: "Any change to an Order must be in writing; no party will assert that an Order was modified in any other way." CAUTION: In some jurisdictions, courts might not enforce a writing requirement like the above alternative; see the Amendments and Waivers Rule (XXX) and its annotations.

b. Any assertion of an oral modification of an Order must be supported by (i) clear and convincing evidence (§ 9.14), with (ii) reasonable corroboration of any testimony by interested witnesses (§ 7.06).

> See also the Corroboration Rule ().

c. A change order must be agreed to by the party against which the change order is sought to be enforced.

> Comment: This borrows from the approach of UCC § 2-201.
>
> ALTERNATIVE: "A change order must be agreed to by both parties."

d. A change order may be agreed to on behalf of a party by any person having actual- or apparent authority.

> Comment: Concerning "apparent authority," see § 6.16.2–4.

> ALTERNATIVE: "A change order must be agreed to on behalf of a party by an officer of the party at the vice-president level or higher."

§ 3.04.1–5 **Orders from Customer affiliates**

a. The Contract may provide that one or more affiliates (defined in § 9.07) of Customer may submit one or more proposed Orders for transactions with Supplier under the Contract; if accepted by Supplier, each such Order will be governed by the Contract in the same manner as if Customer itself had submitted the Order.

> Comment: 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.

b. Customer is not responsible for its affiliates' obligations under Orders entered into with Supplier under the Contract.

> ALTERNATIVE: "IF: A Customer affiliate enters into an Order with Supplier under the Agreement for a transaction; THEN: Customer is jointly and severally responsible, together with its affiliate, for the affiliate's obligations under that Order." COMMENT: Supplier might want Customer to guarantee orders from Customer's affiliates, because any given affiliate might not (in Supplier's view) be sufficiently creditworthy.

c. Each proposed Order from a Customer affiliate under the Contract must be specifically agreed to by Supplier, in Supplier's sole discretion.

> Comment: Supplier might want to decline an order from a Customer affiliate, for example if Supplier doesn't have a basis for believing that the affiliate is sufficiently creditworthy.

§ 3.04.1–6 Deliveries

a. *Basic delivery commitment:* Supplier is to cause delivery of the deliverables — in the quantities, and on the schedule — as specified in the order.

> ALTERNATIVE: "Supplier will endeavor to cause delivery …."
>
> Comment: This is phrased as "Supplier *will cause delivery*" instead of "Supplier *will deliver*" because in many cases Supplier will use a carrier to actually make the delivery.

b. *Delivery times* are subject to reasonable variation.

> ALTERNATIVE: "Time is of the essence for delivery." COMMENT: 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 provision** if it appeared that the provision was included as a mere "stock phrase" as opposed to being genuinely negotiated and agreed to. As one example: A California appeals court held that "a provision in the parties' contract making time of the essence does not automatically make Rugger's untimely performance a breach of contract because there are **triable issues** regarding the **scope** of that provision and whether its enforcement would result in a **forfeiture** to Rugger and a windfall to MCR." Magic Carpet Ride LLC v. Rugger Investment Group LLC, No. G056896, slip op. at 2 (Cal. App. Oct. 25, 2019) (reversing and remanding summary adjudication). See generally Restatement of Contracts § 242, comment d.

c. *Packaging and labeling:* Supplier is to cause all deliverables to be appropriately packaged and labeled for shipment and delivery; this includes, without limitation, conformance to:

1. any requirements of law (including for example any required country-of-origin labeling);

2. any specific packaging- and/or labeling instructions in the order.

d. *P.O. number:* IF: Customer provides a purchase-order number or other identifier for the order; THEN: Supplier is to cause that identifier to be included on shipping labels, shipping documents, and order-related correspondence.

e. *Passage of title:* Unless otherwise agreed in writing, title and risk of loss for deliverables will pass per INCOTERMS 2020 EXW – Ex Works Supplier's facility.

> Comment: 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 passage of title and risk of loss.

f. *Delivery to third party:* Customer may designate, in writing, a third party to which deliverables are to be shipped. In any such case:

1. Supplier is to cause the deliverables to be shipped to the third party (absent reasonable objection on your part).

> Comment: 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.

2. Customer's designation must take place a reasonable time before shipment.

3. Unless otherwise agreed, Customer is to pay any additional costs (e.g., shipping, insurance, etc.) arising from Customer's designation.

§ 3.04.2. Opt-in terms

The following terms will apply only to the extent, if any, that the Contract clearly so states.

§ 3.04.2–1 Stocking Point Delivery Option

IF: The 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.

> Comment: Just-in-time delivery of parts to stocking points 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.

§ 3.04.2–2 Substitution Prohibition Option

Supplier may not substitute different deliverables for those specified in the order without Customer's prior written consent.

§ 3.04.2–3 Substitution Authorization Option

Supplier may make substitutions for deliverables specified in an accepted order as follows:

1. The substituted deliverables must meet any functional specifications stated in the order for the ordered deliverables.
2. Supplier must advise Customer of the substitution no later than the scheduled time for delivery.
3. Customer may reject the substituted deliverables on or before 14 days after delivery.

§ 3.04.2–4 Partial- or Early Deliveries Rejection Option

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.

> Comment: 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.

§ 3.04.2–5 Partial- or Early Deliveries Authorization Option

Supplier may, in its discretion, ship partial deliveries of ordered deliverables unless Customer notifies Supplier otherwise a reasonable time in advance.

> Comment: Supplier might want to be able to ship things as they're finished, without waiting for the order to be completed.

§ 3.04.2–6 Shortages Flexibility Option

IF: Supplier runs short of ordered deliverables, for whatever reason or reasons; THEN: Supplier may do some or all of the following:

> Comment: This shortages 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 the Force Majeure Rule (§ 5.06).

1. allocate Supplier's available production as Supplier deems appropriate;
2. delay or stop shipments; and/or
3. send partial shipments with prior notice.

§ 3.04.2–7 Environmental Damage Responsibility Option

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.

§ 3.04.2–8 Opt-in terms for shipping documentation

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ Supplier is encouraged to consolidate shipping documents wherever practicable.

❑ Seller will advise Customer in writing when an order has been shipped, including any specific details reasonably requested by Customer, such as tracking information for the shipment.

❑ 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.

> Comment: 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.

§ 3.04.2–9 Opt-in terms for delivery delays

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ Supplier will 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. (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.)

❑ 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.

❑ Supplier will not be liable for any failure to deliver all or any part of an order.

§ 3.04.2–10 **Opt-in terms for dealing with rejected deliverables**

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ Customer may direct that rejected deliverables be returned to Supplier (at whatever address Supplier specifies) at Supplier's sole expense.

❑ Customer may store rejected deliverables, at Supplier's risk, pending Customer's receipt of Supplier's return shipping instructions.

❑ Supplier is to pay, or reimburse Customer for, all charges for storage, insurance, and return shipping of rejected deliverables.

❑ IF: Customer rejects one or more deliverables as authorized by this Agreement; BUT: Supplier does not provide Customer with pre-paid return shipping instructions within a reasonable time; THEN: Customer may, in its sole discretion: (i) destroy some or all of the rejected deliverable(s); (ii) sell some or all of the rejected deliverable(s), at a commercially reasonable public- or private sale; and/or (iii) otherwise dispose of some or all of the rejected deliverables. ¶ If Customer sells some or all of the rejected deliverables, it will apply any proceeds in the following order:

(w) expenses of the sale; (x) storage charges not paid for by Supplier; (y) any other amounts due to Customer from Supplier; and (z) payment of any remaining balance to Supplier.

§ 3.04.2–11 Option: Supplier's Dealing with Orphaned Deliverables

a. This Option will apply 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, in accordance with the Expense Reimbursement Rule (§ 4.05).

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.

§ 3.04.2–12 Opt-in terms for order size

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ Customer may submit an Order of any size.

❑ 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.

> Comment: 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.

§ 3.04.2–13 Opt-in terms for Supplier's acceptance of orders

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ Supplier may decline any proposed Order in its sole discretion. (In case of doubt: For this purpose, *decline* has the same meaning as *reject*.)

❑ Supplier will not unreasonably decline an Order.

❑ Supplier will not decline any 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 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 revoke Supplier's acceptance of Customer's Orders that Supplier previously accepted but has not yet filled or completed.

❑ Supplier may not revoke its acceptance of an Order.

❑ Supplier may revoke its acceptance of an Order only under the following circumstances: [DESCRIBE].

§ 3.04.2–14 Opt-in terms for Customer cancelation of order

> Comment: One or more of the following can be copied and pasted into the Contract.

❑ 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]*.

§ 3.04.2–15 **Advance Payment Option**

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 Contract otherwise provides for Supplier to perform first and be paid later.

§ 3.05. Product Returns Rule *[TO DO]*

[To come later]

§ 3.06. Defects Rule *[TO DO]*

[To come later]

§ 3.07. Software License Rule *[TO DO]*

[To come later]

§ 3.08. Marketing Rule *[TO DO]*

[To come later]

§ 3.09. Training Rule [to come]

§ 3.10. Other opt-in rules for operations

§ 3.10.1. Generally-Applicable Price Increases Rule [opt-in]

During the term of the Contract, 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 items.

> Comment: 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.

§ 3.10.2. Pricing Lock-In Rule [opt-in]

During the term of the Contract, pricing for transactions under the Contract will be as stated in the Contract.

> ALTERNATIVE: "During the term of the Contract, pricing for transactions under the Contract will be as posted on Supplier's Web site at the effective date of the Contract."

§ 3.10.3. Price-Increase Limit Rule [opt-in]

During the term of the Contract, Supplier will not increase the pricing it charges to Customer (i) no more often than once per year and (ii) by no more than [FILL IN PERCENTAGE OR AMOUNT] for any given increase year.

§ 3.10.4. Price Adjustment Discretion Rule [opt-in]

Supplier is not restricted in its ability to adjust its pricing from time to time in its sole discretion.

§ 3.10.5. Price Increase Notice Rule [opt-in]

During the term of the Contract, Supplier must give Customer at least 30 days advance written notice of any pricing changes.

> Comment: A requirement for advance notice of price increases would give Customer the chance to "stock up" at the old price if it desired.

§ 3.10.6. Cost Pass-Through Rule [opt-in]

a. During the term of the Contract, 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 reasonable supporting documentation showing the increase in Supplier's relevant costs.

§ 3.10.7. Code of Conduct Limitation Rule [opt-in]

a. *Applicability:* This Rule modifies any requirement in the Contract that Alice must follow a code of conduct prescribed by Bob.

> Comment: Some customers demand that vendors commit to abiding by their (the customers') codes of conduct. Vendors understandably push back, not because they want to engage in unethical behavior, but because it's a pain in the [neck] even to read different customers' codes of conduct, let alone try to manage compliance with the different codes' various requirements.

> This Option still gives customers what they often *really* want, namely the opportunity to publicly throw a vendor under the bus if the customer perceives a code-of-conduct problem.

b. *Termination as EXCLUSIVE REMEDY (with exceptions):* IF: Alice violates Bob's code of conduct; THEN: Except as otherwise provided in subdivision c, Bob's EXCLUSIVE REMEDY will be — in Bob's sole discretion — to terminate the Contract by giving notice of termination to Alice.

c. This Rule will not preclude Bob from seeking any remedies available for breach of contract if Alice's violation of the code of conduct also constituted a breach of the Contract.

> Comment: 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.
>
> – The retail giant Walmart and other retailers were confronted with a similar problem when a clothing factory in Bangladesh burned, killing over 100 people.
>
> – The pharmacy chain 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.

§ 3.10.8. Compliance with Law Indemnity Rule [opt-in]

Each party will defend and indemnify (see § 5.06.3) each other party and that other party's Protected Group (§ 9.42) from any third-party claim arising from any violation of law by the indemnifying party.

§ 3.10.9. Deceptive Practices Prohibition Rule [opt-in]

a. This Prohibition applies only if the Contract expressly adopts it.

b. Each party, in its dealings relating to the Contract, will refrain from engaging in any deceptive, misleading, or unethical practice with or directed to third parties.

c. Each party will defend and indemnify each other party, in accordance with the Indemnity & Defense Rule (§ 5.06.3), against any third-party claim arising out of any alleged such practice by the defending party.

> Comment: Deceptive practices prohibitions are sometimes seen in contracts where, say, a manufacturer's reputation might be adversely affected by deceptive conduct on the party of a reseller.
>
> In many garden-variety cases, however, the parties won't feel the need for such a prohibition. This prohibition is therefore set up as an option and not as a provision incorporated into all agreements adopting the Tango Terms.

§ 3.10.10. Disparagement Prohibition Rule [opt-in]

a. This Prohibition applies only if the Contract expressly adopts it.

b. Each party is to refrain from disparaging the other party, and/or the products or services of that other party, to any third party.

> Comment: 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.
>
> CAUTION: 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.
>
> CAUTION: The (U.S.) National Labor Relations Board has taken the position that a lawsuit by an employer to enforce a contractual non-disparagement provision would be partly preempted by the National Labor Relations Act, and that the employer's continued prosecution of the lawsuit after receiving a warning letter from the NLRB would violate the Act. See Advice Memorandum (Strange Law Firm), March 4, 2019.
>
> PRO TIP: A disparagement prohibition could lead to bad publicity, as discussed in the Review Restrictions Rule XXX. Consider the so-called "Streisand effect," named for the legendary singer-actress Barbra: 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.
>
> Note: 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).

c. 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.

d. Each party will defend and indemnify each other party, in accordance with the Indemnity & Defense Rule (§ 5.06.3), against any third-party claim arising out of any alleged such disparagement by the defending party.

§ 3.10.11. Franchise-Law Benefits Waiver Rule [opt-in]

a. The parties do not intend for anything in this 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.

> Comment: 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.

§ 3.10.12. Free Trade and Drawbacks Rule [opt-in]

a. *Applicability:* This Rule relates to orders for deliverables, submitted by a party ("*Customer*") and accepted by another party ("*Supplier*"); it applies 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

> Comment: 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).

3. any similar industrial benefit from a governmental authority.

Comment: This Clause draws on ideas seen in § 2.4 of a Honeywell purchase-order form archived at https://perma.cc/CUV6-NKTY.

b. *Supplier responsibility:* 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.

Comment: In this section, the two reasonableness qualifiers serve to leave it open how much Supplier is obligated to do without compensation (in addition to the price of the ordered goods).

§ 3.10.13. Most-Favored Customer Rule [opt-in]

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

> Note from Redline: "From the seller's perspective, these clauses are, to be charitable, stupid. I used to work for a really big software company that regularly donated products to schools - would this be a requirement to make all products freeware? At the very least, a sane vendor is going to require language that the deal has to be similar in customer, size etc. - and all things being equal, things are never equal.
>
> "From the buyer's perspective, this is the account team being lazy. They want to know that they got a good deal, sure, and maybe some "price insurance" just in case they didn't do their diligence well enough. Has anyone ever been able to win significant cash on one of these in a commercial context?"

And another: "**Vendor believes** [*would not even go as far as warranting*] **that the prices set out in this Agreement** [*i.e. no future commitment*] **are as or more favorable than the prices that Vendor currently offers** [*again no future commitment*] **in respect of orders placed by other of its customers which orders together with the nature, volume and overall value of the trading relationship [***should probably cover 'nature' - retail/wholesale/distributor; volume - obviously; and 'overall value' - deliberately vague to allow for various factors, not just aggregate order volume over time, although that would be important*] **between the Vendor and the customer placing that order are equivalent to both the nature, volume and overall value of the trading relationship between the Vendor and Customer."**

> And another: "Vendor believes that the prices set out in this Agreement are as or more favorable than the prices that Vendor currently offers in respect of orders placed by other of its

customers which orders together with the nature, volume and overall value of the trading relationship between the Vendor and the customer placing that order are equivalent to both the nature, volume and overall value of the trading relationship between the Vendor and Customer. Nothing in this section will be construed to provide Customer with audit rights. Customer's sole remedy and Vendor's sole obligation for breach of this section is for Licensor to provide a credit to Customer against future payments to Vendor or if none, to refund to Customer the difference between the rates set out under this Agreement and the lower rates of Vendor's other customers."

And: "When I've been on the buyer side, common limitations were:

- add clause taking all public sector entities out scope
- make dependent on quantities, sales volume, like types and services, similar skill levels and experience, similarly situated clients, etc.
- tie to underlying third party costs -- e.g. if you're a value-added reseller, tie it to markups, not overall price

Another option is to try to neuter the audit right. E.g., they can exercise the most favored pricing clause if they actually find out about a lower priced sale, but you withhold your other sales records on confidentiality grounds.

At best, these are a Trap for the Unwary that rises up and bites in government contracting. I avoid religiously, whichever side I'm on."

And: "As such, we would suggest removal of this clause in its entirety.
See United States v. Blue Cross Blue Shield of Mich., 809 F. Supp. 2d 665 (E.D. Mich. 2011) (7he DOJ's complaint alleged that the combination of both of the MFNs in BCBSM's contracts and the market power of BCBSM resulted in higher prices for Michigan healthcare consumers and the exclusion of potential BCBSM competitors. In particular, the complaint alleged that BCBSM's MFNs cause anticompetitive harm); See also United States v. Apple, Inc., et al., No. 12-cv-2826 (S.D.N.Y. Apr. 11, 2012) (the DOJ filed suit against Apple, Inc. and five of the six largest US publishers Hachette, HarperCollins, Simon & Schuster, Penguin and Macmillan, alleging anticompetitive violations due to agreements on the pricing of the

publishers' e-books on Apple's iBookstore). See also European Commission, Case COMP/C-2/39.847 Ebooks (EC MEMO/12/983, December 2012) (The EC initiated antitrust proceedings against international publishers Hachette Livre (France), HarperCollins (USA), Simon & Schuster (USA), Penguin (UK) and Verlagsgruppe Georg von Holtzbrinck GmbH (Germany). The decision to open the proceedings was based on the concern that, with the assistance of Apple, these publishers had entered into agency agreements with MFN clauses for the sale of e-books restricting competition in the EU, namely by limiting retail price competition, Apple committed to of a five-year ban on retail price MFN clauses in all e-books agreements):

And: "If any price protection clause remains, under no circumstances will I agree to any "claw-back" provision stating that the terms of sale are automatically revised to reflect any more favorable terms offered to other customers."

And: "Another option is to go with a tighter obligation but add conditions to the applicability of the clause; eg, it applies only during the first year of the relationship, and thereafter, only if certain payment thresholds are met. I've made a proposed edit to this effect. In the face of implacable procurement insistence, the vendor may be willing to go along, but only on the assumption that the handcuffs are justified by higher revenues."

Wilson Sonsini piece: https://www.wsgr.com/en/insights/digital-health-report-fall-2019.html

§ 3.10.14. Other Necessary Actions Rule [opt-in]

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 an agreement.

Comment: Provisions like this are sometimes seen in agreements where unanticipated glitches might arise, such as merger- and acquisition agreements

§ 3.10.15. Past Dealings Disclaimer Rule [opt-in]

The parties do not intend, and neither party is to assert, that the parties' past dealings will have the effect of modifying or supplementing an agreement.

§ 3.10.16. Phase-Out Rule [opt-in]

a. *Applicability:* This Rule applies if all of the following are true:

1. under the Contract, Bob has authorized Alice to conduct one or more activities (the "*Authorization*");

> Comment: Examples of such Authorizations might be when the Contract provides for a party (i) to earn commissions for referrals to another party, and/or (ii) to resell the other party's goods and/or services.

2. the Contract clearly indicates that if the Authorization ends, then Alice is to have a period of time (the "*Phase-Out Period*") in which she may continue conducting the authorized activities; and

3. the Authorization does end, whether by expiration or termination.

b. *Duration:* The Phase-Out Period: (i) will begin on the date that the Authorization ends; and (ii) will end at 12 midnight at the end of the day on the date ten business days thereafter.

c. *Permitted activity:* Except as otherwise stated in this Rule:

1. During the Phase-Out Period, Alice may attempt to complete any activities undertaken under the Authorization that were genuinely in progress before the end of the Authorization.

2. Alice's attempts under subdivision 1 will be on the same terms as before the end of the Authorization.

d. *Exception in case of material breach:* If Alice is in material breach of the Contract at the time that the Authorization ends, then she may not continue the activities in question after that time.

e. *Phase-out list:* Not later than two business days after the start of the Phase-Out Period, Alice must provide Bob with a complete written list of pending activities that she wishes to complete during the Phase-Out Period.

f. *Supporting evidence:* For any particular transaction in Alice's list of pending activities, Bob may ask Alice to furnish evidence, reasonably satisfactory to him, that Alice has in fact been actively engaged in completing the transaction; if Alice does not comply with Bob's request within a reasonable time, then Alice will not be eligible to complete that transaction.

g. *Disagreements about eligibility:* IF: Alice and Bob disagree about whether Alice is entitled to complete a particular transaction during the Phase-Out Period; THEN: The Internal Escalation Rule (§ 7.02) will apply; otherwise, Bob's good-faith determination of the issue will be final, binding, and non-appealable.

§ 3.10.17. Pricing change opt-in terms

In the opt-in Rules below, *:* This Rule applies if, under the Contract, a party ("*Supplier*") is authorized to charge another party ("*Customer*") for goods, services, and/or other items.

§ 3.10.18. Recordkeeping Rule [opt-in]

a. *Applicability:* When the Contract requires a party (a "*Recordkeeping Party*") to keep records, this Rule sets out specific requirements for recordkeeping.

> Comment: 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).

b. *Required records:* 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 Contract;
2. billing of charges or other amounts, by the Recordkeeping Party to another party, under the Contract;
3. all payments, by the Recordkeeping Party to another party, under the Contract, 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 Contract requires the Recordkeeping Party to report to another party.

> Comment: In some situations, parties might want to negotiate specific records to be kept. ¶ 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).

c. *Specific records:* 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 Contract.

> Comment: The above list 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).
>
> 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.

d. *Time period:* The Recordkeeping Party must keep the Required Records during the term of the Contract.

e. *Recordkeeping standards:* All Required Records must:

1. be accurate and materially complete;

> Comment: 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.

2. comply with at least commercially reasonable (§ 9.15) standards of recordkeeping; and

3. comply with any other, stricter recordkeeping standards specified in the Contract.

> Comment: In some situations, parties might want to negotiate specific recordkeeping standards.

f. *Record retention:* The Recordkeeping Party will keep each of the Required Records for at least the longest of the following (the "*Record-Retention Period*"):

> Comment: The Record-Retention Period is not the same as the recordkeeping period in § **Error! Reference source not found.**.

1. any retention period required by applicable law;
2. the duration of any timely commenced audit of the Required Records permitted by an agreement; and
3. any other period specified in an agreement, if any.

> Comment: 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.

g. *Audit right:* Any party described in subdivision b may have the Required Records audited in accordance with the procedures set forth in § 5.03.

h. *Option: Record retention per FAR standards:* If clearly so stated in the Contract, the Recordkeeping Party is to 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. In case of doubt, this option is included for the convenient reference of the parties, who do not intend to imply or concede that the Contract and/or their relationship are subject to the FARs.

> Comment: The FARs' record-retention requirements go into some detail; drafters might want to take advantage of that specificity.

Chapter 4: Payment Rules

§ 4.01. Invoicing Rule

§ 4.01.1. The Rule

a. *Invoice requirement:* If Alice wish to be paid an amount due to her under the Contract, she must send Bob an invoice for that amount unless Bob has agreed otherwise in writing (for example, in the Contract itself).

> Comment: Invoicing: 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.
>
> PRO TIP: A party submitting an invoice might want to confirm the current 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.)

b. *Required information:* Each invoice must include such information as Bob reasonably requests in writing.

> Comment: Invoices should be detailed enough to permit the paying party to exercise any audit rights it might have under an agreement.
>
> 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.

c. *Invoice language:* Each invoice must be written:

1. in the language in which the Contract is written; or
2. if required by law, in the official language of the destination country.

d. *Invoice timing:* If Alice and Bob have agreed in writing to a schedule for invoices to be sent (for example, in the Contract or a statement of work), then that agreement will control; otherwise, Alice is to send invoices only when her applicable performance being invoiced has been completed (for example, delivery of goods or completion of services).

> Comment: 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.

e. *Itemization of certain invoiced charges:* In each invoice, separate itemization is required for any charges for shipping and/or delivery; insurance; and (to the extent not prohibited from being billed) taxes.

§ 4.01.2. Additional opt-in invoicing terms

§ 4.01.2–1 **WAIVER of Late-Submitted Invoices Rule [opt-in]**

IF: Alice and Bob have agreed in writing to an invoicing deadline; AND: Bob receives an invoice from Alice after that deadline; THEN: Whether and when to pay the invoice will be in Bob's sole discretion.

> Comment: 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

§ 4.02. Payment-Terms Rule

§ 4.02.1. The Rule

a. *Payment terms:* IF: Alice invoices Bob for an amount that Bob owes under the Contract; THEN: Bob must pay the invoice net 30 days from the date that Bob receives a correctly-stated invoice.

Comment: "Net X days" means that payment in full is to be received by the payee no later than X days after the stated date.

Some payers want longer terms, e.g., net 45 days, net 60 days, etc.

ALTERNATIVE: "Invoice payments are due net 30 days from the date of the invoice." Payees sometimes want this alternative, but paying parties generally push back because they need (or want) more time to process invoices.

ALTERNATIVE: "Invoice payments are due 2% 10 days, net 30 days …" 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. See generally Net D (Wikipedia.com).

b. *Payment method:* Bob may pay Alice by any payment method to which Alice does not reasonably object.

ALTERNATIVE: "Payments are to be made using the following means: *[DESCRIBE]*."

Comment: The "any payment method to which Alice does not reasonably object" language is a commonly used formulation. See the additional comments for other possibilities.

c. *Erroneous invoices:* If Bob believe that an invoice from Alice is incorrect, then:

1. Bob must advise Alice in writing, specifying in reasonable detail why she believes the invoice is incorrect;

2. Bob must provide Alice with reasonable written documentation to support her position;

3. If Bob so requests, Alice must promptly issue Bob a refundable credit for any amount that they agree was incorrectly invoiced;

4. if Bob so requests in writing, Alice must issue Bob one or more appropriate replacement invoices;

5. Bob must pay any correct portions of the invoice by the original due date; and

6. to the extent that the parties are unable to resolve the invoice disagreement at the working level, the Tango Disagreement Rules (§ 5.01) will apply.

§ 4.02.2. Additional commentary

Some widely-used payment methods include the following:

– Check: See Investopedia at https://goo.gl/19C7Rv . The check could be 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.

Importantly, 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 [XXX].

– Automated clearing house ("ACH") electronic debit transaction in lieu of a check: See Investopedia at https://goo.gl/1P9EQa;

– Certified check: See Investopedia at https://goo.gl/aVLbsE: A *certified* check (see above) is written by the payer and drawn on the *payer's* account, but 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.

With a certified check, 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.

– Cashier's check: See Investopedia at https://goo.gl/EZ7Vec. A *cashier's* check is 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.

– 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).

§ 4.03. Deposits Rule

Deposits and other advance payments, if any (each, a "*deposit*") are to be applied as stated in the Contract; any remaining balance of a deposit is to be promptly refunded, without interest.

> ALTERNATIVE: 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 Charges Rule (§ 4.04).

§ 4.04. Interest Charges Rule

§ 4.04.1. The Rule

a. *Maximum interest rate:* If Alice owes Bob money under the Contract and has not paid on time, then Bob may charge Alice interest on past-due amounts at no more than (i) 5% per annum simple interest or (ii) the maximum rate permitted by law under the circumstances, whichever is less.

> Comment: 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.

b. *Interest-charge start date:* Bob may not begin to charge interest on an unpaid balance until 30 days after the due date.

> Comment: The usury statutes in some states might prohibit charging interest before the end of a specified grace period.

c. *How payments are to be applied:* Bob is to apply Alice's payments first to accrued interest (if any), then to unpaid principal, in each case in the order in which Alice's payment obligations were incurred (that is, oldest-first).

> Comment: "In the order" provisions of this kind are often seen in promissory notes. This language 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 members).

d. *Usury savings clause (if too much interest is charged):* Alice and Bob intend for any interest charged by Alice or paid by Bob under the Contract to comply with law. IF: Such a charge or payment 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 considered 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 Bob has not yet paid the excess interest, then Alice will cancel the excess-interest charge; and

3. If Bob *has* paid excess interest, then Alice will promptly (i) refund it to Bob, and/or (ii) credit the excess to any balance still owed by Bob, in either case together with interest on the excess at the maximum rate permitted by law.

> Comment: Usury savings clauses might or might not be effective in a given jurisdiction. • 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 court affirmed a trial-court ruling that a commercial loan agreement for more than $400,000 was void as usurious.

§ 4.04.2. Additional commentary

§ 4.04.2–1 Usury law: 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. (Disclosure: Ross Spence is a friend of the author.)

§ 4.04.2–2 Usury law: 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).

§ 4.04.2–3 (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. Failure to do so cost a party some money: Cellport Systems 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).

§ 4.04.2–4 **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 it's even worthwhile to push for an interest provision.

§ 4.05. Expense Reimbursement Rule

§ 4.05.1. The Rule

a. *Applicability:* This Rule will apply if the Contract calls for Bob to reimburse Alice for expenses incurred.

b. *Basic requirements:* Alice may seek reimbursement only for those expenses that she actually incurred and that are eligible for reimbursement under the Contract.

c. *Documentation:* Unless Bob advises otherwise in writing (e.g., for small expenses), Alice must provide the reimbursing party with receipts to support each of her reimbursement claims.

> Comment: Many reimbursement policies do not require receipts for small expenses, e.g., under $25.

d. *Markups:* Alice may not mark up expenses for reimbursement unless Bob has clearly agreed otherwise in writing.

> Comment: Some contracts are cost-plus, meaning that reimbursable expenses would be allowed to be marked up, typically by an agreed percentage.

e. *Written reimbursement policies:* Alice must comply with any commercially reasonable written reimbursement policy that Bob provides to her from time to time, as long as Bob provides the policy to Alice:

1. in a manner reasonably calculated to let Alice's relevant people know about the policy's requirements; and

2. a reasonable time before Alice incurs an expense that is subject to the policy or otherwise becomes obligated to pay that expense.

> Comment: 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.
>
> The "from time to time" language signals that the reimbursing party may update its reimbursement policy and send the updated policy to the incurring party.
>
> This provision doesn't immediately require compliance with a written reimbursement policy, because the customer might or might not want to impose a specific policy at the time of contracting, while leaving that option open for the future.
>
> This provision doesn't require formal notice of the reimbursement, because that's likely to fall through the cracks.

§ 4.05.2. Additional opt-in rules for expense reimbursement

The terms below will apply in the Contract only to the extent (if any) that the Contract clearly says so.

§ 4.05.2–1 Expense Reimbursement Preclearance Rule [opt-in]

Before Alice incurs any individual expense item in excess of [SPECIFY AMOUNT] for which Alice expects to be reimbursed, Alice must consult with Bob about the expense.

> ALTERNATIVE: "… Alice must obtain Bob's prior written approval." This alternative requirement might be overkill for many relationships, but some reimbursing parties might want this language so as to keep tight control over reimbursable expenditures.

§ 4.05.2–2 Expense Reimbursement Direct Billing Rule [opt-in]

Alice may arrange for specified individual expenses to be billed directly to Bob, who must timely pay any such direct-billed expense.

> Comment: This direct-billing option 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.

§ 4.05.2–3 Expense Reimbursement Flagging Rule [opt-in]

In each invoice for reimbursement, Alice must suitably flag any submitted expense as to which Bob might reasonably disagree that the expense is eligible for reimbursement.

> Comment: This option is intended to help ease the reimbursing party's administrative burden of expense reimbursement, taking into account that the incurring party will usually have the easiest time identifying questionable expenses.

§ 4.06. Guaranty Rule

§ 4.06.1. The Rule

a. *Definitions:*

1. *"Guarantor*" or "***you***" refers to an individual or organization that states, in a writing signed by the individual or organization, that the individual or organization guarantees a Guaranteed Payment Obligation.

   Comment: 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.

2. *Guaranty* refers to a guaranty that adopts this Rule or is otherwise subject to its terms.

3. *Creditor* refers to any individual or organization to which a Guaranteed Payment Obligation is owed.

4. *Payer* refers to any person that owes a Guaranteed Payment Obligation.

5. *Payment Obligation* refers to any payment, under any Guaranteed Agreement, that is guaranteed in writing.

   Comment: 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).

6. *Guaranteed Agreement* refers to the Contract.

b. *Guaranty:* You guarantee the full payment, by each Payer, when due, of each Payment Obligation; for this purpose, it does not matter:

1. how or when the Payment Obligation in question previously came to exist, is coming to exist now, or comes to exist in the future (including, without limitation, by acceleration or otherwise); or

2. whether the Payment Obligation is direct or indirect, absolute or contingent.

> Comment: 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 Payment Obligations) (Posner, J).

c. *Joint and several guarantor liability:* If there are multiple Guarantors for a Payment Obligation, then each Guarantor is jointly and severally liable to each Creditor for all amounts due, from each Guarantor, under the Guaranty in respect of that Payment Obligation.

> Comment: 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 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.

d. *Enforcement forum:* If it becomes necessary for a Creditor to sue you under the Guaranty, the Creditor may do so in any court or other forum having jurisdiction.

> Comment: 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).

OPTION: "In addition, you agree that your obligations under the Guaranty may be enforced against you in any court that has jurisdiction in the following location: [FILL IN]. In case of doubt, however, this provision is limited to enforcement of the Guaranty and does not constitute your submission to the *general* jurisdiction of any forum." COMMENT: 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).

ALTERNATIVE: "Each Creditor agrees that this Guaranty may be enforced only in the following forum: [FILL IN]."

OPTION: "In no event will the Guarantors, in the aggregate, be liable under the Guaranty for more than the amount specified." COMMENT: In some transactions a cap on Guarantor liability might be a possible negotiation point.

OPTION: "No later than 45 days after the end of each calendar quarter, you will provide each Creditor with a copy of your financial statements for that quarter." COMMENT: This will help give creditors at least some ongoing comfort that the guarantor(s) continue to have the financial wherewithal to back up their commitments.

OPTION: "Each set of financial statements that you provide to Creditors must be prepared in accordance with the disclosure requirements applicable to guarantors of guaranteed debt under the U.S. securities laws." COMMENT: See generally, e.g., Michael H. Friedman, Public Offerings of Guaranteed Debt and the SEC's Proposed Rule Changes (PepperLaw.com 2018), which discusses Rule 3-10(a)(1) of Regulation S-X.

OPTION: "The year-end financial statements that you provide to Creditors must be audited, and the quarterly financial statements must be reviewed, by an independent public accounting firm." COMMENT: See generally, e.g., Michael H. Friedman, Public Offerings of Guaranteed Debt and the SEC's Proposed Rule Changes (PepperLaw.com 2018), which discusses Rule 3-10(a)(1) of Regulation S-X.

e. *Beneficiaries:* Any Creditor may enforce your obligations under the Guaranty when those obligations come due; any Creditor's successors and assigns may do likewise.

> Comment: This subdivision is included because loans are often packaged and sold to different parties that collect payments (sometimes being "sliced and diced" in the process). This subdivision allows a guaranty to be transferred to the original lender's successors and assigns as part of the "collateral" for the loan.

f. *Guarantor consideration:* You are undertaking your obligations under the Guaranty in consideration of each Creditor's entry into the Guaranteed Agreement (and also to induce each Creditor into doing so).

> Comment: 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.

g. *Governing law:* Any dispute arising out of or relating to this Guaranty (including without limitation any dispute concerning the interpretation and/or enforcement of this Guaranty) is to be governed by the same law as governs the Guaranteed Agreement, applied in accordance with the Governing Law Clause.

h. *Creditors need not sign:* You WAIVE acceptance of the Guaranty by the Creditors, notice of such acceptance, and signature of the Guaranty by the Creditors.

> Comment: 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.

i. *Certification of financial information:* You represent and warrant, to each Creditor and to that Creditor's successors and assigns (if any), that the credit-related information you provided in connection with the Guaranty is complete and accurate.

Comment: 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.

> Of course, creditors likely would do at least some financial due diligence on guarantors; this certification provides creditors with at least some anti-fraud assurance.

j. *Expenses of collection:* You must pay any court costs and other reasonable expenses that a Creditor incurs in enforcing one or more of:

1. that Creditor's rights against you under the Guaranty; and/or
2. the Payment Obligation in question.

> Comment: Language similar to that of this clause was used in the guaranty in Eagerton v. Vision Bank, 99 So. 3d 299, 305 (Ala. 2012).

k. *Refund of bankruptcy payments:* This provision applies if a Credit❑ (i) refunds (as defined below) a payment made by a Payer on a Payment Obligation because of a requirement of bankruptcy law; fraudulent-transfer law; or comparable law; or (ii) makes a partial refund of such a payment in settlement of a claim for a larger refund.

> Comment: If a principal of a 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). "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).
>
> A creditor in bankruptcy does have the right to contest its obligation to refund an avoidable preference. That can be difficult, though, because 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.

1. In any such case, you 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.

2. 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.

l. *Your liability for deficiencies after foreclosure:* IF: Foreclosure on collateral is not enough to pay the Payment Obligation or other obligations under the Guaranty; THEN: To the fullest extent permitted by applicable law, you will be liable for any remaining amount — this will be true even if the Payer's liability for such a deficiency were to be wiped out by the foreclosure under a statute or judicial decision.

> Comment: 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).

m. *No defenses against enforcement:* Your obligations under the Guaranty are absolute, unconditional, direct and primary; you **WAIVE**, and expressly agrees that you will not assert (and you will cause your affiliates, if any, not to assert):

> Comment: This waiver language is adapted from California Civil Code § 2856(c) and (d).
>
> The use of all-caps, bold-faced type for WAIVE is for conspicuousness; see the discussion at § 12.16.
>
> Comment: 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.

1. any claim or defense that your obligations under the Guaranty are allegedly illegal, invalid, void, or otherwise unenforceable;

> Comment: 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).

2. any claim or defense pertaining to any Payment Obligation, other than the defense of discharge by full performance — this includes, 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 Payment Obligation;

3. any setoff available to the Payer or any other such person liable, whether or not on account of a related transaction;

> Comment: 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).

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 Payment Obligation, resulted in impairment or destruction of your 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 or you.

> Comment: 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).

n. *Collection timing:* You must honor your obligations under the Guaranty as soon as a Creditor asks in writing that you do so following a default by the Payer in the relevant Payment Obligation.

Comment: This language makes it clear that a creditor needn't jump through any particular hoops to be entitled to collect from a guarantor.

(BUT: 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 Payment Obligation, then your obligations under the Guaranty will not kick in before the end of that cure period.)

o. *No need to go after the Payer(s) first:* A Creditor is allowed to go after you to enforce your obligations under the Guaranty without having to go after the Payer first; 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 Payment Obligation.

Comment: This is sometimes referred to as a guaranty of *payment*.

ALTERNATIVE: "The Guaranty may not be enforced as to any Payment Obligation until the Credit❑ (i) has obtained a final judgment against the Payer, from which no further appeal is taken or possible, enforcing, in whole or in part, the Payment Obligation in question; and (ii) has been unable to collect the judgment after diligently making reasonable efforts to do so." COMMENT: This is known as a guaranty of *collection*. Creditors will typically object to this alternative because 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.

p. *Effect of modification of Payment Obligation:* You will no longer be obligated under the Guaranty if the Payment Obligation is altered, in any material respect, without your written consent.

Comment: The general rule — which is strictly applied by courts — is 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).

ALTERNATIVE: "An amendment to or modification of a Payment Obligation does not discharge or otherwise affect your obligation under the Guaranty in respect of that Payment Obligation." COMMENT: 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).

§ 4.06.2. Additional commentary

§ 4.06.2–1 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. Traditionally, "guaranty" is the noun, while "guarantee" is the verb; see, e.g., Uhlmann v. Richardson, 287 P.3d 287 (Kan. 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.

§ 4.06.2–2 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.

§ 4.06.2–3 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.

§ 4.06.2–4 Additional reading about guaranties (optional)

See, e.g.:

– Henri Chalouh, The Commercial Lease Guarantee: An Overview For Landlords And Tenants (Mondaq.com 2015)

– Pamela Westhoff, Charles Donovan and Lydia Lake, Commercial Lease Guaranties From Foreign Entities: What You Need to Know to Safeguard Your Security (2015) archived at https://perma.cc/V6MW-X3JF

§ 4.07. Payment Security Rule

a. *Applicability:* This Rule applies if the Contract calls for one party ("***you***") to establish security for your payments to another party ("*Supplier*") for an order.

> Comment: This payment-security provision draws on ideas seen in § 2.2 of the General Electric PO, cited at XXX.

b. *Deadline for establishing payment security:* No later than ten business days after agreeing to an order so specifying, you must establish — and you must keep in force as set forth below — payment security that meets any and all requirements stated in this section and/or otherwise agreed to in writing.

c. *Required form & financial institution:* 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; and

> Comment: "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).

2. be issued (or confirmed) by a financial institution, reasonably acceptable to Seller (the "*Bank*").

d. *Required payment types:* The 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 you in connection with the order.

e. *Required term of payment security:* You must keep the payment security 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.

f. *Modification of payment security upon Supplier request:* You must do some or all of the following no later than ten days after Supplier gives you notice under subdivision g below:

1. increase the amount of the payment security;

2. extend the term of the payment security;

3. make any other appropriate modifications to the payment security.

g. *Basis for modification:* Supplier may give you notice under subdivision f if, in Supplier's reasonable judgment, doing so is appropriate in view of the circumstances of an order — including without limitation your payment history and other facts bearing on your ability to pay.

h. *Cost of payment security:* You must bear all costs and expenses associated with establishing and maintaining the payment security.

i. *Effect of failure to obtain and maintain payment security:*

1. 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

2. Any failure on your part to timely provide, maintain, and/or update the required fully-effective payment security will be a material breach of the Contract in respect of the order.

§ 4.08. Pay If Paid / When Paid Rule

§ 4.08.1. For paying parties: Dos and don'ts

a. *Applicability:* This Rule applies if, under the Contract, a party ("*you*") must make a particular payment (the "*contingent payment*"), BUT the Contract clearly indicates that:

1. the payment obligation is contingent on your receipt of one or more third-party payments; and

2. the contingency referred to in subdivision 1 is either "pay if paid" or "pay when paid," or comparable wording in either case.

> Comment: 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 need not pay the painter unless the homeowner pays the contractor.

b. *Due date of contingent payment:* You must promptly make the contingent payment after you have received — on an unconditional basis — and accepted the specified third-party payment(s).

c. *Collection efforts for pay-when-paid obligation:* If you owe money under a pay-when-paid obligation, then you must make commercially-reasonable efforts (§ 9.15) to collect all relevant third-party payments.

> Comment: 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. See the additional commentary XXX following this Rider for additional information.

d. *Collection efforts for pay-if-paid obligation:* If you owe money under a pay-if-paid obligation, then you need not make any particular efforts to collect any associated third-party payment; any such efforts will be:

1. in your sole discretion; and

2. solely for your benefit.

Comment: 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).

Because a pay-*if*-paid clause essentially puts the risk of non-payment on the subcontractor, 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 clauses 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).

For additional information, see generally, e.g., Robert Cox, Pay-if-Paid Clauses: A Surety's Defense for Payment Bond Claims? (JDSupra.com 2019).

§ 4.08.2. For payees: Assumption of risk

IF: You will be owed money under the Contract for a pay-if-paid obligation; THEN: You certify — with the intent that the paying party rely on your certification — that:

1. You have taken into account the risk that the paying party might not get paid by the relevant third party or -parties, and thus that *you* might not get paid;

2. You are relying on the credit and the willingness and ability to pay of those third parties, and not on that of the paying party, for you to be paid that amount; and

3. You KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY **ASSUME AND ACCEPT THE RISK** that one or more of those third parties might not be able or willing to pay the paying party, in which case you might not get paid (or might not be paid in full).

§ 4.09. Additional opt-in payment terms

The terms below will apply in the Contract only to the extent (if any) that the Contract clearly says so.

§ 4.09.1. No Waiver of Other Paying-Party Rights Rule [opt-in]

In case of doubt: If Bob pays Alice an amount under the Contract, the fact of the payment will not diminish any rights that Bob might have, under the Contract or the law, concerning the subject matter of the invoice. Such other rights might include, without limitation, warranty rights concerning goods delivered and/or services performed.

§ 4.09.2. Offset Authorization Rule [opt-in]

a. IF: Bob owes Alice money under the Contract; AND: Alice also owes Bob money (under the Contract or otherwise); THEN: Bob, in his sole discretion, may reduce his payment to Alice by the amount that Alice owes him.

b. IF: Bob reduces his payment to Alice as provided in subdivision a; THEN: Bob must take the following actions promptly, and in any case no later than the due date of his payment to Alice:

1. advise Alice in writing that he is taking an offset; and
2. provide Alice with a reasonable explanation of each offset, with reasonable supporting documentation.

> ALTERNATIVE**:** "A paying party may not offset, against amounts it allegedly owes to another party, any amount that the other party owes to it."
>
> CAUTION: 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).

§ 4.09.3. Offset Prohibition Rule [opt-in]

IF: Bob owes Alice money under the Contract; AND: Alice also owes Bob money (under the Contract or otherwise); THEN: Bob may not reduce his payment to Alice by the amount that Alice owes him.

> Comment: This Rule might be important to Alice if she will be depending on Bob's timely payment for the cash flow she needs to run her business.

a. *COD Terms Option:* 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.

> Comment: Applicable law might well implicitly permit a payee to demand COD terms after late payment if the late payment constituted a material breach of this Agreement.

b. *No Infringement from Non-Payment Option:* IF: A party ("*Customer*") does not timely pay another party ("*Provider*") amounts required by an agreement for goods or services furnished by Provider; THEN: Provider's remedies (if any) will not include remedies for infringement of Provider's intellectual property rights.

> Comment: A customer purchasing and using (or reselling) goods, or acquiring a license to use software, might be interested in this clause, because:
>
> – Nonpayment of a software license fee might means that the non-paying user was infringing the copyright in the software. *See* MDY Indus., LLC v. Blizzard Entm't., Inc., 629 F.3d 928, 939-41 (9th Cir. 2010), where in a dictum the court said: "A licensee arguably may commit copyright infringement by continuing to use the licensed work while failing to make required payments ...." *Id.* at 941 n.4.
>
> – And the damage award for such infringement might be significantly more than simply having to pay the required fee. See, e.g., Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc., 886 F.2d 1545 (9th Cir. 1989) (*Frank Music II*), where the MGM Grand Hotel's casino floor show was found to infringe the copyright in the Broadway musical *Kismet*, and the resulting damage award included 2% of MGM's profits from the hotel operations as a whole, including the casino itself.

§ 4.10. Payment security playbook

Extension of Supplier's performance time pending receipt

Supplier need not begin its performance under an order (nor continue it, if Supplier has already begun performance) until Supplier receives the fully effective payment security (and/or any required modified payment security), and all Supplier performance deadlines will be extended accordingly.

Payment-security failure as 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 an agreement in respect of the order.

Chapter 5: Supporting operations terms

The terms in this chapter will apply to the same extent as described in § 2.01Operating protocols.

§ 5.01. Archive Copies Rule

a. *Applicability:* This Rule will apply if the Contract clearly indicates that a party ("*you*") may retain archive copies (or "archival copies") of documents or other materials instead of returning them to another party or destroying them.

> Comment: 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 Discloser 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.

b. *Copies:* You may cause a reasonable number of archive copies to be made, and/or retained, for purposes of documentation; backup; and disaster recovery. This includes, without limitation,

1. photographs and video / audio-visual recordings made to document tangible objects and/or events; and
2. sound recordings of audible events.

c. *Location:* You may maintain archive copies at one or more reasonable locations that you select, subject to the security requirements below.

d. *Retention period:* You may retain archive copies indefinitely, so long as the requirements of this Rule are met.

> Comment: Some parties might want to put a time limit on the right to retain archive copies.

e. *Security:* You must cause all archive copies to be maintained in accordance with commercially reasonable security standards. This could be done, without limitation, 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.

f. *Confidentiality:* You must comply with the Tango Confidentiality Rule (§ 2.02) for any information contained in archive copies that qualifies as Confidential Information or trade secrets of another party under that Rule.

g. *Access restrictions:* Without limiting your obligations under subdivision f, you must take prudent measures to ensure that archive copies containing such information are not made accessible to anyone except as follows:

> Comment: The "prudent measures" requirement is a tightening up of the "commercially reasonable measures" standard used in, e.g., § 9 of the Mutual Non-Disclosure Agreement between large companies Sybase and SAP (https://goo.gl/MwkmNa). (Sybase was acquired by SAP in 2010.)

1. by your personnel who maintain the archive copies, if applicable;

2. as agreed in writing; and/or

3. as directed (or permitted) by a tribunal having jurisdiction.

h. *Use restrictions:* Without limiting your obligations under subdivision f, you must not use archive copies (nor allow or knowingly assist in such use) except, from time to time, for one or more of the following purposes:

1. helping to determine, and confirm your compliance with, your continuing obligations under the Contract;
2. documenting the parties' interactions relating to the Contract;
3. reasonable testing of the accuracy of the archive copies; and/or
4. as otherwise agreed in writing.

i. *Custodian:* You may, but need not, use an independent custodian to maintain the archive copies, in which case.

> Comment: If the archive custodian(s) is not required to be independent (a term well understood by corporate lawyers), then the custodian(s) might be, for example, the retaining party's IT staff.
>
> Alternatively: The archive custodian(s) might be required to be the retaining party's outside counsel — assuming, of course, that the outside counsel is willing to take on that role, which is not a given. The phrase *outside counsel only* is well understood by lawyers who work in litigation. See, for example, paragraph 11(c) of the protective order entered in an antitrust case brought by the [U.S.] Department of Justice

1. The custodian must be legally obligated, by contract or otherwise, to comply with your obligations under this Rule.
2. You will be responsible for any breach, by the custodian, of those requirements.

§ 5.02. Assignment Consent Rule

§ 5.02.1. The Rule

a. *Applicability:* The parties will follow this Rule if the Contract or the law requires a party, referred to as an "*assigning party*," to obtain the consent of another party ("***you***") before assigning the Contract.

> Comment: 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; **this general rule is thought to promote economic efficiency**, as discussed in the additional reading (§ 5.02.2).
>
> CAUTION: In a long-term contractual relationship, a party's desire to require consent to assignment by the other party can be strategically dangerous for the other party; this too is discussed in the commentary below.

b. *Consideration of relevant factors:* You must take into account any evidence that the assigning party timely provides to you concerning the relevant qualifications, capabilities, and financial position of the proposed assignee.

> Comment: The idea for this "due consideration" 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.

c. *Prompt communication of consent decision:*

1. You must promptly advise the assigning party, in writing, whether you consent to the proposed assignment; and

2. If you do not consent to the assignment, you must, at the same time, provide the assigning party with a written explanation, in reasonable detail, of all your reason(s) for withholding consent.

d. *Standard for withholding consent:* You must not arbitrarily or capriciously withhold or condition your consent to assignment of the Contract.

> ADD-ON OPTION: "Any withholding, delay, or conditioning of the reviewing party's consent to assignment is presumed to be done in good faith."
>
> ALTERNATIVE: "The reviewing party will not unreasonably or arbitrarily withhold, delay, or condition its consent." Comment: Even without this alternative, **applicable law *might* require that consent to assignment not be unreasonably withheld** (§ 5.02.2–10). BUT: The reviewing party might be **willing to "play chicken"** with the assigning party by (metaphorically) folding its arms and saying "we think we're reasonably withholding consent; if you don't agree, then sue us — and watch your deal disappear while you wait months or years for the court proceedings to end."
>
> ADD-ON OPTION TO ALTERNATIVE: "A requirement that the assigning party pay a fee (no matter how named) in addition to any fee or other payment that may be due under this Agreement, as a prerequisite to consent to assignment, is to be considered an unreasonable and arbitrary condition to consent."
>
> ADD-ON OPTION TO ALTERNATIVE: "IF: The reviewing party unreasonably or arbitrarily withholds, delays, or conditions its consent to a proposed assignment; THEN: (1) The reviewing party is to be deemed as having given its consent, effective retroactively to the date that the reviewing party received the request for consent; and (2) such deemed consent will not affect any other remedy for the unreasonable withholding that might be available to the assigning party, such as (for example) the right to recover monetary damages." Comment: This add-on option is adapted from a suggestion by Ric Gruder; it's included to discourage a reviewing party from rolling the dice and refusing consent in the hope of extracting unwarranted concessions from the assigning party.

ALTERNATIVE: "The reviewing party may grant, withhold, or condition its consent in its sole and unfettered discretion."

CAUTION: **It could be dangerous for a prospective assigning party even to ask f**or a prohibition of unreasonable withholding of consent. Why? Because if the reviewing party were to say "no" (i.e., if the reviewing party were to refuse to agree to the prohibition against unreasonable withholding), then the refusal might well be interpreted as conclusively establishing that consent could be withheld in the reviewing party's sole discretion.

Comment*:* If the agreement does not address the standard for granting or withholding consent, then the applicable law might — or might not — require consent to assignment not to be unreasonably withheld; see the additional commentary (XXX) for more discussion.

e. *Asset transaction consent exception:* The assigning party need not obtain your consent to an assignment of the Contract that occurs in conjunction with a sale or other transfer of substantially all of the assets of the assigning party's business to which the Contract relates.

Comment: This exception is stated as a standard part of this Rule because the exception is likely to be 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.

ALTERNATIVE: "An assignment of this Agreement in conjunction with a sale or other disposition of the assigning party's business assets requires consent to the same extent as any other assignment."

Background: 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. 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.)

f. *Pledges consent exception:* Except as stated in this subdivision, the assigning party need not obtain your consent to a "Pledge," namely: (i) an assignment- or pledge of a right under the Contract, and/or (ii) a grant of a security interest in any such right.

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

1. This Pledge exception applies regardless whether the Pledge is absolute or collateral.

2. This Pledge exception does not apply, however, in case of a Pledge that: (i) purports to delegate any material obligation of the assigning party under the Contract, and/or (ii) has such an effect as a matter of law.

Comment: 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).

g. *Unconsented assignment as material breach:* Any assignment of the Contract without a consent required by the Contract is a material breach of the Contract.

ALTERNATIVE: "Assignment without a required consent is a material breach only if it would otherwise qualify as such under applicable law."

Comment: The default choice here supposes that if a party regarded an assignment-consent requirement as being important enough to include in an agreement, then that requirement would likely qualify as a "material" term, and therefore failure to obtain consent would be a *material* breach. And this can matter — 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"? 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*. And then, if B *did* give notice of termination for B's (supposedly) material breach, then B's termination might itself constitute a 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).

An improper termination for breach 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.

h. *Assignment void without required consent:*

1. Except as provided in subdivision 2, an assignment of the Contract is void if made without your consent.

Comment: A court applying the so-called **"classical approach"** to voidness 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 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).

2. Subdivision 1 does not apply to an assignment that occurs automatically by operation of law, as part of a merger or other transaction, unless the Contract expressly requires the assigning

party to obtain your consent to the merger or other transaction itself.

> Comment: **The law seems to vary** as to whether a merger or similar transaction has the effect of an assignment of contracts by operation of law; see the commentary below (§ 5.02.3).

i. *Future consent by assignee:* An assignee of or successor to an *assigning party* must obtain your consent to an assignment to the same extent as then-former assigning party.

j. *Effect of reviewing-party assignment:* If you assign the Contract (or if another party succeeds to your right to consent to the other party's assignment), then that assignee (or successor) has the sole right to grant consent to an assignment; you will no longer have that right.

§ 5.02.2. Additional commentary

§ 5.02.2–1 Background: To promote economic efficiency, most contracts can be freely assigned

Suppose A and C enter into a contract. And suppose that B could carry out A's contract obligations at lower cost than A could do so. In such circumstances, 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:

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

– 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.

– 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.

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**:

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

– 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.

§ 5.02.2–2 But some types of contract can't be assigned without consent

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.

§ 5.02.2–3 IP licenses generally can't be assigned without consent

Under U.S. law, licenses of intellectual property are an exception to the general rule of assignability — a licensee of intellectual property 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, but it 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.

§ 5.02.2–4 **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 XXX

§ 5.02.2–5 ***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.

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.

§ 5.02.2–6 Business danger # 1: De facto control of assigning party's destiny

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: 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: 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).

§ 5.02.2–7 Business danger # 2: Burden of obtaining consents

Obtaining assignment consents could be burdensome for the assigning party. 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 best, 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, 143 So.3d 881 (Fla. 2014) (holding that distinction between assignment and sublicense is not determined by the mere application of a bright-line rule).

§ 5.02.2–8 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.

§ 5.02.2–9 Business danger # 4: 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).

§ 5.02.2–10 The law might — or might not — impose a reasonableness obligation on the reviewing party

If the Contract does not address the standard for granting or withholding consent, then the 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 finding that a patent's owner, 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).

§ 5.02.3. Playbook options [opt-in]

The following terms apply only to the extent (if any) that the Contract clearly so states.

§ 5.02.3–1 Assignment by Merger Option

a. A Merger Transaction (defined below) requires consent to the same extent, if any, as would an assignment by the assigning party outside of such a transaction.

b. The term "*Merger 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.

> Comment: **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).

– *Accord*, Florey Inst. of Neuroscience & Mental Health v. Kleiner Perkins Caufield & Byers, No. CV 12-6504 SC, slip op. part IV.B (N.D. Cal. Sept. 26, 2013) (granting in part motion to dismiss): "The Court therefore begins from the presumption that **a reverse triangular merger, which leaves intact the acquired corporation, does not effect a transfer of rights** from the wholly owned subsidiary to its acquirer as a matter of law. What little applicable law there is could be analogized from California cases on stock sales, like [citation omitted], which suggested that if a plaintiff had sold all of his stock in a corporation, there could be no contention that the corporation's licenses would be extinguished as a matter of law, since the two contracting parties were still extant and in privity." *Id.*

– The same California federal court, reviewing case law, had earlier noted the existence of variations in different states' laws on this point. The court held that the law governing the purportedly-assigned 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.

On a related subject: 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).

§ 5.02.3–2 Assignment Insecurity Option

a. This Option applies if the assigning party assigns the Contract in a manner that delegates the assigning party's performance under the Contract.

> Comment: The [U.S.] Uniform Commercial Code has a provision similar to this Option, namely UCC § 2-210(5) (which applies by its terms only to sales of goods). That provision 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.

b. The non-assigning party may demand commercially reasonable assurance that the assigning party's obligations under the Contract will be duly performed. Any such demand is to be made by notice to the assigning party.

c. The non-assigning party's right to demand assurance under subdivision b does not affect any other right or remedy that the non-assigning party might have against the assigning party and/or the assignee.

> Comment: An "assignee" is a third party to which the agreement is assigned, that is, transferred.
>
> Until the non-assigning party receives such assurance, the non-assigning party may, if commercially reasonable to do so, suspend any performance under the Contract for which the non-assigning party has not already received the agreed return.

d. IF: The non-assigning party does not receive such assurance within a reasonable time (not to exceed 30 days) after the effective date of its demand for assurance; THEN: The assignee and the assigning party are to be deemed to have repudiated the Contract.

> Comment: This provision is modeled on UCC § 2-609, which allows a non-assigning party to suspend its performance (if commercially

reasonable) and eventually treat the agreement as repudiated if the assignee does not provide adequate assurances.

Repudiation of an agreement, sometimes known as *anticipator repudiation*, is considered **a form of breach of contract**. See generally the Wikipedia article Anticipatory repudiation.

§ 5.03. Audit Rule (and playbook)

§ 5.03.1. The Rule

a. *Applicability:* This Rule applies if the Contract authorizes an "*auditing party*" to have one or more audits conducted of specified records kept by another party (the "recordkeeping party").

Introduction: The nuclear Navy has a saying: You get what you inspect, not what you expect. This saying can be true in the world of contract relationships as well: Mistakes can happen — and sometimes, so can creative accounting, stonewalling, and even outright fraud. 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 on 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.

Sample adoption language: "From time to time, Bravo may cause audits to be conducted of Alpha's books and records that evidence Alpha's billings to Bravo under this Agreement in accordance with the Tango Terms Audit Rule."

b. *Inspection Rule:* The Tango Inspection Rule (§ 3.10.7) is incorporated by reference; for purposes of that protocol, the "inspecting party" is the auditing party and the "host" is the recordkeeping party.

> Comment: The Inspection Rule contains a variety of general provisions designed to promote smoothly-running inspections with minimal interference to ongoing business. Incorporation by reference of the Inspection Rule helps to avoid the dangers associated with violating the D.R.Y. (Don't Repeat Yourself) principle (§ 12.08).

c. *Access to records:* You must make all auditable records available to the auditors in the form in which those records are kept in the ordinary course of business. (See also § 5.03.1.i for place of audit.)

> Comment: An auditing party probably would not want its auditors to be handed a stack of papers; 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).

> Pro tip: A recordkeeping party might want to restrict auditors' access to the party's facilities, computers, etc. For example, in audits of a licensee's usage of software, a possible compromise might be to allow a third-party auditor to have limited access to the licensee's 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).)

> ALTERNATIVE: "The recordkeeping party is to provide the auditors with a complete copy of the auditable records, subject to the confidentiality obligations of the Audit Rule."

d. *Access to personnel:* You must (i) make your relevant personnel reasonably available to the auditors, and (ii) direct them to answer reasonable questions from the auditors, except as otherwise provided in this Rule or elsewhere in the Contract.

> Comment: 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.

e. *Advance notice:* The auditing party must give you at least ten business days' notice of any proposed audit except for good reason (defined in the Inspection Rule, § 5.08.2.e).

> Comment: 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.

f. *Audit request deadline:* The auditing party may request an audit of any particular record only on or before the later of the following dates, unless there is good reason (see subdivision a) for a later audit:

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

> Comment: 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.

g. *Audit request frequency:* Unless good reason (see subdivision a) exists for more-frequent audits, the auditing party may request an audit only: (1) up to once per 12-month period, and (2) up to once per period audited.

> Comment: An audit might end up being at least somewhat burdensome and disruptive to the recordkeeping party. Most recordkeeping parties will thus want to limit the auditing party's ability to initiate audits. See also the option requiring the auditing party to reimburse the recordkeeping party's expenses (§ 5.03.2–1).

h. *Permissible auditors:* The auditing party may engage any Big Four accounting- or consulting firm to conduct an audit. Any other auditor(s) is subject to your approval, but you must not unreasonably withhold your approval.

> Pro tip: Contract-negotiation consultant John Tracy suggests (in a LinkedIn discussion thread) that an auditing party should consider engaging the outside CPA firm that regularly audits the recordkeeping party's books. 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."

i. *Audit time and place:* Unless otherwise agreed, the auditing party is to cause each audit to be conducted:

1. at the location or locations where the auditable records are kept in the ordinary course of business;

> Comment: 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.)

2. during the regular working hours, at that location, of the party having custody of the records; and/or

3. at your option, at one or more other reasonable times and places that you designate in advance in consultation with the auditing party.

j. *Exclusion of certain information:* Unless the Contract 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, including without limitation 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.

Comment: 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 3 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.

k. *Auditor workspace:* IF: An audit is to be conducted at one or more sites controlled by the recordkeeping party; THEN: You must cause the audit site(s) to be furnished with appropriate facilities, of the type customarily used by knowledge-based professionals, at your own expense.

> Comment: "Appropriate facilities" would normally include, for example, furniture, lighting, air conditioning, electrical outlets, and Internet access.
>
> (In an unfriendly audit, an uncooperative recordkeeping party might try to make the auditors work in a closet, a warehouse, or worse.)

l. *Auditor confidentiality obligations:* The auditors must comply with the same confidentiality obligations that apply to the auditing party.

m. *Auditor retention of copies:*

1. The auditors may make and keep copies of auditable records, subject to the confidentiality- and return-or-destruction provisions of this Rule.

> Comment: 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. And auditors might insist on being able to take copies with them to file as part of their work papers.
>
> Pro tip: In some circumstances, the recordkeeping party might want to negotiate for limits on the types of records that the auditor(s) may copy and take away.

2. The auditors must destroy or return any copies that the auditors retain of records they examine, in accordance with their regular, commercially reasonable policies and processes;

n. *Copy of audit report to recordkeeping party:* If you so request in writing to the auditors (with a copy of the request to the auditing party), the auditors must promptly furnish you with a complete and accurate copy of the audit report, at no charge.

> Comment: If the recordkeeping party will have to come up with extra money, or is accused of a material breach, it likely will want to get

> a copy of the audit report. And if the dispute were to go to litigation or even arbitration, the odds are high that the auditing party's lawyers would be able to get a copy of the audit report, e.g., as part of the discovery process in the U.S.

o. *True-up payment:* Each party must promptly correct any discrepancies revealed in an audit that are the responsibility of that party, for example in case of an overbilling or underpayment.

> Comment: Adjustment requirements are practically a universal feature of audit provisions. Otherwise, what would be the point of having audit rights?

p. *Interest:* A party that is found by an audit to owe money due to its fault must pay simple interest to the other party on the amount(s) owed, at 1.5% per month from the date originally due — or at the maximum interest rate permitted by law, if lower, from the earliest start date permitted by law, if later. The Interest Charges Rule (§ 5.09) will govern.

> Comment: Contract drafters should be very careful about "usury" laws, which can have very sharp teeth, as discussed in the Interest Charges Rule (XXX).

> Pro tip: If an agreement also is going to provide for charging interest on past-due amounts apart from an audit provision, then the agreement should clearly so state. 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).

q. *Reimbursement of audit expenses:* You must reimburse the auditing party for its reasonable out-of-pocket expenses actually incurred if the audit was occasioned by, or revealed or confirmed, one or more of the following:

1. overbilling or underpayment of the auditing party by 5% or more for the period being examined; and/or
2. fraud and/or material breach of an agreement for which you are is responsible under an agreement.

Such expenses would include (without limitation) reasonable fees and expenses charged by the auditor(s).

> Comment: 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 0.5% for billing discrepancies in services.
>
> "For the period being examined": Suppose that a discrepancy for a single month is 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.

§ 5.03.2. Playbook options [opt-in]

> Comment: Drafters can consider adopting one or more of the options below by referencing its heading.

§ 5.03.2–1 Recordkeeping Party Reimbursement Option

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 must reimburse the recordkeeping party (and the recordkeeping party's subcontractors, if applicable) for reasonable expenses actually incurred in connection with the audit. Such expenses would include (without limitation) reasonable fees and expenses for an auditor engaged by the recordkeeping party to monitor the audit.

Comment: Two construction lawyers have noted 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).

§ 5.03.2–2 True-Up EXCLUSIVE REMEDY Option

This Option applies if the recordkeeping party complies with the discrepancy-related requirements of the Audit Rule within ten business days after receiving, from the auditor(s), a copy of an audit report providing clear support for the existence of a discrepancy for which the recordkeeping party is responsible.

1. Except as provided in subdivision 2, the recordkeeping party's compliance with such requirements will be the recordkeeping party's only liability, and the auditing party's EXCLUSIVE REMEDY, for the discrepancy.

2. The exclusive-remedy limitation of subdivision 1 does not apply if the audit revealed or confirmed fraud or a material breach of the Contract for which the recordkeeping party was responsible by law and/or under the Contract.

Comment: A software customer might want this exclusive-remedies provision as a shield against an aggressive software licensor in case an audit 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.)

§ 5.03.2–3 Audit Requirement Flowdown Option

The recordkeeping party must make sure that each of its subcontracts under an agreement, if any, includes "flowdown" provisions as follows:

1. a requirement that the subcontractor permit audits by the auditing party in accordance with the Contract's audit provisions; and
2. an authorization for the subcontractor to deal directly with the auditing party and its auditors in connection with any such audit.

Comment: Flowdown requirements are quite common in government contracts.

§ 5.04. Background Checks Rule

§ 5.04.1. The Rule

§ 5.04.1–1 Definitions

1. *Applicable Background Checks* refers to the specific background check(s) that are to be performed under the Contract, namely Criminal-History Checks.

Comment: The defined term used here
is Applicable Background Checks, as opposed
to Required Background Checks, for two reasons:

1. To avoid creating the implication that the Applicable Background Checks are always an absolute, mandatory requirement, because that could create future difficulties if

a background check were skipped and then the checked individual did something bad; and

2. less importantly, to have the term be alphabetized first with the other definitions below.

Some drafters will want to specify additional background checks.

2. *Checked Individuals* refers to the individual or individuals whose backgrounds are to be checked under the Contract, namely any individual whom a Checking Party, directly or indirectly, causes or permits to engage in one or more Restricted Activities if not otherwise specified.

3. *Checking Party* refers to a party that is required to perform background checks under the Contract.

4. *Credit Check* refers to standard credit reporting from all major credit bureaus serving the jurisdiction in question.

Comment: Credit checks, if not done correctly, can get a checking party in trouble under the [U.S.] Fair Credit Reporting Act, as discussed in the additional commentary.

5. *Criminal History*, as to a Checked Individual, refers to the Checked Individual's having been convicted of, or having pled guilty or no contest to, one or more of (A) a felony; and/or (B) a misdemeanor involving fraud or moral turpitude.

6. *Criminal-History Check* refers to a nationwide check of records of arrests, convictions, incarcerations, and sex-offender status. A Criminal-History Check is not required to include fingerprint submission to confirm identity.

Comment: Criminal records checks in basic form seem to be available from any number of Web sites at low cost. (The author has never personally used any such site and can't recommend any particular one; human-resources personnel might be able to recommend one.)

CAUTION: Using criminal-records checks to deny employment might lead to trouble with government agencies or with the persons checked if the denials have the effect of unlawful discrimination against minorities or other protected classes.

7. *Critical Activity* refers to any activity involving a substantial possibility of (i) bodily injury to or death of one or more individuals, including but not limited to a Checked Individual; and/or (ii) loss of, or damage to, tangible or intangible property of any kind; such loss or damage might be physical and/or economic.

Critical Activities: This definition is used in the restrictions on assigning personnel to engage in such activities if their background checks indicate Drug Misuse.

8. *Driving-Record Check* refers to a check of records of accidents; driver's-license status; driver's-license suspensions or revocations; traffic violations; criminal charges (e.g., DUI).

9. *Drug Misuse*, as to a Checked Individual, refers to evidence of use, by the Checked Individual, of one or more of: (1) illegal drugs; and/or (2) prescription drugs other than in accordance with a lawfully-issued prescription.

10. *Drug Testing* refers to testing for illegal drugs and controlled pharmaceuticals.

Comment: Customers with safety concerns might want its contractors' employees to be drug-tested. Depending on the position, even legal drugs might disqualify an individual. For example, an individual taking certain prescription medications might be disqualified from (say) driving a bus or other commercial vehicle.

CAUTION: Companies should be cognizant of disability laws such as the Americans with Disabilities Act, which might affect a company's ability to deny employment because of prescribed drug use.

Companies might also consider the possible effect on employee morale of asking them to take a drug test – and about what they might have to do if a valued employee were to bust the test. As the saying goes, be careful about asking a question if you're not prepared to deal with the answer.

11. *Education Verification* refers to confirmation of dates of attendance, fields of study, and degrees earned.

Comment: Educational verification checks are sometimes used as a way of detecting people who falsify their résumés. Sadly, résumé padding is not an uncommon occurrence. For example, in 2014 the chief spokesman of Walmart resigned after the retail giant learned that he had falsely claimed to have graduated from college, when in fact he had not finished his course work (DailyMail.com 2014). Ditto the former dean of admissions at MIT (NPR.org 2015).

12. *Employment Verification* refers to confirmation of start- and stop dates and titles of employment for the past seven years.

Comment: Verification of employment *dates*, in particular, can help expose undisclosed résumé gaps — or "fudging" of employment dates as listed on the résumé to shorten or eliminate gaps.

It's thought by some that a good practice is not to rely on employer contact information provided by the (former) employee, but instead to find the contact information independently. Otherwise, it's possible that the "employer" is actually someone colluding with the former employee to provide false information.

> Some parties might want to obtain more than just the listed information, adding (for example) job duties, salary history, reason for leaving, and/or eligibility for rehire.
>
> Some parties want employment history for the past five to ten years, or for the past two to five employers.

13. *Lien, Civil-Judgment, and Bankruptcy Check* refers to a check of records of tax- and other liens; civil judgments; and bankruptcy filings.

14. *Personal Reference Check* refers to telephone- or in-person interviews with at least three personal references, seeking information about the individual's ethics; work ethic; reliability; ability to work with others (including, for example and where relevant, peers, subordinates, superiors, customers, and suppliers); strengths; areas with room for improvement; personality.

15. *Requesting Party* refers to the Signatory Party other than the Checking Party.

16. *Residence Address Verification* refers to confirmation of dates of residence addresses for the past seven years.

> Comment*:* This check has in mind that an individual might omit one or more previous residence addresses in the hope of evading a criminal records check.

17. *Restricted Activity* refers to any one or more of the following, when engaged in, in connection with the Contract, by an employee of, or other individual under the control of, a Checking Party: (A) working on-site at any premises of a Requesting Party; (B) having access (including without limitation remote access) to the Requesting Party's equipment or computer network; (C) having access to the

Requesting Party's confidential information; (D) interacting with the Requesting Party's employees, suppliers, or customers; and (E) any Critical Activity.

§ 5.04.1–2 **For the Checking Party: Dos and don'ts**

a. *Reasonable manner:* The Checking Party is to take prudent measures to cause each background check to be performed in a commercially-reasonable manner, by a reputable service provider if not by the Checking Party itself.

> Comment: The Checking Party's obligation is to *cause* background checks to be conducted. Very few parties will actually conduct their own background checks. Even those (few) parties that might be able to conduct their own checks are likely to want to "outsource" that responsibility to an outside party that can do such things more cost-effectively (and at which the finger can be pointed if something goes wrong).
>
> This language gives the Checking Party a safe harbor: If the Checking Party hires a reputable service provider, then it will have complied with its obligation under this provision.

b. *Compliance with law:* The Checking Party is to take prudent measures to cause each background check to be conducted in accordance with law, including, for example:

1. any applicable privacy laws, including for example any requirement to obtain the consent of the relevant Checked Individual; and

2. any applicable requirement (for example, in credit-reporting laws) that the relevant Checked Individual must be notified before or after a decision is made using information learned in the background check.

> Comment: This obligation is phrased as "prudent measures," as opposed to an absolute obligation. Expressly requiring the Checking Party to comply with law is arguably superfluous. Still, doing so can be useful to remind drafters and parties of privacy laws protecting employees and consumers, including for example the Fair Credit Reporting Act, and the HIPPA Privacy Rule, and to give the other party a contractual remedy — not to mention a certain amount of political cover — in case the party required to conduct background checks violates the law in doing so. See generally, e.g., Kim C. Stanger, HIPAA: disclosing exam results to employers (Lexology.com 2015).

c. *Criminal-history consequences:* IF: A Checked Individual's background check reveals any Criminal History; THEN: The Checking Party is not to assign, nor permit, that individual to engage in any Restricted Activity without first consulting with the Requesting Party.

d. *Drug-misuse consequences:* IF: A Checked Individual's background check indicates use, by the Checked Individual, of one or more of: (i) illegal drugs; and/or (ii) prescription drugs other than in accordance with a lawfully-issued prescription Drug Misuse; THEN: The Checking Party must not assign nor permit that individual:

1. to engage in any Critical Activity without the express prior written consent of the Requesting Party; nor
2. to engage in any other Restricted Activity without first consulting with the Requesting Party.

> Comment: This provision requires the Checking Party only to *consult* with the Requesting Party, as opposed to obtaining the Requesting Party's *consent*. (The latter seems to be traditional in provisions of this type.) This is because in recent years the practice of *automatically* disqualifying people with criminal convictions has come under fire from government regulators and the plaintiff's bar as being potentially discriminatory (the so-called "ban the box" movement).

> For obvious reasons, subdivision 1 imposes tighter restrictions on Critical Activities than on other Restricted Activities.

e. *Independent reference contacts:* As a safeguard against falsified references, all reference checks (if any) other than personal character references are to be completed using contact information obtained other than from the Checked Individual.

> Comment: This provision helps to guard against the possibility that an applicant might provide a Checking Party with fake contact information when listing former employers, etc., as references. Then when the Checking Party contacts the "references," it ends up talking to one of the applicant's friends who is in on the scam.

f. *Checking Party indemnity obligation:* The Checking Party must defend and indemnify (§ 5.06.3) the Requesting Party and its Protected Group (§ 9.42) against any and all third-party claims — including but not limited to any claim by a Checked Individual and any claim by a government authority — arising from any allegation of breach of governing law in the performance of background checks under the Contract by or at the direction of the Checking Party.

> Comment: This indemnity obligation is worded carefully to focus on just what breaches are subject to that obligation.
>
> The business context: Suppose that a customer requires a provider to have background checks done on all provider personnel who will be accessing the customer's premises. Then suppose that an employee of the provider complains that the background check violated his rights under applicable law. The provider employee might be tempted to sue the customer, not just the provider. In that situation, this provision would require provider to protect the customer from the cost of defending and/or paying damages for such claims.
>
> As with any indemnity obligation, drafters should consider:
>
> – pairing this indemnity obligation with an insurance requirement; and

> – whether the indemnifying party might be liable for unforeseeable damages as well as foreseeable damages; see (XXX) for additional details.

g. *Requesting Party's background checks:* The Requesting Party may cause its own background checks to be conducted on any or all Checked Individuals, in which case:

1. in conducting any such background checks, the Requesting Party will comply with the background-check provisions of the Contract, and defend and indemnify the Requesting Party for any noncompliance, as though the Requesting Party were the Checking Party and vice versa;

2. the Requesting Party will bear its own expenses associated with any background checks that it conducts;

3. The Checking Party will provide reasonable cooperation with the Requesting Party in attempting to obtain any necessary consent for checks from each Checked Individual; and

4. The Requesting Party will provide the same defense and indemnity to the Checking Party and its Protected Group (if any) as the Checking Party must provide under this Rule (that is, the parties' roles for this purpose will be deemed reversed).

> Comment: This provision allows (for example) a service provider's customer to initiate its own background checks on service-provider personnel.

h. *Reimbursement of Checking Party expenses:* The Requesting Party is to reimburse the Checking Party for all reasonable out-of-pocket expenses incurred by or on behalf of the Checking Party in connection with performing background checks required by the Contract.

> Comment: Service providers often take the view that any customer that wants background checks to be conducted on the provider's personnel should pony up for that cost. On the other hand, a customer might take the position that background checks should be an overhead expense that the provider must bear.

§ 5.04.2. Additional commentary

§ 5.04.2–1 Business intent

It's not uncommon for customers to want service providers to do background checks on the providers' key personnel. The goal is normally to identify people with criminal records or other indicia of potential trouble. As discussed below, this can be a sensitive topic, possibly with legal complications.

A customer might especially want (or need) for a supplier to have background checks run on the supplier's personnel, for example:

– if the customer is a government contractor;

– if the supplier will have access to the customer's confidential- or sensitive information;

– if the supplier's personnel will "face" the customer's own customers or clients, that is, be seen or heard by them.

§ 5.04.2–2 Caution: Obtaining consent of Checked Individuals might be advisable even if not legally mandatory

Parties conducting or commissioning background checks should be sure to check applicable law to see if any particular form of consent is required.

It might well be prudent to obtain consent to a background check even if the law doesn't *require* it. If the individual were to learn of an unconsented background check, his displeasure might go viral on social media, especially given today's heightened sensitivity to privacy concerns.

§ 5.04.2–3 Have background checks already been done?

It's entirely possible that, due to the nature of the industry (e.g., technology consulting services), the contractor might have already had background checks performed on its relevant people.

§ 5.04.2–4 CAUTION: Credit-check issues under the Fair Credit Reporting Act

Credit checks can get a checking party in trouble under the [U.S.] Fair Credit Reporting Act. One particular procedural requirement seems to come up in class-action lawsuits: Section 1681b(b)(2)(A) of the Act, which states that, with certain very-limited exceptions:

> … a person may not procure a consumer report, *or cause a consumer report to be procured*, *for employment purposes* with respect to any consumer, unless–
>
> (i) a clear and conspicuous disclosure has been made in writing to the consumer at any time before the report is procured or caused to be procured, *in a document that consists solely of the disclosure*, that a consumer report may be obtained for employment purposes; and
>
> ii) the consumer has authorized in writing … the procurement of the report by that person.

(Emphasis and paragraphing added.) Hat tip: Ken Remson, Employers Hit With Background Check Lawsuits, May 20, 2014; see also Todd Lebowitz, Publix to Pay $6.8 Million Settlement over Noncompliant Background Check Forms (EmploymentClassActionReport.com Nov. 3, 2014).

In July 2015, the Chuck E. Cheese restaurant company settled a class-action lawsuit by employees who asserted that the company's background-check consent form did not comply with the FCRA's strict requirements. See, e.g., David M. Gettings, Timothy St. George and David N. Anthony, Chuck E. Cheese Settles Background Check Lawsuit For $1.75 Million (Mondaq.com).

§ 5.04.2–5 Caution: Restricting personnel assignments might be attacked as discriminatory

A blanket prohibition against using personnel with criminal records could be problematic: It might be alleged to have a disproportionate impact on racial- or ethnic minorities and thus to be illegal in the U.S. See generally the EEOC general counsel's enforcement guidance published in April 2012.

The EEOC has filed lawsuits against employers who allegedly "violated Title VII of the Civil Rights Act by implementing and utilizing a criminal background policy that resulted in employees being fired and others being screened out for employment …." EEOC press release, June 11, 2013.

Companies should also be cognizant of disability laws such as the Americans with Disabilities Act, which might affect a company's ability to deny employment because of prescribed drug use, as opposed to making accommodations of some sort.

§ 5.04.2–6 Caution: State- or federal law might restrict employers' personnel decisions

In addition, some states might likewise restrict an employer's ability to rely on criminal background information in making employment-related decisions. Drafters should pay particular attention to the law in New York, Massachusetts, Illinois, and Pennsylvania (not necessarily an exhaustive list).

On a related note: "Bills pending in both houses of Congress would make it unlawful for most federal contractors to request a job applicant, whether orally or in writing, to disclose criminal history record information before the applicant has received a conditional offer of employment." Garen E. Dodge, Richard I. Greenberg, and Susan M. Corcoran, Proposed ‘Ban the Box’ Legislation Would Limit Criminal History Inquiries by Federal Contractors (JacksonLewis.com 2015).

For a list of states and cities with ban-the-box laws, see Michelle Natividad Rodriguez and Nayantara Mehta, Ban the Box: U.S. Cities, Counties, and States Adopt Fair Hiring Policies (NELP.com 2015).

§ 5.04.2–7 Further reading

Consider checking the Wikipedia entry on background checks to get ideas for further research on this subject.

§ 5.05. Evergreen Extension Rule

a. *Applicability:* This Rule will apply in any case in which both of the following are true:

1. The Contract 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 Contract also states that the time period, right, or obligation is to be automatically renewed or extended for one or more specified periods.

> Comment: Evergreen-extension clauses are typically used by parties who expect to be in a long-term contractual relationship but want the ability to opt out every now and then in case things aren't going well.

b. *Reminder requirement option:* This option applies if (i) the Contract clearly so states, and (ii) one party is eligible to opt out of automatic extension but the other party is not.

> Comment: This will be a typical requirement in a contract where a supplier would like for the contract to be automatically extended but the customer wants a reminder.

1. For the Evergreen Period to be automatically extended, the non-eligible party must send the eligible party a written reminder of the upcoming expiration date of the Evergreen Period; the eligible party must receive or refuse the reminder, or the reminder must be undeliverable after reasonable efforts, no earlier than 60 days, and no later than later than 30 days, before the upcoming expiration date.

> CAUTION: By law, some states restrict automatic extension or renewal of certain contracts unless specific notice requirements are met. Examples of such states include California, Illinois, New York,

North Carolina, and Wisconsin. *See* Cal. Bus. & Prof. Code § 17600-17606 (consumer contracts); 815 ILCS § 601 (consumer contracts); N.Y. Gen. Oblig. L. § 5-903 (contracts for services, maintenance or repair); N.C. Gen. Stat. § 75-41 (consumer contracts); **Error! Hyperlink reference not valid.** (business equipment leases and business services). *See generally* Faegre Baker Daniels, Automatic Renewal Laws in All 50 States: An Updated Guide, *archived at* https://perma.cc/AAS6-RNF6.

2. IF: The non-eligible party does not timely send the eligible party the written reminder required by subdivision 1; THEN: The eligible party may affirmatively elect to extend the Evergreen Period, for the same length of time as would otherwise have happened automatically, by giving the other party notice of its election no later than (i) 30 days after receiving a belated reminder from the non-eligible party; or (ii) 90 days after what would otherwise have been the expiration date of the Evergreen Period.

Comment: This provision is set up to prevent a party that doesn't *want* to extend an Evergreen Period (e.g., a supplier) from allowing the Evergreen Period to expire silently without first reminding the party eligible extension (e.g., a customer) that the opt-out deadline is coming up.

c. *Automatic extension:* If no eligible party opts out as provided below, then the Evergreen Period will be extended, at its then-current expiration date and on the same terms, for successive extension periods, without a break.

LANGUAGE NOTE: The term "extension" is used because the term "renewal" (which seems to be the common term) *might* require a party to renegotiate as a condition of being able to exercise an option to renew. See Camelot LLC v. AMC ShowPlace Theatres, Inc., 665 F.3d 1008, 1011-12 (2012) (8th Cir. 2012), where both the trial court and appeals court held that under Minnesota law, a movie theater chain's option to "extend" its lease of space in a shopping center would apply only if the chain and its landlord agreed to new terms. (In this author's view, the movie chain got "hometowned"; see the author's blog post criticizing the decision.) ¶ For a more-sensible outcome on a similar question, see Indian Harbor Ins. Co. v. F&M Equip., Ltd., 804 F.3d 310 (3d Cir. 2015): The court, citing Black's Law Dictionary, held that under Pennsylvania law, a "renewal" of an insurance policy "requires continuation of coverage on the same, or nearly the same, terms as the policy being renewed." *Id.* at 315 (cleaned up, footnote omitted).

The "without a break" language is a roadblock clause.

d. *Duration of extension periods:* Each successive extension periods will be of the same duration as 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 terms.

EXAMPLE 2: A three-year Evergreen Period would be automatically extended for successive one-year terms.

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: **Long extension periods can be problematic;** here's a real-world example of an evergreen automatic-extension provision gone awry: • A client of the author's once agreed to give a steep pricing discount to a particular customer for five years, if memory serves. (The author wasn't involved in that deal.) • The agreement provided that the discount would be automatically extended for **another five years** if the author's client didn't opt out when the first five-year period was expiring. • No one in the client's organization noticed that the five-year discount period was ending. As a result, the client didn't send the customer a notice that the client was opting out of the pricing commitment. **The client had to honor the steeply-discounted pricing for that customer *for another five years*.** This, even though the client had raised its prices significantly for the rest of its customer base.

e. *Opt-out right:* Each party is eligible to opt out of an extension by giving notice to that effect; if that happens, then the Evergreen Period will come to an end at its then-current expiration date.

CHECKLIST QUESTION: *Which party is eligible to opt out?* This provision allows either party to opt out, but in some contractual relationships (e.g., a customer-supplier relationship), one party might feel that it should have more flexibility than the other party to opt out of an evergreen extension.

PRO TIP: Drafters might want to put "strings" on the opt-out right, e.g., by requiring a fee before a certain date. See Foodmark, Inc. v. Alasko Foods, Inc., 768 F.3d 42 (1st Cir. 2014).

f. *Opt-out deadline:* Any opt-out notice must be effective no later than 30 days before then-current expiration date of the Evergreen Period.

CHECKLIST QUESTION: *When is the deadline to opt out?* The deadline for giving notice of non-extension should be considered carefully for its possible business implications.

– In some supplier-customer relationships, a customer might want the ability to opt out right up to the then-current expiration date, or even for a limited period of time after the automatic extension.

– On the other hand, a supplier might want several months' advance warning that its customer was opting out of the relationship, or vice versa, to allow time for planning to wind down the relationship, find replacement business, etc.

– 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."

> OPTION: "[FILL IN PARTY NAME] may not opt out of an extension before [SPECIFY DATE]." COMMENT: The intent here is to 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.

g. *Maximum number of extensions:* The Evergreen Period will continue to be extended indefinitely, with no maximum number of extensions, until such time (if any) as an eligible party opts out.

> Comment: If the parties' relationship is working well *and* either party can opt out, then there might be no reason to have it come to an end unless one party wants it to end.
>
> On the other hand, it might be that only one party has the right to opt out. This might be the case in a supply agreement, in which the customer may opt out but the supplier may not. In that situation, the supplier might want to limit the number of automatic extension periods.
>
> CAUTION: An agreement with an evergreen term might be held to be one 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 appellate 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.

§ 5.06. Force Majeure Rule

§ 5.06.1. The Rule

a. *Definition:* The term "*force majeure*" refers generally to any single event or series of events as to which a prudent person, in the position of the party invoking force majeure, would not reasonably have been able to anticipate and take reasonable measures to avoid a resulting failure of timely performance.

> Comment: This provision relies on applicable law instead of laying out a detailed protocol for invoking force majeure, but drafters can drop in one or more of the supplemental terms below if a more-detailed provision is desired.

b. *Invocation:* In response to actual- or imminent occurrence of one or more force majeure events, any party (an **invoking party**) may invoke force majeure by advising another affected party by any reasonable means.

> Comment: 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.

c. *Excused nonperformance:* A party that invokes force majeure at a reasonable time — which might be before or after the relevant force majeure event or -events — will not be liable under an 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.

> Comment: This language more or less reflects the way the law operates anyway

d. *Termination right:* Any party may terminate all going-forward obligations under the Contract if the aggregate effect of the relevant force majeure:

1. is material considering the Contract as a whole; and

> Comment: The "material to the Contract 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).

2. lasts longer than 30 days after invocation of force majeure by a party entitled under the Contract to invoke force majeure.

> Comment: The parties might negotiate different earliest termination dates for different parties or different situations.

§ 5.06.2. Additional commentary

§ 5.06.2–1 Business purpose: To customize the law

Force majeure clauses are not uncommon in commercial contracts. To one degree or another, they reflect and vary the way that the law generally works anyway in many jurisdictions.

North Dakota's supreme court 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).

§ 5.06.2–2 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 such 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 defer that expenditure of time and money ("kick the can down the road") by using a force-majeure clause instead.

§ 5.06.2–3 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).

§ 5.06.3. Playbook options [opt-in]

§ 5.06.3–1 Force Majeure Option: No Mitigation or -Remediation Obligation

Neither party is obligated to make any efforts to mitigate and/or remediate the effects of the invoked force majeure.

> ALTERNATIVE: In some contracts, it might make sense to refer to an exhibit or appendix where the desired "disaster plan" mitigation and/or remediation efforts can be spelled out in appropriate detail.
>
> Comment: Mitigation, remediation, or both? Note that there are two distinct options presented here: One for *mitigation*, one for *remediation*, which are two different things.
>
> In a supply- or services agreement, the customer might not want to be bound by any obligation to respond to force majeure events.
>
> 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.
>
> 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, however, might be reluctant to agree to a best-efforts commitment, for the reasons discussed in the additional commentary concerning best efforts (§ 11.02).

§ 5.06.3–2 Force Majeure Option: Extension of Expiring Right

IF: One or more properly invoked events of force majeure make it impracticable or impossible for an invoking party to timely exercise a right under an agreement; THEN: The time for exercising that right will be deemed extended for the duration of the resulting delay.

> Comment: This option addresses a potential gap (depending on one's perspective) in many force-majeure clauses. *See* Beardslee v. Inflection Energy, LLC, 25 N.Y.3d 150, 31 N.E.3d 80, 8 N.Y.S.3d 618

> (2015) (on certification from Second Circuit), where New York's highest court held that "that the force majeure clause does not modify the habendum clause and, therefore, the leases terminated at the conclusion of their primary terms." *Id.*, 25 N.Y.3d at 153.

§ 5.06.3–3 **Force Majeure Options: Exclusions**

The following categories of event are not eligible to be deemed an event of force majeure: [LIST CATEGORIES].

> Comment: See the examples of force majeure below for possibilities to consider for exclusion.

§ 5.06.3–4 **Force Majeure Option: Examples**

The term *force majeure* includes, without limitation, any event that (i) is not excluded by the Contract and (ii) falls within one or more of the following categories *(some are in a different color 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 Contract; • 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.

> Comment: This "laundry list" of force-majeure examples is drawn from various agreement specimens.
>
> This list of examples does not include the so-called "act of God" because of the vagueness of that term.
>
> Economic changes: See Kevin Jacobs and Benjamin Sweet, 'Force Majeure' In the Wake of the Financial Crisis, Corp. Counsel, Jan. 16, 2014.
>
> Labor difficulties: In some customer-oriented supply- and service contract forms, labor difficulties are excluded from the definition of force-majeure event.

§ 5.06.3–5 **Force Majeure Option:Economic Out**

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.

> Comment: This language could be a source of mischief because of the potential for disputes about what would constitute "a commercially reasonable cost."

§ 5.06.3–6 Force Majeure Option: Status Report Requirement

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.

> CAUTION: Depending on the nature of the contract, a party might not want to commit to providing force-majeure status reports.

b. Any party receiving any force-majeure status information from an invoking party must maintain that information in confidence unless and until (i) the invoking party approves disclosure in writing, or (ii) the information becomes available to the general public.

§ 5.06.3–7 Force Majeure Option: Subcontractors

IF: A party invoking force majeure does not timely perform its obligations (or exercise its rights) under the Contract; AND: The invoking party's performance failure was due to a failure of performance of a subcontractor or supplier to the invoking party; THEN: The invoking party's performance 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.

> Comment: This type of provision is sometimes seen in customer forms of supply contracts.

§ 5.06.3–8 Force Majeure Option: Supplier Allocation Discretion

If Supplier experiences shipping delays as a result of one or more force-majeure events, the supplier may allocate its available goods or services to its customers in its discretion.

§ 5.06.3–9 Force Majeure Option: Customer Pro Rata Priority

IF: Supplier experiences shipping delays as a result of one or more force-majeure events; THEN: 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.

> Comment: This option is inspired by a Honeywell purchase-order form at XXXX.

§ 5.07. Indemnity and Defense Rule

§ 5.07.1. The Rule (1): General terms

a. *Applicability:* This Rule will apply whenever the Contract requires one party (the “*Payer*”) to defend and/or indemnify another party (the “*Beneficiary*”) in respect of a specified “*Event*.”

> Comment: The “Event” that triggers the Payer’s obligation to indemnify (read: reimburse) the Beneficiary could be just about anything.

b. *Synonyms:* In the context of this Rule, the terms *indemnify* and *hold harmless* are synonyms; each means that, if such a specified Event occurs, then the Payer must pay for any loss or expense that the Beneficiary incurs as a result of the Event.

> Comment: 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.

c. *Limitations:*

1. The Contract 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; to do so, the Contract must clearly so state.

> Comment: 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.

d. *Consequential damages:* Unless the Contract 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.

> Comment: 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 XXX).

– 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."

e. *Proof of negligence not required unless specified:* In case of doubt, 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 indemnity obligation, by its clear terms, extends only to the Payer's negligence.

Comment: 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).

f. *Not limited to third-party claims:* Unless an indemnity obligation clearly specifies otherwise, the obligation is not limited to *third-party* claims against the Beneficiary and do not exclude the Beneficiary's own claims against the Payer.

Comment: This section tries to settle a split in the case law as to whether an indemnity 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 an unsuccessful petition to the Texas supreme court in Claybar v. Samson Exploration LLC, No. 09-16-00435-CV (Tex. App.—Beaumont 2018, pet. denied):

– Appellant's brief: https://tinyurl.com/ClaybarSamsonAppellantBrief,

– Respondent's Brief: https://tinyurl.com/ClaybarSamsonRespBrief.

g. *Insurance to support obligation:* Unless the Contract clearly specifies otherwise, it is up to the Payer to decide whether or not to carry insurance to cover the Payer's defense- and/or indemnity obligation(s) under the Contract.

> Comment: 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].

h. *Consequences of Beneficiary's own fault:* The Payer is not obligated to defend- or indemnify 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 Contract must clearly so state, in terms that are both (i) express, and (ii) conspicuous; and
2. Applicable law must not prohibit such an obligation.

> Comment: This section adopts the express-negligence doctrine that applies **in some states.** 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.

> CAUTION: 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)..

i. The Payer is not required to defend and/or indemnify the Beneficiary for losses and/or expenses resulting from the Beneficiary's willful misconduct (§ 9.60).

> Comment: 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.

j. *Payment timing:* 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.

> Comment: This subdivision aims to prevent an indemnifiable obligation from creating a cash-flow crunch for the protected party.

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.

§ 5.07.2. The Rule (2): Defense against claims

a. *Implied defense obligation:* IF:

1. the Contract requires the Payer to pay the Beneficiary for losses and expenses resulting from specified third-party claims;

2. but the Contract is silent about whether the Payer must *defend* the Beneficiary against such claims; and

3. a Claimant does make such a specified claim against the Beneficiary;

THEN: Unless the Contract clearly provides otherwise, the Payer must provide the Beneficiary with a defense against the claim — at the Payer's expense — as provided in this section.

> Comment: 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.)

b. *Required notification of claim:* 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.

> Comment: 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.

c. *Untimely notification of claim:* 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.

> ALTERNATIVE: "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 this Agreement would otherwise require it."

> Comment: 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 would be a much stronger statement than the provision above — but the Beneficiary would likely push back hard against it.

d. *Required defense:* The Payer must provide the Beneficiary with a timely, competent, diligent defense — by suitably-experienced and reputable defense counsel — against the claim.

> Comment: The substantive standards in this section 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.

e. *Defense at Payer's expense:* The Payer is to pay for all fees and expenses charged by the defense counsel engaged to defend the Beneficiary against the claim.

f. *If no defense requested:* IF: The Beneficiary never asks the Payer to defend against the claim — and even if the Beneficiary does not *want* a defense against the claim; THEN: 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; BUT: The Payer 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.

> Comment: 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, for example in the case of a patent- or copyright-infringement claim against a customer Beneficiary that might have adverse consequences for the supplier Payer.

g. *Beneficiary's role in the defense:* 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).

> Comment: Beneficiaries are normally glad to agree to cooperate in their own defense, as long as it's at the Payer's expense.

1. Without limitation, the Beneficiary must provide the Payer and/or the Payer's counsel with all information reasonably requested for the defense.

> Comment: The "reasonably request" language allows some flexibility, which might be appropriate if requested information is subject to, e.g., 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.

2. 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.

> Comment: This section 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.

h. *Control of the defense:* For as long as the Payer provides the Beneficiary with a defense against the claim in accordance with this Rule, the Payer is entitled to control the defense — albeit with some exceptions as stated below.

> 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.

i. *Beneficiary's monitoring counsel:* Whenever the Payer is controlling the defense against the claim, the Beneficiary may engage separate counsel to monitor the defense.

1. If the Beneficiary does engage separate counsel, it will be at the Beneficiary's own expense.

2. The Payer and the Beneficiary must each instruct their respective counsel to provide reasonable cooperation with each other concerning the defense.

Comment: 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 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 other jurisdictions as well), an attorney's loyalty is to the client, not to a third party that's paying the bills.

j. *Beneficiary assumption of control:* IF: 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; THEN: 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.

Comment: This is a standard provision under legal-ethics rules: The lawyer for Party A probably cannot also represent Party B in the same matter if the two parties have conflicting interests. ¶ The language, "IF: Reasonable minds *could* conclude" (emphasis added) is intended to make sure that close calls go in favor of separate counsel.

k. *Control of settlement discussions:* The Payer may settle the claim against the Beneficiary, EXCEPT that unless the Beneficiary gives its prior written consent, 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 to one or more third parties, where each such payment is funded in advance by or on behalf of the Payer with no recourse against the Beneficiary; 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.

Comment: 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).

l. *Settlement with consent judgment:* IF: The Payer is entitled 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 otherwise inconsistent with this Rule.

> Comment: 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.

m. *Settlement by the Beneficiary:* IF: The Payer is defending the Beneficiary against the claim; AND: The Beneficiary settles with the Claimant without the Payer's prior written consent; THEN: The Beneficiary will be deemed to have released the Payer from any further defense- or reimbursement obligation as to the claim UNLESS the Payer *unreasonably* withheld consent to the Beneficiary's settlement, in which case the Payer's defense- and reimbursement obligations will remain in place.

> Comment: This section 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.*

n. *Limitations on Beneficiary admissions and waivers:* 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.

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, by way of either defense or reimbursement.

> Comment: Admissions and stipulations to *factual* matters 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.

o. *Limitation of liability for defense:* The Contract 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 Contract clearly so states.

> Comment: 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).

§ 5.07.3. Additional commentary

§ 5.07.3–1 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.)

§ 5.07.3–2 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) (cleaned up; extensive citations omitted; extra paragraphing, bracketed numbering, and bullets added).

§ 5.07.3–3 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).

§ 5.07.3–4 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.

§ 5.07.3–5 Will a *contractual* indemnity obligation 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.

§ 5.07.3–6 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).

§ 5.07.3–7 **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.

§ 5.07.3–8 **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).

§ 5.07.3–9 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.

§ 5.07.4. Indemnity exercises

§ 5.07.4–1 Exercise: 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.

§ 5.07.4–2 Exercise: The spontaneously-combusting widgets

FACTS:

Alice manufactures electronic widgets. Each widget has a battery that is sealed into the widget and not replaceable.

Bob manufactures electronic gadgets that include electronic widgets.

Bob enters into a contract with Alice to buy electronic widgets from her.

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.

Bob takes delivery of a large quantity of Alice's widgets and stores them in an appropriate storage room.

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.)

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:

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.

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.

EXPLAIN IF FALSE: If Alice had negotiated the indemnity provision to cover only third-party claims, the provision likely would be enforceable.

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.

§ 5.07.4–3 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?

§ 5.07.5. 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?[1]

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.) [2]

QUESTION 3: IF FALSE, EXPLAIN WHY: An indemnity obligation allocates at least some of the financial risk of Event X.[3]

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. [4]

§ 5.08. Inspections Rule

This Rule applies if the Contract authorizes an “*inspecting party*” to have one or more inspections, audits, or other examinations (collectively, “*inspections*”) conducted of facilities, products, books, records, or other items of another party (a “*host*”).

[1] 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.

[2] False — it doesn't *reduce* the risk, it *allocates* the risk.

[3] True.

[4] False — it should be "Alice *will indemnify* Bob [i.e., future tense] …."

Introduction: The nuclear Navy has a saying: You get what you inspect, not what you expect. This saying can be true in the world of contract relationships as well.

§ 5.08.1. For the inspecting party: Dos and don'ts.

a. *Advance notice:* The inspecting party must give the host reasonable advance written notice of its desire to have an inspection conducted.

Comment: Both parties will benefit if the host has a reasonable time to collect its records, remedy deficiencies, etc., before the inspector(s) get there. "Reasonable" notice might be very short notice if the inspecting party has reason to suspect cheating or other malfeasance.

b. *Who may actually conduct inspections:* The inspecting party must engage one or more of the following to conduct the inspection:

1. any Big Four accounting- or consulting firm; and/or

2. any other inspector that the inspecting party proposes in writing, if the host does not state a reasonable objection to the proposal within a reasonable time.

Comment: This Rule provides a compromise between two competing preferences: • A host might want the absolute right to veto the inspecting party's choice of inspectors. • On the other hand, the inspecting party might be uncomfortable with the host having such a veto right; it might also be concerned that a dispute on that subject would be time-consuming and could thus endanger the integrity of the inspection.

Pro tip: An inspecting party might want to add that consent to a proposed choice of inspector is deemed to be given if the host does not object in writing within X days after receiving or refusing the inspecting party's written proposal.

c. *Deadline for completion of inspection:* The inspecting party must ensure that the inspection is completed no later than three months after the effective date of the notice of the inspection unless there is good reason to allow more time.

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

d. *Inspecting party's confidentiality obligations:* The inspecting party must:

1. take prudent measures to keep confidential any non-public information that it learns via the inspection.

2. not use non-public information learned through the inspection except for correcting discrepancies identified in the inspection or enforcing the inspecting party's rights under an agreement;

3. not disclose any non-public information of the host to any third party except (i) as required by compulsory legal process (see below) or (ii) as expressly permitted by law, including without limitation the (U.S.) Defend Trade Secrets Act;

4. promptly advise the host if the inspecting party or any of its affiliates or personnel is served with compulsory legal process (such as a subpoena or a search warrant) covering the host's information, unless its doing so is prohibited by law;

5. provide reasonable cooperation with the host, if and as requested by the latter, to preserve the confidentiality of the host's information after a compulsory legal demand to the inspecting party;

6. disclose only the minimum information required by a compulsory legal demand; and

7. ensure that its inspectors have agreed in writing to comply with the confidentiality obligations of this Rule.

> Comment: This section provides what amounts to a nondisclosure agreement ("NDA") in miniature. For especially sensitive matters, the parties might wish to negotiate a separate NDA for the inspector(s) to sign — perhaps using the Tango Confidentiality Rule (§ 2.02).

§ 5.08.2. For the host: Dos and don'ts.

a. *Working hours for the inspectors:* The host may make reasonable decisions about just when the inspection is to be conducted (what days, what time of day), with a view toward balancing the efficiency of the inspection against possible interference with the host's business.

> Comment: In some situations, a host might find it more convenient for inspections 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.

b. *Minimum standards for host-provided working space:* IF: The host furnishes workspace for use by the inspectors; THEN: The host must cause the workspace to have appropriate facilities and equipment of the type customarily used by knowledge-based professionals. This would normally include, for example, furniture; lighting; air conditioning; electrical power; and Internet access.

> Comment: This Rule sets forth standards for when inspection working space is provided by the host. That's because in an unfriendly inspection, an uncooperative host might try to make inspectors work in a closet, an unairconditioned warehouse, or worse.

c. *Host-personnel cooperation with inspectors:* The host must require its personnel to provide reasonable cooperation with the inspectors, including without limitation answering reasonable questions from the inspectors, to the extent consistent with this Rule.

> Comment: This Rule requires the host to provide reasonable cooperation with inspectors: Inspections sometimes take place after relationships start to turn sour, and it's not unheard of for parties' personnel to be uncooperative.

d. *Host's withholding of privileged information:* The host need not give the inspectors access to information that, under applicable law, would be immune from discovery in litigation, for example due to attorney-client privilege, work-product immunity, or any other privilege.

> Comment: Disclosure of attorney-client privileged information to inspectors or other outsiders might well would waive the privilege in many jurisdictions and thus make the privileged information available for discovery by others, including third parties. (A host might also want to specify other exclusions.)

e. *Good reason definition:* For purposes of the inspection provisions of an agreement, *good reason* includes, without limitation, any one or more of the following:

1. significant lack of cooperation, by the host, in an inspection under an agreement; and/or

2. the discovery of substantial evidence of (i) fraud, or (ii) material breach of an agreement, in either case by or attributable to the host.

f. *Option for limits on inspection report contents:* If the Contract clearly so indicates, the inspectors must disclose to the inspecting party only whether a reportable discrepancy was revealed by the inspection, and if so, the size and general nature of the discrepancy.

> Comment: A host might want to limit what the inspector(s) report to the inspecting party if the inspection might delve into confidential information that the host doesn't want to be provided to the inspecting party.

g. *Survival of inspection right:* The Contract's inspection-related provisions:

1. will survive any termination or expiration of the Contract; and
2. will remain subject to all deadlines and other limitations stated in the Contract.

> Comment: Not specifying that inspection rights survive termination of an agreement might result in the inspection right ending when an 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): In that case, a union benefits fund tried to audit an employer's contributions to the fund after the employer had terminated its agreement to participate in the fund; the court held that the audit right died with the agreement.

§ 5.09. Insurance Rule (in progress)

§ 5.09.1. The Rule

(BEGIN HIDDEN TEXT FOR LATER DCT USE)

(END HIDDEN TEXT)

§ 5.09.2. Insurance: Additional commentary

§ 5.09.2–1 Comment: 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 (the equivalent of malpractice insurance for lawyers).

– 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.

§ 5.09.2–2 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.

§ 5.09.2–3 (Skim:) Carrier ratings

Coverage is often required to be maintained with carriers having at least a stated A.M. Best rating.

§ 5.09.2–4 (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.

§ 5.09.2–5 Combined single limit

See generally Leland-West Insurance Company, What is a Combined Single Limit? (accessed Aug. 22, 2007).

§ 5.09.2–6 (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.

§ 5.09.2–7 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).

§ 5.09.2–8 (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.

§ 5.09.2–9 (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 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 down the contractor's insurance-coverage money first, so that the customer's claims history with its own carrier, and thus the customer's future insurance-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.

§ 5.09.2–10 (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.

§ 5.09.2–11 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.

§ 5.10. Intellectual Property Ownership Rule

§ 5.10.1. Default rules for IP ownership & use

a. *No ownership change for existing IP unless expressly agreed:* Under the Contract, neither party will acquire ownership of any preexisting IP owned or assertable by another party unless expressly agreed.

b. *Ownership of newly-created IP:* IF: Intellectual property is created in the course of the performance under the Contract; THEN: As between the parties, the following will apply:

> Comment: This "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), *aff'd as to a tangential issue,* 563 U.S. 776, 131 S. Ct. 2188, 2194-95 (2011): In that case, the intermediate appeals court affirmed a lower-court ruling that that Roche was part-owner of a Stanford patent (and thus did not need a license to practice the patented invention) because one of Stanford's researchers, a co-inventor on the patent, had previously signed a Roche visitor agreement giving Roche his ownership interest. (The Supreme Court did not take up that specific issue.)

1. Each party will own whatever IP (if any) that it creates on its own.

2. The parties will jointly own — in equal, undivided interests — whatever IP that they jointly create under this Agreement (if any).

   Comment: See the extended commentary (XXX).

   Joint creation of intellectual property can occur, for example: • in services-type contracts; and • in collaboration agreements of various kinds, e.g., R&D joint-venture agreements. See generally this article about patent joint ownership and this article about copyright joint ownership.

   Who is to own jointly created IP will sometimes be a negotiation point.

   ALTERNATIVE: "[FILL IN PARTY NAME] will own all such created IP except for Toolkit Items, defined in XXX." COMMENT: Note the separation of ownership of the intellectual property contained in deliverables versus the IP in Toolkit Items. See the discussion in the extended commentary at XXX.

3. Newly created IP (if any) is not agreed to be a work made for hire.

   Comment: 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). THIS MAKES A DIFFERENCE in the long term: Under 17 U.S.C. § 203, when an author transfers or licenses a copyright *and the work is not a work made for hire,* the author or his or her heirs can terminate the transfer or license and, in essence, "recapture" the author's ownership; see generally the Copyright Office explanation at https://www.copyright.gov/docs/203.html. 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).

c. *Use of jointly-created IP:* Either party may make whatever use it desires of jointly created IP.

1. Such use may include, without limitation, authorizing others to make any such use, whether (i) for the authorizing party's benefit — this is sometimes referred to as "have-made rights," and/or (ii) as a licensee of the authorizing party.

Comment: "[U]nder 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). In that case, schools paid FedEx Office to make copies of materials that were licensed under a Creative Commons license that prohibited "commercial use." The court held that the copying still qualified as noncommercial, even though FedEx had charged the schools for making the copies.

2. A party making use of jointly created IP need not account to the other party for such use — for example, the first party need not share profits with, nor pay royalties to, the other party.

Comment: As discussed above, in the U.S., the 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.

d. *Certain future IP rights are transferred now:* IF: Under the Contract, an individual or organization (the "*Owner*") is to be the owner of specified intellectual property that will be or might be created in the future; BUT: By law the specified IP is or might be owned by another individual or organization, as opposed to being automatically owned by the Owner upon creation (as in the case of a "work made for hire" under copyright law); THEN: The following will apply:

1. The other party hereby assigns all right, title, and interest in all such specified IP to the Owner.

   Comment: This "hereby Assigns" language is phrased as a *present* assignment – as opposed to a promise to assign at some unspecified point in the future — with the intent of avoiding a timing problem of the kind that resulted in Stanford University's being unable to assert a patent that it owned (or so it had thought) against Roche. *See* Bd. of Trs. of the Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 583 F.3d 832 (Fed. Cir. 2009), *aff'd as to a different issue*, 563 U.S. __, 131 S. Ct. 2188, 2194-95 (2011).

2. IF: By law, any moral rights or other intellectual property rights in specified IP cannot be assigned to the Owner; THEN: The other party hereby grants to the Owner and its successors and assigns a perpetual, irrevocable, worldwide, royalty-free, fully transferable license under all such non-assignable rights.

   Comment: This is an anchor-to-windward provision. See generally the Wikipedia entry on moral rights.

e. *Employee- and subcontractor IP agreements:* A party other than the Owner will ensure that its employees and subcontractors (if any) have signed (and, if applicable, notarized) written agreements sufficient to enable that party to comply with any obligations it has under this Rule. (This subdivision in itself neither authorizes nor prohibits the use of subcontractors by any party.)

> Comment: A customer *might* not need for a supplier's employees to be bound by written agreements to cause the employee's work product to be owned by the customer (at least under U.S. law). See generally this annotated flowchart that the author prepared some years back.
>
> On the other hand a *subcontractor* likely would indeed need to sign such an agreement in order to transfer *ownership* to another party.

> The other party *might* be able to claim an implied license to use and further-develop the deliverable — but the associated litigation would likely be an expensive headache. *See, e.g.*, Graham v. James, 144 F.3d 229 (2d Cir. 1998) (software created by contractor was not work made for hire but *was* orally licensed nonexclusively); Latour v. Columbia University, 12 F. Supp. 3d 658, 662 (S.D.N.Y. 2014) (granting summary judgment in favor of defendant university, which had an implied license to use material developed by former interim faculty member); Numbers Licensing LLC v. bVisual USA Inc., 643 F. Supp. 2d 1245, 1252-54 (E.D. Wash. 2009) (denying motion for preliminary injunction; while software in dispute had been created by plaintiff as outside contractor and thus was not work made for hire, defendant had implied license).

f. *Definition: "Toolkit Item"* refers to any concept, idea, invention, strategy, procedure, architecture, or other work, that:

> Comment: The definition of "Toolkit Item" comes into play if a service provider wants to retain ownership of the "tooling" that it develops in the course of a project for a client or customer, even if the customer is to own the resulting work product.

1. is, in whole or in part, created by a party in the course of performing under this Agreement; but

2. *(in the case of a provider performing services for a customer:)* is not specific, and/or is not unique, to the customer and its business.

In case of doubt, the term *Toolkit Item* does not encompass Confidential Information of another party.

§ 5.10.2. IP Ownership Transfer Rule

a. *Applicability:* This Rule applies whenever, in or under the Contract, a party (the "*former owner*" transfers ownership ("*assigns*") of specified intellectual property ("*IP*") to another party (the "*new owner*").

b. *Definition: Ownership:* In respect of particular IP, the term "*ownership*" (and related terms such as "*own*") — whether or not capitalized — refers to: • legal- and equitable ownership • of all right, title, and interest in that IP, •anywhere in the world,• under any law relating to IP, such as (without limitation), laws governing patents, copyrights, trade secrets, mask works, industrial designs, and trademarks, unless otherwise specified.

> Comment: If a party is assigning IP rights in a technology, an assignment of *trademark* rights might *or might not be* part of the deal as contemplated by the parties — because the assigning party might not want to give up control of the "brand" associated with the rights.

c. *Effect of IP assignment:* When a party assigns intellectual property in or under the Contract, it has the effect of permanently and irrevocably transferring all ownership of the IP to the new owner and the new owner's successors and assigns. This transfer of ownership encompasses, as applicable to the type of IP in question:

1. any and all patent applications for any portion of the specified IP, no matter when filed — this includes, without limitation, all original, continuation, continuation-in-part, divisional, reissue, foreign-counterpart, or other patent applications;

2. any and all patents issuing on each patent application described in subdivision 1;

3. the right to claim priority in, to, or from any patent application described in subdivision 1 or any patent described in subdivision 2;

4. any and all registrations for, and any and all applications to register, the copyright or trademark rights (if any) in the specified IP;

5. any other intellectual property rights, of whatever nature, in the specified IP, together with any applications for, or issued registrations for, the same; and

6. the right to recover, and to bring proceedings to recover, damages and any other monetary awards, and/or obtain other remedies, in respect of infringement or misappropriation of any item listed in any of items 1 through 5, whether the infringement or misappropriation was committed before or after the date of the transfer of ownership.

d. *Documents to be signed:* Whenever requested by the new owner from time to time, the former owner is to cause documents to be signed and delivered to the new owner to establish and/or confirm the new owner's rights in the specified IP.

> Comment: The "cause documents to be signed …" language recognizes that a corporate party might have to cause its employee inventors and authors to sign individual assignments of rights.

1. Such documents might include (for example, and without limitation) patent applications; copyright- or trademark registration applications; and assignment documents.

2. The former owner will not be responsible for the cost of preparing and filing any such documents unless otherwise agreed in writing.

3. The former owner will not be entitled to (additional) compensation for doing the things required by this subdivision.

The new owner's determination as to what types of document are appropriate for purposes of this subdivision is final unless the former owner shows that the new owner's determination is not commercially reasonable.

§ 5.10.3. Additional commentary

§ 5.10.3–1 Patent ownership

In the United States, the general rules about patent ownership can be summarized as follows.

– Inventors initially own the legal rights (if any) to their inventions. See generally 35 U.S.C. § 111(a)(1) (inventor may apply for patent).

– Joint inventors ("co-inventors") of an invention jointly own the invention. See 35 U.S.C. § 262.

– Unless otherwise agreed in writing, each of the co-inventors of an invention may use and/or license the invention as he or she sees fit, with no obligation to account to any other co-inventor. See id.

– Owners of patent rights may transfer their rights in writing. See 17 U.S.C. § 261 (transfers of patent ownership).

§ 5.10.3–2 Copyright ownership

– As with patents, the "author" of a copyrighted work initially owns the copyright. See generally 17 U.S.C. § 201(a).

– Joint authors likewise co-own their jointly created work.

– As is the case with inventions, the co-authors of a joint work may make use of the work as they see fit.

– But unlike the case with inventions, co-authors must account to one another (that is, share the proceeds) from their uses of the work. As an example of this principle, see 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 lawsuit in which she alleged that she was Lee's co-author of the song; she was awarded one-half of the royalties.

For copyright purposes, an employer is considered the "author" of a copyrighted work if either:

– the work is created by an employee who is working within the “scope of employment”; or

– the work is a commissioned work that falls into one of nine specific statutory categories, and the actual author(s) and the commissioning party agree, in a written agreement — which must be signed before the work is created — that the work will be a work made for hire.

§ 5.10.3–3 Customers can sometimes be very demanding about IP ownership …

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 supplier 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. [CITATION NEEDED]

§ 5.10.3–4 … but their IP ownership demands might make little *business* sense

In many cases, a 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.

And often a customer's insistence on IP ownership simply won't make business sense, because:

– The supplier’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 supplier’s ability to compete in the supplier’s market space;

– The customer might have no particular reason to own the IP, other than "I wanna."

– The supplier might not have standing to sue for infringement of the IP rights.

In the author's view, a customer would take too short-term a view — and would be partially free-riding on past customers' payments, if today's customer insisted on owning "foreground" IP rights for IP that wasn't critical to the customer's core business competitive position (it's a different analysis without that final qualifier). Here's why:

– The supplier has "background" IP available to offer precisely because yesterday's customer paid the supplier to develop that background IP, thus reducing the total price that today's customer must pay.

– It's therefore entirely reasonable for the supplier to insist that whatever foreground IP it develops for today's customer must likewise be put into that supplier-owned and -managed pool of background IP assets.

– So, if today's customer insists on owning that foreground IP anyway, then the price should go up dramatically — not least because of the future burden to the supplier of tracking which IP is available to it in the future as background IP.

§ 5.10.3–5 Possible negotiation strategy for suppliers

If a customer persists in demanding outright ownership of IP created in connection with the contract, the supplier could propose that:

– The customer's ownership of intellectual-property rights extends only to the specific Deliverables identified in the statement of work; and

– The supplier 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 it could be an acceptable business risk.

§ 5.11. Lead Representative Rule

This Rule will apply if the Contract clearly indicates that one or more parties is to designate a lead representative (possibly on an as-requested basis).

> Comment: 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.

For convenience, the designating party is referred to as "Alpha" and any other party is referred to as "Bravo."

§ 5.11.1. The role of the designating party ("Alpha")

a. *Designation:* Alpha must designate an individual, in a written communication to Bravo, as being authorized to act as a lead representative ("*lead rep*") on Alpha's behalf.

b. *Multiple lead reps:* Alpha may designate multiple lead reps for the same purpose (possibly for different time periods) and/or for different purposes.

> Comment: Alpha might designate Alice as Alpha's lead rep for the day shift; Allen for overnight; Amy for weekends; etc.
>
> Or, Alpha might designate Alice as its lead rep for engineering matters; Allen for personnel matters; Amy for financial matters; etc.

c. *Changing a lead-rep designation:* At any time, Alpha may "un-designate" one or more of its lead reps in any way that Alpha is allowed to make such a designation.

1. Alpha's un-designation of a lead rep will not change the effect of that lead rep's prior communications in that role.

2. If the un-designation means that Alpha no longer has a lead rep that the Contract requires Alpha to have, then Alpha must promptly designate a replacement.

d. *Binding nature of lead-rep communications:* Except as otherwise provided in this Rule, Bravo is entitled to rely on any communication from Alpha's lead rep as being authorized by Alpha and binding on

Alpha. This applies no matter what kind of communication it is (e.g., oral or written).

§ 5.11.2. The role of the other party ("Bravo")

a. *Designated limits on lead rep's authority:* Bravo must note any limits that Alpha places on a lead rep's authority (i) in Alpha's initial designation of that lead rep, and/or (ii) in a subsequent written notice to Bravo. In any such case, a communication by the lead rep outside the stated limits will not be binding on Alpha, and Bravo will not be entitled to rely on it.

> Comment: Example: Alpha's designation of Alice as its lead rep 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.)

b. *Nonbinding nature of communications by other representatives:* IF: Alpha has designated a lead rep; AND: Another of Alpha's representatives makes a request of Bravo or issues an instruction to Bravo; AND: The other Alpha representative has not been designated by Alpha as a lead rep (in the relevant area, if applicable), THEN:

1. Bravo may not rely on the other Alpha representative's request or instruction as being from Alpha;
2. Bravo need not comply with the request or instruction; and
3. If Bravo does comply with the request or instruction, it does so at its own risk and expense.

> Comment: This provision 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).

c. *Certain communications specified as nonbinding:* Bravo may not rely on any communication from Alpha's lead rep, and the communication will not be binding on Alpha, to the extent that the communication itself states that it is not binding on Alpha in one or more respects.

§ 5.11.3. Role for both parties

a. *Written summary of oral communications:*

1. Except as provided in subdivision b, an *oral* communication from Alpha's designated lead rep will not be binding on Alpha, and Bravo may not rely on it, unless the oral communication is promptly followed up with a written summary — by either Alpha or Bravo — containing reasonable detail and successfully transmitted to the other party by any means, including but not limited to email and text.

> Comment: This subdivision is intended to encourage *written* communications in the interest of trying to forestall future "he said, she said" disputes.

2. A written summary by a party will be binding on the other party if the other party does not object to it within a reasonable time after receiving it.

b. *Required proof of other oral communications:* An oral communication from an Alpha lead rep that is not summarized as stated in subdivision a will be binding on Alpha, and Bravo may rely on it, only if Bravo can show the terms of the communication by clear and convincing evidence (§ 9.14) with reasonable corroboration of any testimony by interested witnesses (§ 7.06).

> Comment: This section bows to the reality that parties likely will not always reduce their important oral communications to writing.

§ 5.12. Trademark License Rule [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 an 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 an 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 an 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 an 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 an 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 an 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

a. 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 Licenso 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.

b. 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 an 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 an 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 Licenso

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.

Chapter 6: General Provisions

When adopted in an agreement (the "*Agreement*"), these General Provisions will apply except to the extent, if any, that the Contract clearly states otherwise.

> These General Provisions are listed more or less alphabetically; in the author's view, an alphabetical arrangement is the most useful for the greatest number of potential users.

§ 6.01. Amendments & Waivers Rule

§ 6.01.1. The Rule

a. *Writing requirement:* A party asserting (i) that the Contract or other document related to the Contract (each, an "*Agreement document*") was amended, or (ii) that any provision or breach of an Agreement document was waived, must show that the amendment or waiver was:

1. in writing;

> Comment: Contracts often state that amendments and waivers must be in writing to reduce the chances of later he-said-she-said disputes about alleged oral amendments or waivers.
>
> CAUTION: Under a century-old New York precedent (which this author calls the "**Cardozo Rule**," after the judge who authored it), **parties are free to orally waive** a contract's requirement that amendments and waivers must be in writing, subject to any possible impact of 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 modern trend**, however, seems to be to uphold requirements that amendments and waivers must be in writing; 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 amendments-in-writing and waivers-in-writing provisions, such as the New York statute referred to in subdivision c below, as well as UCC 2-209(2) for amendments to agreements for the sale of goods.

2. labeled as such with reasonable prominence; and

Comment: This requirement should reduce the risk that a party might not notice, and inadvertently agree to, an amendment or waiver. See generally, e.g., Linda R. Stahl, Beware the Boilerplate: Waiver Provisions (Andrews Kurth Jan. 14, 2013) (citing Texas cases about conspicuousness).

3. signed by an authorized representative of the party against which enforcement (of the amendment or waiver) is sought.

ALTERNATIVE: "… (ii) signed by a vice president or higher of the relevant party or parties." This alternative would help to preclude a party from claiming to have relied on the "apparent authority" of other would-be signers.

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

b. *Other terms unaffected:* An amendment or waiver will affect only the specific provision(s) of the Contract document clearly identified in the amendment or waiver document; all other terms of the Contract document will remain in effect as before the amendment or waiver.

> Comment: Language along these lines is often seen in amendments and waivers; this provision makes it automatic. See generally, e.g., Title Guaranty Escrow Services, Inc., v. Wailea Resort Co., No. SCWC-14-0001138, slip op. at 5 (Haw. Dec. 24, 2019), where an amendment to the contract in suit contained similar language (which was not relevant to the lawsuit).

c. *One-time waivers:* A waiver is effective only for the specific provision or breach being waived, on a one-time basis only.

> Comment: 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).

d. *Choice of law:* All disputes arising out of or relating to this Rule are to be governed by and resolved in accordance with New York's General Obligations Law 15-301(1), regardless what law governs the Contract in other respects.

> Comment: 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."

1. In that statutory provision, the term "change" is to be deemed to encompass both amendments and waivers.

2. The parties agree to this provision-specific choice of law to reduce possible future uncertainty about how this Rule might be interpreted by a court or other tribunal.

> Comment: See § 7.14.6–6 below concerning choosing the law to govern a specific section of a contract.

e. *Fallback rule:* This fallback rule applies if: (i) a party claims that the Contract was orally amended or waived ("modified"); and (ii) a court or other tribunal of competent jurisdiction holds that the applicable law allows oral modification despite the parties' agreement to this Rule. In such a case, the party claiming an oral amendment or waiver must prove its claim as follows, failing which it WAIVES the claim:

> Comment: In some jurisdictions a court might ignore this Rule, as discussed in the commentary about the Cardozo Rule (§ 6.01.1.a.1)

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;

> Comment: See the Tango definition of clear and convincing evidence (§ 9.14).

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

> Comment: Corroboration is required because witness testimony can be unreliable if the stakes are significant; see the commentary below (§ 7.05).

3. If asked, the party claiming the oral amendment or waiver must promptly produce all related (unprivileged) evidence in the party's possession, custody, or control in accordance with the initial-disclosure and discovery procedures of the (U.S.) Federal Rules of Civil Procedure.

> Comment: Litigation counsel often reflexively want to hold back information, thinking that it doing so give them an advantage at trial. Equally often, though, the real effect of such holding back of information is merely to delay settlement — not a good outcome,

given that the vast majority of disputes are settled instead of being tried to a conclusion.

§ 6.01.2. Additional commentary: Unilateral amendments

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.

§ 6.01.2–1 **A unilaterally amendable contract *might* be deemed "illusory" absent *advance* notice and a *Halliburton* savings clause**

A unilateral-amendment provision might cause contracts to be unenforceable — and thus cause important provisions to disappear, for example, an arbitration provision with a class-action waiver — 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 to compel individual arbitration, on grounds that:

– the Blockbuster terms of service allowed Blockbuster to amend the terms of service unilaterally;

– 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

– 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. The court's holding 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.

In another case, 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).

§ 6.01.2–2 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).

§ 6.01.2–3 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 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, provided such alteration does not run afoul of the

> California Labor Code. 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).

§ 6.01.2–4 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).

§ 6.01.2–5 Optional 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).

§ 6.02. Binding Agreement Rule

In entering into the Contract, each party:

1. acknowledges that it has read and understood the Contract and had an opportunity to seek clarification of any provision it did not understand;

2. agrees to be bound by the Contract — except for provisions, if any, that are clearly identified as nonbinding; and

   Comment: The agreement's terms might include some specified nonbinding provisions, for example if the Contract is a letter of intent (Chapter 2:).

3. agrees that the Contract will also bind each party's heirs, legal representatives, successors, and (if any) permitted assigns.

§ 6.03. Copies of Agreement Rule

To reduce the cost of litigation and other proceedings: In any action or other context of any kind, photocopies and electronic images of an agreement and related documents may be used as originals in the same manner as provided in Rule 1003 of the U.S. Federal Rules of Evidence.

> Comment: 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."

§ 6.04. Counsel Consultation Rule

Each party acknowledges the following facts:

> Comment: See the Acknowledgement Definition and its commentary (§ 9.01). The acknowledgements in this section are mainly "litigation insurance," intended to try to forestall any contrary argument by creative litigation counsel.

1. The acknowledging party had the opportunity to consult counsel of its choice in deciding whether to enter into the Contract on the terms stated in it.

> Comment: This subdivision 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.
>
> This subdivision also refers to consultation with counsel when the parties were *entering into* their agreement, not to when they were

negotiating the agreement (because there might not have been any negotiation).

2. If the acknowledging party did not consult counsel, it made an informed decision not to do so.

3. The acknowledging party is not relying on advice from legal counsel for any other party in deciding whether to enter into the Contract.

> Comment: 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!*)

4. Each party other than the acknowledging party is reasonably relying on the acknowledgements in this Rule.

§ 6.05. Entire Agreement Rule

a. This Declaration applies unless the Contract clearly indicates the contrary.

b. The Contract is the parties' complete, final, and exclusive agreement concerning the matters addressed in it.

> CAUTION: Drafters should keep in mind that the exact boundaries of the term "the matters addressed in [the agreement]" 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, 34 Cal. App. 5th 605 (2019) (reversing denial of motion to compel arbitration).

c. All prior discussions, of any kind in any medium, concerning those matters are merged into the Contract.

> Comment: "Prior discussions" generally refers to oral- and/or written discussions or negotiations; comments; remarks; and interim- or partial commitments.

d. Additional- or different terms in purchase orders, order confirmations, invoices, and similar documents will be of no effect — even if one or more parties takes action consistent with those terms — unless those terms meet the requirements to amend or waive an agreement.

> Comment: 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). Allowing such additional- or different terms to take precedence would give a party a blank check to "re-trade the deal" by including such terms in a purchase order, an order confirmation, an invoice, etc.
>
> "Action consistent": A party might claim that another party had implicitly accepted additional- or different terms by taking action that conformed to some of those 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. This language tries to forestall such an interpretation.

§ 6.06. Freedom of Action Rule [opt-in]

a. This Rule applies only if the Contract clearly says so.

b. Unless the Contract clearly states otherwise, Alice will not assert that the Contract:

1. obligates Bob to enter into any other agreement, relationship, or transaction;
2. precludes Bob from doing any kind of business with anyone else; nor
3. requires Bob to restrict the assignment of employees or other personnel.

Comment: 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).

§ 6.07. General Representations Rule [opt-in]

a. This Rule applies only if the Contract clearly says so.

b. Alice represents to Bob that, so far as Alice is aware, the following assertions are true:

Comment: Some strategically-important types of agreement routinely include more-detailed "reps and warranties" of this kind; see, for example, the merger agreement between United Airlines and Continental Airlines, at the EDGAR Website maintained by the Securities and Exchange Commission, at https://www.sec.gov/Archives/edgar/data/100517/000095015710000587/ex2-1.htm.

NOTE: Representations and warranties are similar, but in American law they have some significant differences, discussed in the Representations and Warranties entry XXX

"So far as the representing party is aware": 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.

That argument should not prevail; still, to paraphrase a former student, that's a conversation I don't want to have.

1. Alice has the legal power to enter into and perform her obligations under the Contract without obtaining any additional approval; this legal power includes, without limitation, the power to make any grant that Alice makes in the Contract or is to make under the Contract.

Comment: 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).

2. Alice is not a party to any agreement — nor is she involved in any pending litigation or other claim — that could reasonably be regarded as posing a risk of materially interfering with her performance of her obligations under this Agreement.

OPTIONAL ADDITION: "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."

c. *Inquiry:* Unless the Contract clearly says otherwise, Alice has not necessarily made any particular inquiry concerning the matters set forth in subdivision b.

ALTERNATIVE: "The representing party has made a reasonable inquiry concerning the matter set forth in subdivision a."

§ 6.08. Government Subcontracting Disclaimer

a. Each party (each, "***you***") represents and warrants, to each other party, that — except to the extent (if any) expressly disclosed otherwise in the Contract — the Contract is not a subcontract in respect of a contract between you and any governmental authority.

> Comment: 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.

b. Without the other party's express prior written consent, you will not purport to do any of the following:

> Comment: 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

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. You 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.

> Comment: 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."

§ 6.09. Independent-Contractors Rule

§ 6.09.1. The Rule

a. Each party ("***you***") acknowledges the following and agrees not to assert otherwise except to the extent — if any — that the Contract clearly and unmistakably says otherwise.

> Comment: The agreement not to assert otherwise is intended to make it a separate breach of contract to dispute the substance of this acknowledgement.

1. 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.

> Comment: A contract's declaration that the parties are independent contractors will not necessarily carry the day; see § 6.09.2 for extended discussion.

2. In particular, the parties do not intend for the Contract to establish, nor to evidence, a fiduciary relationship between the parties.

   Comment: This subdivision is a lawyer-repellent provision, intended to try to dissuade trial counsel from alleging that counsel's client was owed a previously unsuspected and now-breached fiduciary duty by another party. Aggressive claims of fiduciary duty are not unheard of; for example, see Pappas v. Tzolis, 20 N.Y.3d 228 (2012)

3. You are not authorized to act as an agent for any other party.

   Comment: 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). In that case: • Homeowners hired a roofing company to replace their roof. The roofers bought packages of shingles that were shrink-wrapped in plastic — and, under the shrinkwrap, the package included an arbitration agreement. The homeowners had problems and sued the shingle manufacturer for selling a defective product. • The manufacturer claimed — successfully — that the homeowners could not sue in court, but instead had to arbitrate the dispute, because the roofers were the agents of the homeowners, for purposes of assenting to the arbitration agreement.

   But on similar facts, the Oklahoma supreme court reached the opposite conclusion in Williams v. Tamko Bldg. Prods. Inc., 2019 OK 61; the supreme court held that "[a]n implied agent whose sole authority is to select and install shingles does not have the authority to waive the principal's constitutional rights. Further, the intentional printing of an agreement to waive a constitutional right on material that is destined for garbage and not the consumer's eyes is unconscionable. The Homeowners never had an opportunity to make a knowing waiver of access to the courts." Id. ¶ 19.

   PRO TIP: 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.

b. You are to conduct yourself in accordance with the statement of intent in this Rule; without limitation, you may not do (nor to purport or attempt to do) any of the following EXCEPT to the minimum extent (if any) that the Contract expressly states otherwise:

1. make any promise, representation, or warranty *on behalf of any other party* concerning the subject matter of the Contract, other than as expressly stated in it;

2. hold yourself out as an employee, agent, partner, joint venturer, division, subsidiary, branch, or other representative of that other party;

   Comment: Suppose that a manufacturer terminates (say) a distributor relationship. It's not unheard-of (as in, the author once represented a client that it happened to) 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.

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.

c. If you fail to comply with the requirements of this Rule, then you must, upon request by another affected party to the Contract:

1. defend and indemnify that other party (§ 6.01) against any third-party claim resulting from your non-compliance; and

   Comment: 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 Rule.

2. indemnify that party against any other loss or expense resulting from such non-compliance.

§ 6.09.2. Additional commentary

§ 6.09.2–1 There's no magic protective incantation to ensure that parties are independent contractors

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.

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.

§ 6.09.2–2 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).

§ 6.09.2–3 Special case: California's statutory definition of *employee*

In 2019, the California legislature enacted a statute, known as AB 5, which added a new section 2750.3 to California Labor Code, setting out a three-part initial test for whether someone is an independent contractor instead of an employee:

> (a) (1) For purposes of the provisions of this code and the Unemployment Insurance Code, and for the wage orders of the Industrial Welfare Commission, a person providing labor or services for remuneration *shall be considered an employee rather than an independent contractor unless* the hiring entity demonstrates that all of the following conditions are satisfied:
>
> (A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

> (B) The person performs work that is outside the usual course of the hiring entity's business.
>
> (C) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

(Emphasis added.) The statute, however, goes on to set forth carve-outs for certain occupations that are worth a careful review. See generally, e.g., Jaclyn Gross & Joshua A. Rodine, Something's Afoot in Tinsel Town: New Laws for the Entertainment Industry (Dec. 2019).

§ 6.10. Labor-Law Rights Rule

a. The parties agree to this Rule to help forestall later claims of the kind referred to below.

b. In case of doubt: Nothing in the Contract is intended to restrict the ability of a party ("***you***") 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 Rule, however, also is not to be asserted as establishing, evidencing, or asserting:

1. that an employment relationship exists you and any other party; nor

2. that the NLRA or other legislation applies; nor

3. that the NLRB or EEOC has jurisdiction.

Comment: 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.

§ 6.11. Language Rule

§ 6.11.1. Definition: Contract Language

The term "*Contract Language*" refers to the language in which the body of the Contract is principally written.

Comment: In some cases, the body of the Contract might be written in multiple languages, or the Contract might have attachments in different languages.

CAUTION: Drafters of transnational contracts will want to check local law (and possibly engage local counsel) to see whether the law in a potentially-relevant jurisdiction requires contracts to be in the local language. EXAMPLE: • Indonesia • Québec • China.

§ 6.11.2. The Rule

a. *Written communications:* Except to the extent (if any) clearly agreed otherwise in writing, the Contract Language is to be used for:

1. any notices under the Contract; and

2. all service of legal process in any dispute arising out of or relating to the Contract 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.

Comment: Requiring notices and service of process 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).

The Contract Language may also be used for any other written communication in connection with the Contract.

b. *Oral communications capability:* 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. NOTE: This requirement 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 Contract.

Comment: 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).

c. *Translations:* Any translation of the Contract or any related document 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.

> Comment: Drafters dealing with multi-lingual appendixes, exhibits, etc., will want to consider this provision carefully.

§ 6.11.3. Additional commentary

In a LinkedIn discussion (membership required), the following points were suggested:

– English is the global lingua franca.

– The choice of language for drafting a contract should take into account the jurisdiction (or jurisdictions) 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.

§ 6.12. Master Agreement Rule

§ 6.12.1. The setting

This Rule applies if the Contract clearly indicates, expressly or implicitly, that the Contract is to be a master agreement under which multiple transactions might be conducted, with the Contract setting forth terms and conditions for possible individual written agreements (each, an "*Order*"; see the Order Fulfillment Rule, § 3.04) for any specific agreed transactions.

> Comment: It's possible that one or more Orders may be agreed to at the same time as the Contract is agreed to, or possibly afterwards, as agreed by the parties.

§ 6.12.2. The Rule

a. The parties intend to use the Contract as a pre-negotiated set of terms and conditions for one or more purchase orders, statements of work, or other specific agreements incorporating the Contract by reference.

b. Unless the parties expressly agree otherwise in writing, the Contract 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.

> Comment: This section is motivated 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).

c. Any prior master agreement between the parties concerning the subject matter of the Agreement is cancelled, on a going-forward basis only, as follows:

> 1. The Contract (along with any applicable transaction-specific agreement) will govern any transaction concerning that subject matter whose performance is begun during the term of the Contract.
>
> 2. Unless the Contract expressly states otherwise, IF: Performance of a transaction has already commenced under a prior master agreement between the parties; THEN: That prior master agreement will remain in effect as to that transaction until its performance is completed.

d. *[TO DO: Precedence of master agreement vs. transaction agreement]*

§ 6.12.3. Additional commentary

§ 6.12.3–1 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.

§ 6.12.3–2 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.

Unilateral extensions (XXX) and/or evergreen extensions (XXX) can also be useful, but should be approached with caution.

§ 6.12.3–3 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 thus 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.

§ 6.12.3–4 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.

§ 6.12.3–5 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.

The author is on the fence about that one:

– In one sense, Little'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.

§ 6.12.3–6 **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 an 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 — but 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:

> An 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" an 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 an 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.

§ 6.12.3–7 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.

§ 6.12.3–8 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).

§ 6.13. Notices Rule

a. *Applicability:* This Rule governs any communication — each, a "*notice*" — that can reasonably be interpreted as intended to have *some significant effect* under an agreement, such as (without limitation, and where applicable) any communication that:

1. formally invokes a right or obligation under an agreement or otherwise;

2. advises a party that the party has allegedly breached an agreement; and/or

3. advises a party that the advising party is terminating an agreement or some aspect of the parties' business relationship or engagement.

> Comment: The "some 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).

b. *Writing requirement:* Each notice must be in writing.

> Comment: Contracts typically contain notices-in-writing provisions to try to avoid "he said, she said" disputes over whether notice was or was not given orally.

c. *Addresses:*

1. Notices may be addressed to the address or addresses for notice stated in an agreement, if any.

> Comment: 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.

2. A party may change its address for notices by communicating the new address in any reasonable written manner.

> Comment: The This provision doesn't require formal notice of a change of address; some notice provisions do include such a requirement.
>
> ALTERNATIVE: "A party desiring to change its address for Notice must do so by giving Notice of the address change."

d. *Attention line:* To reduce the chances of notices going astray, any notice to an organization must be addressed to the attention of a specific position of responsibility in the organization.

> Comment: This subdivision 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.
>
> Note that the "attention:" line should designate a position of responsibility, not an individual's name, because the designated individual won't necessarily still be with the party in question when the notice is sent, and so the notice might go astray.

e. *Copies to others:* If so specified in a party's address for notice, a copy of any notice must be *separately* sent to the attention of the individual or position so specified in the address — for example, "With a copy to the attention of the Legal Department" — in a manner prescribed or permitted by this Rule.

> Comment: It's not uncommon for notices provisions to require additional copies of notices, in part to provide a backup in case the "main" notice goes astray.

f. *When effective:* Each notice is considered effective — regardless what address was used — if and when the notice: (i) is actually communicated to, or (ii) is actually refused by, or (iii) after reasonable efforts, is undeliverable to:

1. the addressee him- or herself, 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).

> Comment: 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, 135 Nev. Adv. Op. 19, No. 71941-CO, slip op. at 5-7 (Nev. App. June 6, 2009) (citing cases).)
>
> See also the "mailbox rule" option below.

g. *Copies to legal counsel:* 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.

> Comment: 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.

h. *Notice by FAX or email:* Any notice may be sent by email or FAX, but it will not be effective unless one or more of the following is true:

> Comment: 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.

1. the party being notified has expressly designated the specific address, in writing, as one to which such notices may be sent; or

Comment: 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 agrees 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.

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

CAUTION: Absent agreement, a notice received by email might well be effective even if no human recipient ever saw the notice. This could occur, for example, under § 15(e) of the Uniform Electronic Transactions Act.

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.

Comment: 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.

In case of doubt, the inclusion of a FAX number or email address in contact information for an individual or for a party does not in itself satisfy the express designation provision of subdivision f.1.

i. ❑ *Option for Notices by Regular Mail (applies only if the Contract clearly so states):* 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.

CAUTION: In business-to-business contracts, the better practice is not to allow notices to be automatically effective a certain number of days after being mailed. As the Third Circuit said: "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).

Comment: 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).

Comment: 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 of receipt 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.

§ 6.14. Personnel Compensation Rule

a. In this Rule, "***you***" refers to each party.

b. As between the parties, you are responsible for paying:

1. all salary and employment benefits (if any) of your employees and other personnel; and

2. all employment-related taxes and/or fees (if any) that are required, in any jurisdiction, for those personnel.

c. You must defend and indemnify each other party against any claim or determination that the other party is responsible for any payment under subdivision a.

d. Unless the Contract expressly states otherwise, no other party intends for the Contract to confer, on any of your personnel, any entitlement to the employment benefits (if any) that the other party provides to its own employees or other personnel.

§ 6.15. Redlining Rule

§ 6.15.1. The Rule

a. The parties agree to this Rule so that each party can sign or countersign the final draft of the Contract, and any related documents, without having to re-read the final document in its entirety before doing so (to verify that no surreptitious changes were made by the other side).

b. Each party's signing and delivery of the Contract or any related document constitutes a representation of that party's good-faith belief that the party 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.

> Comment: This Rule helps to streamline the process of final review and signature of the Contract: 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.
>
> CAUTION: If a party objects to this Rule, that could be a red flag that the party might not be a good business partner.

§ 6.15.2. Additional commentary

§ 6.15.2–1 Purpose

The Redlining Rule helps to streamline the process of final review and signature of the Contract: 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.

This provision is a statement of good-faith belief, not a warranty, because the former comes across as "softer" and is more likely to be accepted by a contract's legal reviewer.

§ 6.15.2–2 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?

§ 6.15.2–3 But surreptitious changes to contract documents do happen.

The overwhelming majority of lawyers would never try to pull something so underhanded as to make surreptitious changes to signature versions of a document, not least because it could severely damage the lawyer's reputation and possibly even lead to disciplinary action.

But in Hand v. Dayton-Hudson, 775 F.2d 757 (6th Cir. 1985), a party surreptitiously altered a release before signature. The appellate court affirmed the trial court's judgment reforming the release, that is, revising it after the fact.

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 surreptitiously altered his employment agreement, changing a two-year noncompetition provision to a two-month period.

And 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.

§ 6.16. Signature Protocol

§ 6.16.1. The Rule

a. *Applicability:* This Protocol applies in all cases where one or more parties is to sign a document — including but not limited to the Contract.

> Comment: It might seem puzzling how parties can "agree" to a signature protocol before they've even signed the Contract. Technically, this Protocol likely would be held to have been ratified by the parties' signature to the Contract.

b. *Signing of separate counterparts:* 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.

> Comment: 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.

c. *Delivery of signed signature pages only:* If the requirements of this subdivision are met, then any party may deliver a signed document to another party by transmitting just an image of a signed signature page, by email, FAX, or other electronic transmission means.

> Comment: **Emailing PDFs of scanned, signed signature pages only has become fairly typical.**

1. The Contract, when signed, is one such document that may be delivered in this way.

2. It must be clear, from all the circumstances, that the signature page is actually from the document in question (for example, the final agreed draft of the Contract) and not of some other document.

> Comment: A signature page should preferably be tied to a specific version of the Contract by including, on each page of the Contract, 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. Failure to do so in one case led the Delaware chancery court to conclude that there had been no "meeting of the minds" about an alleged agreement to grant equity in a company to an independent sales representative. See Kotler v. Shipman Assoc., LLC, No. 2017-0457-JRS (Del. Ch. Aug. 27, 2019).
>
> PRO TIP: It's a good 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.

d. *Electronic signatures:* 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.

> Comment: See the additional commentary on electronic signatures (§ 6.16.6).

§ 6.16.2. Commentary: Who should sign?

§ 6.16.2–1 Be sure the other side's signer has authority to commit

A contract signed by an individual who doesn't have authority to commit his principal **might be worthless** to the other side. For example: Liberty Ammunition, Inc. v. United States, 835 F.3d 1388 (Fed. Cir. 2016), in which:

– 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, 131 N.E.3d 99: 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 the state statute** that authorized an unincorporated association to lease or purchase real estate in its own name.

§ 6.16.2–2 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.

§ 6.16.2–3 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.

§ 6.16.2–4 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.

– 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.

So the question is: **Would "a reasonable person" think the signer for The Other Side had authority to commit that company to the contract?**

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.

§ 6.16.2–5 Pro tip: 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.

§ 6.16.2–6 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 had later ratified the lease agreement. Zions Gate RV Resort, LLC v. Oliphant, 2014 UT App 98, 326 P.3d 118, 121 ¶ 8, 122-23.

§ 6.16.2–7 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. [TO DO: 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 deceptive backdating of a contract (§ 6.16.7–4). 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.)

§ 6.16.2–8 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 § 6.16.2–9.

§ 6.16.2–9 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:

– 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.

– 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, it makes it more likely that the lawyer will 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. (This factor might not be important as a practical matter, though, because as a participant in the negotiations, the lawyer might well be deposed anyway as a fact witness.)

§ 6.16.3. Commentary: Templates for signature blocks

§ 6.16.3–1 Corporate- and LLC signature blocks

Here are examples of signature blocks for different types of organization. On the left is a signature block for when the signer's name and title are known; on the right, when not.

AGREED:
Alpha Bravo Inc, by:

____
Alice Able, CEO

____
Date signed

AGREED:
Gamma Delta LLC, by:

____
Signature

____
Printed name

____
Title

____
Date signed

In the signature blocks above:

– Each organization's signature block lists the organization's name **followed by the word "by" and a colon**.

– Date signed: **Each signer should hand-write the date signed**, for reasons discussed at § 6.16.4.

– Printed name: In signature blocks with blank lines, be sure to include a space for the printed name, because **the signatures of some people are difficult to read**.

– Title: In any signature block for an **organization**, be sure to include the signer's **title**, to establish a basis for concluding that the signer has authority to sign on behalf of the organization (see § 6.16.2). If the employee's title includes the word "president," "vice president," "manager," or "director," that's likely enough to establish the employee's *apparent* authority (§ 6.16.2–4).

PRO TIP: Consider also including a representation such as the following: "When an individual signs this Agreement on behalf of a corporation or other organization, that individual *personally* represents that the individual is authorized to sign this Agreement on behalf of the organization." This should help smoke out situations in which an unauthorized person would sign.

§ 6.16.3–2 "Agreed" in the signature block

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

§ 6.16.3–3 Use a concluding paragraph? *(No.)*

The author prefers not 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.

§ 6.16.3–4 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]

§ 6.16.3–5 Caution: Signature block for an LLC

Look again at the signature block just 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, as discussed in § 6.16.2–6.

§ 6.16.3–6 Caution: 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(c) (emphasis added). In such cases, the signature block of a limited partnership might look like the signature block of a corporation or LLC, above.

CAUTION: A limited partner who, *acting in that capacity*, signs a contract on behalf of the limited partnership could be exposing herself to claims that she 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.)

§ 6.16.3–7 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

§ 6.16.3–8 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."

§ 6.16.4. Commentary: Backdating contracts

§ 6.16.4–1 "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.

§ 6.16.4–2 But *deceptive* backdating of 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: ten 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 prison because 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).

§ 6.16.4–3 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 normally hand-write the actual signature date, even if a blank line for the signature date is not provided.

– 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 initial the change.

§ 6.16.4–4 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.

§ 6.16.4–5 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).

§ 6.16.4–6 Optional further reading about backdating contracts

Colin Riegels, Backdating Contracts And Other Documents And Instruments (Mondaq.com Apr. 2016: https://goo.gl/mhfP5H).

§ 6.16.5. Commentary: Signature & delivery mechanics

§ 6.16.5–1 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:

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."

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.

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.

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.

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.

Electronic signatures: More and more contracts are getting "signed" electronically, using various commercial services.

§ 6.16.5–2 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.

§ 6.16.5–3 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.

§ 6.16.5–4 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 prenuptial 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 prenup 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 prenup agreement.

§ 6.16.5–5 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.

In the same vein, see Lerner v Newmark & Co. Real Estate, Inc., 2019 NY Slip Op 08611 (App. Div. Dec. 3, 2019), where the court held that "defendants knew how to draft an agreement that could be accepted only by signature, but they did not so draft the Termination Agreement. The evidence, i.e., the parties' months-long email exchanges, … supports a finding that the parties intended to be bound by the Termination Agreement, despite their failure to sign it." *Id.* (citation omitted).

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:

– Email

– Text message

– IM / Slack / other chat

– Social media

– An inadvertently-binding letter of intent.

§ 6.16.6. Commentary: Electronic signatures

It's becoming increasingly common for parties to sign their contracts electronically.

§ 6.16.6–1 Electronic signatures are largely authorized by statute

U.S. law explicitly law supports the use of electronic signatures:

– 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).

– Electronic signatures are now common in England and Wales; see generally LAW COMMISSION, ELECTRONIC EXECUTION OF DOCUMENTS (2019), at https://perma.cc/UCQ7-U94M.

§ 6.16.6–2 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.

§ 6.16.6–3 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).

§ 6.16.6–4 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).

§ 6.16.6–5 **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).

§ 6.16.7. Commentary: Notarizing a document

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

(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.)

§ 6.16.7–1 "Notarizing" a document with an acknowledgement certificate

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 as the 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).

§ 6.16.7–2 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.

§ 6.16.7–3 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.

§ 6.16.7–4 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 it has a certain ring to 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.

§ 6.16.7–5 A lawyer who "notarizes" a client's signature might later 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.)

§ 6.16.7–6 Study exercises: Notary-public acknowledgements

FACTS: Your client, Landlord, has negotiated a five-year commercial lease 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 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.

§ 6.17. Status Conference Rule

a. *Purpose:* To try to reduce the chances of disagreements, the parties will confer, whenever reasonably requested from time to time by either party, about the Contract and any related subjects.

> Comment: 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 — *and making it a contractual requirement also gives each party an incentive not to ignore or brush off the other party.*
>
> It's often extremely helpful to hold status conferences immediately after (and even 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.

b. *Mechanics:* Status conferences will preferably (but not necessarily) be by Webcam video conference; they may also be by phone or, if so agreed, in person.

> Comment: Video conferences with screen sharing can be especially effective for status updates and are becoming quite affordable from providers such as Amazon Chime; GoToMeeting; Skype Business; and Zoom.us.

c. *Arrangements:* 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).

d. *Agenda:* Each status conference should include discussion of some or all of the following "**G-PP-AA**" items: **G - goals** of the parties in respect of the Contract; **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

e. *Expenses:* Each party is responsible for its own expenses of status conferences.

f. *Good faith:* The parties expect each other to participate in status conferences in good faith, but in the interest of avoiding ancillary litigation, each party **WAIVES** any claim that a party's actual participation was not in good faith. (This waiver does not extend to waiver of a breach of the Contract requirements.)

> Comment: 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.

§ 6.18. Survival of Terms Rule

a. All provisions of the Contract in the categories listed in subdivision b (if any) will continue in effect beyond termination or expiration of the Contract.

> Comment: Termination and expiration are separately mentioned to avoid any argument over whether one includes the other.

b. The surviving provisions are those (if any) concerning:
• arbitration; • attorney fees; • confidentiality; • early neutral evaluation; • expense-shifting after settlement-offer rejection; • forum selection (or choice of forum); • governing law (or choice of law); • indemnification; • insurance requirements; • intellectual-property ownership; • limitations of liability; • non-competition; • non-solicitation; • remedy exclusions and -limitations; • representations and warranties; • warranty disclaimers; • warranty rights.

> Comment: Contract drafters should be careful about what rights and obligations would survive termination – see Jeff Gordon, Night of the Living Dead Contracts (2008), https://perma.cc/G76F-5K6T.

c. All provisions of the Contract relating to the recovery of attorney fees and other dispute expenses will survive the entry of a judgment, arbitration award, or other decision in a contested proceeding.

§ 6.19. Tax Responsibilities Rule

a. *Tax definition:*

1. The term *tax* refers to any tax, assessment, charge, duty, levy, or other similar governmental charge of any nature, imposed by any government authority.

2. 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.

b. *Tax examples:* Illustrative examples of taxes include the following, without limitation, 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.

> Comment: 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 Clause in the General Terms.

c. *Sales tax definition:* 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.

> Comment: 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).

d. *Sales tax responsibility:* Unless the parties agree otherwise in writing in connection with a particular transaction: Any party that, under the Contract, invoices another party for goods, services, or other things potentially subject to sales taxes (as defined above) is to 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;

> Comment: 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.

2. separately list all sales taxes in the relevant invoice;

3. timely report and remit all sales taxes to all relevant taxing authorities anywhere in the world; and

4. defend and indemnify, in accordance with § 5.06.3: (i) each invoiced party, and (ii) each member of the invoiced party's Protected Group (defined in § 9.42), against any claim by a taxing authority for unpaid sales taxes.

> 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.

e. *Responsibility for taxes on income, etc.:* As between the parties, each party:

1. is solely responsible for all taxes on that party's income arising from or relating to the Contract; and

2. will defend and indemnify, in accordance with § 5.06.3: (i) each other party, and (ii) each member of the other party's Protected Group (defined in § 9.42), against any third-party claim that the indemnifying party failed to pay taxes for which the indemnifying party is responsible under subdivision 1.

> Comment: 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.

Chapter 7: Disagreement Rules

§ 7.01. Applicability

The provisions in this chapter:

1. are to be followed in the order in which they appear below except to the extent, if any, that the Contract clearly states otherwise; and

2. will apply to all disagreements that the parties are unable to resolve themselves at the "working level."

§ 7.02. Internal Escalation Rule

a. *Escalation requirement:* At either party's request, the parties will jointly internally escalate any disagreement that cannot be resolved at the working level.

> Comment: 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").

b. *Levels of escalation:* Each party's internal escalation is to go "up" at least two management levels in succession, or if less, the maximum number of levels remaining.

> Comment: Some escalation provisions require issues to be referred all the way up to "executive-level management." Apart from the vagueness of that 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

c. *Prerequisite to litigation:* Any party involved in escalation of an issue must finish the escalation before going to court or arbitration, EXCEPT:

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.

> Comment: This section seeks to forestall a non-aggrieved party from going to court (or arbitration) to seek a declaratory-judgment action about the issue.

d. *Limited admissibility of escalation communications:* All communications made in the course of an issue escalation 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 per se would apply in a court proceeding or arbitration concerning the issue.)

> Comment: 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.)

§ 7.03. Early Neutral Evaluation Rule [opt out]

§ 7.03.1. The Rule

a. *Applicability:* This Rule will apply whenever an Agreement-Related Dispute (§ 9.03) becomes, or appears reasonably likely to become, the subject of litigation, arbitration, or other mandatory adversarial dispute-resolution procedure, UNLESS a party timely opts out in accordance with § 1.03.

> Comment: The goal of early neutral evaluation is to provide parties to a dispute and their counsel with a neutral "reality check." This Rule and its commentary are adapted in part from the Early Neutral Evaluation (ENE) Web page of the U.S. District Court for the Northern District of California, the federal court whose district includes Silicon Valley.

b. *Initiation:* At any time before the main adversarial hearing, either party may submit the dispute to (nonbinding) early neutral evaluation in accordance with the Early Neutral Evaluation procedures of the American Arbitration Association as then in effect.

> Comment: Other ENE rules include, for example, those of the U.S. district courts f❑ • the Northern District of California (encompassing San Francisco and Silicon Valley); • the Southern District of California; • the Eastern District of Wisconsin; • the Western District of Pennsylvania.

c. *Confidentiality:*

1. If a party privately discloses information to the neutral evaluator, then the evaluator is not to reveal that information to any other party without the disclosing party's consent.

> Comment: The rationale for confidentiality is that parties are likely to be more candid in settlement discussions if they have some basis for assuming that a carelessly-worded comment, by a party or by

counsel, won't later be quoted by opposing counsel in front of a judge or jury.

The American Arbitration Association's Early Neutral Evaluation procedures provide (among other things) for confidentiality of the proceedings, including evidentiary provisions analogous to Rule 408 of the Federal Rules of Evidence. Litigators will remember Rule 408 as providing that — with certain limited exceptions — communications made in the course settlement discussions are inadmissible in court. (So, too, do many counterpart state-law rules.)

2. The results of the neutral's evaluation are confidential and not to be shared with the trial judge or arbitrator.

d. *Limited admissibility of ENE communications:* Communications made in the course of an early neutral evaluation 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 per se would apply in a court proceeding or arbitration concerning the issue.)

Comment: 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.)

§ 7.03.2. Additional commentary

In any dispute, *early* neutral evaluation can be useful, either to get the case settled entirely or at least to cut down on expensive discovery fishing expeditions and satellite litigation.

§ 7.03.2–1 **Why bother with getting a neutral outsider involved?**

ENE can come in handy because:

– Each side's lawyers – especially male lawyers – might well be overly optimistic about whether they're going to win their cases; see this summary in the ABA Journal of the published research findings; see also Rick Lowes, *Recognizing the Role of*

Optimism Bias in Case Evaluation(LegalIntelligencer.com June 2016), also available without the paywall (DuaneMorris.com).

– Both lawyers and clients can get into ego clashes with the other side.

– Lawyers want to be perceived by their clients as team players who are committed to doing "whatever it takes" to win the case for the client; they therefore have at least some incentive to tell their clients what they think the clients want to hear, and to try to protect their clients from unpleasant truths.

– And of course lawyers would miss out on a certain amount of fee income from litigation if their clients' disputes were to be settled early.

All of these factors can hamper getting disputes settled quickly, and in fact can even cause disputes to escalate. That will usually result in extra expense and grief for all concerned.

In that situation, sometimes an early, non-binding "sanity check" from a knowledgeable, neutral outsider can help the parties and their lawyers get back onto more-productive tracks. Otherwise, positions can harden and business relationships can suffer — and of course, legal bills will start to mount up.

ENE might happen in court anyway, because that some courts routinely refer selected cases to mandatory early neutral evaluation to help the parties explore their cases in more depth. This is explained at the Web site of the U.S. District Court for the Northern District of California, the federal court whose district includes Silicon Valley; see U.S. Dist. Ct. for the N.D. of Cal., *Early Neutral Evaluation (ENE)*.

§ 7.03.2–2 An ENE success story

The ENE process apparently helped the Chuck E. Cheese restaurant operation to settle a class-action lawsuit by employees who asserted that the company's background-check consent form did not comply with the Fair Credit Reporting Act’s strict requirements. In issuing its preliminary approval of the settlement, the district court noted that "the case … went through the Early Neutral Evaluation process which encouraged the settlement." See *Ford v. CEC Entertainment, Inc. d/b/a Chuck E. Cheese’s*, No. 14-CV-677, slip op. at 11:1 (S.D. Cal. July 7, 2015) (order granting preliminary approval of class-action settlement); see also David M. Gettings, Timothy St. George and David N. Anthony, *Chuck E. Cheese Settles Background Check Lawsuit For $1.75 Million* (Mondaq.com).

§ 7.03.2–3 Must the parties turn over all their cards in ENE?

No: In the evaluation proceedings, no party need reveal any particular information to the other party or to the evaluator — but each party is encouraged to make a full disclosure of its position and supporting evidence.

§ 7.03.2–4 Can the neutral evaluator force a settlement?

No — the evaluator has no power to impose settlement and is not allowed to try to force a party to accept any proposed terms.

§ 7.03.2–5 A contrary view of early neutral evaluation

Not everyone is a fan of early neutral evaluation. See, for example, the commentary to ADR Rule 2-3(a)of the U.S. District Court for the Northern District of Illinois (which encompasses Chicago), which states in part:

> … The *[advisory committee on a pilot mediation program]* recommended to the court that non-binding arbitration and early neutral evaluation **not** be court annexed alternatives in the Western Division.
>
> Regarding early neutral evaluation, the recommendation of the committee was based on the impression that early neutral evaluation appeared, under the Northern District of California Local Rules, to offer no more than mediation and to lack the resolution oriented approach of mediation.
>
> *It is assumed, however, that mediators, although neutrals, will not only act to facilitate compromise but will be willing and able to offer litigants frank and confidential third-party assessments of their relative positions and risks.*

(Emphasis and extra paragraphing added.) *Author's note:* True, *in theory* mediators will "offer litigants frank … assessments of their relative positions and risks." But the author's (limited) experience as litigation counsel in mediation, along with anecdotal evidence from other counsel, indicates that too many mediators are reluctant to offer frank assessments, even though in many cases that might be precisely what's needed to dynamite stubborn parties off their positions.

§ 7.04. JURY TRIAL WAIVER [opt out]

§ 7.04.1. The Rule

a. *Broad applicability:* This waiver applies to the greatest extent not prohibited by law UNLESS a party timely opts out in accordance with § 1.03.

b. *Waiver:* Each party (each, a "waiving party") KNOWINGLY, VOLUNTARILY, INTENTIONALLY, PERMANENTLY, AND IRREVOCABLY **WAIVES** ANY RIGHT IT MIGHT HAVE TO TRIAL BY JURY of any Agreement-Related Dispute (§ 9.03).

> Comment: 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 all-caps type is for conspicuousness.

c. *No contrary representations:* Each waiving party:

1. 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 Contract's waiver of jury trial; and

> Comment: Provisions like this sometimes show up in waivers of the right to jury trial.

2. acknowledges that each other party will actually and reasonably rely on that certification in deciding whether to enter into the Contract on the economic- and other terms stated in it.

§ 7.04.2. Additional commentary

§ 7.04.2–1 CAUTION: In California, Georgia, and (mostly) Arkansas, advance waivers of jury trial are not enforceable.

Arkansas: See Tilley v. Malvern Nat'l Bank, 2017 Ark. 343, 532 S.W.3d 570 (state constitution prohibits pre-dispute jury waivers unless authorized by law), *overturned in part by* ARK. CODE § 16-30-104 (new statutory exception for contracts to borrow or lend money), *discussed in* Tilley v. Malvern Nat'l Bank, 2019 Ark. 376 (holding that supreme court's mandate remanding for jury trial was not affected by intervening enactment of statutory exception).

California: See 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: See Bank South, N.A. v. Howard, 264 Ga. 339, 444 S.E.2d 799 (1994).

§ 7.04.2–2 Other jury-trial waiver cautions

– 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.)

– 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).

§ 7.04.2–3 Optional reading about jury-trial waivers

– Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018) (archived at https://perma.cc/3G4L-UVZB).

§ 7.05. Arbitration Rule [opt in]

This Rule will apply if the Contract requires some or all disputes to be submitted to arbitration.

> Comment: **Arbitration is "a creature of contract"**; as a general rule, a party will not be required to arbitrate a dispute unless the party has clearly agreed that it will do so. [TO DO: CITE]
>
> ADOPTION TEMPLATE: "All disputes that the parties do not resolve by agreement are to be submitted to arbitration in accordance with the Tango Terms 2020A Arbitration Rule."
>
> ALTERNATIVE (narrower): "All disputes arising out of this Agreement are to be submitted to arbitration in accordance with the Tango Terms 2020A Arbitration Rule."
>
> CAUTION: If drafting an arbitration provision for an employment agreement, see Kacey Riccomini and Art Sibergeld, 23 tips for drafting employment arbitration agreements (JDSupra 2019), https://perma.cc/ARW7-T864.
>
> CAUTION: The law might restrict arbitration, as discussed in the additional commentary (§ 7.05.16–1).
>
> 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, 34 Cal. App. 5th 605, No. G055685, slip op. (Cal. App. Apr. 22, 2019) (reversing denial of motion to compel arbitration); *accord*, AlterG, Inc. v. Boost Treadmills LLC, No. 18-cv-07568-EMC, slip op. at

part III.C.1.a (N.D. Cal. Sept. 5, 2019) (denying defendants' motion to dismiss breach-of-contract claim) (citing cases).

§ 7.05.1. Which disputes must be arbitrated

a. *Broad scope:* Except as clearly stated otherwise in this Rule (or otherwise in the Contract), the parties are to arbitrate any Agreement-Related Dispute (§ 9.03), including without limitation the following:

As one longtime 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, notwithstanding 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).

1. claims arising by statute or by any form of common law; and

Comment: Statutory claims can be arbitrated in the U.S., but the parties' agreement to do so must be explicit. Compare, e.g., 14 Penn Plaza LLC v. Pyett, 556 U.S. 249 (2009) (reversing court of appeals; provision in union collective bargaining agreement, requiring arbitration of age-discrimination claims, was enforceable) with Ibarra v. United Parcel Service, 695 F.3d 354, 356 (5th Cir. 2012) (arbitration provision in collective bargaining agreement did not cover statutory discrimination claims because it did not include a clear and unmistakable statement that statutory claims were to be arbitrated).

2. claims that a party was induced to enter into the Contract by fraud or negligent misrepresentation.

Comment: If an arbitration agreement did not expressly encompass claims of fraud and negligent misrepresentation, then a court might deny a motion to compel arbitration. This happened in Correct Rx Pharmacy Services, Inc. v. Cornerstone Automation Sys., L.L.C., No. 18-11387, slip op. (5th Cir. Dec. 19, 2019), where the appeals court noted that the district court had refused to compel arbitration because "claims of fraudulent inducement arise from a general obligation imposed by law, not the underlying contract." *Id.* at 5 n.3 (cleaned up, citation omitted). The appeals court affirmed judgment on a jury verdict of negligent misrepresentation.

b. *Exception for administrative-agency claims by employees:* You need not arbitrate a charge or other claim against your current- or former employer before the [U.S.] National Labor Relations Board or other administrative agency having jurisdiction.

Comment: This exception addresses a holding by the National Labor Relations Board that a mandatory arbitration provision, in a company's sales-commission agreement, unlawfully interfered with employees' right of access to the Board's processes, in violation of section 8(a)(12) of the National Labor Relations Act; the Board distinguished the arbitration provision from another arbitration provision that contained an adequate exception for Board charges. *See* Beena Beauty Holding, Inc., 368 NLRB No. 91 (2019).

c. *Exception for small claims:* Unless either party timely opts out of this small-claims exception in accordance with § 1.03, you may waive arbitration, and instead require the claim to be heard by a court of competent jurisdiction, (i) as long as the aggregate amount of money being sought does not exceed USD $10,000, and (ii) subject to the following qualifiers:

Comment: Small claims likely won't be worth the expense of arbitrating; consequently, **many consumer arbitration provisions include exceptions for such claims.** One example is the AT&T Mobility arbitration agreement, mentioned by the [U.S.] Supreme Court in its Concepcion opinion. To like effect, see generally, e.g.: • U-Haul arbitration provision (accessed Aug. 22, 2015) (includes small-claims exception); • Lawrence Mortorff, David A. Robinson, and Richard Chernick, Before Closing That Killer Deal: Considerations for Negotiating and Drafting Appropriate and

> Enforceable Arbitration Provisions at 21 (ADR.org 2012) (example of small-claims exception).
>
> A small-claims exception can **help defeat a claim that the arbitration provision is unconscionable** due to the expense of arbitrating a small claim. New Mexico's supreme court ruled that a small-claims exception in a consumer-contract arbitration provision contributed to the court's conclusion that the arbitration provision was not unconscionable. Dalton v. Santander Consumer USA Inc., 385 P.3d 619 (N.M. 2016) (reversing trial court and court of appeal).

1. If the Contract includes a forum-selection provision (§ 7.14.4), then you must bring the (small) claim in a court that is permitted by that provision.

> Comment: See generally the Forum Selection Option and its commentary (§ 7.14.4).

2. In case of doubt: This Rule does not itself authorize class- or collective-action arbitration.

> Comment: This is a roadblock provision to forestall an argument that an agreement, by allowing small claims to be litigated, thereby (or so goes the argument) implicitly authorized class- or collective-action arbitration (for more detail, see § 7.05.4).

3. If the parties disagree whether arbitration is required for a (small) claim filed in court under this exception, then that particular dispute is to be decided by the court, and the arbitral tribunal will have no power to do so.

> Comment: The "no power" language ties in with subdivision d below concerning delegation of disputes about arbitrability.

d. *Delegation of (most) arbitrability issues:* Except as otherwise expressly stated in the Contract (including but not limited to elsewhere in this Rule), the arbitral tribunal is delegated the power to decide any disagreement whether a particular dispute is or is not subject to arbitration. This delegation includes, without limitation, the power to decide disagreements about, without limitation, the following matters:

1. whether the parties entered into an agreement to arbitrate that covers the dispute in question;
2. whether the agreement to arbitrate is binding, enforceable, applies to a particular type of controversy, and/or is in conflict with a non-waivable legal right; and
3. whether a party seeking arbitration has waived arbitration.

ALTERNATIVE: "Any question about whether a particular dispute is arbitrable is to be decided by a court of competent jurisdiction and not by the arbitral tribunal."

Comment: **Under U.S. law, it is the court, not the arbitrator, that normally must determine** whether the parties have agreed to arbitrate — unless, that is, the arbitration agreement itself clearly and unmistakably delegates that power to the arbitrator. See First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) (reversing court of appeals and holding that agreement in question did not give arbitrator power to determine arbitrability). And **even then,** any challenge specifically to the "delegation agreement" itself will be heard by the court, not by the arbitrator. See Rent-a-Center, West, Inc. v. Jackson, 561 U.S. 63, 68-69 (2010) (reversing 9th Circuit holding that court must determine enforceability of arbitration agreement). For a useful survey of the law in this area, see Paul T. Milligan, Who Decides the Arbitrability of Construction Contracts? in The Construction Lawyer, Vol. 31, No. 2, Spring 2011.

Delegation of arbitrability disputes might well be expressly addressed in the chosen arbitration rules; consequently, by agreeing to arbitration rules, the parties might implicitly delegate arbitrability disputes to the arbitrator. See, e.g., decision in *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019), *on remand,* 935 F.3d 234 (5th Cir. 2019). On remand in that case, however, the Fifth Circuit held that the arbitration provision in question — which incorporated AAA rules by reference, which included a delegation provision — did not clearly and unmistakably delegate arbitrability decisions *about claims for injunctive relief*. See 935 F.3d at 282-83.

Arbitration of arbitrability might result in the case being ping-ponged: The worst of both worlds might occur if (i) a contract contains an arbitration provision that delegates determinations of arbitrability to the arbitrator, but then (ii) the arbitrator determines that the dispute in question is not arbitrable and therefore must go back to court, thus wasting the expense of bringing the arbitrator up to speed. The stage was set for that to happen in Kubala v. Supreme Proc. Svcs., Inc., 830 F.3d 199 (5th Cir. 2016).

Other badly drafted terms in an agreement might undermine an arbitration-arbitrability delegation in the agreement. For example, in one case, the contract included an *arbitration* clause, but the savings clause implied that a *court* might determine that the agreement as a whole was unenforceable. A California appeals court held that the contract had not clearly and unmistakably delegated the question of enforceability to an arbitrator; therefore, said the appeals court, that question was properly resolved by the courts, not by the arbitrator. See Peleg v. Neiman Marcus Group, Inc., 204 Cal. App. 4th 1425, 1442-43, 140 Cal. Rptr. 3d 38 (2012).

§ 7.05.2. Arbitration details

a. *Language of arbitration:* The English language is to be used in all proceedings, notices, and decisions in the arbitration.

Comment: 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).

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 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 notice of arbitration had been in English.

b. *Governing law for arbitration:* The arbitration is to be governed by Texas arbitration law and the United States Federal Arbitration Act.

Comment: **Texas arbitration law,** Tex. Civ. Prac. & Rem. Code ch. 171, is chosen here not only because it lays out a sensible process, but mainly because **it allows f❑** (i) compulsory depositions of adverse witnesses, *see id.* §§ 171.050 and 171.051, and (ii) an expanded right of appeal if desired, which would not be available under the Federal Arbitration Act, as discussed in the commentary (§ 7.05.12).

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).

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

An ordinary choice-of-law provision might not apply in an arbitration proceeding. 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).

c. *Arbitration rules:*

1. The arbitration is to be governed by the Commercial Arbitration Rules of the American Arbitration Association as in effect at the time of the demand for arbitration.

Comment: 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 parties agree to such rules, they have 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," part of the AAA), are said to be based on the UNCITRAL Rules (mentioned below) but with administration features included. For a discussion of 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.

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

Comment: 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. In re Salomon Inc. Shareholders' Derivative Lit., 68 F.3d 554 (2d Cir. 1995); see also, e.g., 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 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 to grant motion to compel arbitration; citing cases); Nachmani v by Design, LLC, 901 N.Y.S.2d 838, 74 A.D.3d 478 (N.Y. 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).

§ 7.05.3. Arbitral tribunal

a. *Number of arbitrators:* The arbitration is to be conducted before an arbitral tribunal consisting of a single arbitrator.

Comment: 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.

b. *Arbitrator selection:* The arbitral tribunal is to be selected (i) as provided in the arbitration rules or, (ii) failing that, as provided by law.

> Comment: The fallback provision in subdivision (ii) is to avoid having a court refuse to compel arbitration in such a circumstance — that's currently the subject of a circuit split among U.S. federal courts, as discussed (with citations) in Frazier v. Western Union Co., 377 F. Supp. 3d 1248, 1265-66 (D. Colo. 2019).

c. *Arbitrator qualifications:* If the Contract specifies qualifications for arbitrators in addition to those specified in the arbitration rules, then each member of the arbitral tribunal must have those additional qualifications.

> Comment: Arbitrator qualifications are worth some thought; some contracts specify different arbitrator qualifications for different types of dispute. *See* BP America Production Co. v. Chesapeake Exploration LLC, 747 F.3d 1253, 1256 (10th Cir. 2014) (different arbitrators for different dispute categories).

§ 7.05.4. Class-action arbitration prohibited

a. Unless the Contract expressly provides otherwise, you must arbitrate only your own dispute; you may not do so as a plaintiff or representative class member in a purported class action, collective action, or representative proceeding, nor in a purported capacity of private attorney general.

> ALTERNATIVE: "A claimant may arbitrate a dispute as a representative of a class: (i) as provided in the arbitration rules, if applicable; otherwise (ii) in the same general manner as provided in the (U.S.) Federal Rules of Civil Procedure as interpreted by the courts."

> Comment: A majority of the (U.S.) Supreme Court is of the view **that arbitration is so different from litigation** — with very different procedures and, crucially very little right of appeal — that the "default" rule, at least for arbitrations under the Federal Arbitration Act, is that **class-action arbitration is not allowed unless the parties expressly agree to it**. *See* Stolt-Nielsen SA v. AnimalFeeds International, 559 U.S. 662, 130 S. Ct. 1758 (2010); see also AT&T

Mobility LLC v. Concepcion, 563 U.S. 333, 131 S. Ct. 1740 (2011). In other cases, the Court has similarly held that:

– **The FAA preempts state law barring enforcement of a class arbitration waiver**; see AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 131 S. Ct. 1740 (2011) (reversing Ninth Circuit); see also, e.g., Davis v. Nordstrom, Inc., 755 F.3d 1089, 1092-94 (9th Cir. 2014) (reversing denial of Nordstrom's motion to compel employee to arbitrate her claims individually and not as a class).

– **A contractual waiver of class arbitration is enforceable** under the Act **even if the plaintiff's cost** of individually arbitrating a federal statutory claim exceeds the potential recovery. See American Express Co. v. Italian Colors Restaurant, 570 U.S. 228 (2013) (reversing Second Circuit). And a contractual waiver of class arbitration trumps employees' collective-bargaining rights under section 7 of the National Labor Relations Act. Epic Systems Corp. v. Lewis, 584 U.S. ___, 138 S. Ct. 1612 (2018).

Class actions might be available if the arbitration agreement includes a **provision allowing parties to opt out of arbitration**. Some companies include such provisions in their arbitration agreements, especially in employment agreements and customer agreements. Opting out of arbitration would preserve an employee's or customer's right to bring class-action litigation. But how many people will actually bother to opt out? One case, involving an arbitration provision in an employment agreement, is instructive: An employee failed to opt out of arbitration, and therefore was stuck with her choice. See Johnmohammadi v. Bloomingdale's, Inc., 755 F.3d 1072, 1074 (9th Cir. 2014) (affirming grant of Bloomingdale's motion to compel arbitration of employee's claim and dismissal of her class-action suit) (citation omitted).

CAUTION: An employer that prohibits class arbitration AND that agrees to pay arbitration fees might find itself **overwhelmed by individual arbitration claims**. See, e.g., Henry Allen Blair, DoorDash TROs Signal a New Frontier in Mass Individual Arbitrations (ArbitrationNation 2019).

In 2019, the Second Circuit held that a company's employees who agreed to mandatory arbitration under AAA rules could be bound by the outcome of class arbitration even if they did not individually opt into the class. The court said, "Although the absent class members have not affirmatively opted in to this arbitration proceeding, by signing the RESOLVE Agreement, they consented to the arbitrator's authority to decide the threshold question of whether the agreement permits class arbitration." Jock v. Sterling Jewelers Inc., 942 F.3d 617 (2d Cir. 2019). One observer commented: "Whoa! This holding gives some serious teeth to class arbitrability determinations by an arbitrator. It also raises profound due process issues[] … that SCOTUS has articulated with class arbitrations." Henry Allen Blair, More on Class Arbitrability, Even Though It's So Last Decade (ArbitrationNation.com 2020).

b. The arbitral tribunal will have no power to decide a claim that the agreement allegedly allows arbitration in any manner other than by a claimant acting solely in an individual capacity.

Comment: This "no power" language is intended to avoid a Supreme Court holding that if an arbitration agreement ***delegates** to the arbitrator* the decision whether class arbitration is allowed, then **the arbitrator's decision about class-action arbitrability cannot be overruled by a cour***t* except on very-limited grounds. *See* Oxford Health Plans LLC v. Sutter, 569 U.S. 564 (2013) (affirming denial of motion to vacate arbitrator's approval of class action); see also § 7.05.1.d, which otherwise delegates arbitrability decisions to the arbitral tribunal.

c. *Location of the arbitration:* The arbitration hearing is to be conducted in a location determined in accordance with the arbitration rules; that location is to be considered the "seat" of the arbitration.

Comment: The choice of arbitration location — sometimes referred to as the "seat" of the arbitration — can have **significant procedural implications**. For example, the choice of location might determine the arbitral law that will govern the arbitration proceedings themselves. Suppose that an arbitration agreement specified that the arbitral location would be (say) London. Suppose also that the agreement did not specify an arbitral law. In that situation, *procedurally* the arbitration proceedings might well be governed by English arbitration law. That would be true even if the agreement's governing-law provision did specify a 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).

(The arbitration rules might well specify how to determine the arbitral location in the absence of the parties' agreement to a particular location.)

d. *Arbitration administrat*❑

1. The arbitration is to be administered by the American Arbitration Association.

Comment: 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. (*Disclosure*: The author is an arbitrator on the AAA's commercial panel.) Among the **reasons** for preferring administered arbitration:

– **Administrative 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) (paywalled).

– 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).

2. If no administrator designated in this Rule or elsewhere in the Contract is willing or able to serve in that role, and the parties do not agree on another administrator, then the arbitral tribunal is to administer the arbitration.

> Comment: This is another 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.

§ 7.05.5. Notice of court action (in arbitral language)

If you file an action, in any forum, seeking (i) to confirm or enforce an arbitration award, or (ii) to vacate an award in whole or in part, then you must cause notice (§ 6.12) to be promptly given to the other party — in the arbitral language — that the action has been filed. (An actually-received or -refused written notification, in the arbitral language, from an arbitration administrator will suffice for this purpose.)

> Comment: Imagine being a *non*-Chinese company and receiving a document in the mail — in Mandarin — which, when finally translated, turns out to be a notice of an arbitration claim filed by a Chinese manufacturer. In one such situation, an American company **missed a crucial deadline** and proceeded to lose a case in arbitration, as discussed above (§ 7.05.2.a)

§ 7.05.6. Preliminary relief

a. In case of doubt: Any party to an arbitration may seek temporary, interim, or preliminary injunctive relief, in accordance with applicable law, from one or more of (i) a court or other tribunal of competent jurisdiction; and/or (ii) the arbitral tribunal.

> Comment: While some arbitration rules expressly provide for preliminary relief, e.g., Rule R-37 of the AAA's Commercial Arbitration Rules, this Option makes the parties' agreement explicit.

b. A party's seeking of such relief in court (or other forum), instead of from the arbitral tribunal, will not in itself waive that party's right to arbitrate.

> Comment: This term seeks to avoid the contrary result that would apply under some holdings; see Grigsby & Associates Inc. v. M Securities Investment, 664 F.3d 1350, 1353-54 (11th Cir. 2011).

c. If a party moves or otherwise petitions for such relief in a court or other non-arbitral tribunal, the arbitrability of the motion or other petition is to be decided by that tribunal.

> Comment: This express carve-out (from the broad delegation of authority in § 7.05.1.d) attempts to avoid the uncertainty that required a trip to the Supreme Court in *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019), *on remand,* 935 F.3d 274 (5th Cir. 2019), where on remand the appeals court noted that "the arbitration clause [requiring arbitration under AAA rules] creates a carve-out for 'actions seeking injunctive relief.' It does not limit the exclusion to 'actions seeking *only* injunctive relief,' nor 'actions for injunction in aid of an arbitrator's award.' Nor does it limit the carve-out to *claims* for injunctive relief." *Id.*, 935 F.3d at 283 (emphasis original).

§ 7.05.7. Confidentiality of arbitration

a. *Obligations:* The obligated parties described in subdivision b must, at all times:

1. maintain in confidence all non-public information disclosed, in the course of the arbitration proceedings, by any party to the arbitration;

2. use any such information only for purposes of the arbitration and any related court proceedings; and

3. not disclose any such information to any third party, except to the minimum extent authorized or required by: (i) the arbitration rules; (ii) the disclosing party; or (iii) applicable law.

> Comment: Companies often regard confidentiality as one of the major benefits of arbitration in comparison to litigation.

b. *Obligated parties:* This section obligates the following:

1. each party to the dispute;
2. each member of the arbitral tribunal; and
3. each other participant in the arbitration proceedings.

c. *Written agreement required:* Each person referred to in subdivision b must agree in writing (and, if an organization, must cause its employees and others under its direction to agree in writing) to comply with the requirements of this section.

d. *Effect of breach:* A breach of this section will not affect the enforceability of any arbitration award.

> Comment: This subdivision is a roadblock provision, intended to cut off any contrary argument by creative counsel.

§ 7.05.8. Award conformance to law and Agreement

a. The arbitral tribunal has the power only to award such relief as would meet the qualifications of both of subdivisions b and c.

> Comment: The "has the power only to award such relief" language has in mind that, under the (U.S.) Federal Arbitration Act, one of the **very few grounds** allowing a federal court to vacate an arbitration award is that "the arbitrators exceeded their powers …." 9 U.S.C. § 10(a)(4). It's unclear whether such an effort would be successful, as discussed in the commentary to § 7.05.12 (enhanced appeal option).

b. Any award by the arbitral tribunal must be of a kind that a court could award if the dispute were being litigated instead of being arbitrated, taking into account the applicable law — including, without limitation, any applicable statute of limitation or of repose.

> Comment: See generally Liz Kramer, Don't Find Yourself SOL: Know Whether the Statute of Limitations Applies to Your Arbitration (ArbitrationNation.com 2016).

c. All relief awarded by the arbitral tribunal must also be consistent with the Contract, including, without limitation:

1. any agreed limitation of liability — and that term includes, without limitation, exclusions of remedies; and
2. any shortened limitation period stated in the Contract.

> ALTERNATIVE: "The arbitral tribunal may grant any remedy or relief that the tribunal deems just and equitable and within the scope of this Agreement." This alternative is adapted from Rule R-47(a) of the American Arbitration Association's Commercial Arbitration Rules (2013); it falls into the category of the arbitral tribunal acting as *amiable compositeur* or *ex aequo et bono*, as discussed in more detail below.
>
> Background: Under the law and the arbitration rules, **an arbitrator might have the power to decide a case as she sees fit, in accordance with her own notions of fairness**; the arbitrator need not stay within the strict bounds of either the agreement or the law, unless the agreement or the arbitration rules say otherwise. (The legalese names for this concept are *amiable compositeur* and *ex aequo et bono*.)
>
> This arbitrator freedom sometimes causes parties **to 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 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 that 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.

For a discussion of arbitrators' broad authority, see,, e.g., 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); LG Electronics, Inc. v. Interdigital Communications, Inc., 98 A.3d 135 143-44 & n.4 (Del. Ch. 2014) (extensively-annotated discussion), aff'd, 114 A.3d 1246 (Del. 2015).

Note **that 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 act 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.

§ 7.05.9. Attorney fees for defending against unsuccessful arbitrability challenge

a. This section will apply if you unsuccessfully challenge the arbitrability of a dispute in court, including without limitation:

1. by opposing a motion to compel arbitration;
2. by moving to enjoin arbitration; and/or
3. by opposing confirmation of an award on grounds that the dispute was not arbitrable.

> Comment: It's not unheard of for parties in high-stakes arbitration to challenge arbitrability in one of the ways listed above.

b. As the unsuccessful challenger, you must reimburse the other party for the reasonable attorney fees and related expenses it incurred in connection with your arbitrability challenge, in both trial- and appellate courts.

> Comment: The idea here is to give each party some financial downside (some "skin in the game") that should cause it to think seriously about whether to challenge arbitrability.

c. The amount that you owe under this section is to be determined by the court, not by the arbitral tribunal.

> Comment: Who decides issues like this is sometimes the subject of satellite litigation, which increases expense and delay.

§ 7.05.10. Attorney fees for award confirmation

a. This section applies if you fail to comply with an award and another party successfully goes to court to obtain judicial confirmation or -enforcement of the arbitration award.

b. You must pay, or reimburse the successful party for, the successful party's reasonable attorney fees, related expenses, and costs of court and/or arbitration, that the successful party incurred at all stages of the confirmation- or enforcement proceedings in both trial- and appellate courts (in addition to any other relief granted to the successful party).

> Comment: This section is intended to avoid the result in Diathegen, LLC v. Phyton Biotech, Inc., No. 04-14-00267-CV (Tex. App.–San Antonio Aug. 26, 2015): In that case, an appeals court affirmed a trial court's refusal to award attorney fees incurred in post-arbitration confirmation proceedings.

§ 7.05.11. Jury trial WAIVED for arbitrable disputes

In case of doubt: By agreeing to arbitration, you knowingly, voluntarily, intentionally, permanently, and irrevocably **WAIVE** the right to have the case heard in court, as well any right you might have to a jury trial, except to the limited extent (if any) that the Contract expressly states otherwise.

> Comment: A New Jersey supreme court decision held that an arbitration provision was unenforceable because it did not expressly waive jury trial; to the surprise of many observers, the Supreme Court denied *certiorari* (that is, the Court declined to hear the losing side's appeal). *See* Atalese v. US Legal Serv. Group, LLP, 219 N.J. 430 99 A.3d 306 (2014).
>
> **BUT**: For a contrary result, see MMAWC, LLC v. Zion Wood Obi Wan Trust, 135 Nev. Adv. Op. 38, 448 P.3d 568 (2019), where the Nevada supreme court held that a state statute imposing requirements on arbitration agreements was preempted.
>
> Advance waivers of jury trials are unenforceable by law in California and Georgia (§ 7.04) , but those laws likely would be preempted in cases where the Federal Arbitration Act applied (0).

§ 7.05.12. Option for Enhanced Appeal of Award

a. *Applicability:* This Option applies only if the Contract clearly so states.

b. *Limits on arbitrator power:* The arbitral tribunal's powers do not include the power to render an award that:

1. is based on errors of law or legal reasoning that would be grounds for reversal if made by a judge in a civil trial to the court (sometimes known as a "bench trial"); or

2. is based on evidence that would not satisfy the requirements of law in such a trial; or

3. grants relief prohibited by the Contract or not available under applicable law.

> Comment: The rationale of subdivision a is that **the parties bargained**, not just for the arbitrator's interpretation of the agreement and the law, but **for the arbitrator's *legally correct* interpretation** and application.
>
> The "no power" language attempts to trigger one of the limited *federal* statutory grounds for vacating an award, namely that "the arbitrators exceeded their powers …." That language represents an effort to "write around" the Supreme Court's *Hall Street* decision — but it's unclear whether such an effort would be successful, as discussed in the additional commentary (**Error! Reference source not found.**).

c. *Enhanced judicial review:* IF: A court of competent jurisdiction finds that an arbitration award is based, in whole or in part, on one or more of the factors enumerated in subdivision b; THEN: The parties desire that, upon application of either party, the award is to be vacated on grounds that (without limitation) the arbitral tribunal thereby exceeded its agreed powers.

d. *Jettison:* If this Option is found to be unenforceable, the parties' agreement to arbitrate may be rescinded as provided in the Arbitration Jettison Option (§ 7.05.13).

> Comment: This subdivision is informed by Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp., 320 S.W.3d 252 (Tenn. 2010). In that case, the state's supreme court held that an agreement to arbitrate in a contract must be rescinded for mutual mistake in view of that court's holding that the agreement's expansion of the scope of judicial review was invalid.

§ 7.05.13. Arbitration Jettison Option

a. *Applicability:* This Option applies only if the following prerequisites are satisfied:

1. the Contract clearly states that a particular provision of their agreement to arbitrate is subject to this Option; and:

2. A court of competent jurisdiction holds that the provision is unenforceable; such a holding must be in a final judgment from which no further appeal is taken or possible (a "*Final-Final*" judgment).

b. *Unilateral rescission:* Either party may, by notice to the other party and to the court, unilaterally rescind the parties' arbitration agreement and thereby automatically vacate any arbitration award. The notice of rescission must be effective no later than five court days (i.e., days on which the court is open for routine business) after the judgment becomes Final-Final.

> Comment: The term "court days" is defined here because (for example) by statute, "[a]ll courts of the United States shall be deemed always open for the purpose of filing proper papers, issuing and returning process, and making motions and orders." 28 U.S.C. § 452.

c. *Tolling of statute of limitations:* If a party exercises this rescission right, then any applicable statute of limitation or -repose is to be deemed to have been retroactively tolled beginning with the date on which the demand for arbitration was made and ending five court days after the effective date of the notice of rescission.

> Comment: This should preclude a party from escaping liability merely because the arbitration agreement was rescinded after an award was entered.

§ 7.05.14. Survival of arbitration provisions

The provisions of an agreement relating to arbitration are intended to survive any termination or expiration of an agreement or of any one or more rights or obligations under an agreement.

§ 7.05.15. Additional commentary

§ 7.05.16. Key takeaways

Here are some key general takeaways about arbitration:

– **Arbitration is generally binding** — this is in contrast to mediation, which generally is nonbinding.

– **Arbitration is heavily favored** in U.S. jurisprudence when agreed to by the parties. [XXX FILL IN CITE]

– Arbitration is especially popular in international contracts, because, **by treaty** (the New York Convention), enforcement of foreign arbitration awards — for example, by getting law-enforcement authorities to seize the defendant's assets — is very often easier than enforcement of foreign court judgments.

– Arbitration proceedings can be kept **confidential** if the parties so agree — this is another reason for the popularity of arbitration with many businesses.

– **Arbitration is not necessarily a better deal for parties than litigation**, mainly because trial counsel, accustomed to rolling along in the same old greased grooves, and arbitrators who are attorneys, are comfortable with familiar rules of civil procedure; moreover, arbitrators, who generally want to get hired again, can be reluctant to hold trial counsel's feet to the fire to streamline proceedings. *See generally, e.g.*, Thomas J. Stipanowich, Arbitration: The New Litigation, 2010 Ill. L. Rev. 1, 12-13. For one distinguished federal trial judge's view, see CellInfo, LLC v. Am. Tower Corp., 352 F. Supp. 3d 127, 135 (D. Mass. 2018), where Judge William Young tees off against where arbitration has gotten to:

> The litigation costs *[of arbitration and litigation]* will be roughly equivalent, though the start-up costs of arbitration are greater.
>
> So long as one party wants speed, the Massachusetts federal courts are markedly faster, 5-8 months start to finish.
>
> In arbitration, CellInfo and American Tower can cloak themselves in secrecy; in federal court they cannot.
>
> At the conclusion of arbitration, the parties will receive an award but no explanation and will have virtually no appellate rights.
>
> At the end of a federal trial the parties will get a thorough written decision and award.
>
> Each will have full rights to appeal to one of the finest appellate courts in America.
>
> Which course is better? You be the judge.

Id. at 137-38 (extra paragraphing added).

§ 7.05.16–1 Legal restrictions on arbitration?

By law, not all arbitration provisions will necessarily be enforced by U.S. courts. For example:

– The Dodd-Frank Act prohibits mandatory arbitration of Sarbanes-Oxley Act **"whistleblower" claims**. See, 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 federal 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).

– **U.S. 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 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 generally 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.

– Federal regulations governing **long-term care facilities** (e.g., nursing homes) require arbitration agreements to conform to transparency requirements. See 84 FR 34718 (Jul. 18, 2019), which revised 42 C.F.R. § 483.70(n) (the revisions are not yet in the CFR).

The U.S. Equal Employment Opportunity Commission formerly took the position that it was against public policy for an employer to require employees to agree to arbitration before a dispute had arisen; . In 2019, the EEOC retracted that position.

§ 7.05.16–2 *State-law* restrictions on arbitration might be preempted

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 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 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.

Starting in 2020, new section 432.6 of the California Labor Code purports to prohibit most employers from requiring employees to agree to arbitration as a condition of employment. Whether that prohibition will survive federal preemption has yet to be determined; see, e.g., Benjamin Ebbink and James McDonald, Jr., New California Law Prohibits Most Mandatory Arbitration Agreements—For Now (Oct. 2019); James McDonald, Jr., Business Groups Bring Legal Challenge to California's Prohibition on Mandatory Arbitration Agreements (Dec. 2019).

§ 7.05.16–3 Arbitration confidentiality?

Arbitration proceedings might not be confidential unless the parties expressly so agreed. The arbitration rules, however, likely will include more-detailed confidentiality provisions, which would likely be deemed incorporated by reference into the arbitration agreement. For various arbitration rules on this point, see Claude R. Thomson & Annie M. K. Finn, Confidentiality in Arbitration …, Dispute Resolution Journal, May-Jul 2007.

In addition, the law might independently require confidentiality. For example, English law implies a duty of confidentiality in arbitration proceedings, with sanctions for violation — but confidentiality might be lost in subsequent court proceedings. See, e.g., Liz Tout, Arbitration exposed? Recent cases remind us that parties cannot assume arbitration awards will remain confidential (Dentons.com 2017).

And of course the substantive law (e.g., privacy law) might independently impose a duty of confidentiality because of the nature of the dispute.

§ 7.05.16–4 Be sure arbitration-agreement *signatures* can be satisfactorily proved up

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 order compelling 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).

§ 7.05.16–5 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).

Employers should also see Kacey Riccomini and Art Sibergeld, 23 tips for drafting employment arbitration agreements (JDSupra 2019), https://perma.cc/ARW7-T864.

§ 7.05.16–6 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) (emphasis added). 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.

§ 7.05.16–7 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 Option (§ 7.14.4–2).

§ 7.05.16–8 A broad arbitration provision coupled with a narrow choice of law provision could spell trouble

See XXXX 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.

§ 7.05.16–9 A one-way arbitration clause might be vulnerable to challenge

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 an 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. (In the present author's view, the dissent in that case arguably has the stronger position.)

§ 7.05.16–10 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).

§ 7.05.16–11 Enhanced judicial review is not available if the Federal Arbitration Act is the only governing law

In Hall Street Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576, 128 S. Ct. 1396 (2008), the Supreme Court held that, **when the sole authority for an arbitration proceeding is the Federal Arbitration Act, the courts may not entertain an appeal of the award except on the limited, misconduct-based grounds provided in section 10 of that statute.** In an arbitration proceeding under the Federal Arbitration Act, however, it likely will be difficult to persuade a reviewing court that the arbitrator exceeded his or her powers. As the U.S. Supreme Court explained in a later case:

> A party seeking relief under *[§ 10(a)(4) of the Act]* bears a heavy burden. It is not enough to show that the arbitrator committed an error — or even a serious error.
>
> **Because the parties bargained for the arbitrator's construction of their agreement**, an arbitral decision even arguably construing or applying the contract must stand, regardless of a court's view of its (de)merits.
>
> Only if the arbitrator acts outside the scope of his contractually delegated authority — issuing an award that simply reflects his own notions of

> economic justice rather than drawing its essence from the contract — may a court overturn his determination.
>
> So **the sole question for us** is whether the arbitrator (even arguably) interpreted the parties' contract, not whether he got its meaning right or wrong.

Oxford Health Plans LLC v. Sutter, 569 U.S. 564, 133 S. Ct. 2064, 2068 (2013) (citations, internal quotation marks, and alteration marks omitted; emphasis and extra paragraphing added).

Drafters can keep in mind another possibility for enhanced appellate review:

– In its Hall Street decision, **the Court expressly left open the possibility that enhanced review might be available under some other authority**, such as state law or (in the case of court-annexed arbitrations) a court's inherent power to manage its docket.

– Subsequently, **both the California and Texas supreme courts ruled** that, in proceedings under the arbitration acts of their respective states, the parties were free to agree to enhanced judicial review — see Cable Connection, Inc. v. DIRECTV, Inc., 44 Cal.4th 1334, 82 Cal. Rptr.3d 229, 190 P.3d 586 (2008) (reversing and remanding reversal of district court's vacating of arbitration award); Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84 (Tex. 2011) (reversing and remanding confirmation of arbitration award that failed to address losing party's allegation that arbitrator did not comply with law as required by arbitration agreement).

– **In contrast, the Tennessee supreme court reached the opposite conclusion**; the court held that the arbitration agreement's expansion of the scope of judicial review was invalid. See Pugh's Lawn Landscape Co. v. Jaycon Dev. Corp., 320 S.W.3d 252 (Tenn. 2010) (vacating judgment confirming arbitrator's award).

– **The New Jersey arbitration statute** provides that "nothing in this act shall preclude the parties from expanding the scope of judicial review of an [arbitration] award by expressly providing for such expansion in a record." N.J. Stat. Ann. § 2A:23B-4(c); see also Hogoboom v. Hogoboom, 924 A.2d 602, 606, 393 N.J. Super. 509 (App. Div. 2007) (explaining history of expanded review statute and holding that initial review must be by trial court, not appellate court). (Hat tip: arbitrator Laura Kaster.)

§ 7.05.16–12 Enhanced judicial review might require express reference to a congenial arbitral law

In BNSF R.R. Co. v. Alstom Transp., Inc., BNSF lost an arbitration; on appeal it claimed that the arbitration panel had "completely botched" certain issues. The Fifth Circuit held that under Oxford Health Plans, the railroad was stuck with the arbitration panel's interpretation of the relevant contract, even if that interpretation was arguably incorrect. The Fifth Circuit rejected BNSF's contention that the court should engage in more-searching review of the award under either the Texas or Illinois arbitration acts. The court explained:

> In *Hall [Street]*, the Supreme Court noted that parties may obtain more searching review of arbitration decisions by stipulating in the arbitration agreement that state statutes or common law rules apply. *Action* is consistent with Hall. *Action* simply states that the FAA provides the default standard of review, and that parties must unambiguously express their agreement to non-FAA standards to obtain more searching review.
>
> **Because an agreement does not refer** to the TAA, IAA, or any other body of law offering a competing standard of review, we hold that the FAA's standard of review controls.

BNSF R.R. Co. v. Alston Transp., Inc., 777 F.3d 785, 790 (5th Cir. 2015) (vacating district court's vacatur of arbitration award and remanding with instructions to reinstate award; citations omitted, extra paragraphing added), citing Action Indus., Inc. v. U.S. Fid. & Guar. Co., 358 F.3d 337, 341 (5th Cir. 2004).

§ 7.05.17. Playbook terms [opt-in]

The following terms apply only to the extent, if any, that the Contract clearly so states.

§ 7.05.17–1 Arbitration Punitive *Damages* Prohibition Option

The arbitral tribunal will have no power to award punitive damages, exemplary damages, multiple (e.g., treble) damages, or similar relief.

> Comment: The "no power" language is keyed to the [U.S.] Federal Arbitration Act, 9 U.S.C. § 10(a)(4), discussed in the additional commentary (**Error! Reference source not found.**).

This prohibition of punitive damages is phrased without the qualifier, "to the maximum extent permitted by law"; **otherwise, the prohibition might be disregarded**, as happened in Stark v. Sandberg, Phoenix & von Gontard, P.C., 381 F.3d 793 (8th Cir. 2004).

Portions of this prohibition are adapted from a provision at issue in Wells Fargo Bank, N.A. v. WMR e-PIN, LLC, 653 F.3d 702 (8th Cir. 2011) (affirming confirmation of award, albeit for procedural reasons).

§ 7.05.17–2 Arbitration Punitive *Sanctions* Prohibition Option

The arbitral tribunal will have no power to order punitive sanctions against a party, in respect of an issue (or multiple issues), in the form of (i) preclusion of evidence or defense concerning the issue; or (ii) entry of judgment concerning the issue.

Comment: This prohibition seeks to avoid the result in Seagate Technology, LLC v. Western Digital Corp., 854 N.W.2d 750 (Minn. 2014). In that case, the Minnesota supreme court upheld an award in excess of **$600 million** — not because the claimant had proved its case, but because the arbitrator barred the respondent from contesting the claimant's assertion on one point, as a punitive sanction for fabrication of evidence.

§ 7.05.17–3 Arbitration Severability Option

a. This Option applies — except as provided in the Arbitration Jettison Option — if a court of competent jurisdiction determines, in a decision from which no further appeal is taken or possible, that one or more provisions of the parties' agreement to arbitrate is void, invalid, or otherwise unenforceable for any reason.

b. The unenforceable provision is severable from the remainder of the agreement to arbitrate; the remainder of the agreement to arbitrate is to be enforced.

> Comment: See generally Liz Kramer, Severability Squared: Can Invalid Provisions Within an Arbitration Agreement Be Severed? (ArbitrationNation.com 2011).

§ 7.06. Corroboration Rule

a. *Applicability:* This Rule will apply whenever the Contract calls for a factual assertion to be supported by corroborating evidence.

b. *Required corroboration:* Whether sufficient corroboration has been provided is to be governed by a rule of reason:

1. Each case must be decided on its own facts; hard and fast rules will not necessarily apply.
2. Not every detail need be independently and conclusively supported by corroborating evidence.

> Comment: Some Tango Terms 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).
>
> 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).

As to how much corroborating evidence is required: The requirement language above is adapted from the *TransWeb* opinion, 812 F.3d at 1302.

§ 7.07. Fraud Proof Rule [opt out]

§ 7.07.1. The Rule

a. *Required elements to be proved:* Unless a party timely opts out in accordance with § 1.03, any assertion that a person committed or engaged in fraud must be established by showing — in addition to any other elements required by law — one or both of the following:

1. that the person made an untrue statement of a material fact with knowledge of the statement's untruth; or

2. that the person omitted a material fact with knowledge that the material fact was necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

Comment: The specific proof requirements are adapted from the famous definition in Rule 10b-5 promulgated by the U.S. Securities and Exchange Commission; see the Wikipedia article "Rule 10b-5."

Other elements required by law: See the additional commentary at **Error! Reference source not found. Error! Reference source not found.**.

> Purpose: Cries of "fraud!!!" are often seen in litigation, whether or not justified. This Requirement sets out standard ground rules, based on settled law in many jurisdictions, for such claims, so that parties will have a better idea, going in, what they must prove if they wish to make a fraud claim.

b. *Standard of proof:* Each element of proof listed in subdivision a must be supported by clear and convincing evidence (§ 9.14) that includes reasonable corroboration (§ 7.05) of any self-interested statements.

> Comment: The requirement of proof by clear and convincing evidence is based on the widely- (but not universally-) applied standard in U.S. law for fraud claims. See, e.g., New York Pattern Jury Instruction 3:20 (not available on-line, apparently).

c. *Broad applicability:* This Requirement applies, without limitation:

1. to any claim of fraud made in an Agreement-Related Dispute (§ 9.03); and
2. whether the claim purports to arise under contract law, tort law, strict liability law, statutory law, or otherwise.

d. *WAIVER of other fraud claims:* In case of doubt: Each party **WAIVES** any claim of fraud that is not proved in accordance with this Requirement.

[Additional commentary follows]

§ 7.07.2. Comment: "They lied!" is a go-to phrase for litigation counsel

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 — because "they lied!" is the trial lawyer's weapon of choice. 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."

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. "They lied!" is usually an easier sell in court: Litigation counsel know that jurors typically won't understand whatever technology is involved. (In fact, the customer's lawyers might well try to exclude any prospective juror who knows even a little about the technology.) That can make it hard for customers to win such cases on garden-variety 'technical' grounds such as breach of contract or breach of warranty. Judges and jurors absolutely do get it, on the other hand, when it appears someone lied or cheated.

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 against EDS 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, it seems to me, 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.

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.

§ 7.07.3. The threat of punitive damages and rescission raises the stakes

If a customer's lawyers can prove fraud by the 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 punitive damages ordinarily aren't available in 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.

§ 7.07.4. 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.

§ 7.07.5. 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).

§ 7.08. Baseball Arbitration Rule [opt out]

Comment: Baseball arbitration (a.k.a. "last-offer arbitration" or "pendulum arbitration") **promotes settlement** by forcing the decision maker to choose between the parties' competing proposed resolutions. That constraint forces each party, in submitting its proposed resolution(s) for the issue, to think hard about: • how the decision maker sees the case, as opposed to how convinced the party is of the rightness of its own view; and • the risk that the decision maker might regard the other party's proposed resolution as being closer to the "correct" one — in golf terms, "closest to the pin" — and thus the risk that the decision maker will be forced to adopt the other party's proposed resolution. As one commentator put it, baseball arbitration is "**designed to produce a settlement, not a verdict**." Thomas Gorman, The Arbitration Process – the Basics, in Baseball Prospectus (2005) (http://perma.cc/CZR4-9XC7) (emphasis added).

§ 7.08.1. The Rule

a. *When this Rule applies:* Unless a party timely opts out in accordance with § 1.03, this Rule will apply to any Agreement-

Related Dispute (§ 9.03) that is to be decided by a tribunal (§ 9.57), where the dispute falls into of the following categories:

1. any dispute about what a party must do (or not do) in the future — as a non-limiting example, a dispute about just what action a party must take, but has not yet taken, to satisfy a reasonableness requirement;

2. any dispute about which number is the right one — as a non-limiting example, a dispute about the amount of damages owed for breach of the Contract; and

   Comment: Disputes about numbers are the quintessential type of dispute that is appropriate for last-offer arbitration.

3. any other dispute that the Contract states is to be resolved by “baseball arbitration” or “last-offer arbitration” or similar terminology.

b. *Successive rounds of party proposals:* The parties are to do two successive rounds of exchanging written proposed resolutions to the dispute, copying the tribunal. Each party may include, in any proposed resolution, a brief explanation why the tribunal should select that resolution.

Comment: The idea behind doing two rounds of proposed resolutions is to nudge each party into assessing whether the other party’s proposal might look better *to the tribunal*, which can promote settlement.

c. *Tribunal commentary:* The tribunal, in its sole discretion but no more than once, may advise the parties that in the tribunal's view, none of the then-current proposed resolutions should be selected (preferably, explaining why). If the tribunal does advise the parties of its views, the tribunal is to allow the parties a reasonable time to submit — and confer about — revised proposed resolutions if they so choose.

> Comment: Disclosure of the tribunal's impressions can likely help the parties reassess their settlement positions and thus formulate their next proposals for resolution of the dispute.
>
> Note: The ABA/AAA code of ethics for arbitration expressly contemplates that arbitrators will "comment on the law or evidence …. These activities are integral parts of an arbitration." Commentary, Canon I of the ABA/AAA Code of Ethics for Arbitrators in Commercial Disputes (https://perma.cc/Y6TX-M97V).

d. *Tribunal's selection of one proposal:* If the parties' exchange of proposed resolutions does not lead to settlement, then:

1. The tribunal is to select, as the resolution of the dispute, without modification, the one, party-proposed resolution that the tribunal regards as most-closely matching the resolution that the tribunal would adopt had the parties not agreed to use this Rule.

> Comment: One of the perceived advantages of baseball-style decision-making is that, because the tribunal must choose between the parties' proposals, it follows that the tribunal can neither "go rogue," as is sometimes a concern about arbitrators (see § 7.05.8 and its commentary) nor "split the baby."
>
> Language choice: The "is to select" language is used, instead of "must select," in deference to the fact that the tribunal might be a court (which would not be bound by the parties' agreement) and not an arbitration panel.

e. This Rule does not grant the tribunal any other power to decide the parties' dispute.

> Comment: This language is intended to trigger one of the (very few) grounds under which a U.S. court will ordinarily set aside an arbitration award under the Federal Arbitration Act, namely that the arbitrators "exceeded their powers …." 9 U.S.C. § 10(a)(4).

f. *Binding effect of tribunal's selection:* The tribunal's decision will be binding unless otherwise agreed.

> Comment: If a "baseball" provision is being used in arbitration, as opposed to litigation, the parties' arbitration agreement might provide that the resulting issue determination does not immediately become binding, so as to give the other party an opportunity to take another bite at the apple in court; see XXX.

§ 7.08.2. Additional commentary

The success of baseball arbitration has been demonstrated in real life:

– In 2018's baseball salary arbitration season, fully **179 out of 201 arbitration-eligible players** reached a settlement with their teams without having to go to hearing; in 2019 the settlement rate was **187 out of 201 players**. See Arbitration Tracker 2018 and 2019, https://www.mlbtraderumors.com/arbtracker2018 and https://www.mlbtraderumors.com/arbtracker2019.

Anecdotally, two personal experiences of the author seem relevant:

– A tech lawyer friend in Silicon Valley once recounted how a client of hers got into a dispute concerning a contract that she had drafted for the client. She told the client's CEO that the contract required baseball-style arbitration of the dispute; she and explained what that entailed. The CEO exploded: "[Expletive], that means I have to be *reasonable*." (The parties settled the dispute.)

– Some years ago, at the author's urging, three different litigation clients and their adversaries, in three different lawsuits, agreed to baseball-style arbitration; in each case, the parties promptly settled. The author had the impression that, after agreeing to this type of arbitration, the business people on each side looked at each other and said, in effect, *hold on — we're not that far apart; we don't need to pay the lawyers and the arbitrator for this*.

§ 7.09. Attorney Fees Prevailing Party Rule

§ 7.09.1. The Rule

a. *Right to recovery:* In any proceeding (defined in subdivision c), the prevailing party, if any, may recover its Attorney Fees (defined in subdivision b) from the other party, in addition to any other relief that may be granted.

> Comment: This Option negates the "American Rule" in which each party to a litigation pays 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 and discussing American Rule), *citing* Baker Botts LLP v. ASARCO LLC, 576 U.S. __, 135 S. Ct. 2158 (2015).
>
> The prevailing-party rule is sometimes called the "loser pays" rule, or the "everywhere but America" rule. See generally the additional commentary at § 7.09.2.

b. *Definition:* The term "*Attorney Fees*" refers to some or all of the following as actually incurred in a "proceeding" as defined in subdivision c:

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 such individuals and/or firms in connection with the proceeding, such as (without limitation) printing, photocopying, duplicating, and shipping; and

3. costs of the litigation, arbitration, or other proceeding, such as (without limitation) costs of court; administration fees charged by an arbitration provider; and arbitrator fees and expenses.

> Comment: The text of this definition 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).
>
> The term "Attorney Fees" is most-often rendered as *attorneys' fees* or *attorney's fees*; this manual omits the apostrophe, following the suggestion of eminent lexicographer Bryan Garner.

c. The term "proceeding" in subdivision b refers to (without limitation) a hearing or motion in a court action or arbitration; an appeal at any level; or other contested proceeding in the action or arbitration — including without limitation any proceeding to recover Attorney Fees under the Contract or otherwise — that arises out of or relates to the Contract or any transaction or relationship resulting from it.

§ 7.09.2. ADDITIONAL COMMENTARY: Introduction

Some view a prevailing-party allocation of attorney fees as fundamentally more fair than the so-called American Rule under which each party must pay its own attorney fees: 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.

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.

§ 7.09.3. What constitutes a *prevailing* party?

Some courts have held that, if the putatively winning side did not receive any monetary damages or equitable relief, then it will not be considered the "prevailing party" for purposes of an attorney fee award. 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 contract drafters should specify what they mean by "prevailing party," but few drafters seem to do so.

§ 7.09.4. Special case: The "Texas rule" for attorney fees

If a party negotiating a contract thinks it might be more likely to be the defendant in a dispute than the plaintiff, AND Texas law will apply, then that party it might want to affirmatively include an “American Rule” provision requiring each party to pay its own lawyers (§ 7.13). That’s because 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 rule 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).

§ 7.09.5. Special case — 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 also states that attorney fees under the section cannot be waived.

§ 7.09.6. 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).

§ 7.09.7. 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).

§ 7.10. Attorney Fees Motion Practice Rule [opt out]

a. *Purpose:* To provide parties with an incentive to amicably resolve any subsidiary- or ancillary dispute that is brought before a tribunal (§ 9.57) (each, a "*Motion*"), this Rule will apply UNLESS a party timely opts out in accordance with § 1.03.

> Comment: Much of the expense of litigation (and, to a lesser extent, of arbitration) comes from pre-trial motion practice; this Option tries to provide an incentive for the parties to avoid such motion practice.

b. In any Motion proceeding, the prevailing party is entitled to recover its Attorney Fees (defined in § 7.09.1.b) for the Motion — unless the tribunal, for good cause, rules otherwise.

c. A tribunal's decision not to award Attorney Fees under this Rule is final and non-appealable.

> Comment: This no-appeal provision is to reduce the chance of "satellite litigation" over attorney-fee demands in motion practice.

d. A party that pays Motion-related Attorney Fees may not recapture the payment as part of a later recovery of Attorney Fees for the overall action.

§ 7.11. Attorney Fees ADR Non-Participation Rule [opt out]

a. *What will trigger this Rule:* Unless a party timely opts out in accordance with § 1.03, this Rule will apply if a party (the "*non-participating party*") does any of the following things:

1. the non-participating party fails, upon written request by another party, to participate in efforts or proceedings required by a dispute resolution provision (defined in subdivision b); and/or

2. the non-participating party challenges the enforceability of a dispute resolution provision.

b. *Definition:* The term "*dispute resolution provision*" refers to any provision in the Contract requiring any of the following: • arbitration; • early neutral evaluation; • economical litigation agreement; • escalation of disputes; • forum selection; • jury-trial waiver;

• mediation; • minitrial to management; • service of process by courier.

c. *No recovery of attorney fees by non-participating party:* A non-participating party will not be entitled to recover its attorney fees or expenses, and each non-participating party hereby **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 Contract 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.

> Comment: This Option is modeled on a *mediation* provision in a standard California residential real-estate purchase agreement, which has been enforced 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); • 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.

d. *No limitation of other party's entitlement to relief:* In case of doubt, this Rule does not limit any other party's right to relief, if any, in respect of an action or omission by a non-participating party.

§ 7.12. Attorney Fees Serious Accusations Rule [opt out]

a. *What will trigger this* Rue*:* Unless a party timely opts out in accordance with § 1.03, this Rule will apply in any Agreement-Related Dispute, regardless of any other outcome in the dispute, if:

1. a party (the "*accuser*") makes an accusation within the scope of any of the Serious Accusation definition in subdivision b; but

2. in the final judgment in litigation or the 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 Contract.

In such a case, the accuser is referred to as an "*unsuccessful accuser*" and the accusation is referred to as an "*Unproved Serious Accusation*."

> Comment: This Rule is intended to discourage litigation counsel from larding up court pleadings with unsupported accusations of fraud, gross negligence, bad faith, breach of fiduciary duty, and the like, in the hope of unduly influencing a jury and/or gaining settlement leverage. For an example of what might well have been such a larded-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.

b. *Definition:* The term "*Serious Accusation*" refers to any assertion that one or more other individuals and/or organizations (each, an "*accused*") 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/or

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.

c. *Consequences:* The unsuccessful accuser:

1. must reimburse the accused for all of the accused's Attorney Fees (defined in § 7.09.1.b) incurred in the entire case (not merely in defending against the Unproved Serious Accusation), unless the tribunal determines otherwise for good reason supported by clear and convincing evidence;

2. may not 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 Contract and/or applicable law; and

3. 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 Unproved Serious Accusations in the case, over and above the accused's Attorney Fees.

Comment: This provision has in mind that if a party accuses another party of fraud, then that party should be made to have some serious "skin in the game." The underlying concept is inspired by a remark made many years ago by the author's then-law partner and longtime mentor, über-patent-litigator John F. Lynch. Back then, accused 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 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 Option doesn't (and can't) go quite that far. It does, though, provide parties and their counsel with an incentive to be cautious about making Serious Accusations.

d. *Severability:* The parties intend for any and all parts of this Rule to be severable from the Contract if found to be unenforceable for any reason.

§ 7.13. Attorney Fees American Rule [opt-in]

In any litigation, litigation, arbitration, or other arbitration, or other action arising out of or relating to the Contract or any transaction or relationship resulting from it, each party is to bear its own attorney fees and expenses.

Comment: This is the "default" practice in the U.S.; 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 and discussing American Rule), *citing* Baker Botts LLP v. ASARCO LLC, 576 U.S. __, 135 S. Ct. 2158 (2015).

Some parties might want to expressly adopt the American Rule in a contract where applicable law might have a loser-pays "prevailing party" feature — or where the "Texas rule" would give a prevailing contract *plaintiff,* but not a prevailing defendant, the right to recover fees (§ 7.09.4).

§ 7.14. Additional opt-in disagreement terms

§ 7.14.1. Bond Waiver Rule [opt-in]

CAUTION: Agreeing to this Rule might be a really bad idea for a party that might be hit with an injunction. That's because it might turn out (i) that the injunction should not have been granted, but (ii) the claimant that sought the wrongfully-granted injunction doesn't have the money to compensate the respondent for the resulting harm. In that situation, the respondent might never be able to recover damages for its wrongful harm.

a. This Rule addresses the situation in which:

1. a party (a "*claimant*") proves that it is entitled to injunctive relief or other equitable relief against another party (a "*respondent*") for breach or threatened breach of the Contract; but

2. under the law, the claimant is required to post a bond as a condition of obtaining the injunctive relief sought.

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(c); Tex. R. Civ. P. 684. Thomas E. Patterson, Handling the Business Emergency, ch.3 (American Bar Association 2009), excerpted at http://goo.gl/ak7Mt (books.google.com).

EXAMPLE: In a lawsuit over alleged breach of a noncompetition covenant, the Alabama supreme court rejected a $25,000 bond as being too low; the court noted case law from other jurisdictions saying, in essence, that trial courts should err on the side of setting too-high a bond rather than too-low a bond. *See* DeVos v. The Cunningham Group, LLC, No. 1180088, slip op. at 17-24 (Ala. Dec. 20, 2019). (reversing and remanding order denying motion to increase bond). Interestingly, the supreme court also directed the trial court to reexamine whether the noncompetition covenant was valid, and ordered that if the trial court did not do so within 30 days, then the injunction would automatically be dissolved. *See id*. at 25.

b. The respondent hereby **WAIVES** the bond requirement referred to in subdivision a.2.

Comment: See the caution at the beginning of this Rule.

§ 7.14.2. Contra Proferentem Waiver Rule [opt-in]

§ 7.14.2–1 The Rule

The parties do not desire for the *contra proferentem* principle of contract interpretation — under which ambiguities are to be construed "against the offeror" — to be used in interpreting their agreement; each party therefore **WAIVES** any argument in favor of such use.

§ 7.14.2–2 Comment: *Contra proferentem* only if all else fails

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.

NOTE: 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).

§ 7.14.2–3 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 circumstances might jeopardize the enforceability of the entire contract.

(Hat tip: Jonathan Ely, in a comment in a LinkedIn group discussion (group membership required).)

§ 7.14.2–4 Arguing *contra proferentem* might be a tough sell

In Song v. Iatarola, 83 N.E.3d 80, (Ind. App. 2017), one party 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).

§ 7.14.2–5 Related disclaimer: Prior dealings; usage in the trade

In cases of ambiguity, a court *might* look to the parties' prior dealings, and/or to usage of terms in the trade, to ascertain the parties' intent. It's not unheard of for contract forms to disclaim the use of such evidence — see, for example, 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."

But it often won't make much sense to preclude the use of prior dealings and usage in the trade to *explain* terms in a contract: 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.

§ 7.14.2–6 Review questions

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?[5]

§ 7.14.3. Equitable Relief Rule [opt-in]

§ 7.14.3–1 The Rule

a. *Definitions:* For purposes of this Option:

1. "*Injunctive relief*" refers, without limitation, to an order (by any tribunal) directing specific performance; 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*").

> Comment: "Claimant" is defined here as potentially being any party. This contrasts with some forms of contract (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.)

b. *Injunctive relief is available:* The claimant may obtain injunctive relief in accordance with the four-factor test restated by the (U.S.)

[5] Chances are that the court would rule in favor of Seller, because you (on behalf of Buyer) drafted the price-increase provision.

Supreme Court in eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391 (2006).

> Comment: Prospective claimants often ask for much-stronger language than this: They typically want a flat statement that the claimant is *entitled* to injunctive relief. Prospective respondents typically push back against such stronger language, because it could severely disadvantage them in litigation by waiving the normal requirement that the claimant affirmatively "prove up" its entitlement to relief.

c. *Stipulation of possible irreparable harm:* The respondent hereby acknowledges that some types of breach of the agreement by the respondent could result in irreparable harm to the claimant that would not be adequately compensable by monetary damages or other remedies at law.

> Comment: Claimants usually want a stronger version of this stipulation, in which the respondent concedes 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 — for example, cases involving misappropriation 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.
>
> A potential *claimant* should keep in mind that courts will not necessarily accept claims of irreparable harm that are grounded "in platitudes rather than evidence." Herb Reed Enters., LLC v. Fla. Entm't Mgmt., Inc., 736 F.3d 1239, 1250 (9th Cir. 2013), quoted in Greg Young Publishing, Inc., v. Zazzle, Inc., No. 18-55522, slip op. at 3 (9th Cir. Nov. 20, 2019) (district court did not abuse discretion in vacating its own permanent injunction) (unpublished).

§ 7.14.3–2 Comment: Stipulations to irreparable harm have been enforced

In a 2012 opinion, then-chancellor Strine of the Delaware chancery court (later chief justice of the state's supreme court) relied in part on a clause like this Rule 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).

In a similar vein, see Athene Life and Annuity Co. v. Am. Gen. Life Ins. Co., No. 2018-0244-SG, slip op. at part II-B-1 (Del. Ch. July 31, 2019), where the court refused to order specific performance: "The request for equitable relief through specific performance strikes me as entirely unnecessary to remedy the alleged breach." *Id.*, text accompanying n.63.

§ 7.14.4. Forum Selection Rule [opt-in]

§ 7.14.4–1 **The Rule**

a. *Applicability:* This Rule applies if the Contract specifies a choice of forum.

> CAUTION: A court might refuse to enforce a choice-of-forum provision if the choice conflicts with an important public policy of the forum jurisdiction; see the additional commentary at § 7.14.4–7.

b. Any dispute arising out of the Contract — if not required to be resolved by other means such as, for example, arbitration — may be heard in the court or courts having jurisdiction in the location specified in the Contract (each, an "*Agreed Forum*").

> Comment: The term "any dispute arising out of the agreement" is a relatively conservative wording. At the other extreme would be to have this section apply to all Agreement-Related Disputes, which is defined — very broadly — at § 9.03.

> CAUTION: Concerning the term *Agreed Forum*, 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 geographically that it extends into multiple counties; consequently, a reference to "the courts of the State of Texas having jurisdiction in Houston" would cover all of those counties.

c. If the Contract states that the Agreed Forum is exclusive, then no party will seek to transfer a dispute that is brought there under this section.

> Comment: 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 XXX.

§ 7.14.4–2 Additional commentary: Introduction

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). As one court explained:

> 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., 435 P.3d 518, 528-30 (Id. 2019).

§ 7.14.4–3 How broadly should a forum-selection provision apply?

In the author's view, it's not necessarily a good idea to agree in advance to a choice of forum that would apply to more than just actions "arising out of" this Agreement. Here's a hypothetical example, using an A-to-Z motif:

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.

§ 7.14.4–4 Have multiple, *territory-specific* Agreed Forums?

Some companies' boilerplate terms include territory-specific forum selections (and choice of law). For example, here's such a forum-selection provision 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.

§ 7.14.4–5 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.)

§ 7.14.4–6 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.)

§ 7.14.4–7 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).

§ 7.14.4–8 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.

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?

§ 7.14.4–9 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).

§ 7.14.4–10 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).

§ 7.14.4–11 Negotiation strategy: An *exclusive*-forum clause is a hand grenade that 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 situation, 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 auth❑ 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.

§ 7.14.4–12 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.

§ 7.14.4–13 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).

§ 7.14.5. Governing Law Rule [opt-in]

§ 7.14.5–1 The Rule

a. *Applicability:* This Option applies if the Contract specifies a governing law (synonym: choice of law).

> CAUTION: A court might refuse to enforce a choice-of-law provision if the choice conflicts with an important public policy of the forum jurisdiction; see the additional commentary at § 7.14.6–1.

b. *What disputes are covered:* Unless clearly agreed otherwise in writing, the specified governing law is to apply in any Agreement-Related Dispute (§ 9.03).

c. No *renvoi*: The specified 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.

> Comment: 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, 528-30 (Idaho 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, even though the contract said that arbitration must be in Dallas. According to the supreme court, "the 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."

d. *Governing law and arbitration:* If the Contract also requires arbitration of some or all disputes, then:

1. Any such arbitration is to be governed by the specified governing law unless the arbitration agreement expressly provides for a different arbitral law; in that case, the stated arbitral law will govern.

2. Hypothetical example: Suppose that the Contract specifies Texas for the governing law but 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.

e. *Excluded laws:* The Contract may exclude one or more laws, to the extent not prohibited by law.

OPTION: "The United Nations Convention on Contracts for the International Sale of Goods will not apply." COMMENT: It's not uncommon for parties to exclude the United Nations Convention on Contracts for the International Sale of Goods ("UN CISG" or "Vienna Convention"). That convention, in some ways, amounts to an international version of the U.S. Uniform Commercial Code, but with 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).

OPTION: "The Uniform Computer Information Transactions Act ("UCITA") will not apply." COMMENT: It's less common these days to exclude the Uniform Computer Information Transactions Act ("UCITA"). 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.

§ 7.14.6. Additional commentary: Introduction

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, for example, 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).

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. See also 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.

§ 7.14.6–1 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.)

§ 7.14.6–2 *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.

§ 7.14.6–3 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 Clause — 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 Clause). 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.

§ 7.14.6–4 Territory-specific choice of law?

Some companies' boilerplate terms include territory-specific choices of law (and forum selections). For example, here's a territory-specific governing law provision 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.

§ 7.14.6–5 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.

§ 7.14.6–6 Choose different laws for different contract provisions?

In the interest of uniformity on certain important matters (and also in the interest of not reinventing the wheel), some Tango Terms provisions merely state that a particular jurisdiction's law will govern, even though some other law might govern generally. This is the case, for example, of the requirement that amendments and waivers must be in writing (§ 6.01) and the definition of *representation* (§ 9.49), both of which adopt New York law.

It might seem strange to specify a choice of law to govern just one particular provision in a 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).

§ 7.14.7. 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 transferring 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; see O'Connor v. Uber Technologies, Inc., 904 F.3d 1087 (9th Cir. 2018).)

§ 7.14.8. 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; see 907 F.3d 1018 (7th Cir. 2018}.

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 enough to exclude punitive- or multiple damages. See, e.g., Pat Murphy, $48M arbitration award vs. investment advisor upheld (McCarter.com 2015).

§ 7.15. Limitation Period Option

a. This Option will apply if the Contract limits the period in which a claim, arising out of or relating to the agreement, must be commenced before a tribunal.

b. The agreed limitation period will begin on the date when the claimant knew or should have known of the potential existence of the claim.

c. The claimant's failure to bring the claim within the agreed time **WAIVES** the claim.

d. The Limitation of Liability General Rule (§ 7.17.3) applies whenever this Option does.

§ 7.16. Reliance Disclaimer

§ 7.16.1. The Rule

a. *Applicability:* This Disclaimer applies if the Contract states, in substance, that one or more parties waives or disclaims reliance on extra-contractual statements by one or more other parties.

1. If the Contract states simply that this Disclaimer applies, but it does not specify a disclaiming party, then each party is considered to be a disclaiming party.
2. When this Disclaimer applies, the parties have agreed to it as part of their knowing, intentional allocation of the risks and benefits associated with the Contract.

b. *Disclaiming party's commitment:* In entering into the Contract, each disclaiming party represents and warrants to each other party that:

> Comment: 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).

1. The disclaiming party is capable of evaluating and understanding (on its own behalf or through independent professional advice) the terms, conditions and risks of the Contract and the transaction(s) contemplated by the Contract;

2. The disclaiming party understands and accepts those terms, conditions, and risks;

3. The disclaiming party is not relying on any representation, warranty, recommendation, advice, statement, or other communication, written or oral, by that other party **other than:** (i) the specific representations and warranties set forth in the Contract (if any), including without limitation in applicable exhibits, schedules, etc.; and (ii) any representations or warranties expressly incorporated into the Contract by reference; and

4. The disclaiming party: (i) intends for each other party to rely on the disclaiming; and (ii) stipulates that such reliance is reasonable.

c. *Advance release of claims arising from reliance:* In entering into an agreement, each disclaiming party — having had the opportunity to consult legal counsel of the waiving party's choice — hereby:

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

Comment: This release language is based on an online comment.

CAUTION: The author has not researched the extent to which advance releases are enforceable or not.

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."

d. *Other terms applicable:* The Limitation of Liability General Terms (0) are incorporated by reference into this Disclaimer.

§ 7.16.2. Additional commentary

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.

§ 7.16.2–1 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 Alice 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 reliance waivers, especially when the parties are sophisticated (but often not in cases of *intentional* false representations).

EXAMPLE: If Hewlett-Packard's EDS subsidiary had included a reliance disclaimer 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).

EXAMPLE: 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).

§ 7.16.2–2 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).

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).

§ 7.16.2–3 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 representations** 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).

§ 7.16.2–4 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).

§ 7.16.2–5 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 initials it*.

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.

§ 7.16.2–6 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 Contract, so that the representations were no longer extrinsic but instead were express.

§ 7.16.2–7 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).

§ 7.16.2–8 (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.

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§ 7.17. Additional opt-in limitations of liability terms

§ 7.17.1. Consequential Damages Limitation Option

a. *Applicability:* This Option will apply if the Contract excludes or otherwise limits consequential damages.

b. *Exclusion / limitation:* As an agreed allocation of economic risk, no party will be entitled — nor will it seek — to recover consequential damages from any other party to the extent precluded by the Contract's exclusion or limitation of consequential damages.

> Comment: The “nor will it seek” language is intended to make it a separate breach of contract to seek consequential damages in violation of the Contract’s exclusion or limitation.

c. *Knowledge of potential for harm not relevant:* This Option will apply even if the liable party was advised, or had other reason to know, of the possibility, or even the probability, of the kind of harm referred to in the definition of consequential damages above.

> Comment: This reason-to-know language is typical for consequential-damages exclusions; it “writes around” the key dictum in *Hadley*, in which the court said that the defendant carrier that had failed to bring back the mill-wheel axle on time *would* have been liable for the corn mill’s extra down time if the mill’s owners had communicated their special circumstances (i.e., they didn’t have a spare axle for the mill wheel) to the carrier.

d. The Limitation of Liability General Rule (§ 7.17.3) applies whenever this Option does.

§ 7.17.2. Damages Cap Option

a. *Applicability:* This Option will apply if the Contract states, in substance, that a party’s liability for damages is limited to
(i) a specified amount, or (ii) an amount that can be computed.

> Comment: A damages cap will sometimes be more workable than an exclusion of consequential damages (§ 7.17.1). Consider the real-world cases below, in which a supplier might find itself liable for significant damages because of problems with its product: “consequential” damages:
>
> – 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 press release: A Taiwan company, TSMC, makes computer chips; the company 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* ...." BOTTOM LINE: "This incident is *expected to reduce Q1 revenue by about US$550 million* ...." (Wow!)
>
> Now imagine that you were the supplier that provided • the software to Southwest Airlines, or • the pet-food ingredients to Hill's Pet Nutrition, or • the photoresist to the chipmaker. How would you like to have to litigate which damages were "direct" and which were "consequential"? Drafters whose clients might be in that position should consider instead trying to negotiating a damages cap, to cut the Gordian knot — or to be like Indiana Jones dealing with the black-clad Cairo swordsman.

b. *Illustrative examples:* The following hypothetical examples are provided to illustrate the meanings of terms that may be used to state the amount of a damages cap:

1. *ABC's liability for breach is capped at 2X:* This means that ABC will not be liable for, and no other party will seek, 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.

c. *All monetary recoveries:* The agreed damages cap applies to all damages and other monetary recoveries that arise out of or relate to breach of the Contract.

> Comment: The term "relate to" is considered broader than "arise out of"; this means that a relate-to damages cap would potentially limit the recovery for more categories of claim than would an "arise out of" damages cap.

d. *Aggregate amount:* 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.

> ALTERNATIVE: "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 an agreement and/or by applicable law."

e. *Additional terms:* The Limitation of Liability General Rule (§ 7.17.3) applies whenever this Option does.

§ 7.17.3. Limitation of Liability General Rule

a. *Applicability:* This Rule will apply if the Contract limits the liability of one or more parties, including without limitation (i) any disclaimer of warranties and (ii) any exclusion of, and any cap on, one or more forms of monetary relief.

b. *Affected claims:* Each limitation of liability set forth in the Contract 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.

> Comment: 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.

c. *No effect of failure of "exclusive" remedies:* IF: The Contract says that a harmed party is entitled only to certain specific types of remedy, and perhaps even to just one type of remedy; BUT Those remedies did not solve the problem — in legalese, the remedies "failed of their essential purpose"; THEN: Any limitation(s) of liability in the agreement will remain in effect nonetheless.

> Comment: 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; *but see* 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), which arguably would have led to a different result in the *Sanchelima Int'l* case for reasons not important here.
>
> To illustrate subdivision c with a made-up example, suppose that: • A customer signs a purchase agreement calling for the customer to buy a car from a dealer. • Under the purchase 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.") • The purchase agreement also says that the dealer will not be liable for "consequential damages" (Chapter 7:). • The customer's specific car has a problem that the dealer is simply unable to fix. RESULT: In that situation, the agreement's exclusive remedy is said to have failed — but the exclusion of consequential damages will remain in effect anyway.

d. *No effect of knowledge of potential harm:* A limitation of liability 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.

> Comment: This is a shout-out to the English court decision in *Hadley v. Baxendale*, discussed in the commentary to the Consequential Damages Exclusion Rule (**Error! Reference source not found.**).

e. *If the law provides otherwise:* A limitation of liability would not apply if, and only 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.)

Chapter 8: Termination Rules

§ 8.01. Termination General Rule

§ 8.01.1. The Rule

a. *Applicability:* This Rule applies in any case of termination of the Contract. Such a termination might be as authorized by the Contract itself or by law.

b. *No monetary liability for termination per se:* Unless the Contract clearly specifies otherwise, neither party will owe another party money solely because of termination of the Contract in accordance with its termination provisions. (It would be another matter if a party owed money under other provisions of the Contract or for breach of the Contract.)

c. *Termination of transaction, etc., instead of Contract:* In lieu of terminating the Contract, a party authorized to terminate the Contract may instead terminate one or more of the following specific items to the extent that they exist under the Contract:

1. transactions, for example, a purchase order;
2. grants, for example, a lease or license;
3. relationships, for example, a distributorship.

> Comment: This option would give a terminating party more flexibility than an all-or-nothing right to terminate an agreement.

d. *Alternative grounds for termination:* IF: A party terminates the Contract 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.

> Comment: 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).

e. *Effect of termination:* To the extent not manifestly inconsistent with mandatory applicable law, any termination:

1. cancels the parties' relevant, respective, post-termination rights and obligations, except to the extent (if any) that the Contract provides otherwise, for example in a survival provision;

> Comment: 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.

2. cancels any right a party has to continue its performance of its relevant pre-termination obligations;

> Comment: This subdivision is 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). In other words, the Ahrens company was fired and presumably was replaced by another contractor hired by the bonding company — presumably at Ahrens's expense, which almost surely cost Ahrens more than just finishing the job would have cost it.

3. does not affect any claim, by any party, for pre-termination breach by another party; and

4. is without prejudice to any party's other rights or remedies except to the extent, if any, that the parties' agreement clearly provides otherwise.

f. *Notice of termination itself is required:*

1. 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).

2. The notice of termination must describe, with reasonable specificity, (i) the basis for termination and (ii) the putative effective date of termination.

> Comment: A notice of termination should be clear, because neither the terminating party nor the non-terminating party will want to have to litigate whether a particular communication constituted a termination notice. That was the unfortunate result 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.

g. *Expiration as termination:* Unless otherwise clear from the context:

1. Any expiration of the term of the Contract (or, if applicable, of a transaction, grant, or relationship under the Contract) is to be presumed to have the same effect as a termination of the same.

> Comment: This is one of those "roadblock" provisions designed to forestall litigation counsel from making creative arguments to the contrary.

2. For this purpose, the term *expiration* includes, without limitation, expiration due to a party's exercising a right to opt out of an automatic-extension provision.

3. A notice of an upcoming expiration is not needed for the expiration to be effective unless the Contract clearly requires otherwise.

> Comment: See also the Evergreen Extension Rule (§ 5.05), which allows the Contract to require a party to give notice of an upcoming expiration as a prerequisite to the expiring period being automatically extended.

§ 8.01.2. Commentary

§ 8.01.2–1 General effects of termination

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.

§ 8.01.2–2 Is termination of *the Contract* the right wording?

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.

§ 8.01.2–3 **Post-termination actions**

Different types of agreement might require different post-termination obligations. Consider, for example:

– issuance of final invoices

– payment of outstanding amounts

– return of confidential information

– assistance in transitioning a customer to another supplier or service provider

§ 8.02. Termination for Breach Rule

§ 8.02.1. The Rule

a. *Which party or parties may terminate for breach:* Either party may terminate (i) the Contract, and/or (ii) an order under the Contract, for breach by the other party in accordance with this Rule.

> Comment: 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 would not have the right to terminate their contract — his only recourse against Alice would (typically) be an action against Alice for damages or (sometimes) for specific performance.

b. *Types of breach allowing termination:* Termination for breach is allowed only for material breach (§ 9.37).

> 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. In that vein, the Indiana supreme court held that in the contract in suit, the specific identification of standards of materiality took precedence over a Restatement of Contracts 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).

c. *Termination procedure:* To terminate for breach, the terminating party must:

Comment: This Rule 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]

1. give the breaching party notice of the breach, stating at least: (i) the circumstances of the breach, in reasonable detail; and (ii) the duration of the specific cure period that the terminating party believes to be applicable, if any, as set forth below;

2. wait for the cure period, if any, to elapse; and

3. give the breaching party notice of termination if the (curable) breach has not been cured by the end of the cure period.

d. *Cure period:* The cure period will be as follows, beginning upon the effective date of the notice of breach:

Comment: The cure periods stated here are placeholders; contract drafters and reviewers should give some thought to what would be appropriate for their particular situations.

1. *Nonpayment* of an amount due under the Contract: Five business days.

2. *Missed deadline* for which the Contract expressly states that time is of the essence: No cure period.

3. *Other, curable missed deadline* stated in the Contract: Five business days.

4. Other, curable breach: Ten business days.

5. Breach clearly not capable of being cured: No cure period.

Comment: 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).

e. *Multiple "minor" breaches as material breach:* IF: A party breaches the Contract multiple times; BUT: None of the individual breaches is material; THEN: The *series* of breaches could amount to a material breach, even if the individual breaches are cured.

> Comment: 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).

f. *Non-exclusive remedy:* Termination is not the terminating party's exclusive remedy for breach unless expressly agreed otherwise in writing.

§ 8.02.2. Additional commentary

A termination-for-material-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 an agreement — and if the breach is incurable, the other party may terminate the agreement. *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).

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).

§ 8.03. Additional opt-in termination terms

None of the terms below apply in the Contract unless the Contract clearly says so.

§ 8.03.1. Termination at Will Option

a. *Applicability:* This Option will be relevant if the Contract (or the law) allows a party to terminate the Contract at will or to do likewise as to some related aspect (for example, termination at will of a statement of work or other order). NOTE: For this purpose, the terms *termination at will* and *termination for convenience* are considered synonyms.

> Comment: 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.

b. *Termination at will is discretionary:* Absent a clear restriction in the Contract, a party entitled to terminate at will may do so in its sole and unfettered discretion.

> Comment: The Contract 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. PRO TIP: A party that will be making a significant investment of time or money in the Contract might want to negotiate for one or more of

such restrictions on the other party's right to terminate at will, so as to allow enough time to recoup at least some of that investment.

§ 8.03.2. Termination for Insolvency Option

a. *Termination right:* Any party (each, a "*terminating party*") may terminate the Contract if another party to the Contract:

1. ceases to do business in the normal course;

2. becomes insolvent;

3. admits in writing its inability to meet its debts or other obligations as they become due;

4. makes a general assignment for the benefit of creditors;

5. files a voluntary petition for protection under the bankruptcy laws or similar laws of the relevant jurisdiction, or to effect a plan or other arrangement with creditors; or

6. has a receiver, administrative receiver, administrator, liquidator, trustee in bankruptcy, or similar functionary in the relevant jurisdiction, appointed for its business or assets; or

7. becomes the subject of an involuntary petition under the bankruptcy laws, or a similar petition or other filing under the laws of the relevant jurisdiction, and the same is not vacated, released, dismissed, stayed, reversed or otherwise overturned, or bonded off before the end of 60 days after the date of the petition or other filing.

CAUTION: In the U.S., 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* Robert L. Eisenbach III, Are "Termination On Bankruptcy" Contract Clauses Enforceable? (Cooley.com 2007), https://perma.cc/PV6N-VFTC.

As an "in the wild" example of such a provision, see 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.

b. *Sunset:* The right to terminate under subdivision a will expire at the end of 90 days after the date that the terminating party first learns, via any source, of the most-recent event listed in subdivision a.

Comment: This "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.

§ 8.03.3. Termination for Legal Violation Option

a. *Termination right:* Any party (each, a "*terminating party*") may terminate the Contract if another party commits any act or omission that:

1. is material to the other party's rights or responsibilities under the Contract, and

2. violates any applicable law where the violation is likely to materially and adversely affect the other party.

b. *Cure period:*

1. IF: The Contract 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.

2. Otherwise, the terminating party may terminate the Contract under subdivision a without giving the breaching party an opportunity to cure the breach.

c. *Deadline for legal-violation termination:* 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 learned, via any source, of the most-recent act or omission giving rise to the right to terminate.

> Comment: 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.

§ 8.03.4. Termination for Reputation Risk Option

a. *Termination right:* Any party (each, a "*terminating party*") may terminate the Contract if the terminating party reasonably determines that: • one or more Reputation Risk Actions, defined below, • when taken by (i) another signatory party to the Contract or (ii) an affiliate of the other signatory party, • 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.

> Comment: 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 the offshore companies' 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 ended its relationship with troubled blood-testing company Theranos (NYTimes.com).

– In 2015, the Twin Peaks restaurant organization terminated the franchise of a restaurant in Waco, Texas, after a shootout between rival motorcycle gangs left nine dead. See, e.g., this news story.

– Car manufacturer Hyundai terminated one of its dealerships because the New York attorney general had obtained a court judgment against the dealership for having engaged in fraudulent and illegal business practices. Giuffre Hyundai, Ltd. v. Hyundai Motor America, 756 F.3d 204 (2d Cir. 2014).

– 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.

b. *Definition:* 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.

> Comment: 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).

c. *Deadline for termination:* The right to terminate for reputation risk will expire (if not sooner exercised) at 12 midnight at the end of the day on the date 90 days after the date that the terminating party first learned, via any source, of the most-recent Reputation Risk Action.

> Comment: This "sunset" period forces the terminating party to make up its mind – to fish or cut bait (or fill in your own metaphor).

d. *No separate obligations or liability:*

1. This Option establishes only a conditional right to terminate the Contract; in itself it does not obligate any party in any way.

2. The other party will not be liable, in damages or otherwise, for any Reputation Risk Action that does not otherwise breach the Contract.

§ 8.03.5. Termination After Change of Control Option

a. Any party (each, a "*terminating party*") may terminate the Contract following a change of ownership of the power to vote more than 50% of the voting power entitled to vote for members of the other party's board of directors (or equivalent body in a non-corporate organization).

> Comment: This provision has in mind that a party might not want to continue doing business with a counterparty if, say, the counterparty was acquired by one of the first party's competitors. (For this purpose, the parties might want to specify a different definition of *control*.)

b. If not exercised, the right to terminate under subdivision a will expire at the earlier of:

1. 90 days after the date that the terminating party first learns, via any source, of the change of control; or

> Comment: The 90-day termination period forces the terminating party to make up its mind; the termination period starts when the terminating party first learns of the change of control, as opposed to when the other party gives notice of the change of control. The terminating party might prefer it to be the other way around, but that might be too burdensome for the other party to manage.

2. six months after the effective date of the change of control.

> Comment: This limit has in mind that if the terminating party hasn't seen fit to terminate within that time — for example, because it hasn't noticed any ill effects from a change of control — 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.

§ 8.03.6. Termination After Certain Personnel Changes Option

a. Any party (each, a "*terminating party*") may terminate the Contract following any change, of a type expressly specified in the Contract, among the personnel of the other party.

> Comment: This provision might be used in a contract with a small company or startup company whose ability to continue to perform might be called into question if too many senior- or key people were to leave.

b. The right to terminate under subdivision a will expire at the earlier of:

1. 90 days after the date that the Terminating Party first learns, via any source, of the most-recent personnel change in question; or

> Comment: This termination period forces the terminating party to make up its mind.

2. six months after the most-recent personnel change in question.

> Comment: This six-month limit 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 personnel change of the specified type — 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.

§ 8.03.7. WAIVER of Damages for Termination Option

a. For purposes of this clause, the term "*Termination-Related Claim*" refers to a claim for compensation for loss of distribution rights or other rights; loss of goodwill; or any similar loss, resulting from:

1. expiration of the Contract, including for example expiration because of a party's opting out of what otherwise would have been an automatic extension (§ 5.05) (if applicable); or

2. a duly-effected termination of the Contract in accordance with its terms.

b. For the avoidance of doubt:

1. Upon any *termination* of the Contract, whether or not the termination was allegedly wrongful, the non-terminating party will not have, and may not assert or maintain, any Termination-Related Claim against the terminating party, nor against any member of the terminating party's Protected Group (§ 9.45); and

2. Upon any *expiration* of the Contract, no party will have, and no party may assert or maintain, any Termination-Related Claim against any other party, nor against any member of that other party's Protected Group.

> Comment: The author once read, but now cannot locate, a case in which a party had allowed the term of an agreement to *expire*. In the ensuing lawsuit, the other party tried (unsuccessfully, if memory serves) to recover damages that it claimed to have suffered as a result of the expiration. This Option attempts to forestall such a claim.

§ 8.03.8. Cross-Default Termination Option

Any party entitled to terminate one transaction, grant, or relationship for material breach by the other party may in its discretion terminate some or all other uncompleted transactions, grants, or relationships between the parties.

> Comment: If a terminating party has multiple contracts with a breaching party, this Option will allow the terminating party to

sever all ties with the breaching party, not just the one breached contract.

§ 8.03.9. Exclusive-Termination Option

No party may terminate or rescind the Contract, no matter what the circumstances, except as expressly provided in the Contract.

Comment: This section seeks to prevent the application of the general presumption that contracts of indefinite term may be terminated at will by either party. *See* Burford v. Accounting Practice Sales, Inc., 786 F.3d 582, 586 (7th Cir. 2015) (reversing summary judgment that copyright license agreement of indefinite duration was terminable at will; applying Illinois law), *citing* Baldwin Piano, Inc. v. Deutsche Wurlitzer GmbH, 392 F.3d 881, 885-86 (7th Cir. 2004) (reversing summary judgment that trademark licensor had the right to terminate license agreement at will; applying Illinois law).

§ 8.03.10. Termination Prohibition Option

No party may terminate or rescind the Contract, no matter what the circumstances; in case of breach of the Contract by the other party, that party's sole remedy shall be limited to an action at law for damages, and any purported termination will be of no effect.

Comment: This provision is modeled on one that was in the contract (but apparently did not affect the court's holding) in Mercado-Salinas v. Bart Enter. Int'l, Ltd., 671 F.3d 12, 16 (1st Cir. 2011) (affirming preliminary injunction).

In a Facebook discussion thread, a well-known lawyer told a war story: A world-famous global tech company once claimed that the lawyer's client (a well-known non-profit organization) could not terminate a contract between the two parties — ever — and was obligated to continue performing "until the entropic death of the universe," so long as the large corporation continued to exercise its one-sided renewal right under the contract. The non-profit organization's lawyer suggested that the Thirteenth Amendment might be relevant. For a different viewpoint on that issue, see

> Nathan B. Oman, Specific Performance and the Thirteenth Amendment, 93 MINN. L. REV. 2020 (2009).

§ 8.03.11. No Waiver of Termination by Subsequent Conduct

a. This provision applies if, following any termination or expiration of the Contract, one or both parties engages in conduct contemplated by the Contract — for example, if the parties continue to do business with each other in accordance with the terms of the Contract.

b. Such conduct by one or both parties is not to be construed:

1. as a waiver of the termination or expiration of the Contract (as applicable), nor

2. as an extension or continuation of the term of the Contract beyond the period specified in a notice of termination, if applicable.

> Comment: This language is modeled on that of the contract in suit in Sleepy's LLC v. Select Comfort Wholesale Corp., 779 F.3d 191, 196 n.4 (2d Cir. 2015). Unlike the contract in the *Sleepy's* lawsuit, this language explicitly makes the no-waiver provision equally applicable to expirations and terminations; that distinction caused the Second Circuit to reverse the district court's ruling (for reasons that are not of interest here).

Chapter 9: Definitions and Usages (general)

§ 9.01. Acknowledgement Definition

When a party *acknowledges* an assertion, it means that the acknowledging party:

1. agrees, with binding effect, not to contest the assertion; and
2. **WAIVES** any requirement that another party to the Contract bear a burden of proof that the assertion is true.

Comment: An *acknowledgement* is tantamount to an admission under the (U.S.) Federal Rules of Civil Procedure, 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." (Emphasis added.)

Acknowledgements can be useful to establish facts for future litigation … but don't be a jerk about it. 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."

An acknowledgement in this sense does not require the certification of a notary public or other official (see Notarizing a document).

§ 9.02. Affiliate Definition

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

> Comment: This definition provides parties with **two separate two "proof paths"** for establishing affiliate status: One by showing a control relationship between two persons, in this subdivision a; the other by naming two persons to be affiliates, regardless whether they have a control relationship, in subdivision e.
>
> **CAUTION**: It's a bad idea for a contract to state that a party to a contract is "ABC Corporation *and its affiliates*"; see generally the Preamble additional notes at § 12.09.8.

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

all as stated in more detail below.

> Comment: The above 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 NY and Del. statutes).

b. If B is a corporation or other organization, then A *controls* B if A has the power to vote more than 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).

> Comment: **A minimum voting percentage of greater than 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.

> In addition, some drafters might want voting control also to arise from one or more of the following:
>
> – 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;
>
> – 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
>
> – 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.)

c. A person A controls another person B if A has the power — by contract — to direct B's relevant management and policies.

> Comment: **This definition 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 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 in the additional commentary (§ 9.02.3).

d. For purposes of determining affiliate status, control can be direct, or it can be indirect through one or more intermediaries. Example: If A controls B and B controls C, then A controls C indirectly.

e. Parties identified as affiliates in the Contract are considered such without regard to whether they are in a control relationship.

> Comment: This provision allows drafters to **designate specific affiliate groups 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.

[Additional commentary follows]

§ 9.02.2. Why contracts sometimes define "affiliate"

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

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

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

§ 9.02.3. 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 the Six Flags 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).

§ 9.02.4. 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."

§ 9.02.5. 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 Int'l, 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.

§ 9.03. Agreement-Related Dispute Definition

Agreement-Related Dispute refers to any claim, controversy, or other dispute between the parties — whether based on the law of contract; tort; strict liability; statute; or otherwise — that: (i) is brought before any tribunal (§ 9.57); and (ii) is based upon, arises out of, or relates to any of the following:

1. the Contract;

2. a document executed in conjunction with the Contract;

3. a transaction or relationship memorialized by, or resulting from, the Contract (each, a "*Transaction*" or "*Relationship*", respectively);

4. a service provided pursuant to, or incidentally to, the Contract or a Transaction or Relationship;

5. insurance coverage for, or relating to, the Contract or a Transaction or Relationship;

6. a document that documents or otherwise contains information about any of the items listed in subdivisions 2 through 5;

7. an application for, or an advertisement, solicitation, processing, closing, or servicing of, a Transaction or Relationship; and

8. any representation or warranty made (i) in or in connection with any document listed in subdivisions 6 and/or 7; or (ii) to

induce anyone to enter into, agree to, or accept any such document.

Comment: This "laundry list" borrows concepts from the second of two arbitration agreements in suit in Porter Capital Corp. v. Roberts, 101 So. 1209, 1218-19 (Ala. App. 2012) (affirming denial of plaintiffs' motions to compel arbitration of defendant's counterclaims).

Some of the language is adapted from a suggestion in Glenn D. West & W. Benton Lewis, Jr., Contracting to Avoid Extra-Contractual Liability — Can Your Contractual Deal Ever Really Be the "Entire" Deal?, 64 Bus. Law. 999, 1036, text accompanying n.232.

Subdivision 3: The *transaction or relationship …* term is modeled on the arbitration provision in Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008), *citing* Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005).

Subdivision 8: The reference to inducement has in mind claims of fraudulent inducement; it borrows from model language in Byron F. Egan, Forum-Selection, Jury-Waiver, and Choice-of-Law Provisions in Acquisition Agreements (2018), archived at https://perma.cc/3G4L-UVZB), at part V, text accompanying note 105.

§ 9.04. And/Or Definition

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. A hypothetical example: *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 just on one and only one of them.

Comment: The useful term *and/or* is equivalent to the inclusive-or, as opposed to the exclusive-or (which is expressed mathematically as XOR).

Some scorn *and/or*; for example, one judge excoriated the use of the term as "indolent." That judge — no slave to brevity, he — proclaimed that a drafter instead "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).

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. Properly used, the term can be a serviceable shorthand expression. So the better practice might well be just to define the term 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 work in many cases. See Kenneth A. Adams, "A, B, and/or C", Dec. 2, 2012, at http://goo.gl/m9U3p (adamsdrafting.com).

§ 9.05. 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, representations, conditions, and terms of quality ("Warranties, Etc.").

Comment: This 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.

b. An as-is disclaimer:

1. applies, without limitation, to any *implied* Warranties, Etc., of merchantability or fitness for a particular purpose that might otherwise apply;

2. does not apply to any express Warranties, Etc., *of performance*; and

   Comment: Here's an 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

3. does not apply to any applicable implied Warranty, Etc., of *title*.

   Comment: This carve-out is modeled on UCC § 2-312, which requires that a disclaimer of an implied warranty of title must be expressly stated. From a business perspective this makes sense, of course; as an example, if Alice sells Bob a car "as is," Bob should still be entitled to assume that Alice isn't trying to sell him stolen property.

§ 9.06. Associated Individuals Definition

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, such as a limited liability company; and/or

4. any other individuals expressly specified in an agreement, if any.

> Comment: 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: Oracle agreed to pay $25 million in cash and to provide the state with echnology worth another $75 million.)

§ 9.07. Blue-Pencil Request Definition

a. If the Contract includes a blue-pencil request, the parties have in mind that a tribunal of competent jurisdiction might hold that a provision of an agreement is invalid, void, unenforceable, or otherwise defective.

b. In any such situation, the parties desire the following:

1. All other provisions of the agreement are to remain enforceable.

2. The holding of defectiveness is to apply only in the jurisdiction of the tribunal issuing the holding.

3. The holding of defectiveness is to apply only for so long as the holding remains in effect.

4. The tribunal is respectfully requested (if a court or other governmental body) or directed (if an arbitral tribunal) 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.

> Comment: 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, e.g., Heraeus Medical, LLC v. Zimmer, Inc., No. 19S-PL-471 (Ind. Dec. 3, 2019) (vacating preliminary injunction in part on grounds that Indiana blue-pencil doctrine permits only *deleting* language, not *adding* it to add limitations to non-competition covenant); see generally Kenneth J. Vanko, A Quick State-By-State Guide on the Blue-Pencil Rule, 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.

§ 9.08. Best Efforts Definition

§ 9.08.1. The Rule

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

> Comment: 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).

b. In case of doubt, a party obligated to use best efforts:

1. need not take any unreasonable action;

   Comment: This subdivision is intended to clarify what might be an uncertainty about the law, as discussed in the additional commentary below (§ 9.08.7).

2. need not take every conceivable reasonable action to achieve the stated objective; and

   Comment: This provision recognizes that *with the benefit of hindsight*, a motivated opposing counsel and expert witness can almost always find *something* more that the a party conceivably *could* have done to achieve the stated objective, as discussed in the additional commentary below (§ 9.08.11).

3. need not materially harm its own lawful interests.

   See the previous comment.

[Additional commentary follows]

§ 9.08.2. ADDITIONAL COMMENTARY: Overview

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!)**

§ 9.08.3. Why do some contracts include best-efforts terms?

Best-efforts obligations are especially common when one party grants another party exclusive rights, such as exclusive distribution rights or an exclusive license under a patent, trademark, or copyright. This was the case, for example, in Kevin M. Ehringer Enterpr., Inc., v. McData Serv. Corp., 646 F.3d 321 (5th Cir. 2011).

§ 9.08.4. 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*.

§ 9.08.5. 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.

§ 9.08.6. 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 British Columbia's supreme court. *See* Atmospheric Diving Sys. 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 Adams's view that "best efforts" means simply "reasonable efforts.")

§ 9.08.7. CAUTION: Best efforts might mean different things to different courts

Courts in some jurisdictions 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." 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]

§ 9.08.8. "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).

§ 9.08.9. "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).

§ 9.08.10. *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.

§ 9.08.11. 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 were to arise, then the other side's lawyers, who of course have 20-20 hindsight, might argue that there were X number of additional things that you supposedly could have done to achieve the agreed goal. As one court remarked (about a different issue): "… 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." Hertz v. Luzenac Group, 576 F.3d 1103, 1113 (10th Cir. 2009) (citations omitted).

– 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 summary-judgment motion 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.

§ 9.08.12. 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.

§ 9.08.13. 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).

§ 9.09. Board of Directors Definition

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

> Comment: 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.

§ 9.10. Business Day Definition

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* (§ 9.18).

> Comment: 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 generally a 2015 LinkedIn discussion on that subject (membership required).

§ 9.11. 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.

> Comment: Why specify the Gregorian calendar? To be sure, 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).

b. An *interval* of a calendar year, beginning at a specified time on a particular date or 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.

> Comment: 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 at the end, of the anniversary date.

§ 9.12. Certify Definition

When a party "*certifies*" an assertion relating to the Contract (in a "*certification*" or "*certificate*"), the certifying party does the following:

1. represents that the assertion is true;

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

3. acknowledges that it intends for another party to the Contract to rely on the certification; and

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

§ 9.13. 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 government authority.

> Comment: This definition 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.

b. A claim might be set forth, without limitation:

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

> Comment: 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

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

§ 9.14. Clear and Convincing Evidence Definition

For an assertion 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.

> Comment: 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. See, e.g., the indemnification agreement quoted in Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 YALE L.J. 814, 867 (2006), at http://perma.cc/R46W-H5JA

§ 9.15. Commercially Reasonable Definition

> Comment: The phrase commercially reasonable is a "let's kick the can down the road" term, as in, we'll deal with this issue later instead of spending time now to try to get a precise definition of what's expected. Many business people are drawn to such clauses because they can speed up contract negotiations, although the vagueness of the term can pose a risk of future disagreement, as discussed in the additional commentary.

§ 9.15.1. The Rule

a. Defining the term *commercially reasonable* 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.

> Comment: 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 additional commentary (§ 9.15.5).

b. In case of doubt: If the Contract 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;

   Comment: A court might interpret a commercially reasonable-efforts obligation as requiring a party actually to do X; see the additional commentary (§ 9.15.3).

2. need not make all reasonable efforts to accomplish X; and

   Comment: Business people might 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 additional commentary (§ 9.15.3).

3. may take its own business interests into account.

   Comment: See the additional commentary (§ 9.15.4).

[Additional commentary follows]

§ 9.15.2. ADDITIONAL COMMENTARY: Introduction

The term *commercially reasonable* 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.

Clients, however, 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.

§ 9.15.3. The danger of leaving the term undefined

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).

§ 9.15.4. Balancing the parties' 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).

§ 9.15.5. 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).

> Footnote: 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.

§ 9.15.6. 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).

§ 9.15.7. 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).

§ 9.16. Consequential Damages Definition

§ 9.16.1. The Rule

The term *"consequential damages"* refers to harm where:

1. the harm was a foreseeable result of the breach; but

2. reasonable people, experienced in the relevant area(s) of business, would not have expected that type of harm to occur in the usual course of things as a result of the type of breach in question.

[Commentary follows; see also the commentary concerning damages caps at § 7.17.2.]

§ 9.16.2. Language origin

This definition is based on the landmark English case of Hadley v. Baxendale, [1854] EWHC Exch J70 (the "corn mill crankshaft case"), and its progeny, discussed in more detail in the additional commentary below.

The definition responds to the injunction: **When In Doubt: Define!**, because even many lawyers don't really understand what *consequential damages* means under the law.

"In the usual course of things": This phrase is quoted verbatim from the opinion in the *Hadley* case.

See also the additional commentary at **Error! Reference source not found.**.

§ 9.16.3. *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. *Hadley* involved a corn mill in which a crankshaft turned a grinding wheel. The crankshaft broke, so the mill owners engaged a transporter to take the broken crankshaft to a manufacturer, which would use the broken crankshaft as a template to make a new one. Unbeknownst to the transporter, the mill owners didn't have a spare crankshaft, and so their corn mill was out of commission. Then the transporter 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 transporter 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:

– the particular type of harm from the transporter'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 transporter had no reason to expect that its breach would cause that kind of harm; for example, the transporter 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.

> Footnote: The Hadley rule thus 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:

> 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.)

So with the *Hadley* court's comments in mind, let's suppose hypothetically 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.

§ 9.16.4. *Hadley* is still followed (with variations)

The principles announced in *Hadley v. Baxendale* are still followed, albeit with variations. 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 foreseeable *and 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 and extra paragraphing added); see also Kreg Therapeutics, Inc. v. VitalGo, Inc., 919 F.3d 405, 418-19 (7th Cir. 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).

(The potential difficulty of proof one way or another is a major *business* reason for disclaiming consequential damages.)

A different approach, *possibly* more tractable in litigation, is found in North Carolina law, quoted in a Fourth Circuit case:

> Consequential or special damages for breach of contract are those claimed to result as a secondary consequence of the defendant's non-performance. They are distinguished from general damages, which are based on *the value of the performance itself, not on the value of some consequence that performance may produce.*

Severn Peanut Co. v. Industrial Fumigant Co., 807 F.3d 88, 90-91 (4th Cir. 2015) (emphasis added) (emphasis added, citations omitted).

For a stricter definition than that of *Hadley*, see the Texas supreme court's *El Paso Marketing* case, 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.*

El Paso Marketing, L.P. v. Wolf Hollow I, L.P., 383 S.W.3d 138, 144 (Tex. 2012) (cleaned up, emphasis added). This test replaces *Hadley's* "usual course of things" with "necessary and usual."

§ 9.16.5. 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 ophthalmologist, 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).

§ 9.16.6. Determining which damages were "contemplated" could be tricky

Imagine what it would take to try a case in which a party was claiming that it was entitled to be reimbursed for certain specific uncommon harm because the harm was specifically contemplated by the parties at the time they entered into their agreement. The discovery (in the U.S.) would have been expensive, the trial even more so.

On the other hand, with a categorical *exclusion* of consequential damages, there's no need for the parties to engage in that particular battle about what the parties supposedly "contemplated" when they entered into their agreement. A consequential-damages disclaimer thus somewhat 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."

§ 9.16.7. A consequential-damages exclusion can still leave room for disputes

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.

This can be seen as well in the long-running case of *Indiana v. IBM.* In that "interesting" case, the State of Indiana contracted with IBM to develop a computer system to support a modernized state welfare system. Things did not go well, and as is so often the case, the parties blamed each other. In the first "bench" trial (i.e., without a jury), a state-court judge found that IBM had not breached the contract but the state *had* breached. The state appealed, and the state appellate court and supreme court held that IBM had indeed breached the contract — while also ordering a retrial before a different judge.

Here's where *Indiana v. IBM* gets interesting for consequential-damages purposes: In the second trial, the new judge sided with the state in holding that IBM had to pay for a replacement computer system that the state acquired after IBM was fired, known as the "Hybrid" system — even though the Hybrid system was an upgrade from the system that IBM had agreed to build. The judge held that the additional cost of the upgrade was properly classified as *direct* damages, and thus subject to an agreed cap of $125 million, and not as *consequential* damages, which would have been subject to a cap of $3 million. *See* IBM v. Indiana, 112 N.E.3d 1088, 1100-01 (Ind. App. 2018), *summarily aff'd*, 124 N.E.3d 1187, 1189 (Ind. 2019).

Dissenting on that issue, a state supreme court judge argued that "it was not IBM's breach but the State's decision to switch to the different, more expensive Hybrid system that caused the State to incur these additional expenses. The State's additional, Hybrid-related costs are at most consequential damages, not direct damages." *Id.* at 1193 (Slaughter, J., dissenting in part, concurring in part).

§ 9.16.8. A consequential-damages exclusion *allocates* economic risk

There's a business principle behind exclusion of consequential damages. That is: As a matter of agreed allocation of risk — and also 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.

As the court said in *Hadley*, 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 economic risk associated with the uncommon harm — although that might affect the pricing 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.

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.

The Fourth Circuit cited this reasoning as the policy basis behind the use, and enforcement, of consequential-damages exclusions:

> Contractual limitations on consequential damages also serve to *further predictability in business relations*. By allowing parties to bargain over the allocation of risk, freedom of contract permits individuals and businesses to allocate risks toward those most willing or able to bear them. Parties who allocate risks away from themselves thereby *cap their future expected litigation and liability costs*. Parties assuming risks often receive benefits in the form of lower prices in exchange**.** …
>
> The benefits of consequential damages limitations for consumers and producers may explain why they are both widespread and widely enforced.

Severn Peanut Co. v. Industrial Fumigant Co., 807 F.3d 88, 91 (4th Cir. 2015) (emphasis added) (affirming summary judgment for defendant). The court went on:

> 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 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.*

Id. at 92 (emphasis and extra paragraphing added).

§ 9.16.9. What specific *types* of damages might be "consequential"?

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), diminution of value might well be one of the principal measures of damages, so that might be a dangerous thing to specifically exclude. 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 — but excluding damages for this type of harm would normally be a really bad idea, at least from the perspective of a party that intended to disclose its confidential information to another party;

– loss of goodwill;

– loss of investment;

– loss of product;

– loss of production;

– loss of profits *from collateral business arrangements*, as opposed to all lost profits. This 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. (NOTE: See also the caution below.)

– 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.

CAUTION: In a Seventh Circuit case, the contract's exclusion of consequential damages excluded all lost profits. On the facts of the case, that meant that the plaintiff could recover no damages for breach. That, said the district court, meant that under Wisconsin law, the agreement's limited remedy (i) failed of its essential purpose and (ii) was unconscionable — and so under UCC § 2-719, all UCC remedies were available to the plaintiff, including lost profits as consequential damages. On appeal, the Seventh Circuit agreed; the appellate court noted that while the majority of states had since shifted to the opposite view, it was not within the purview of the federal courts to change state law. See Sanchelima Int'l, Inc. v. Walker Stainless Equipment Co., 920 F.3d 1141 (7th Cir. 2019) (with extensive citations).

§ 9.16.10. Use a damages cap instead?

Even with an exclusion of consequential damages, there's still a risk of expensive future disputes about what specific damages are excluded, as discussed above. So drafters might wish instead to simply impose a cap on recoverable damages — either a cap on overall damages or a cap on consequential damages. For more details, see the Damages Cap Clause.

§ 9.16.11. 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.

§ 9.17. Consumer Price Index / CPI definition

§ 9.17.1. The Rule

Unless otherwise agreed, "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.

[Commentary follows]

§ 9.17.2. 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).

§ 9.17.3. 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.

§ 9.17.4. 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.

§ 9.17.5. 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]

§ 9.17.6. 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)

§ 9.18. 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 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.

c. For this purpose, *12 midnight* refers to local time if only one time zone is relevant and to UTC otherwise.

> Comment: 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.

§ 9.19. Deadline Definition

IF: This 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.

> Comment: This definition simply provides a benchmark reference point; using this definition, drafters can precisely specify deadlines as desired.

§ 9.20. Discretion Definition

a. If the Contract provides that a party may act in its discretion (or, equivalently, in the party's reasonable discretion), then that party:

1. must act both (i) reasonably, and (ii) in good faith; but

2. is to be strongly presumed to have complied with subdivision 1 unless shown otherwise by clear and convincing evidence.

> Comment: 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 Clause (Winston.com 2013), archived at https://perma.cc/TR7G-CNU8.
>
> 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, June 2013, at 20, 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).

b. If the Contract provides that a party may act in its "sole discretion" (or "unfettered discretion" 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

3. the party is to be conclusively deemed to have satisfied any applicable standard of good faith.

> Comment: 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.

> Unlike the UK cases cited above, this definition does not impose a good-faith requirement on exercises of *sole* discretion, because doing so can complicate litigation.

c. In case of doubt: For purposes of the definition of *discretion*, not acting is considered an action.

§ 9.21. Effective Date Definition

The effective date of the Contract is the last date signed as written in the signature blocks if the Contract does not specify otherwise.

§ 9.22. Ending Time Definition

a. IF: The Contract states that a time period, a right, an obligation, etc., ends or expires on a specified day; BUT: The Contract does not clearly indicate the *time* of day for ending or expiration; THEN: The end or expiration will be is exactly 12 midnight at the end of the specified date.

b. If not otherwise specified in the Contract, 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.

> Comment: 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.

§ 9.23. Examples usage

a. Examples are for purposes of illustration and not limitation; 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.

> Comment: 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."

b. The Contract 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.

§ 9.24. Exclusivity Definition

a. Unless clearly agreed otherwise in writing, a grant of a right to do or not do something (including but not limited to a grant of consent) is not exclusive; each of the grantor and the grantee is 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.

b. An exclusive grant does not preclude the grantor, in its sole discretion, from engaging in the same activities that are the subject of the grant, anywhere in the world in any market segment, even if in competition with the grantee.

c. The grantor of an exclusive grant need not account to, nor compensate, the grantee if the grantor engages in the same activities that are the subject of the grant.

> Comment: A grant of exclusivity 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.
>
> Subdivision (c), no accounting required: This subdivision 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].

§ 9.25. Gender references

When necessary, unless the context clearly requires otherwise, any gender-specific or gender-neutral term in an agreement (for example, *he*, *she*, *it*, etc.) is to be read as referring to any other gender or to no gender.

> Comment: Usage definitions along these lines are sometimes seen in longer contracts.

§ 9.26. Good Faith Definition

§ 9.26.1. The Rule

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.

> Comment: The s 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."

§ 9.26.2. ADDITIONAL COMMENTARY

§ 9.26.3. CAUTION: "Good faith" requirements can lead to messy disputes

Business people sometimes like to include obligations to act 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: for example 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.

§ 9.26.4. Why *define* good faith?

The above definition follows the W.I.D.D. principle: **When In Doubt, Define**, because, as the [U.S.] Supreme Court has noted,

> 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, 572 U.S. 273, 134 S. Ct. 1422, 1431, at part III (2014) (cleaned up; extensive citations omitted, emphasis added).

§ 9.26.5. A business rationale for a good-faith commitment

Parties' use of a good-faith standard 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*.

Robert E. Scott and George G. Triantis, Anticipating Litigation in Contract Design, 115 Yale L.J. 814, 852 (2006) (emphasis added, 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.

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 added).

§ 9.26.6. Does the law *imply* a duty of good faith?

"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.)

Litigants invoke the duty of good faith because 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).

Texas law, however, does not impose a *general* duty of good faith and fair dealing, as explained by the Fifth Circuit:

> Texas law does not impose a generalized *contractual* duty of good faith and fair dealing and, in fact, rejects it in almost all circumstances. But in an extremely narrow class of cases, the Texas courts have determined that a special relationship may give rise to a *tort* duty of good faith and fair dealing.
>
> A duty of good faith and fair dealing may arise in two contexts. The first, not pertinent here, is when the parties are in **a formal fiduciary relationship** (*e.g.,* principal-agent, attorney-client, or trustee-beneficiary); in such situations, the ordinary bundle of duties incumbent on a fiduciary includes a duty of good faith and fair dealing.
>
> The second context, relevant here, is when the parties are not formal fiduciaries but are nonetheless in a **special or confidential relationship**. If they are, Texas law imposes a duty of good faith and fair dealing (but **not** the whole bundle of associated fiduciary duties).
>
> Texas courts usually describe this special relationship in broad terms. The duty arises in discrete, special relationships**, earmarked by specific characteristics** including: long standing relations, an imbalance of bargaining power, and significant trust and confidence shared by the

> parties. The relationship must exist before and apart from the contract or agreement that forms the basis of the controversy.
>
> A party's unilateral, subjective sense of trust and confidence in the opposing party **is not sufficient** to give rise to a special relationship and the attendant duty. …
>
> The Texas Courts of Appeals have **restricted the special-relationship doctrine to narrow and carefully circumscribed situations**. Indeed, those courts recognize only one special relationship — that between an insurer and an insured.
>
> **Texas courts have refused** to impose a tort duty of good faith and fair dealing on any of the following relationships: employer-employee, lender-borrower, medical provider-patient, mortgagor-mortgagee, supplier-distributor, franchisor-franchisee, creditor-guarantor, issuer and beneficiary of a letter of credit, or insurance company-third-party claimant.

Hux v. Southern Methodist University, 819 F.3d 776, 781-82 (5th Cir. 2016) (affirming dismissal of former student's tort claim against professor) (cleaned up; emphasis and extra paragraphing added, extensive citations omitted).

And UK courts have likewise 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). But this might be changing:

> 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.)

§ 9.26.7. What sorts of thing can amount to *bad* faith?

The Restatement of Contracts lists examples of breach of 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), *rev'ing* 87 Mass. App. Ct. 85 (2015).

§ 9.26.8. 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).

§ 9.26.9. 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).

§ 9.27. 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.

§ 9.28. Gross Negligence Definition

§ 9.28.1. The Rule

a. 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.

> Comment: 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).

b. An assertion of gross negligence must be proved by clear and convincing evidence.

> Clear and convincing evidence 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; allegation of gross negligence requires proof by clear and convincing evidence) (citing cases).

[Additional commentary follows]

§ 9.28.2. 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.

§ 9.28.3. Language origin: New York's definition of *gross negligence* is fairly reasonable

§ 9.28.4. Other jurisdictions' definitions are less middle-of-the-road

– 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).

§ 9.29. Hold Harmless Definition

§ 9.29.1. The Rule

The term *hold harmless* has the same meaning as *indemnify.*

§ 9.29.2. Commentary

The above 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. While some courts 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 — 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.'" 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).

Even so, the 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.)

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).

§ 9.30. 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.

> Comment: 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).

> For a *somewhat*-contrary result from England, see Barton v. Gwyn-Jones, [2019] EWCA Civ 1999: Under a real estate seller's contract with an agent, the agent was entitled to a "success fee" if the property was sold for a stated price — but the sale was for a lower price. The court of appeal held that in context, the term *if* did not mean *if and only if*, and so the agent was awarded a (reduced) success fee under an unjust-enrichment theory — even though normally unjust enrichment is not available when the parties have a contract — on grounds that the parties' agreement did not address what would happen if the sale was at a lower price, and so recovery for unjust enrichment was not precluded. *See id*. at ¶¶ 31-34.

§ 9.31. Implied Warranty Disclaimer Definition

a. *Commitments disclaimed:* A disclaimer of implied warranties disclaims not only all implied *warranties*, but also all purportedly-implied representations, conditions, terms of quality, and other commitments as to the accuracy of assertions about past, present, or future fact (each, an "*implied factual commitment*").

> Comment: 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 **Error! R eference source not found.** for more details (and examples of the dangers of screwing this up).

b. *Specific examples:* A disclaimer of implied warranties has the effect of disclaiming — without limitation — any and all implied factual commitments concerning any of the following matters: • 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 content;

• correspondence to description.

> Comment: The "without limitation" phrase near the beginning of this subdivision is included in view of 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 also 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?* One suspects that the Georgia courts were simply unwilling to enforce the warranty disclaimer in the particular circumstances and, to that end, adopted a risible interpretation of the disclaimer terms.

c. *Express factual commitments unaffected:* Any warranties, representations, or other factual commitments clearly stated in the Contract are unaffected by a disclaimer of implied warranties.

> Comment: This is a "comfort" provision to get the attention of contract reviewers who might be reading the disclaimer language very quickly.

d. A disclaimer of implied warranties applies regardless whether any purported implied factual commitment 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.

> Comment: See generally UCC §§ 1-303 and 2-314(3) concerning course of dealing, etc.

e. *Revocation of disclaimer:* A disclaimer of implied warranties can be revoked, but only by a writing, signed by the disclaiming party, that meets the requirements of the Contract for amending or waiving the Contract.

f. *Additional terms incorporated:* The Limitation of Liability General Terms Clause (XXX) is incorporated by reference into this Disclaimer.

g. *No contrary assertion:* No party will assert that any party disclaiming one or more implied warranties Disclaimer is liable for breach of any Implied Warranty.

> Comment: 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.

h. *Authorization requirement for other factual commitments:* The Contract may provide that no person except an individual holding a specified position is authorized to agree to any factual commitment on behalf of that party that is not expressly stated in the Contract or in a related document.

> Comment: 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.

§ 9.32. 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 an agreement might use expressions such as *including but not limited to* or *including without limitation*. If that is the case:

1. it does not mean that the parties intend for *shorter* expressions — such as, simply, *including*, by itself — to serve as limitations unless an agreement expressly states otherwise;

2. in legalese: The parties do not wish for the principle of *ejusdem generis* (nor of *expressio unius est exclusio alterius*) to call for a different result.

Comment: 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.

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).

Subdivision b.2: 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).

§ 9.33. Incorporation by Reference Usage

§ 9.33.1. The Rule

Incorporation of material by reference into the Contract or other document has the same force and effect as setting forth the full text of the material in the body of the document.

> Comment: 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.

§ 9.33.2. Additional commentary

§ 9.33.2–1 **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.

§ 9.33.2–2 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.

§ 9.33.2–3 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).

§ 9.33.2–4 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, though, the purchase-order 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).

§ 9.33.2–5 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.)

§ 9.33.2–6 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.

§ 9.33.2–7 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).INCOTERMS for shipping goods (commentary)

§ 9.33.2–8 Contract drafters should usually try to take advantage of the INCOTERMS options for the shipment of goods.

The INCOTERMS 2020 contract terms 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.

– **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.)

§ 9.34. Infringement Warranty Definition

§ 9.34.1. Applicability

Unless the Contract expressly provides otherwise, this Definition applies whenever, under the Contract, a party ("*Supplier*") makes any warranty of noninfringement:

1. to one or more specifically-identified other parties (each, a "*warranty beneficiary*");

2. concerning one or more products and/or services as delivered by Supplier or otherwise designated in writing by Supplier (each, a "*deliverable*").

§ 9.34.2. Infringement warranty terms

a. *Covered items:* An infringement warranty covers claims ("*Covered Infringement Claims*") of infringement of the specific rights in the types of intellectual property described in subdivision c, concerning the following "*Covered Items*":

1. deliverables per se that are: (i) as delivered by or on behalf of Supplier, and/or (ii) as modified (x) by Supplier or (y) with Supplier's express written authorization; and

2. the use of any such deliverable, by a warranty beneficiary and/or by other users expressly authorized by the Contract, in accordance with the user manual or other instructions provided by or on behalf of Supplier.

b. *Covered intellectual property:* Except as otherwise stated in this Definition, an infringement warranty covers the following types of claim by third parties (as limited by subdivision d):

1. claims that a copyright is infringed by a Covered Item;

2. claims that a trade-secret right is misappropriated by a Covered Item; and

3. only if expressly so stated in the Contract: claims that a patent right is infringed by a Covered Item.

c. *Exclusion of affiliate claims:* For purposes of an infringement warranty, the term *third party* does not encompass an affiliate (§ 9.02) of a warranty beneficiary.

d. *Who can enforce:* Only a warranty beneficiary is entitled to enforce an infringement warranty.

e. *Excluded claims:* An infringement warranty does not cover claims of infringement:

1. arising from a Covered Item's compliance with a written specification provided by any warranty beneficiary, or by a third

party on behalf of a warranty beneficiary, in either case pursuant to the Contract; or

2. where the infringement, actual or alleged, arises from a combination of a Covered Item with any other tangible- or intangible products, if no claim of infringement is made in respect of (i) the Covered Item itself, or (ii) use of the Covered Item apart from the combination.

f. *Covered jurisdictions:* An infringement warranty covers claims brought under the laws of any jurisdiction.

> ALTERNATIVE: "An infringement warranty covers only claims brought under the laws of the United States of America and its states and territories."

g. *EXCLUSIVE INFRINGEMENT WARRANTY TERMS:* Unless the Contract expressly states otherwise, this Definition states the exclusive terms of any warranty relating to infringement of intellectual property rights; all other such warranties are DISCLAIMED, and WAIVED by each party other than the warranting party, in accordance with the Implied Warranty Disclaimer Definition (§ 9.31).

§ 9.34.3. EXCLUSIVE REMEDIES for infringement warranties

a. *Remedy triggers:* A warranty beneficiary's "*Stop-Use Remedies*" in subdivision b will be triggered if any of the following "*Stop-Use Events*" occurs in respect of a Covered Infringement Claim for an infringement warranty:

1. A court of competent jurisdiction enjoins the warranty beneficiary from using a deliverable as a result of a

Covered Infringement Claim AND Supplier is unable to promptly have the injunction stayed or overturned; or

2. Supplier notifies the warranty beneficiary that Supplier has settled a Covered Infringement Claim on terms that would require a warranty beneficiary to stop using a deliverable; or

3. Supplier determines, in its reasonable judgment, that the warranty beneficiary should stop using a deliverable because of a Covered Infringement Claim.

b. *Stop-Use Remedies:* If a Stop-Use Event occurs in respect of a deliverable, then Supplier will take one or more actions, selected in Supplier's discretion (§ 9.20), as follows:

1. PLAN A: Supplier will modify or replace the deliverable in question with a non-infringing substitute that, in all material respects, performs the same functions as the replaced deliverable.

2. PLAN B: For each warranty beneficiary that was authorized under the Contract to use the deliverable in question: Supplier will — at its own expense — procure for that warranty beneficiary the right to continue using the deliverable.

3. PLAN C: IF: Supplier is unable to follow Plan A or Plan B, or if neither is commercially feasible in Supplier's judgment; THEN: Supplier will (i) direct the warranty beneficiary to stop using the deliverable, and (ii) take the refund action specified in subdivision c.

c. *Refund after Stop-Use Event:* Under Plan C above, Supplier will refund a prorated portion of the amount paid for the deliverable or its use. The prorated amount will reflect amortization, on a straight-line monthly basis, of that paid amount over:

1. 36 months, in the case of a paid-up permanent right to use the deliverable (for example, a deliverable sold outright, or a fee for a paid-up perpetual license), or;

2. the entire duration of a temporary period of entitlement (for example, a software maintenance subscription period); and/or

3. (if applicable) an equitable portion of fees paid for services that created the deliverable in question.

d. *Requirement to stop use:* If Supplier proceeds under Plan C above, then Supplier will not be responsible for any infringing use of a deliverable that is made by any warranty beneficiary (or other user authorized by the Contract) beginning after a reasonable time for the warranty beneficiary to conduct an orderly transition away from the use in question.

e. *EXCLUSIVE REMEDIES:* The remedies of this section are the EXCLUSIVE REMEDIES for any breach of the infringement warranty in question.

§ 9.35. 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.

> Comment: 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, however; 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.

§ 9.36. 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.

> Comment: 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.
>
> As an example of 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).

§ 9.37. Material Breach Definition

§ 9.37.1. The Rule

a. If an agreement states (in effect) that a certain type of breach is to be considered material, then that statement is to be considered conclusive. Otherwise, any determination whether a breach of an agreement was (or would be) material is to take into account the factors listed in the Restatement (Second) of Contracts § 241 (1981), considering an agreement as a whole, with no single factor necessarily being decisive.

> Comment: 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. This is not an uncommon practice; for example, in a major litigation over a computer-software development contract, the Indiana supreme court held that the contract's specific identification of standards of materiality took precedence over a Restatement of Contracts 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).
>
> 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 might well reduce the likelihood of getting summary judgment about the materiality or immateriality of a breach.

b. A history of non-material breaches could collectively constitute a material breach of an agreement when considering an 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.

> Comment: 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 like this 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).

§ 9.37.2. Additional commentary

§ 9.37.2–1 Why does it matter if a breach is "material"?

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).

§ 9.37.2–2 The Restatement's five-factor test

One federal court summarized the effect of the Restatement (Second) of Contracts on the analysis of claims of material 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).

§ 9.37.2–3 Getting a summary judgment about material breach 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 finder**.

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).

§ 9.37.2–4 Caution: "Letting it slide" could result in a waiver 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).

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).

§ 9.37.2–5 *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), *summarily affirmed in pertinent part*, 124 N.E.3d 1187 (Ind. 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 an 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).

§ 9.38. May and *May Not* Definitions

a. The term *may* is permissive; if an agreement states that a party may take (or omit) an action, it means that the party has the right, but not the obligation, to do so, in its sole discretion, unless an agreement clearly states otherwise.

b. If an agreement states that a party *may not* take (or omit) an action, it means that the party is prohibited from doing so.

> Comment: 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).

§ 9.39. Midnight Definition

References to midnight on a stated day are to exactly midnight at the *end* of that day.

> Comment: 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*.

§ 9.40. 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, 2023 ends at exactly midnight at the end of February 29, 2024 (because that year is a leap year and thus February has an extra day).

> Comment: 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.

§ 9.41. Need Not Definition

a. A statement in an 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 an 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.

Comment: 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."

§ 9.42. Organization Definition

The term *organization* refers to any of 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, where *entity* refers to an organization that has a legal identity apart from its members or owners.

Comment: This "laundry list" is adapted from: • UCC §1-201(25) and 1-201(27); • the definition of person in U.S. securities laws, at 15 U.S.C. § 77b(a)(2); and • Entity, BLACK'S LAW DICTIONARY (10th ed. 2014), quoted in Ineos USA LLC v. Elmgren, 505 S.W.3d 555, 563 (Tex. 2016).

§ 9.43. Prohibition usage

The prohibitions and restrictions of an 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.

> Comment: This provision can be useful in contracts — such as intellectual-property license agreements — that restrict a party's right to do something.

§ 9.44. Prompt definition

The term *prompt*, along with corresponding terms such as *promptly*, refer to taking specified action within a reasonable time and with a high priority, but not necessarily immediately nor with necessarily the highest priority.

> Comment: 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.

§ 9.45. Protected Group Definition

a. The term "**Protected Group**," in respect of an individual or organization that is identified by name in an 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 affiliates (§ 9.02), if any;

3. any other individuals or organizations specified in an 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."

> Comment: 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.

§ 9.46. Reasonable Efforts Definition

§ 9.46.1. The Rule

a. *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.

> Comment: 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.)

c. Any assessment of reasonable efforts is to give due weight to the information reasonably available to the relevant person(s) at the relevant time, about, without limitation:

1. the likelihood of success and likely costs of specific action(s) and alternative(s);

   Comment: The terms “likelihood of success” and “likely cost” are inspired by a comment by Janet T. Erskine, Best Efforts versus Reasonable Efforts: Canada and Australia (Nov. 30, 2007).

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.

> Comment: 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.

§ 9.46.2. Additional commentary

§ 9.46.2–1 “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 (i) that a dispute about reasonableness won’t arise, and if a dispute does arise, (ii) that the parties will be able to work it out themselves on a business basis.

§ 9.46.2–2 Pay me now, or pay me more later — maybe ….

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.

On the other hand, it might make perfect sense to take a chance that:

– a dispute about what constitutes *reasonable efforts* probably will never arise;

– if such a dispute does arise, the parties likely will work out the dispute on their own without litigation;

– consequently, it's not worth the time and trouble to try to define, in advance, exactly what's meant by *reasonable efforts.*

§ 9.46.2–3 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.

§ 9.47. Reckless Definition

a. A person (the "actor") acts *recklessly* when the act❑ • 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.

> Comment: This definition is based on Model Penal Code 2.02(c), as implemented in, e.g., Tex. Pen. Code 6.03(c).
>
> 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.

§ 9.48. 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.

> Comment: This definition is adapted from the (U.S.) Federal Acquisition Regulations, Contractor Records Retention, 48 C.F.R. § 4.703(a).

§ 9.49. Representation Definition

CAUTION: Drafters should keep in mind the subtle but potentially significant differences between representations and warranties, as discussed in the additional commentary below.

§ 9.49.1. The setting

This Definition applies when Alice makes a *representation*, that is, a statement of *past*- or *present* fact, to Bob, in connection with (i) the Contract, or (ii) a matter relating to (x) the Contract, and/or (y) a transaction or relationship resulting from the Contract. (The verb *represent* has the corresponding meaning.)

Comment: The term "statement of past or present fact" is suggested by Professor Tina Stark, author of the highly-regarded Drafting Contracts textbook.

The *transaction or relationship* term is modeled on the arbitration provision in Sherer v. Green Tree Servicing LLC, 548 F.3d 379, 382-83 (5th Cir. 2008), *citing* Blinco v. Green Tree Servicing LLC, 400 F.3d 1308, 1310 (11th Cir. 2005).

§ 9.49.2. The Definition

a. By making the representation:

1. Alice asserts that the stated fact is true, so far as she is aware, at the time she makes the representation;

2. Alice also asserts that she has a reasonable basis for making the assertion in subdivision 1; and

3. Alice intends for Bob to rely on her assertions in subdivisions 1 and 2 UNLESS she shows that Bob's reliance on those assertions was unreasonable.

b. In any Agreement-Related Dispute (§ 9.03), any claim that a representation, by a party to the Contract or acting under it, was fraudulent or negligent, is to be decided under the substantive law of New York, regardless what law would govern the dispute in other respects.

> Comment: New York law is chosen for uniformity purposes; see the extended commentary at § 7.14.6–6 concerning the notion of choosing a law to govern a specific section of a contract.

§ 9.49.3. Additional commentary

§ 9.49.3–1 Representations and warranties: 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:

– 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

– 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.

§ 9.49.3–2 *(Skim:)* State laws vary somewhat about negligent misrepresentation and fraud

As to **negligent misrepresentation**, "under **New York** law, the plaintiff must allege that (1) the defendant had a duty, as a result of a special relationship *[such as privity of contract–DCT]*, to give correct information; (2) the defendant made a false representation that he or she should have known was incorrect; (3) the information supplied in the representation was known by the defendant to be desired by the plaintiff for a serious purpose; (4) the plaintiff intended to rely and act upon it; and (5) the plaintiff reasonably relied on it to his or her detriment." Anschutz Corp. v. Merrill Lynch & Co., 690 F.3d 98, 114 (2d Cir. 2012) (granting motion to dismiss claim of negligent-misrepresentation; cleaned up, citations omitted), *quoted in* Kortright Capital Partners LP v. Investcorp Investment Advisers Ltd., 257 F. Supp. 3d 348, 355 (S.D.N.Y. 2017) (denying motion to dismiss claims of negligent misrepresentation).

Somewhat similarly, in **Texas** as in many other states, the courts follow Restatement (Second) of Torts § 552 (1977) in defining negligent misrepresentation as "(1) the representation is made by a defendant in the course of his business, or in a transaction in which he has a pecuniary interest; (2) the defendant supplies 'false information' for the guidance of others in their business; (3) the defendant did not exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers pecuniary loss by justifiably relying on the representation." Federal Land Bank Ass'n of Tyler v. Sloane, 825 SW 2d 439, 442 (Tex. 1991) (rejected borrower's claim of negligent misrepresentation by bank loan officer), *followed in* McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791 (Tex. 1999) (claim against attorneys by non-client) *and* Grant Thornton LLP v. Prospect High Income Fund, 314 SW 3d 913, 920 (Tex. 2010) (investors' claim against auditors).

It bears noting that "**California** courts have expressly rejected that requirement *[of privity of contract or other a special relationship]*, holding that negligent misrepresentation claims may be brought against any person who negligently supplies false information for the guidance of others in their business transactions and intends to supply the information for the benefit of one or more third parties." *Anschutz Corp.,* 690 F.3d at 113 (cleaned up; emphasis added).

As to fraud, New York law is fairly typical: "The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." Eurycleia Partners, LP v. Seward & Kissel, LLP, 12 N.Y.3d 553, 559, 910 N.E.2d 976, 883 N.Y.S.2d 147 (2009) (citations omitted).

Similarly, under **Texas** law, "[t]he elements of fraud are: (1) that a material representation was made; (2) the representation was false; (3) when the representation was made, the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion; (4) the speaker made the representation with the intent that the other party should act upon it; (5) the party acted in reliance on the representation; and (6) the party thereby suffered injury." Italian Cowboy Partners, Ltd. v. Prudential Ins. Co., 341 S.W. 3d 323, 337 (Tex. 2011) (citation omitted).

§ 9.49.3–3 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.

§ 9.49.3–4 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 that 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.

§ 9.49.4. (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 statement's falsity	x	x

Strict liability if statement was false		x
Plaintiff must prove it relied on statement	[c]	
Plaintiff must prove reliance was *reasonable*	[c]	[d]
Plaintiff must prove materiality of statement	x	
Plaintiff must prove defendant's scienter	[e]	
Defendant's proof of due diligence can help it to 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.

§ 9.49.4–1 Contract Ninja Warrior: The Hill of Proof for representations and warranties in a contract

A claim for breach of warranty has a shorter proof checklist than a claim for fraudulent inducement or negligent misrepresentation, but the former also has a more-limited set of remedies available. Think in terms of the American Ninja Warrior TV show, but with a "Hill of Proof" that a plaintiff "**Bob**" must climb in making a claim against a defendant "**Alice**": The Hill of Proof has evidentiary checkpoints along the way up the hill; the "prizes," i.e., the remedies available to our plaintiff Bob, are positioned at different points up the hill.

("The Hill of Proof" sounds like something from a Harry Potter novel, no?)

Suppose that in our Alice-and-Bob case, Alice only *warranted* a fact, but she did not *represent* it; for example, suppose that Alice sold her car to Bob, and she suspected, but didn't know for sure, that the engine was going to need work. In that case, she might (i) *warrant*, but *not* represent, that the car was in good working order, *and* (ii) limit Bob's remedy to Alice's reimbursing Bob for up to, say, $200 in repair costs.

In that situation, **the first three checkpoints that Bob must hit,** in trying to climb the Hill of Proof, would be the following:

(1) Alice *warranted* a statement of past or present fact, to use Tina Stark's formulation *[I'll leave out future facts for now]*. Here, Alice's statement is "the car is in good working order."

(2) Alice's statement was false: Her car, as delivered to Bob, turned out to need some significant work. and

(3) Bob incurred damages as a result, i.e., repair costs.

If, at the trial, Bob can successfully hit those three checkpoints in climbing up the Hill of Proof, then he will be entitled to recover benefit-of-the-bargain damages for Alice's breach of warranty — in this case, limited by contract to $200 in repair costs. And that's it; without more, Bob *doesn't* get tort-like remedies for fraudulent inducement or negligent misrepresentation, such punitive damages and/or rescission.

But now suppose that Alice *represented and warranted* the statement of fact, i.e., that her car was in good working order. In that case, after Bob makes it to the first three evidentiary checkpoints on the Hill of Proof, he can try to keep going to hit still more checkpoints, namely:

(4) Alice intended for Bob to rely on Alice's representation — that will probably be almost a given, of course, by virtue of the representation's being expressly set forth in the contract;

(5) Bob did in fact so rely — ditto; and

(6) Alice made the false representation intentionally (or possibly, in some jurisdictions, was negligent or reckless in doing so). This is usually the biggie, from a proof perspective.

If Bob can successfully make it to all of these additional checkpoints as he climbs up the Hill of Proof (and if Alice fails to show that Bob's reliance on her representation was unreasonable), then Bob would be additionally entitled to more "prizes," namely tort-like remedies such as rescission and perhaps punitive damages. See, e.g., this blog post summarizing California law.

At trial, Bob might well assert both breach of warranty and fraudulent inducement; if he proves unable to show scienter on Alice's part, then he can still fall back on his warranty claim. The same would be true if Alice could persuade the factfinder that Bob's reliance on her (mis)representation was unreasonable: Bob's fraudulent-inducement claim would fail, but his warranty claim would still be viable.

[ADDED:] Now let's change up the hypothetical: Suppose that Alice had no reason to think her car had any problems, but she also didn't want to bear any risk that it did have problems. In that case, Alice might *represent, but not warrant*, that the car was in good working order. In that situation, if the car did turn out to have problems, then Bob would have to hit all six checkpoints on the Hill of Proof to recover from Alice; the first three alone would not be enough, even though the first three *would* be enough if Alice had *warranted* the car's good condition.

In effect, **the Hill of Proof has two different paths up its slopes.** The shorter path is for breach of warranty and leads only to benefit-of-the-bargain remedies. The longer path, for misrepresentation, leads to tort-like remedies.

§ 9.49.4–2 Drafting lessons

– If your client is being asked to represent and warrant some fact, then consider whether the client should only *represent* the fact, or whether the client should only *warrant* the fact. As a matter of negotiation strategy the client might end up agreeing to do both, but as a drafter it's worth giving some thought to the question.

– On the other hand, if your client is asking someone else to represent and warrant a fact, then you'll want to ask for the contract language to include both a representation and a warranty. Your client might not have the bargaining power to insist on getting both, but if it does, then having both will give the client more flexibility if litigation should come to pass.

§ 9.49.4–3 Review exercise

Sketch the Hill of Proof for both representations and warranties.

§ 9.50. Responsible Definition

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.

> Comment: 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).

§ 9.51. Shall Definition

§ 9.51.1. The Rule

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.

§ 9.51.2. Commentary: *Shall* vs. *must* vs. *will*

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) (emphasis added).

§ 9.51.2–1 *Shall* might not be interpreted as mandatory

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.)

Even in the United States, *shall* might not be mandatory. For a U.S. Supreme Court dispute on that point, 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.)

§ 9.51.2–2 *Will* comes across as softer

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:

– Party A *anticipates* taking Action X in the future; or

– 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 me of my 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.

§ 9.52. 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.

> Comment: 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.)
>
> See also the Signature Protocol (§ 6.16).

§ 9.53. Subject to contract definition

If a document states that particular discussions are "subject to contract," the document thereby incorporates the Letter of Intent Rule (§ 2.02) by reference.

§ 9.54. 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.

§ 9.55. Time of Day Definition

A time of day refers to the exact time (in the relevant time zone if not otherwise specified). *Hypothetical example:* The term "The deadline for submitting a bid is 5 p.m." means that a bid will be untimely if submitted after exactly 5:00:00.00 p.m.

> Comment: 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.

§ 9.56. 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.

> Comment: "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.)

§ 9.57. 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* encompasses courts; arbitration tribunals; administrative agencies; and legislative bodies; when acting as stated in subdivision a.

> Comment: 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.)

§ 9.58. Warranty Definition

§ 9.58.1. The Rule

a. *Warranty as statement of past, present, or future fact:* The noun *warranty* (whether or not the term is capitalized) and the verb *warrant* (ditto) refer to a statement, by a party ("warranting party"), that a specified state of affairs: (1) now exists, or (2) existed or will exist at or during a specified time.

> EXAMPLE: "Alice warrants to Bob that the widgets, as delivered to Bob, will be substantially free of defects in materials or workmanship."

> CAUTION: Warranties should be carefully phrased to be clear just what is being warranted: Is it a *present* fact, or is it a *future* fact? This can be important because in many jurisdictions, the statute of limitations clock will not start to tick for a warranty of *future performance* (for example, by goods) until the warranty failure is *discovered*; this is in contrast to a warranty of *present fact* (for example, that goods *as delivered* are free from defects), where the clock starts ticking *at delivery*. See, e.g., Kenworth of Indianapolis, Inc., v. Seventy-Seven Ltd., No. 19S-PL-37 (Ind. Nov. 12, 2019), slip op. at 8-9, 13-14, where a truck manufacturer warranted the future performance of defective trucks.

b. *Warranty as conditional covenant:* A warranty has the effect of a promise by the warranting party: If the warranted statement proves untrue, then the following will take place:

1. The warranting party will take one or more clearly-specified actions, if any.

2. if no such actions are specified, then the warranting party will reimburse the warranty beneficiary (or -beneficiaries) for the foreseeable, ordinary-course economic losses incurred by the beneficiary.

3. In either case, the warranting party's obligations will be subject to any applicable exclusions of remedies or other limitations of liability in the Contract.

> Comment: The "ordinary course" language draws on the well-known case of *Hadley v. Baxendale* [XXX].

c. *Warranty beneficiaries:* A warranty will benefit only the specific individuals and organizations expressly identified in the warranty or otherwise in the Contract — and 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 Contract.

> Comment: A party that wants its affiliates, etc., to benefit from a warranty should make that clear in the warranty language itself. Here is a hypothetical example: "Alice warrants *to Bob and Bob's Affiliates* that …."

d. *No proof of reliance needed:* 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 Contract.

> Comment: This reflects the so-called modern view that proof of reliance is not necessary to a claim of breach of warranty, as discussed in the extended commentary at XXX.

[Additional commentary follows]

§ 9.58.2. Comment: What *is* a warranty (1): Judge 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 federal 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).

§ 9.58.3. 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:

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.

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.)

§ 9.58.4. 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).

§ 9.58.5. 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.

§ 9.58.6. 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 was 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 unreasonable.

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,[6] 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).

§ 9.58.7. 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*

[6] *Author's note:* Disclosure: Professor Stark is a friend and mentor and the author of Drafting Contracts, a well-regarded law school course book.

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.

§ 9.58.8. 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.

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).

§ 9.58.9. 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).

§ 9.58.10. (Study:) Disclaiming implied warranties

Many contracts include disclaimers of implied warranties; the idea could be paraphrased as, whatever representations and warranties are in this contract, that's it.

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).

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).

§ 9.58.11. 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.)

§ 9.58.12. Review: 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?[7]

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"?[8] [Drafting tip: Note where the question mark is, i.e., outside the quotation mark.]

§ 9.58.13. Review: 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

[7] 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."

[8] 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.

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.[9]

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.[10]

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.[11]

§ 9.58.14. Review: Reps and warranties multiple choice questions

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?[12]

[9] On these facts, English law will probably apply.

[10] Under UCC § 2-312(2), the implied warranty of *title* must be expressly disclaimed (or the disclaimer must be apparent from the circumstances).

[11] No - need a disclaimer of implied *conditions* and (probably) *terms of quality* as well.

[12] 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*

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?[13]

QUESTION 3: Should factual representations normally be included in an agreement's recitals? Why or why not?[14]

§ 9.59. *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.

> Comment: This term is defined as a precautionary measure; see the additional commentary at § 9.51.2.

§ 9.60. 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*

I will pay you Tuesday for a hamburger today. **NOTE:** For *drafting* purposes, treat A and B as the only correct answers.

[13] 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.

[14] 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.

or *willful misconduct* or *willful neglect*), refer to action or conduct that would be tortious if engaged in outside the context of a contract.

> Comment: 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.
>
> See also the U.S. Supreme Court's decision in Kawaauhau v. Geiger, 523 U.S. 57, 61-62 (1998). The specific issue there arose from section 523(a)(6) of the Bankruptcy Code, which provides that debts from "willful and malicious injury" are not dischargeable in bankruptcy. The 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**.

§ 9.61. Writing Definition

The term *writing* refers to a tangible or electronic record of a communication or representation; *written* has a corresponding meaning. The terms *writing* and *written* encompass, without limitation:

1. handwriting, typewriting, printing, photocopying, photography, audio or video recording, and e-mail; and
2. words, pictures, and diagrams.

> Comment: Subdivision 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

§ 9.62. Additional commentary

§ 9.62.1. 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 italic 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 ….

§ 9.62.2. Caution: Capitalization consistency 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).

§ 9.62.3. Where to put definitions?

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, as discussed below);

– 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).

Chapter 10: Warranty Rules (rough draft; in progress) Rules

Chapter 11: Notes on selected legal issues

The following notes — which are not part of the Tango Terms rules, options, or definitions — are provided for newcomers to the world of contract drafting and -reviewing.

§ 11.01. Assumption of the risk by the parties

From a Utah supreme court case: "It is a basic principle of contract law that parties are generally free to contract according to their desires in whatever terms they can agree upon. This includes assuming risks that third parties or external environmental circumstances will fail to conform to the parties' expectations." Mind & Motion Utah Investments, LLC, v. Celtic Bank Corp., 2016 UT 6, 367 P.3d 994, 1003 ¶ 35 (affirming summary judgment against bank) (footnotes omitted) (citations omitted).

§ 11.02. Battle of the Forms

§ 11.02.1. Business background

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:

– detailed, and often onerous, terms for the purchase, including for example expansive indemnity requirements; and

– 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, of course: 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 little dance is known as the "Battle of the Forms"; it's expressly addressed in UCC § 2-207 and is sometimes experienced in non-goods transactions as well.

§ 11.02.2. How the UCC handles the Battle of the Forms

The (U.S.) Uniform Commercial Code expressly provides Rules for the Battle of the Forms. To illustrate, let's consider a hypothetical example in which:

– Customer sends Supplier a purchase order for widgets;

– 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

– 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 — the conflicting terms can be thought of 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(s), 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**.**

§ 11.02.3. 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.

§ 11.02.4. 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).

§ 11.02.5. 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 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.)

§ 11.02.6. A "master" agreement *should* preclude a Battle of the Forms

A Battle of the Forms played out in a New Jersey case in which a GE subsidiary claimed that shipping giant UPS was responsible for some $1 million of damage to two shipments.

– The two companies had 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.

(Concerning master agreements, see generally § 6.12.3).

– In the court case, UPS claimed that its *bill of lading* limited its liability for damage to some $15,000.

– In contrast, the GE subsidiary claimed that under the *master agreement*, UPS was liable for the full value of the shipments in question.

The court ruled that the master agreement governed and consequently that damages cap in the UPS bill of lading did not apply. *See* Indem. Ins. Co. of N. Am. v. UPS Ground Freight, Inc., No. 13-3726, slip op. (D.N.J. Mar. 31, 2016) (denying motion for partial summary judgment), *and* slip op. (D.N.J. June 2, 2016) (holding that UPS's liability was governed by the master agreement and not by UPS's bill of lading).

§ 11.02.7. 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.

§ 11.03. Export controls

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. EXAMPLE: A 71-year old emeritus **university professor was sentenced to four years in prison** for export-controls violations. 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 the professor was found to have concealed those graduate students' involvement from the government. (Bloomberg.com 2012: https://goo.gl/gfvGhR) (FBI.gov 2012: https://goo.gl/jtZR7C).

In a related vein, in late 2019 a cryptocurrency expert was arrested for having traveled to North Korea to present at a Pyongyang blockchain and cryptocurrency conference, despite having been warned by the State Department that doing so was prohibited by sanctions legislation. See a Department of Justice press release at https://preview.tinyurl.com/v5hhf6r.

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).

§ 11.04. Fiduciary duties

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).

§ 11.05. Good cause

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, for purposes of letting a manufacturer terminate a dealership, as "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).

§ 11.06. Merchant status

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.

Merchant status matters: Under the (U.S.) Uniform Commercial Code, in some circumstances "merchants" are held to higher standards than others.

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).

§ 11.07. Payment- and performance bonds

§ 11.07.1. 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.

§ 11.07.2. 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).

§ 11.08. Price-fixing, etc.

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 some $1.7 billion in fines, and in four airline executives being sentenced to prison 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, 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: 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).

§ 11.09. 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.

§ 11.10. Security interests, liens, etc.

§ 11.10.1. 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:* The author drafted two small portions of the report while serving on the Commercial Transactions Committee, which I later co-chaired.

§ 11.10.2. 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/g0FnIg.

– *"Perfection" by possession:* Some security interests and liens can be "perfected" by taking possession of the collateral (and, in the case of money, 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.

§ 11.10.3. 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;

§ 11.11. 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 more, see What to Do When You Find the Side Letter… (BorisFeldman.com 2001), at https://goo.gl/ehJbzm, archived at https://perma.cc/NG3H-R7UW.

§ 11.12. Standby letter of credit

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.

§ 11.13. Trademark basics (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.

Chapter 12: Notes on contract drafting

The following notes — which are not part of the Tango Terms rules, options, or definitions — contain general-purpose takeaways for those drafting or reviewing contracts.

§ 12.01. The contract drafter's job is to *educate* and – sometimes – to *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).

I disagree. Adams's 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 the things called for by a contract. *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.

§ 12.02. Partner preferences take priority (within ethics bounds)

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 in XXX (Don't Repeat Yourself). **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.)

§ 12.03. Five crucial questions

(Just skim this section to the extent that you care to, but remember the heading.)

Many 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 when you think about it, the parties themselves often must consult the contract to figure out:

1. What am I supposed to do, when?

2. What should I expect from the other side, and when?

And 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:

3. Exactly what — if anything — did the defendant commit to do or not do in the contract?

4. What event or events could *trigger* the defendant's commitment, and did the necessary triggering event or -events actually occur?

5. 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.

§ 12.04. Contracts can be short and sweet

(Skim this section, with special attention to the bold-faced segments, and be sure to remember the headings.)

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.

§ 12.04.1. A countersigned letter can create a binding contract

Not long after the author started work as an associate at Arnold, White & Durkee in the early 1980s, the senior name partner, Tom Arnold, called me to his office.

> Author’s note: Tom Arnold (1923-2009) 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; he hired me at the firm, and for many years he and his wife, the aptly named Grace Gordon Arnold (1926-2015), were very good to my wife Maretta and me.

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 letter along approximately the following lines:

> 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 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 full-blown 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.

The experience was also 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 more 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 …. *[Additional financial terms omitted.]*
>
> We will provide you with office, computer and other incidental support when in Dearborn, Michigan.
>
> Either you or Ford can terminate the consulting arrangement at any time, in your or Ford's sole discretion, in which event Ford will pay you for consulting services previously rendered and reimburse you for travel and business expenses previously incurred.
>
> The effective date of our agreement shall be the date of your concurrence, below; however, the Company shall pay you in accordance with this agreement for the time you spent consulting with Ford executives in connection with the July meeting of the Board of Directors.
>
> Your signature, below, will also confirm your resignation from the Compensation Committee and the Nominating and Governance Committee of the Company.
>
> 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).

§ 12.04.2. Emails can create binding contracts

Courts have held that an exchange of emails can form a binding contract. See, e.g., Kolchins v. Evolution Markets, Inc., 31 N.Y.3d 100, 96 N.E.3d 784, 73 N.Y.S.3d 519 (2018), in which New York's highest court upheld denial of a motion to dismiss a breach of contract claim because an email exchange — "in essence, we 'offer' and 'I accept,' ... sufficiently evinces an objective manifestation of an intent to be bound for purposes of surviving a motion to dismiss." *Id.*, 31 N.Y.3d at 107-08, text accompanying n.5.

Likewise, in Forcelli v. Gelco Corp., 109 A.D.3d 244, 72 N.Y.S.2d 570 (N.Y. App. Div. 2013), a settlement agreement had been agreed to by an informal exchange of emails, but then the settling defendant tried to back out — the court didn't buy it and enforced the agreement.

§ 12.04.3. Caution: An email *signature block* 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.

§ 12.04.4. 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).

§ 12.04.5. Even an exchange of texts can create a binding contract

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.

– 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.)

The ad agency billed the client for the higher number of sales orders that had been agreed to in the text-message exchange — but the client didn't pay.

The ad agency sued the client and won a judgment for $1,240,655, because:

– The agency's 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 client vice president's "NO LIMIT" response constituted a counteroffer; and

– **The agency's account manager accepted the client's counteroffer by sending the "awesome!" reply.**

The court therefore held that the text-message exchange was binding on the client as an agreement to modify the existing contract. See CX Digital Media, Inc. v. Smoking Everywhere, Inc., No. 09-62020-CIV, slip op. at 8, 17-18 (S.D. Fla. Mar. 23, 2011).

§ 12.04.6. To close more business, a GE unit seriously shortened its contracts

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 unit found that its "comprehensive" contracts 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) (emphasis and extra paragraphing added).

What *was* a surprise was that **the GE legal department actually did something about it**. 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 (emphasis and 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.)

§ 12.04.7. The *Pathclearer* approach uses letter agreements and business incentives

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).

§ 12.05. 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 (https://goo.gl/v8Jbej); Item 3 in the 2013 list of tips to avoid crashing Word, by John McGhie (https://goo.gl/VxqJKs). NOTE: McGhie'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.

Here are some other 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.)

§ 12.06. Title of agreement

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

Especially for companies that have lots of contracts, it can make sense to use this information-dense title style to make lists of agreements more useful.

§ 12.07. Ambiguity

§ 12.07.1. What is ambiguity?

Ambiguity is an occupational hazard of contract drafting. **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.

Here's a simple example of ambiguity from a hypothetical lease:

> 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 Coppe*r 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 (reimburse) the owner for the damage. 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).

§ 12.07.2. 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.

– In contrast: When a contract is ambiguous, creative litigation counsel, exercising 20-20 hindsight, can be quite skilled at proposing meanings that favor their clients.

Ambiguities in a contract 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 — and to borrow a phrase from a former student in a different context: **"That's a conversation I don't want to have."**

§ 12.07.3. A brief review of contract interpretation principles

Here's a quick recap of some basic principles of contract interpretation:

– 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.)

– 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**.

– The judge will try to figure out what the parties had in mind, as expressed in the contract language.

– 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.

– 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.

– 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; **when a provision is ambiguous, 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).

§ 12.07.4. Do courts apply any specific rules?

Yes: 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 can be illustrated with an example: 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. ___, 136 S. Ct. 958, 962 (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*., 136 S. Ct. at 969 (Kagan, J., dissenting).

– **Other things being equal**, under the contra proferentem principle (discussed at § 7.14.2), 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).

§ 12.07.5. 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:

– Nurse is to put a bowl of food down for Patient's cat each day.

– Nurse is to bring cat food with her when s/he visits Patient.

– 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.

§ 12.07.6. What should a drafter *do* about ambiguity?

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, then the other side might argue that you waived application of contra proferentem by "laying behind the log."

– AND: If you don’t correct an ambiguity, you might be setting up your client for an expensive, burdensome fight in the future — a fight that perhaps might have been avoided with clearer drafting.

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.**

§ 12.07.7. 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.

(END)

§ 12.08. D.R.Y.: Don't Repeat Yourself *(because it can be very dangerous)*

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**; thus, 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 in favor of bank).

Another case: One of the author's clients was contemplated being acquired. A potential acquiring party proposed a confidentiality agreement (a.k.a. nondisclosure agreement a.k.a. NDA). The text said, in part: "provided, however, that in the event that a court of law shall determine that a fixed duration of survival is required, said *[confidentiality]* obligations shall survive for a period of **five (3) years** from the later of the following: the date of termination or expiration of this Agreement, or the date that either party notifies the other party that it has decided not to enter into the transaction or agreement contemplated by the parties."

Here are some before-and-after examples of how to do it better:

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, …. *(Also, notice how the ".00" is omitted.)*

And another example:

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 (XXX), not to slavishly follow drafting rules.

§ 12.09. Preamble of the agreement

Here's a preamble for a hypothetical contract:

Purchase and Sale Agreement
for 2012 MacBook Air Computer

This "*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.

§ 12.09.1. "This Agreement"

Many drafters would start this preamble by repeating the title of the agreement in all-caps, thusly:

> THIS PURCHASE AND SALE AGREEMENT (this "*Agreement*") ….

Your author prefers the shorter approach shown above and reproduced just below:

> This "*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. (**Error! Reference source not found.**).)*

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.)*

§ 12.09.2. Quoted, italicized defined terms

Note how our preamble defines the terms *Agreement*, *Buyer*, and *Seller*:

> This "*Agreement*" is between (i) **Betty's Used Computers, LLC**, … ("*Buyer*")
> … and (ii) **Sam Smith**, … ("*Seller*").

These defined terms are not only in italic 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 definitions 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.

§ 12.09.3. Specific terms: “Buyer” and “Seller”

One more point about how the buyer and the seller are identified in this contract:

> This “*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*.

§ 12.09.4. 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*” 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.

§ 12.09.5. Stating details about the parties

Our preamble provides certain details about the parties:

> This "*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."

Doing 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 "AAA 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.

§ 12.09.6. 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 the court's **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 over him or her and the proper venue for a lawsuit against the individual.

– *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.

§ 12.09.7. 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. Your author prefers the "last date signed" approach that's used in the example above:

> This "*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 period — as discussed in the Backdating commentary (§ 6.16.4), 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.)

§ 12.09.8. 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 might 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).

§ 12.09.9. 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).

§ 12.09.10. 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.

§ 12.09.11. 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.

§ 12.10. 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.

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 (see § The contract drafter's job: Educate and persuade). 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.

Bonus: Tips for plainer English

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 s to be bound ....

Modifier order might matter

Place modifiers correctly–"we want only the best" not "we only want the best."

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 ac Prospectus as the "Debt Securities") **supplements**, and to the extent inconsistent therewith repla description of the general terms and provisions of the Debt Securities set forth in the Prospectus, description reference is hereby made.

After: This document describes the terms of these notes in greater detail than our prospectus. It might pr
* information that differs from our prospectus. If the information in this document does differ from o please rely on the information in this document.

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.

Gobbledygook (2)

Adapted from the PlainLanguage.gov site:

Before: The amount of expenses reimbursed to a claimant under this subpart shall be reduced by any amo claimant receives from a collateral source in connection with the same act of international terrori which a claimant receives reimbursement under this subpart for expenses that also will or may be from another source, the claimant shall subrogate the United States to the claim for payment from 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 a also pays you for the same expenses, then you must repay us the amount that we paid you.

Gobbledygook (3)

From the PlainLanguage.gov site:

Before: When a filing is prescribed to be filed with more than one of the foregoing, the filing shall be deem 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 received it.

Exercises: Basic writing rules

(You needn't do these exercises until they're specifically assigned as exercises.)

- Long paragraphs: From the SEC Plain English Handbook
- Long paragraphs: Fix the satire

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.

Long paragraphs: Fix the satire

Rewrite the long paragraph quoted in § Actually, never mind. *(A satire.)*. Don't change the substance of the provisions.

For that matter, don't even consider merely adding pilcrows (a.k.a. paragraph marks, ¶) and subdivision lettering to serve as visual guideposts, like this:

Numbers (incl. currencies & percentages)

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.*

As a general rule, 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 Douglas Adams, the answer to The Ultimate Question of Life, the Universe, and Every is … 42.

Large numbers? Use *million, billion*, etc. (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.

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 (see also § D.R.Y. (Don't Repeat Yourself): Avoid the $693,000 proofreading error).

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; see § D.R.Y. (Don't Repeat Yourself): Avoid th
$693,000 proofreading error.)

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: $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 *(see § D.R.Y. (Don't Repeat Yoursel Avoid the $693,000 proofreading error).*

Active voice: Use it (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."]*

Paragraphs: Short, and on one subject only

Introduction

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.

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, t provisions in this part that authorize or require us to take certain actions extend to any tribe or tr organization that is administering relevant programs or providing specific services under a contra self-governance compact entered into under the Indian Self-Determination and Education Assista 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; (b) may not administer the provisions of this part relating to the granting, approval, or enforceme 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 fr the chairman of the board to all the members of the board at least 30 days before executing this o 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 cha of the board gives notice to all board members at least 30 days in advance of the sale, and (ii) the in its discretion, approves the sale.

Actually, never mind. *(A satire.)*

Forget everything you just read; instead, follow the example of the drafters who wrote the warranty provision reproduced below, which is excerpted from a Collaborative Research and License Agreement between Pfizer and Rigel Pharmaceuticals. *(For now, you don't need to read the provision other than to see how long it is.)*

9.2.12 PATENTS AND TRADEMARKS. To the best of its knowledge (but without having conducted any special investigation), Rigel owns or possesses sufficient legal rights to all patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, and proprietary rights and processes (including technology currently licensed from Stanford University) necessary for its business as now conducted and as proposed to be conducted without any conflict with, or infringement of the rights of, others. Rigel currently licenses certain technology from Stanford University (the "Licensed Technology") on an "as is" basis, with no representation or warranty from Stanford University that such technology does not infringe the proprietary rights of others. To Rigel's knowledge, Rigel has not, as of the date hereof, received any claims from any third party alleging that the use of the Licensed Technology infringes the proprietary rights of such party. Except for agreements with its own employees or consultants and standard end-user license agreements, there are no outstanding options, licenses, or agreements of any kind relating to the foregoing, nor is Rigel bound by or a party to any options, licenses, or agreements of any kind with respect to the patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, and proprietary rights and processes of any other person or entity, other than the license agreements with Janssen Pharmaceutica N.V., Stanford University, SUNY, and BASF. Rigel has not received any communications alleging that Rigel has violated or, by conducting its business as proposed, would violate any of the patents, trademarks, service marks, trade names, copyrights, trade secrets, or other proprietary rights or processes of any other person or entity. Rigel is not aware that any of its employees is obligated under any contract (including licenses, covenants, or commitments of any nature) or other agreement, or subject to any judgment, decree, or order of any court or administrative agency, that would interfere with the use of such employee's best efforts to promote the interests of Rigel or that would conflict with Rigel's business as proposed to be conducted. Neither the execution nor delivery of this Agreement, nor the carrying on of Rigel's business by the employees of Rigel, nor the conduct of Rigel's business as proposed, will, to the best of Rigel's knowledge, conflict with or result in a breach of the terms, conditions, or provisions of, or constitute a default under, any contract, covenant, or instrument under which any of such employees is now obligated. Rigel is not aware of any violation by a third party of any of Rigel's patents, licenses, trademarks, service marks, tradenames, copyrights, trade secrets or other proprietary rights.

Think about all the advantages of having such a long provision:

- When your client reads a provision like the one above, she'll be impressed by your lawyering skills, and happy to be paying your fees to support the creation of a true work of art.

- Your client isn't *that* interested in getting the deal to signature quickly, so it won't bother her that the dense verbiage will take longer for everyone to review, edit, and sign off on.
- The other side's contract reviewer, lulled by the MEGO effect ("Mine Eyes Glaze Over"), might unwittingly skip over the problematic phrase that you (inadvertently?) buried in the middle of the paragraph. Don't fret — surely your counterpart won't think you were trying to pull a fast one on him.
- Nor will your counterpart object to spending a lot of time puzzling over long sentences and paragraphs; it means more billable hours for him.
- Your firm's managing partner will thank you for using such a dense writing style — using less white space in a contract draft means you need less paper and toner to print it out, and those things aren't free. And readability is such a vague, subjective thing. But the cost savings you achieve by printing out fewer pages? Now *those* are easily measured, and will be noticed and rewarded.
- If the signed contract ever has to go to litigation, the judge's law clerk will be glad to have a fine specimen to study, to help fill those endless idle hours in chambers.

So by no means should you ever consider breaking up a long paragraph like the above into shorter ones.

Remember, lawyers have drafted contracts with long, hard-to-read paragraphs since time immemorial. That alone justifies their continuing to do so.

Bonus tip: Challenges to this or any other established practice can be met by closing your eyes, sticking your fingers in your ears, and chanting, "we've always done it that way; we've always done it that way …."

Streamlining 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.

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 *imple*
tion 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 imple
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 imple
decisions. *[Also: Passive voice.]*

After: A military staff advises the commander; transmits his instructions; and implements his decisio

Before: Universal military values include *that we should act with* integrity, dedication to duty, the belie
freedom is worth dying for and service before self.

After:	Universal military values include *commitment to* integrity, dedication to duty, service before se the belief that freedom is worth dying for. *[DCT comment: Here, semicolons might be better than commas.]*

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 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 s 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 **provid** 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.

§ 12.11. Abbreviations to know

You might well be tested on the following:

A.T.A.R.I.	Avoid the Argument: Rewrite It!
D.R.Y.	Don't Repeat Yourself *(with some exceptions)*
F.O.F.L.	*(right of)* First Offer = First Look
F.R.I.L.L.	*(right of)* First Refusal Is Last Look
G.F.	Graceful Failure: it's better to have a Plan B than to have the only fallback be a lawsuit for
O.T.C.	One Throat to Choke! *(Think of two baseball outfielders letting a fly ball drop to the ground because neither one "calls it.")*
Net 30 days	Payment in full is due 30 days after some specified date
R.O.O.F.	Root Out Opportunities for F[oul]-ups *(D.R.Y. is an example of this)*
S.T.R.	Serve the Reader
W.I.D.D.	When In Doubt, *Define*
W.I.D.A.P.	When In Doubt, *Ask the Partner* (after you've done your own homework and possibly co an admin, and/or a paralegal)
W.I.D.A.C.	When In Doubt, *Ask the Client* (after you've asked the partner)
W.T.C.	Whose Throat to Choke? *(Or, be careful about possible false imperatives—whom do I sue if done?)*

§ 12.12. Background of the agreement

A contract will typically include at least some background information to help future readers — business people, litigation counsel, judges — get themselves up to speed about what the parties had in mind when they signed.

§ 12.12.1. Style tip: Delete "Witnesseth" and "Whereas"

Like all purely-style tips: (1) this particular style tip 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.)

> WITNESSETH:
>
> 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:

§ 12.12.2. Use background recitals instead

Instead of using "Whereas" clauses, 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).

§ 12.12.3. Keep the background recitals 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 excerpt is from a highly publicized stock purchase agreement in the tech industry, rewritten into background-section form:

COMPARE: **RECITALS**	WITH: 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 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”);	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 to this Agreement as Exhibit D (the “License Agreement”).

[The remainder of the text has been omitted.]

The original example in the left column 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

§ 12.12.4. 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."

§ 12.12.5. 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 the plaintiffs' 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).

PRO TIP: 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, as discussed in the commentary about acknowledgements (§ 9.01). 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).

§ 12.13. Walls of words (WOW): Simplify them, step by step

Contract *drafters* normally spend far more time reviewing and revising others' draft agreements than they do drafting provisions from scratch. Walls of words — appropriately, "WOW" — can be extremely difficult to review and revise. Most contract professionals spend much of their time reviewing and revising others' contract drafts, many of which include WOW provisions. A reviewer should always consider breaking up any WOW provision, for two reasons:

- To reduce the risk of the MEGO factor (Mine Eyes Glaze Over), and
- to make the provision easier for the client to read.

And in any case, few drafters start a project by crafting language from scratch — instead, they look for one or more existing contracts (or drafts) and then copy and revise language to match their current needs, and some of that language might be in WOW form.

Here's one example of a WOW provision, excerpted from a Collaborative Research and License Agreement between Pfizer and Rigel Pharmaceuticals. (You don't need to read the provision other than to see how long it is.)

> 9.2.12 PATENTS AND TRADEMARKS. To the best of its knowledge (but without having conducted any special investigation), Rigel owns or possesses sufficient legal rights to all patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, and proprietary rights and processes (including technology currently licensed from Stanford University) necessary for its business as now conducted and as proposed to be conducted without any conflict with, or infringement of the rights of, others. Rigel currently licenses certain technology from Stanford University (the "Licensed Technology") on an "as is" basis, with no representation or warranty from Stanford University that such technology does not infringe the proprietary rights of others. To Rigel's knowledge, Rigel has not, as of the date hereof, received any claims from any third party alleging that the use of the Licensed Technology infringes the proprietary rights of such party. Except for agreements with its own employees or consultants and standard end-user license agreements, there are no outstanding options, licenses, or agreements of any kind relating to the foregoing, nor is Rigel bound by or a party to any options, licenses, or agreements of any kind with respect to the patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, and proprietary rights and processes of any other person or entity, other than the license agreements with Janssen Pharmaceutica N.V., Stanford University, SUNY, and BASF. Rigel has not received any communications alleging that Rigel has violated or, by conducting its business as proposed, would violate any of the patents, trademarks, service marks, trade names, copyrights, trade secrets, or other proprietary rights or processes of any other person or entity. Rigel is not aware that any of its employees is obligated under any contract (including licenses, covenants, or commitments of any nature) or other agreement, or subject to any judgment, decree, or order of any court or administrative agency, that would interfere with the use of such employee's best efforts to promote the interests of Rigel or that would conflict with Rigel's business as proposed to be conducted. Neither the execution nor delivery of this Agreement, nor the carrying on of Rigel's business by the employees of Rigel, nor the conduct of Rigel's business as proposed, will, to the best of Rigel's knowledge, conflict with or result in a breach of the terms,

> conditions, or provisions of, or constitute a default under, any contract, covenant, or instrument under which any of such employees is now obligated. Rigel is not aware of any violation by a third party of any of Rigel's patents, licenses, trademarks, service marks, tradenames, copyrights, trade secrets or other proprietary rights.

§ 12.13.1. Split up multiple-*sentence* paragraphs

The first thing to do when encountering a wall-of-words provision is to break each sentence into a separate paragraph.

(EXCEPTION: Multiple, short, sentences concerning a single topic might be left in a single paragraph.)

NOTE: You might not want to bother numbering the new separate paragraphs just yet, although the "after" examples below are generally numbered for convenient reference.

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. 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, (d) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business, (e) Hazardous Materials on, in, under or around the Premises, (f) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations, or

(g) any other matter whatsoever. Tenant has satisfied itself as to such suitability and other pertinent matters by Tenant's own inquiries and tests into all matters relevant in determining whether to enter into this Lease. Tenant accepts the Premises in their existing "AS-IS", "WHERE-IS" condition, and "WITH ALL FAULTS". Tenant shall, by entering into and occupying the Premises, be deemed to have accepted the Premises and to have acknowledged that the same are in good order, condition and repair in all respects. Upon the Commencement Date, tenant shall execute and deliver to Landlord the Acceptance Form attached hereto as Exhibit C.

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.

(e) Tenant does not rely on, and Landlord does not make, any express or implied representations or warranties as to any matters including, without limitation,

(1) 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),

(2) the existence, quality, adequacy or availability of utilities serving the Premises or any portion thereof,

(3) the use, habitability, merchantability, fitness or suitability of the Premises for Tenant's intended use,

(4) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business,

(5) Hazardous Materials on, in, under or around the Premises,

> (6) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations, or
>
> (7) any other matter whatsoever.
>
> (f) Tenant has satisfied itself as to such suitability and other pertinent matters by Tenant's own inquiries and tests into all matters relevant in determining whether to enter into this Lease.
>
> (g) Tenant accepts the Premises in their existing "AS-IS", "WHERE-IS" condition, and "WITH ALL FAULTS".
>
> (h) Tenant shall, by entering into and occupying the Premises, be deemed to have accepted the Premises and to have acknowledged that the same are in good order, condition and repair in all respects.
>
> (i) Upon the Commencement Date, tenant shall execute and deliver to Landlord the Acceptance Form attached hereto as Exhibit C.

ALTERNATIVE: Add bracketed pilcrows [¶] to help the reader's eye locate the beginnings of sentences:

> 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. …

§ 12.13.2. Next: Split up multiple-*topic* paragraphs

When a paragraph covers multiple topics, even if closely related: Consider breaking up those topics into separate paragraphs *each as a complete sentence*. (You might have to add transitional language to "help lead the reader by the hand along the path.")

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.

§ 12.13.3. Watch out for parentheticals addressing separate topics

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 ….

ALTERNATIVE, with em-dashes in lieu of parentheses for greater visibility:—

> 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 ….

§ 12.14. Deciding who will write the first draft

Who will prepare the first draft of a contract will typically depend on a number of factors, including some unwritten conventions:

– Being the drafter can be a good thing: The drafter can control the wording of the first draft to advantage her client in subtle ways.

– But the *client* will generally want the other side to incur the legal expense of preparing the first draft, so that the client's lawyer's role will be "limited" to reviewing and proposing revisions to the draft.

– And busy lawyers will often prefer the reviewer role.

– In real-estate deals, the owner of the real estate generally prepares the contract.

– In commercial transactions for the sale of goods and/or services, the parties will often use the *supplier's* contract form — but many buyers insist on using their standard purchase-order terms and conditions, which can be quite one-sided in favor of the buyer.

– In financing transactions, the party putting up the money will usually insist on using its form of agreement as the first draft.

– In merger-and-acquisition ("M&A") transactions, the buyer will usually prepare the first draft — unless, that is, the target company is putting itself up for auction, in which case the target company's counsel will generally prepare the first draft of the agreement.

§ 12.15. *Avoid* vs. *reduce the chance*

It's often a good idea to try to avoid using the word *avoid* (yes, it's a contradiction), because it could later be branded as a representation of some kind that something undesirable would in fact be avoided. Consider instead using terminology such as, *reduce the chances of* … as a softer, less-committal alternative.

BEFORE: "… *to avoid a significant risk* of the Partnership or the Operating Partnership becoming taxable as a corporation …." (From the Enterprise Products Partners limited-partnership agreement, section 4.7(b).)

AFTER: "… *to reduce the risk* of the Partnership or the Operating Partnership becoming taxable as a corporation …."

§ 12.16. Conspicuousness

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.

§ 12.16.1. The test: Should a reasonable person have noticed it?

The Uniform Commercial Code says that a term or clause is conspicuous when it is "so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it." UCC § 1-201(10).

§ 12.16.2. All-caps does not conspicuousness make

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.

§ 12.16.3. 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).

§ 12.16.4. 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).

§ 12.16.5. Actual knowledge 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 that the above quotation 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) (XXX). 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.).

§ 12.16.6. Should *everything* be deemed "conspicuous" if counsel are involved?

It could be argued that if a party was represented by counsel in entering into an agreement, then any term in an agreement that was not obscured should be deemed conspicuous as to that party. That would cut a Gordian knot: If a party was 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.

§ 12.16.7. 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 SEC's 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.**

§ 12.16.8. Further reading (optional)

See Linda R. Stahl, Beware the Boilerplate: Waiver Provisions (Andrews Kurth Jan. 14, 2013) (citing Texas cases).

§ 12.17. False imperatives (commentary)

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).

§ 12.18. Punctuation can help guide the reader's eye

Make a long sentence easier to grasp by judiciously inserting commas; semi-colons; parentheses; and em-dashes.

Before:

> Landlord shall have no obligation for construction work or improvements on or to any portion of the Premises.

After:

> Landlord shall have no obligation for construction work or improvements on[,] or to any portion of[,] the Premises.

See also the alternative of selectively replacing parentheses with em-dashes.

§ 12.18.1. Next: Spin off "provided that …." language

Seriously consider breaking off "provided that" language into its own paragraph — possibly using terms such as "except as otherwise provided below …" or comparable language, as shown in the example below.

Before:

> 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; *provided that*, with respect to any Seller RSU Award that is subject to performance-based vesting (A) with respect to any performance year that includes the Closing Date, the number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be based on target-level performance, and such Purchaser RSU Awards shall not be subject to performance-based vesting criteria for such performance year, and (B) with respect to any performance year that commences after the Closing Date, Purchaser or its Affiliates shall establish the applicable performance goals following the Closing.

After:

> (a) *Except as provided in subdivision (b) below,* 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 ….
>
> (b) With respect to any Seller RSU Award that is subject to performance-based vesting ….

§ 12.18.2. Sometimes a bit of repetition can add clarity

In the long, single-sentence, "Before" version below, note how there are two different "branches," labeled with "(A)" and "(B)." The "After" version breaks up those branches into two different subdivisions.

Before:

> [W]ith respect to any Seller RSU Award that is subject to performance-based vesting (A) with respect to any performance year that includes the Closing Date, the number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be based on target-level performance, and such Purchaser RSU Awards shall not be subject to performance-based vesting criteria for such performance year, and (B) with respect to any performance year that commences after the Closing Date,

> Purchaser or its Affiliates shall establish the applicable performance goals following the Closing.

After:

> (a) Case 1:
>
> (1) This subdivision applies to any Seller RSU Award that is subject to performance-based vesting with respect to any performance year that includes the Closing Date.
>
> (2) For that Seller RSU Award: (A) the number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be based on target-level performance; and (B) such Purchaser RSU Awards shall not be subject to performance-based vesting criteria for such performance year.
>
> (b) Case 2:
>
> (1) This subdivision applies to any Seller RSU Award that is subject to performance-based vesting with respect to any performance year that commences after the Closing Date.
>
> (2) For that Seller RSU Award: Purchaser or its Affiliates shall establish the applicable performance goals following the Closing.

§ 12.18.3. Consider telling a story to break up long sentences

Give some thought to setting the stage for a long contract provision to provide some context for the reader.

Before:

> [W]ith respect to any Seller RSU Award that is subject to performance-based vesting (A) with respect to any performance year that includes the Closing Date, the number of shares of Purchaser Common Stock subject to each Purchaser RSU Award shall be based on target-level performance, and such Purchaser RSU Awards shall not be subject to performance-based vesting criteria for such performance year, and (B) with respect to any performance year that commences after the Closing Date, Purchaser or its Affiliates shall establish the applicable performance goals following the Closing.

After:

> (a) Some Seller RSU Awards might be subject to performance-based vesting for which the relevant performance year includes the Closing Date. For those awards:
>
> (1) the number of shares of Purchaser Common Stock subject to each Purchaser RSU Award is to be based on target-level performance; and
>
> (2) those Purchaser RSU Awards are not to be subject to performance-based vesting criteria for such performance year.
>
> (b) Other Seller RSU Awards might be subject to performance-based vesting for which the relevant performance year begins after the Closing Date. For those awards, Purchaser or its Affiliates will establish the applicable performance goals following the Closing.

§ 12.18.4. When a sentence includes an "if … then …" statement

Be sure that the *word* "then" is included as a visual guide at the beginning of the "then" portion. This isn't a hard and fast rule, but it's a useful rule of thumb.

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 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, *then* Landlord may ….

EVEN BETTER: If an if-then sentence is long and/or complicated, then consider writing the if-then labels as follows: "IF: …; AND: …; THEN: …." Note especially the use of all-caps, colons, and semi-colons.

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 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, ….

§ 12.18.5. … ❑ Spin off the conditions into a preamble

When confronted with a long if-then provision, consider turning the "if" portion into a preamble for the section, with the "then" part(s) being set forth as subdivisions.

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:
>
> (2) discharge any lien;
>
> (3) take out, pay for[,] and maintain any insurance required under this Agreement; and/or
>
> (4) take (or cause to be taken) any other necessary or appropriate action.
>
> (b) Landlord must give Tenant five business days' written notice to Tenant before taking any action under subdivision (a).
>
> (c) This Agreement does not *require* Landlord to take any action under subdivision (a).
>
> (d) Tenant will not attempt to hold Landlord responsible or liable for any loss, disturbance, inconvenience, annoyance or damage that might result to Tenant arising from any action by Landlord under subdivision (a).

§ 12.18.6. When any paragraph contains a "laundry list"

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, (d) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business, (e) Hazardous Materials on, in, under or around the Premises, (f) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations, or (g) any other matter whatsoever.

AFTER (1):

> 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);
>
> (2) any other aspect of the physical condition of the Premises;
>
> (3) the existence, quality, adequacy or availability of utilities serving the Premises or any portion thereof,
>
> (4) the use, habitability, merchantability, fitness or suitability of the Premises for Tenant's intended use,
>
> (5) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business,
>
> (6) Hazardous Materials on, in, under or around the Premises, or
>
> (7) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations.

AFTER (2): If the above list will be used more than once, turn it into a defined term as a subdivision of the section, (or alternatively in the main Definitions article if appropriate):

> (a) 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 Premises Condition (defined below).
>
> (b) "**Premises Condition**" refers to one or more of the following:

> (1) 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),
>
> (2) the existence, quality, adequacy or availability of utilities serving the Premises or any portion thereof,
>
> (3) the use, habitability, merchantability, fitness or suitability of the Premises for Tenant's intended use,
>
> (4) the likelihood of deriving business from Tenant's location or the economic feasibility of Tenant's business,
>
> (5) Hazardous Materials on, in, under or around the Premises, and
>
> (6) zoning, entitlements or any laws, ordinances or regulations which may apply to Tenant's use of the Premises or business operations.

§ 12.18.7. Spin off lengthy exceptions into separate paragraphs

Time-pressured drafters sometimes keep stuffing exceptions and "provided, that" verbiage into a paragraph as though it were a sausage. That can make life difficult for reviewers and other readers, as seen in the following Before example:

Before:

> 15.1 Event of Default. The occurrence of any of the following shall be an "Event of Default" on the part of Tenant: …
>
> * * *
>
> (2) Failure to perform any other covenant, condition or requirement of this Lease when such failure shall continue for a period of thirty (30) days after written notice thereof from Landlord to Tenant; *provided that* if the nature of the default is such that more than thirty (30) days are reasonably required for its cure, then an Event of Default shall not be deemed to have occurred if Tenant shall commence such cure within said thirty (30) day period and thereafter diligently and continuously prosecute such cure to completion. …

After:

> 15.1 Event of Default. The occurrence of any of the following will be an “Event of Default” on the part of Tenant: …
>
> * * *
>
> (2) *Except as provided in subdivision (b) below*, failure to perform any other covenant, condition[,] or requirement of this Lease [Agreement] if the failure continues for 30 days after written notice of the failure from Landlord to Tenant (the "Cure Period");
>
> (c) *Exception:* IF: The nature of the default is such that more than 30 days are reasonably required to cure it; THEN: An Event of Default will not be deemed to have occurred if Tenant begins to cure the default ….

And another example:

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 .
>
> (c) If the nature of Landlord's relevant obligation(s) is such that more than 30 days are required for performance, then Landlord will not be in default if Landlord begins performance within that 30-day period and thereafter diligently prosecutes the same to completion.
>
> (d) 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.
>
> (b) IF: Landlord has provided Tenant with the name and address of the holder of a first mortgage or deed of covering the Premises; THEN: Tenant must send, to that holder, a copy of any notice under subdivision (a).

§ 12.18.8. Hunt down duplication

Look for and eliminate any duplication of substantive terms in a draft agreement; as discussed in [TO DO: Link: DRY], failing to do so ended up costing a bank $693,000. This is especially important because, as the draft agreement evolves during the parties' negotiations, the duplicate terms could end up being revised differently — and inconsistently.

§ 12.18.9. Actually, never mind. *(A satire.)*

Forget everything you just read; instead, think about all the advantages of having your contract provisions go on and on:

– When your client reads a long provision, she'll be impressed by your lawyering skills, and happy to be paying your fees to support the creation of a true work of art.

– Your client isn't *that* interested in getting the deal to signature quickly, so it won't bother her that the dense verbiage will take longer for everyone to review, edit, and sign off on.

– The other side's contract reviewer, lulled by the MEGO effect ("Mine Eyes Glaze Over"), might unwittingly skip over the problematic phrase that you (inadvertently?) buried in the middle of the paragraph. Don't fret — surely your counterpart won't think you were trying to pull a fast one on him.

– Nor will your counterpart object to spending a lot of time puzzling over long sentences and paragraphs; it means more billable hours for him.

– Your firm's managing partner will thank you for using such a dense writing style — using less white space in a contract draft means you need less paper and toner to print it out, and those things aren't free. And readability is such a vague, subjective thing. But the cost savings you achieve by printing out fewer pages? Now *those* are easily measured, and will be noticed and rewarded.

– If the signed contract ever has to go to litigation, the judge's law clerk will be glad to have a fine specimen to study, to help fill those endless idle hours in chambers.

So by no means should you ever consider breaking up a long paragraph into shorter ones.

Remember, lawyers have drafted contracts with long, hard-to-read paragraphs since time immemorial. That alone justifies their continuing to do so.

Bonus tip: Challenges to this or any other established practice can be met by closing your eyes, sticking your fingers in your ears, and chanting, "we've always done it that way; we've always done it that way ...."

§ 12.18.10. Apply the same step-by-step rewriting skills to your own drafts

As you continue to practice the rewriting skills summarized above, you'll find that you unconsciously do the same kinds of rewriting in your own drafting work. That will result in your producing clearer, more-understandable drafts, which in turn will help you to help your clients get workable contracts to signature sooner.

§ 12.19. 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*.

§ 12.20. Keep track of contract dates

Contract management can be expensive, but lack of it can be even more costly. General Nutrition Centers (GNC) was given a painful lesson in this truth to the tune of a $1.1 million jury verdict — which could have been much higher.

In Olive v. General Nutrition Centers, Inc., 30 Cal.App.5th 804 (2018), the plaintiff, a model and actor, appealed the damage award for being too low; the appeals court affirmed the judgment below, and also affirmed denial of the plaintiff's claim for attorney fees. The case arose because GNC's outside photographic agency shot photos of some 16 models that GNC used in an ad campaign. Among the models was one Jason Olive, who was paid **$4,000** for a three-hour photo shoot and for **the right to use his likeness for one year (a "model release"),** with GNC also having an option to extend the model release for one additional year.

In a classic example of things falling through the crack, **GNC did not keep track of when the model releases expired;** neither did GNC's photographic agency, which by then was no longer doing work for GNC. Consequently, when GNC's ads continued to feature the likenesses of several of the models, including Mr. Olive, it was for longer than the agreed period covered by the model releases.

GNC settled with the other models for between $5,000 and $32,000 each in exchange for five-year extensions of their model releases; Mr. Olive, however, held out for more. Rejecting an eventual GNC offer of $150,000, he sued GNC, under a California statute, for misappropriation of his likeness.

GNC admitted liability; the lawsuit was about the proper measure of damages. Mr. Olive initially asked for some $55 million, but **the jury awarded him a total of $1.1 million.** This was far less than what Mr. Olive had sought, but it was still far more than what GNC had paid any of the other models — and far less than GNC might have paid if it had insisted on the perpetual right to use the models' likenesses, as pointed out by Santa Clara Law professor Eric Goldman, who explains the case in detail at his Technology and Marketing Law blog.

§ 12.21. Other stuff

Ten basic writing rules

In a few places, this chapter steals — don't worry, it's perfectly legal — from the following sources:

- The U.S. Securities and Exchange Commission's Plain English Handbook (Aug. 1998) available at https://goo.gl/DZaFyT (sec.gov)
- The PlainLanguage.gov Web site, available 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)

The 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.

§ 12.22. Commas (skim)

– 22 Reasons Why Commas Are The Most Important Things In The World (BuzzFeed.com) (warning: contains graphic foul language in text messages).

– Village of West Jefferson v. Cammelleri, 2015 Ohio 2463 (Oh. App.) – a woman was issued a parking citation for leaving her pickup truck parked on the street overnight, in violation of a village parking ordinance. The ordinance stated that "[i]t shall be unlawful for any person to park upon any street in the Village, any *motor vehicle camper*, trailer, farm implement and/or non-motorized vehicle for a continued period of twenty-four hours." (Cleaned up.) The woman successfully argued that her pickup truck was not a motor vehicle camper, and that it didn't fit into any of the other categories stated in the ordinance; therefore, it was not a violation for her to park the truck on the street overnight.

– Stark v. Advanced Magnetics, Inc., 119 F.3d 1551, 1555 (Fed. Cir. 1997): The U.S. patent statute uses a comma in one provision but not in a related, substantially-identical provision; the appeals court held that the comma made a substantive difference in the proof required to show that a patent is invalid.