COMMON CONTRACTUAL BATTLEGROUNDS: FOUR SIGNIFICANT, BUT OFTEN OVERLOOKED, PROVISIONS IN DOMESTIC COMMERCIAL CONTRACTS

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Complex Commercial Litigation and Disputes Alert

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When parties enter into a domestic commercial contract, their focus is typically on memorializing their agreement and getting the deal done. As a result, they may not think critically enough about what will happen if the relationship goes south and how the contract provisions that they chose to include—or did not choose to include or accepted without negotiation—will affect how and where they resolve a dispute and shape the remedies to which they may be entitled.

Contractual provisions that parties choose to include in their agreement depend on a number of factors including, among others, the identity of and relationship between the parties and the size and nature of the transaction. This Alert identifies four types of provisions commonly included in commercial contracts that can have significant ramifications for contracting parties if a dispute between them arises.

ALTERNATIVE DISPUTE RESOLUTION PROVISIONS

Many commercial contracts include provisions that chart the path that parties must follow to resolve disputes arising from or relating to their agreement and can include mandatory arbitration clauses or clauses requiring negotiation and/or nonbinding mediation as a prerequisite to arbitration.

When carefully drafted, these provisions can simplify and allow the parties to efficiently, swiftly, and cost-effectively resolve their disputes, and do so without stepping into court. When less than carefully drafted (or not negotiated by the parties), however, these provisions can create a myriad of ancillary procedural distractions relating to their enforceability, scope, and applicability that the parties will be forced to resolve even before they get to the merits of that dispute. Ineffectively drafted or incomplete provisions also can take important decisions out of the control of the parties and leave them in the hands of third parties.

A good example is an arbitration clause that simply provides that all disputes between the parties will be resolved "by the American Arbitration Association ("AAA") in accordance with its Commercial Arbitration Rules." While such a provision commits the parties to arbitrate disputes, the provision does not address, among other issues, the number of arbitrators, how those arbitrators are selected, confidentiality, the ability of the parties to communicate with the arbitrator(s) *ex parte,* the location of the arbitration proceeding, or the substantive law that will govern. Rather, these decisions are left to the AAA's default or gap-filler rules that may be contrary to what the parties desired.

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CHOICE OF FORUM AND LAW PROVISIONS AND JURY TRIAL WAIVERS

If parties agree to litigate their disputes in court, they may include provisions that identify the court in which a lawsuit must be filed, the substantive law that will apply, and whether their dispute should be decided by a judge or a jury.

For example, consider a contract that includes a jury trial waiver, a clause requiring the parties to file in the United States District Court for the Central District of California, and a California choice of law provision. These terms may, at first glance, appear to give the parties security and a measure of certainty as to how (and where) future disputes will be resolved.

What parties may not realize—and likely will not realize until a dispute between them arises—is that their predispute jury trial waiver may be unenforceable depending on the applicable law and/or the court in which they agreed to file (and do file) their claims. For example, such waivers are unenforceable under California and Georgia law. Therefore, if a party filed in the court and under the law specified above, the jury trial waiver would not be enforceable.

Forum selection clauses and choice of law provisions also may be enforced differently depending on the subject matter of the contract. In certain states, for instance, forum selection and choice of law clauses in construction contracts selecting another locale or state's law are void where the work is to be performed in that state.

DAMAGES CLAUSES

In a situation where the other party to your contract breaches it, your company may have to spend money to obtain goods or services to replace the ones it was to receive under the contract. It may lose profits and business opportunities and suffer other damages as well. You may also need to engage outside counsel to represent the company in a lawsuit or arbitration based on the breach. But how much of those damages and other costs incurred as a result of the breach are recoverable?

In general, losses for breach of contract are limited to those damages that follow naturally from the breach or that were reasonably foreseeable to the breaching party at the time the contract was made. In certain circumstances, the types of damages that meet this description are not entirely clear and can lead to litigation. Thus, parties should consider provisions that identify the type of damages that a party may or may not recover if a dispute arises under the contract, including:

- limitation of liability and indemnification provisions;
- consequential damages waivers;
- liquidated damages provisions; and
- fee-shifting provisions.
- However, even when such provisions are included in a contract, disputes relating to damages can—and do—arise, frequently relating to the scope of those provisions and their applicability to a specific situation.

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- Indemnification provisions are prime examples. Under the laws of most states, indemnification obligations are strictly construed and courts will not extend them to include damages or duties that the parties did not intend to assume. If the court finds that the indemnification provision is clear, it will enforce that provision as written. If, however, the court determines that the contract's language is ambiguous, the court will look to extrinsic evidence (such as prior drafts of the contract and communications between the parties during negotiations) to interpret the contract and determine the scope of the indemnification provision. Thus, it is important for a party to understand the standards under state law that will govern the enforceability of these provisions and use those standards in drafting the provisions.

INSURANCE PROVISIONS

One significant way to shift risk between contracting parties is through contractual insurance provisions. Often, purchasers of goods or services will require the party with whom they are contracting to obtain certain types and limits of liability insurance. Many purchasing parties also require the selling party to name them as an additional insured under those policies, presumably with the goal of affording them coverage for claims or lawsuits that may be filed against them (for example, those alleging bodily injury or property damage arising during the selling party's performance of the contract).

However, all additional insured coverage is not created equal. Additional insured status is often conferred through an endorsement to the policy. For example, some are blanket "Additional Insured" endorsements that apply broadly to any person or organization the named insured has agreed to include as an additional insured under a written contract. Others are narrower in scope. Significantly, many such endorsements purport to limit an entity's status as an additional insured under the policy to only those liabilities arising out of the operations, acts or omissions of the named insured (i.e., the selling party) in the performance of its operations for the additional insured.

Unfortunately, more often than not, questions about whether the proper insurance was procured and about the scope of the coverage afforded are not asked until after a loss has occurred. Contractually requiring that copies of insurance policies be provided at the outset of the commercial relationship, so that the coverages afforded can be reviewed and understood before a loss occurs, can eliminate these uncertainties and help to avoid a costly (and possibly unnecessary) dispute.

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When it comes to drafting domestic commercial contracts, an ounce of prevention generally is worth a pound of cure and may prevent a seemingly innocuous or boilerplate provision from creating delays, costs, or other hurdles that could have been avoided through careful drafting. Understanding and identifying the provisions that can, and frequently do, lead to disputes and affect resolution of those disputes is invaluable. Armed with this information, the party can be in a good position to negotiate contract language to avoid finding itself on one of these battlegrounds, or, if it does, minimize the impact (both financially and otherwise) on its business and operations.

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