THE FINE PRINT - CONTRACT TERMS TO WATCH FOR AND AVOID

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I. INTRODUCTION.

Lawyers say that a contract is an agreement the court will enforce; this is a rich concept which bears exploring.

As children, we learned about the three branches of government: executive, legislative and judicial. As adults, we observe soberly that to the governed, the distinction makes little ultimate difference. A fine, a tax, or a toll must be paid all the same, regardless of which branch originates the charge, or enforcement will proceed under penalty of law by armed officers of the State.

Like the other branches of the government, the court enforces its will through men with guns. Backed by sheriff's deputies to carry out foreclosures, levies, and auction sales, and police officers to carry off the intransigent, a judgment for contract damages can be a powerful thing in the hands of determined creditor. The prudent business person learns to see the government as a shadow party to every contract. Before you sign your next contract, consider for a moment the downside risk of the government enforcing it in the event of your breach.

But also consider, downside risks are what contracts are all about. The reason for any contract is to manage and fix risk. People can be rascals. Things happen. The ball takes a bad hop. Absent express agreement on essential terms, the risks of misunderstanding, conflict, sharp practice and inequitable behavior rise to unacceptable levels, and so business people everywhere use contracts to allocate their respective rights and obligations in an exchange. With an express contract, these business risks are minimized, and transactions overall proceed more quickly and at lower cost.

Despite the admitted benefit of expressly allocating business risks, the benefit doesn't have to fall evenly on both sides. In some contracts, terms and conditions are so one-sided as to be unenforceable by the courts because of one public policy reason or another. The judges in their wisdom will not enter judgments which they would not wish to see enforced, and at the heart they understand that bringing men with guns to compel injustice invites revolution. Petitioned to enforce an unjust term of agreement, and in doing so undermine the status quo, the courts will most often discern (or invent) a public policy against enforcement. As a result of this predictable conservatism, lawyers say, "When the facts are against you, argue the law. When the law is against you, argue the facts. When the facts and the law are against you, argue public policy."

Whether through the opinions of reported cases or by the passage of statutes, public policy in time becomes law, but the two do not advance everywhere in the same direction or at the same pace. Overbearing contract terms enforceable in one

jurisdiction may be banned in another. There are, moreover, competing public policies, and fundamental fairness is ever at war with freedom of the marketplace. Everywhere we find contracts which are the product of a gross imbalance of bargaining power, and the courts enforce them all the same. The business ethic remains: if you can't run with the big dogs, stay on the porch.

Now, if you'd like to come down off the porch, there certain things you should know. You need to keep your eyes on the fine print - on the contract terms to watch for and avoid.

I. CONTRACT TERMS TO WATCH FOR AND AVOID:

A. Waivers, Releases and Exculpatory Clauses.

A waiver is the relinquishment of a right. In contract terms, it means that one party is giving up a right it would otherwise have. Waivers may be express (i.e., explicit in the contract) or implied, and include releases and exculpatory clauses.

A release (in the contracting sense of the word) is a waiver of rights by which you give up present or future claims of a certain type against a particular person or group. Such a clause may require that you release the other party from specific acts, omissions or violations of law, or it may constitute a blanket release, in which you (on paper at least) give up every claim you ever had or may ever have.

An exculpatory clause is language contained in a waiver that releases a party from damage which his own fault. It usually lets him off the hook for liability for negligent acts that cause injury. A valid and enforceable exculpatory clause will, in most states, absolve a person from responsibility for her own negligence, but must contain clear, explicit, unequivocal language of waiver. Specifically, the potential plaintiff must be put on notice of the range of dangers assumed, including reference to the types of activities, circumstances, or situations encompassed in which the plaintiff agrees to relieve the potential defendant of his duty of reasonable care.

The inclusion of releases, exculpatory clauses and blanket waivers in form contracts has become common, and offers a trap for the party who fails to negotiate them out. A cardinal danger is presented for an insured party, whose liability carrier may deny coverage for claims caused by a released party. Since a surety has the right to stand in the shoes of its insured and to pursue reimbursement from the party who caused the harm, to the extent that the negligent party has been released by the insured, the carrier is released from its contract of insurance under a legal doctrine known as impairment of subrogation. The carrier in such case can rightfully refuse to pay out on the claim, and the insured is left with no rights against the released party and no rights against the excused insurer.

The courts will generally enforce a waiver only to the extent that it can be shown to have been the voluntary and intelligent relinquishment of a known right, and the extent to which unknown rights can be released changes from place to place. (See, California Civil Code Section 1542: "A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.")

Moreover, waivers and releases can apply not only to the right to sue for damages, but also to other substantive legal rights such as the right to lien, and to

procedural rights such as the right to appeal, the right to a jury trial, and even the right to proceed through the courts in the event of a dispute. Some states, like New Jersey, have declared lien waivers void as against public policy, and by contrast have favored commercial arbitration clauses for the same reason. The question of waiver of procedural rights, such as the right to sue rather than arbitrate, is contested all over the country. These issues are furthermore situation-specific, and the enforceability of a release or waiver will depend not only on the jurisdiction involved but on whether the provision appears in a labor agreement, a commercial agreement, or a consumer contract.

Many contracts contain a "waiver of breach" or "implied waiver" clause which is, in actuality, a waiver of waiver. Such a clause states that the failure of either party to require the performance by the other of any of the contract terms will not affect their respective rights to enforce those terms, nor will the waiver of any breach of any contract provision be construed to be a waiver of any succeeding breach or as a waiver or modification of the said provision. As you can see, things can get complicated.

A. Indemnification / Hold Harmless.

An indemnification clause, in which you agree to reimburse the other party for loss or liability which he may suffer through no fault of your own, is worse than a release or a waiver. With an obligation to indemnify, you risk the obligation to pay actual dollars, as opposed to risking your own loss which you might simply absorb. The typical indemnification clause obligates you to pay for the other guy's lawyer to defend him in the event of suit, and to pay for any adverse judgment or even for any settlement he chooses to make.

As with releases, indemnification can impact your exposure to uninsured risk. If your employee falls through a skylight, workers compensation insurance won't relieve you from indemnification of the owner for premises liability.

Indemnification clauses are notoriously open-ended, and yield unlimited exposure. Unknown claims by third parties are difficult to evaluate or even anticipate, and may be made long after your work is done. When offered an indemnification clause you can't get rid of altogether, it would be far better for you to try to cap your potential liability to the extent of your own insurance coverage. Don't indemnify the other party for any negligence or willful acts on its own part, and always negotiate the right to participate in, or assume control of the defense against any claims which third parties may bring and which may trigger your duty to indemnify.

A. Choice of Forum/Venue.

A choice of venue or venue selection clause picks the location of the court that the parties must use if they end up in litigation relating to the contract. Being forced into a far-away court implies increased costs of suit in the event of breach, and the peril of being "home-towned." Venue selection carries with it by default in many instances the law of the host jurisdiction, which may directly impact your ability to present legal theories for recovery. Choice of law principles found in the law of the forum will govern in the absence of contractual selection.

Generally, a choice of forum or venue clause will be upheld unless the court concludes that the result would be unreasonable or unjust under the circumstances. A court will decline to enforce such a clause only if it fits into one of three exceptions to

the general rule: (1) the clause is a result of fraud or "overweening" bargaining power; (2) enforcement would violate the strong public policy of the state; or (3) enforcement would seriously inconvenience trial. Note, however, that a particular state (such as Michigan) may not enforce choice of venue clauses at all, leaving its own local rules as the sole source of authority for venue selection.

If you're going to be signing on to a choice of forum or venue outside your own, be very careful in the case where you are also dealing with third parties who have not signed such a clause. Your subcontractors or suppliers may have no legal reason to join in a far-off lawsuit, and unless they have consented to the jurisdiction of the foreign court, cannot be compelled to do so.

A. Choice of Law.

As with choice of venue, choice of law clauses can make a huge difference in the extent of your rights under a contract, as for example, where the timeliness of contract claims might be determined alternatively by reference to New York's limitation period or under California's shorter limitation period. With a California choice of law clause, you could be time barred when you go to sue.

Another problem results where a lawsuit is filed in one jurisdiction, but the contract says that the laws of another are to apply. In such a case, the judge's lack of familiarity with foreign law may lead to a wrong call. In actual practice, the judge and local lawyers for both sides may tacitly ignore the issue, or give it lip service only.

A. Liquidated Damages.

A liquidated damages clause provides for payment of a certain fixed amount, in place of actual damages which legally flow from a breach of contract. The government and big businesses love liquidated damages clauses - they avoid so very much fuss when it comes to actually proving a case.

Be careful. When you sign a liquidated damages clause, you are almost asking for an expensive legal battle in the event of the slightest and possibly inconsequential breach. The courts will uphold a liquidated damages clause if it is reasonable under the circumstances, if actual damages are difficult to ascertain by any satisfactory or known rule, and if it is not intended to serve as a penalty. However, a liquidated damages clause will be avoided and not enforced if it is far in excess of the amount of damages the parties may reasonably forecast, or the other side (usually an owner) has not acted reasonably in attempting to mitigate costs to the breaching party (usually a contractor), or the other side (the owner) prevents or delays performance.

A. Jury Waiver.

Waiver by contract of the right to trial by jury is a matter of evolving public policy across the country. Jury waiver is still enforceable in most commercial transactions, but elsewhere only enforceable if it is conspicuous, bargained for and between parties that are not of greatly disparate bargaining power; a jury waiver is therefore usually no good in a boilerplate consumer contract. People argue against the increased costs of trying a case to a jury, but what they really mean is that they are afraid that the jury will deliver a verdict which they cannot control. Juries level the playing field for the big and the little without concern for political fallout. Don't give up the right to trial by jury unless the thought of punitive damages makes you lose sleep.

A. Arbitration.

An arbitration clause is akin to a jury waiver, since it restricts the remedies developed to achieve justice by the common law over the centuries. A binding arbitration clause always acts as a jury waiver, and can be used by design to take a potentially inflammatory lawsuit away from a jury. While much in fashion, there are pros and cons to arbitration, and maybe more cons.

Chief among the points in favor of arbitration are the speed and potential for reduced cost resulting primarily from limitations on the parties' right to discovery. While a pro or con depending on your point of view, the limitation on discovery gives a direct advantage to the better informed party (or the bigger rascal). Arbitration also speeds resolution by allowing the parties to avoid the backlog of a court docket, where criminal matters are given priority on a congested trial calendar.

Arbitration allows the parties to select an expert arbitrator. For example, where the issue is an accounting problem, an accountant can be selected to act as arbitrator.

While overall costs may be lessened, they are telescoped inward and front-end loaded. A party whose lawsuit can be filed for a pittance, and affordably budgeted for over several years, will find herself paying her proportionate share of an arbitrator's and administrator's fees, venue rental, and day after day of attorney's time from the first hearing until the award is rendered.

There is also less procedural protection for an arbitrating party, and limited grounds for appeal or collateral attack on a bad result. Working against the effort to save costs, there is a chance the entire controversy may not be decided in arbitration, since the arbitrability of tort claims and availability of equitable relief is a matter of local law.

Once you've elected to go with arbitration, it is critical to select a set of procedural rules. There are a variety of statutory and private alternative dispute resolution (ADR) administrative schemes. You need to remember that despite the existence of complete sets of rules provided by statute or by established arbitration associations, the parties to a contract can further limit or partially change those established rules by their contract, such as limiting the number of arbitrators or designating the arbitrator. Whichever rules you select, be certain you know whether costs of the proceedings are to be shared or shifted from one party to the other - again, the matter is one for agreement.

Finally, arbitration (which is really just rent-a-court) is to be distinguished from mediation, where a hopefully skilled intermediary tries to broker settlement by agreement. Some contracts call for mediation as a precondition to arbitration; this will serve to insulate the big wrongdoer by exhausting the injured little guy.

A. Pay-When-Paid / Pay-If-Paid (contingency payment clauses).

A pay when paid clause attempts to shift the risk of an owner's insolvency from the prime contractor to the subcontractor. There are several views on the propriety of these types of clauses as a matter of public policy. Most courts refuse to construe a pay when paid clause as a valid defense to non-payment, and instead read them as timing provisions which fix the subcontractor's right to payment within a reasonable time after the work is performed regardless of when the general contractor is paid by the owner.

The minority views break in opposite directions. One minority of jurisdictions (including Florida) further distinguishes such a clause as either a condition precedent or a time of payment provision, and if it is a condition precedent, they see it as stating an obligation to pay only if paid. If so, it will be enforced in accordance with its terms. The second minority (including California) holds that a typical "pay if paid" provision in a contract is contrary to public policy and thus unenforceable.

A. Attorneys' Fees.

The so-called American Rule states that the parties to a lawsuit will each bear their own attorneys' fees, unless some statute or contractual provision states otherwise. Be on guard for fee-shifting contract clauses, which sound fair but seldom are.

First, there is the trouble of picking the "winner" in a multi-party, multi-issue case, with claims on both sides. More modern expressions of shifting fees to the "substantially prevailing" party offer little practical help, and may even act as a hindrance to quick resolution of the dispute.

Second, as if it weren't clear by now, the bigger, richer party not only has an advantage in the lawsuit, but their lawyers always cost more than your lawyers. Think of the biggest law firm in the biggest city in your State, and consider if you could afford their fees. Now think if you'd like to pay their fees (including travel time) and your own lawyer's fees at the same time you have a judgment against you. Now consider that these types of fee shifting clauses seldom if ever consider the issue of where it all ends - judgment, appeal, remand, or never?

A. Incorporation by Reference.

The effect of incorporation by reference is to make other documents part of the contract. While commonplace for plans and specifications too bulky to include in the text of the main contract, this technique presents the menace of multi-level layering of referenced documents. Incorporated project plans and specifications can themselves incorporate other documents, such as the prime contract or government regulations. These pose a significant risk of hidden obligations - a subcontractor may inadvertently agree to additional obligations and limitations of rights of which he has no knowledge. A commonplace example is where a subcontractor, bound by the provisions of an incorporated prime contract, files suit only to be bounced out of court on a motion for stay pending arbitration.

Incorporation by reference is easy to do wrong. When you try your hand at drafting your next contract on the bones of the last one your lawyer did, remember that to effectively make one document part of another you must contain a statement of incorporation, which should include the words "incorporated by reference." Defective incorporation of documents not (yet) in existence, no longer in existence, and laws no longer in force has deviled scriveners and contracting parties for hundreds of years.

Correct incorporation by reference gets to be a moving target on the issue of version control, with updates and revisions to plans and specifications, and updates and revisions to laws and regulations never reaching back to become part of the contract. This becomes especially problematic where the contract also contains an integration clause.

A. Integration.

An integration clause, sometimes in a contract under the headings “No Oral Modification” or “Entire Agreement,” states that the written contract represents the entire understanding of the parties with respect to the subject matter thereof and no changes are valid unless made in writing and signed by the parties. Such a clause will knock out oral understandings, and even common-sense incorporation by reference of updated collateral documents. An integration clause will probably prevent you from successfully suing for any misrepresentations preceding the signing of the contract, knocking out your fraud in the inducement defense to the deceiver’s claims of breach.

A. No Damages for Delay.

A no damages for delay clause means exactly what it says, and is a clearly one-sided clause that has been the topic of much recent legislative and judicial action. The effect is to provide that if the contractor experiences a delay on the project, its sole recourse is to seek an extension of the time to complete. The innocent contractor can go right out of business, waiting for the work to resume, without any claim for damages whether such delay was avoidable or unavoidable. Some states, such as Ohio, prohibit no damages for delay clauses, when the delay is caused by the owner or prime contractor. Other states, such as Minnesota, prohibit public owners from using no damages for delay clauses in public construction contracts, while others enforce them or less narrowly restrict them, such as New Jersey, which has extended the ban to school projects, but not other public works.

A. Termination for Convenience.

A termination for convenience clause brings the concept of one-sidedness to its ridiculous extreme, providing that the owner may, at any time, terminate the contract for the owner's convenience and without cause. Such a clause limits an owner’s liability in the event that the owner for any good faith reason decides to abandon its project, and generally limits the contractor's recovery to cost incurred plus profit on work completed, together with the costs of preparing the termination settlement proposal, and precludes recovery of anticipatory profit.

These clauses were introduced by federal government in the fifties; recently, the concept has recently gained acceptance in private contracts. Look out for a termination for convenience clause buried in popular form contract “General Conditions.” As a rule of thumb, treat all “general conditions” as “generally suspect.”

I. SECTION HEADINGS.

Many contracts have misleading (and maybe deliberately misleading) section headings, labels which have nothing to do with the stated name of the clause. You can’t depend on the section headings in any contract of adhesion, and since the advent of word processing you’re better off ignoring them altogether. You use a section heading as a shortcut to the sense of a clause at your own risk.

Many contracts squeeze the overbearing terms into one catchall clause at the end. Be very concerned whenever you see a “Miscellaneous Clause,” whose banal name may conceal a litany of one-sided terms.

I. CONCLUSION.

When an overbearing clause is met with objection, its proponent will likely offer the stock reply, “It’s only boilerplate. We have it in all our contracts.” The correct rejoinder is, “So what? How does that affect our deal?” Boilerplate is no substitute for thoughtful expression of agreement or rational allocation of risk. Moreover, the foregoing list of objectionable terms is by no means exclusive, and offers room to discuss confidentiality, time of the essence, no reliance, cooperation, separability, additional-named insured, no assignment, confession of judgment, survivorship, force majeure, warrant of attorney, notice provisions, warranties, and other potentially oppressive clauses.

Be on your guard. A contract, as an agreement the court will enforce, heightens the risks it seeks to manage. If you give up a right or take on an obligation at the bargaining table, the government waits in the wings. Remember to keep your eyes on the fine print - on the contract terms to watch for and avoid.

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