Bulletproofing Your Contracts

Lessons For Commercial Contract Clauses From The Litigation Battlefield: Part 1 of 2

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Limitations on Liability

In the context of commercial transactions, it is well settled that parties may limit their liability and limit the types of remedies available for breach of contract and negligence. See, e.g., ABN Amro Verzekeringen BV v. Geologistics Americas, Inc., 485 F.3d 85 (2d Cir. 2007) (affirming judgment for plaintiff over plaintiff’s objection in the amount of $50.00 when defendants tendered that sum in response to plaintiff’s suit under a contract limiting the defendants’ liability to $50 for simple negligence); Tradex Europe SPRL v. Conair Corp., No. 06 Civ. 1760 (KMW) (FM), 2008 U.S. Dist. LEXIS 37185 (S.D.N.Y. May 7, 2008) (limiting the defendant’s liability to the fees paid by the plaintiff under the contract based on the parties’ limitation on liability provision); Abry Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032 (De. Ch. Ct. 2006) (enforcing limitation of remedies provision to bar plaintiff’s request for rescission based on anything less than actual fraud). A contractual provision that limits damages is enforceable unless a special relationship between the parties, a statute, or a public policy imposes liability. McFadyen Consulting Group Inc. v. Puritans Pride, Inc., 34 Misc. 3d 1215A; 946 N.Y.S.2d 67 (N.Y. Sup. Ct. 2010).

“A limitation on liability provision in a contract represents the parties' Agreement on the allocation of the risk of economic loss in the event that the contemplated transaction is not fully executed, which the courts should honor.” Metropolitan Life Insurance Co. v. Noble Lowndes International, Inc., 84 N.Y.2d 430, 436, 618 N.Y.S.2d 882, 643 N.E.2d 504 (1994). “Although such clauses in commercial contracts are enforceable to limit recovery for claims on ordinary negligence, they will not preclude recovery in tort or breach of contract where the losses are the result of gross negligence.” Gold Connection Discount Jewelers v. American District Telephone Company, Inc., 212 App.Div.2d 577, 578, 622 N.Y.S.2d 740 (1995) (citations omitted.)

For public policy reasons, courts will typically refuse to enforce contractual limitations on damages for gross negligence or willful conduct. E.g., Metropolitan Capital Funding, LLC v. Nomura Credit & Capital, Inc., 880 N.Y.S.2d 874 (N.Y. Sup. Ct. 2009) (upholding provision calling for general contractual immunity from liability for consequential damages; rejecting party’s claims that exception applied because “a defendant’s nonperformance of a contract which is ‘motivated exclusively by its own economic self-interest’ does not constitute a ‘willful act’ (citation omitted)). Similarly, Courts will not enforce limitation on liability provisions in cases of intentional
wrongdoing, such as actual fraud. See Metropolitan Life Insurance Co. v. Noble Lowndes International, Inc., 84 N.Y. 2d 430, 643 N.E. 2d 504 (1994).

So called “Himalaya Clauses” can extend limitation on liability clauses to non-signatories to the agreement who act as a signatory’s agent or independent contractor to perform under the contract. See Norfolk Southern Rail co. v. Kirby, 543 U.S. 14, 125 S. Ct. 385 (2004).

In Connecticut, in determining whether any particular provision is for liquidated damages or for a penalty, the courts are not controlled by the fact that the phrase "liquidated damages" or the word "penalty" is used. Rather, it is the intention of the parties to the contract that is determinative. American Car Rental, Inc. v. Commissioner of Consumer Prot., 273 Conn. 296, 306 (2005); Parker v. Knauf, 2010 Conn. Super. LEXIS 553, at *13-*14 (Conn. Super. Ct. Mar. 3, 2010) (holding that claim for liquidated damages based on sales agreement provision providing for liquidated damages of ten percent of the purchase price was enforceable). “Our courts do not enforce provisions which call for a greater benefit than what is appropriate for the failure to perform a contract. Thus, liquidated damages are appropriate and construed as such if three conditions are satisfied: (1) the damage which was to be expected as a result of a breach of contract was uncertain in an amount or difficult to prove; (2) there was an intent on the part of the parties to liquidate damages in advance; and (3) the amount stipulated was reasonable in the sense that it was not greatly disproportionate to the amount of the damages which as the parties looked forward seemed to be a presumable loss which would be sustained by the contract in the event of a breach of contract.” Parker, 2010 Conn. Super. LEXIS 553, at *13-*14; Bellemare v. Wachovia Mortgage Corp., 284 Conn. 193, 203, 931 A.2d 916 (2007).

A liquidated damages provision does not bar equitable remedies such as specific performance unless there is express language in the contract that the liquidated damages provision shall be the sole remedy for breach. See Vacold LLC v. Cerami, 545 F.3d 114 (2d Cir. 2008); cf. L.K. Sta. Group, LLC v. Quantek Media, LLC, 879 N.Y.S.2d 112, 116-17 (N.Y. App. Div. 1st Dep’t 2009) (holding that limitation of liability provision providing only for direct damages manifests explicit language curtailing the availability of specific performance because it was more than a mere liquidated damages provision reciting the amount of liquidated damages that may be recovered; noting that provision bars relief in “contract, tort or otherwise,” except for direct damages resulting from a party’s gross negligence or willful misconduct). Liquidated damages clause for delayed performance can prohibit monetary damage and restrict the remedy to additional time to perform. Law Co. v. Mohawk Constr. & Supply Co., 702 F. Supp. 2d 1304 (D. Kan. 2010).
II. **Indemnification Clauses**

Parties continue to use indemnification clauses for both (1) direct claims; and (2) reimbursement of payments made on behalf of third-parties.

The majority position continues to be that indemnification clauses generally apply to actions for reimbursement of payments made to third-parties. *Amoco Oil Co. v. Liberty Auto & Electric Co.*, 262 Conn. 142 (2002); *Queen Villas Homeowners Assoc. v. TCB Property Mgmt.*, 149 Cal. App. 4th 1 (2007).

The key to drafting an agreement that bars indemnification for direct claims is using words clearly denoting its application to reimbursements for third-party claims such as “indemnify,” “hold harmless” and defining “loss.” The notice procedures also indicate whether an indemnification provision extends to direct claims. The terms used in an indemnification clause will define whether a claim can be made for indemnification for expenses incurred by a party to the agreement as a result of a dispute between the parties to the agreement. See *Rand-Whitney Containerboard L.P. v. Town of Montville*, 290 Fed. Appx. 430, 433 (2d Cir. 2008) (holding that defendant is not required to indemnify plaintiff for attorneys’ fees under the terms of the indemnification provision because it applies only to claims brought by third parties and does not apply to intra-party suits); *Hooper Associates, Ltd. v. AGS Computers, Inc.*, 74 N.Y. 2d 487, 549 N.Y.S.2d 365 (1989) (a claim under an indemnification clause by one contracting party against the other for legal fees incurred in an action between the contracting parties will only be allowed when the clause makes it “unmistakably clear” that it was intended to apply to a dispute between the contracting parties).

Attorneys should focus on the “triggering event” obligating an indemnitor to indemnify an indemnitee. See *MEMC Electronic Materials, Inc. v. Albemarle Corp.*, 241 S.W. 3d 67 (2007) (refusing to enforce indemnity because triggering event did not occur). Definitions can be outcome determinative in evaluating the meaning and scope of an indemnity. See *Smithkline Beecham Corp. v. Rohm & Haas Co.*, 89 F.3d 154 (3rd Cir. 1996) (holding that the definitions in the asset purchase agreement had the effect of limiting the scope of the indemnities); see also *Metropolitan Life Ins. v. AETNA Casualty and Surety*, 255 Conn. 295 (2001) (supplying state’s own definition for the triggering event because agreement did not contain definitions for “occurrence”); *Ocsai v. Exit 88 Hotel, LLC*, 127 Conn. App. 731 (2011) (reversing entry of summary judgment on indemnity claim due to ambiguity of term “operations” in agreement).

1990); see also Marksmen, Inc. v. Interbrand Corp., No. 10 Civ 214, 2010 U.S. Dist. LEXIS 63849 (S.D.N.Y. June 28, 2010); IU North America, Inc. v. Gage Co., No. 00-3361, 2002 U.S. Dist. Lexis 10275 (E.D.P.A. June 5, 2002) (all holding that indemnities have no right to indemnification if the losses are a result in whole or in part from the indemnitees’ own negligence in the absence of clear language in the agreements indicating otherwise). But see Fountain v. Colonial Tupp Signs, Nos. 86C-JA-117, 85C-DE-88, 1988 Del. Super. LEXIS 126 (Del. Super. Ct. Apr. 13, 1988) (holding that indemnitee was entitled to indemnification because the indemnity provision specifically referenced the indemnitee’s own negligence among the covered occurrences); see also Lone Mountain Processing, Inc. v. Bowser-Morner, Inc., No. 2:00cv00093, 2005 U.S. Dist. LEXIS 16340, 2005 WL 1894957 (W.D.Va. Aug. 10, 2005) (holding that indemnitee’s contributory negligence did not prevent its claim for indemnification because losses to third-parties were not the result of its sole negligence per the agreement’s indemnity requirements).

Indemnification and advancement of fees for a corporation’s employees, officers and directors should be included in their employment agreements to better protect the individuals from any government action requiring the corporation to withhold or withdraw indemnification for its employees as a condition to a determination that the corporation is “cooperating” with the government investigation. See McNulty Memorandum from the Dept. of Justice and U.S. v. Stein, 435 F. Supp. 2d 330 (S.D.N.Y. 2006).

Indemnity Provision Requiring Indemnification
Of Seller Even For Seller’s Negligence

The purchaser assumes full responsibility for all loss or damages caused by the property hereby sold, even if said loss or losses arise out of the negligence of the company and the purchaser agrees to pay any and all damages and expenses on its behalf and on behalf of the company which may result in connection with any such loss. The company shall not be responsible for any structural or mechanical defects occurring in the building or structure on which the sign is erected. There shall be no further liability on the part of the company after erection of the sign[s].


III. Disclaimers of Warranties

Disclaimers of warranties will typically be enforced, if they are conspicuous. See, e.g., On Time Aviation, Inc. v. Bombardier Capital, Inc., 354 Fed. Appx. 448 (2d Cir. 2009)
Disclaimers of warranties can be nullified by statements of fact that constitute express warranties. See, e.g., LaTrace v. Webster, 17 So.3d 1210 (Ala. Civ. App. 2008) (ruling that description of lamps sold at auction as “Tiffany” nullified written disclaimers of warranties relating to the provenance of the lamps).

Example (sale of business / business unit):

EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, THE COMPANY MAKES NO REPRESENTATION OR WARRANTY, EXPRESSED OR IMPLIED, AT LAW OR IN EQUITY IN RESPECT OF THE COMPANY OR THE COMPANY’S SUBSIDIARIES, OR ANY OF THEIR RESPECTIVE ASSETS, LIABILITIES OR OPERATIONS, INCLUDING WITH RESPECT TO MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE, AND ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED. BUYER HEREBY ACKNOWLEDGES AND AGREES THAT, EXCEPT TO THE EXTENT SPECIFICALLY SET FORTH IN THIS AGREEMENT, BUYER IS ACQUIRING THE COMPANY ON AN “AS IS, WHERE IS” BASIS. THE DISCLOSURE OF ANY MATTER OR ITEM IN ANY SCHEDULE HERETO SHALL NOT BE DEEMED TO CONSTITUTE AN ACKNOWLEDGEMENT THAT ANY SUCH MATTER IS REQUIRED TO BE DISCLOSED.

Example (sale of equipment):

Seller’s sole liability under this agreement for failure of equipment shall be limited to the amount of actual seller charges incurred by buyer during a period of such interruption, provided that such interruption was caused solely by seller’s willful act or omission or negligence. Seller shall not be liable for any interruption caused by the gross negligence or any act or omission of buyer or any third party furnishing any services to buyer.

SELLER MAKES NO WARRANTIES, EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO, ANY WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. IN NO EVENT SHALL SELLER BE LIABLE TO BUYER OR ANY OTHER PERSON OR ENTITY FOR INDIRECT, CONSEQUENTIAL OR SPECIAL DAMAGES, INCLUDING BUT NOT LIMITED TO LOST REVENUES OR PROFITS, EVEN IF SELLER HAS BEEN ADVISED OF THE POSSIBILITY THEREOF.
IV. **Forum Selection Clauses**

Forum selection clauses are generally enforced. *Albemarle Corp. v. Astrazeneca UK Ltd.*, 628 F.3d 643 (4th Cir. 2010); *Wong v. Partygaming Ltd.*, 589 F.3d 821 (6th Cir. 2009). Such clauses will not be enforced, however, where enforcement would effectively deprive the plaintiff, particularly a consumer, of a day in court. *See, e.g.*, *Doe v. AOL LLC*, 552 F.3d 1077 (9th Cir. 2009) (refusing to enforce forum selection of state courts in Virginia where doing so would bar a consumer class action).

Two types of Forum Selection Clauses exist: (1) mandatory; and (2) permissive. If a party wants to ensure that any litigation takes place exclusively in a particular forum, it needs to draft a mandatory forum selection clause. A mandatory forum selection clause needs to contain explicit language indicating that the parties agree to litigate their claims in the selected forum exclusively. The better practice is to also include an accompanying venue provision indicating where all actions are to be filed. *Boutari and Son v. Attiki Importers*, 22 F.3d 51 (2nd Cir. 1994); *Docksider v. Sea Technologies*, 875 F.2d 762 (9th Cir. 1989); *JHB Resource Mgmt., LLC v. Henkel Corp.*, No. CV044001418, 2006 Conn. Super. LEXIS 1648 (Conn. Super. Ct. May 31, 2006).

A forum Selection clause stating only that the selected forum has jurisdiction over disputes between the parties is insufficient to prevent a plaintiff from filing suit in another forum which has personal jurisdiction over the parties.

Forum selection clause that mandates the use of the courts “in” a state permits an action to be filed in either the state or federal courts of that state. *See, e.g.*, *Simonoff v. Expedia, Inc.*, 643 F.3d 1202 (9th Cir. 2011). Conversely, forum selection clauses that mandate the use of courts “of” a state require an action be filed in the state courts of that state. *Id; New Jersey v. Merrill Lynch & Co., Inc.*, 640 F.3d 545 (2d Cir. 2011); *Doe v. AOL, LLC*, 552 F.3d 1077 (9th Cir. 2009).

Forum selection clauses in prior, superceded contracts can control disputes that arise relative to those contracts absent a release of any and all claims under the earlier contract. *See e.g.*, *Albemarle Corp. v. Astrazeneca UK Ltd.*, 628 F.3d 643 (4th Cir. 2010).


Forum selection clauses can be incorporated into corporate by-laws and will typically be enforced unless adopted after a dispute has arisen. *See, e.g.*, *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011); *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940 (Del. Ch. 2010).
Brad Babbitt, co-chair of the firm's Litigation Section and chair of the Business Litigation Group, represents businesses in a wide variety of industries, helping them to protect their interests in disputes arising from myriad different commercial relationships. In addition to contract and business tort disputes, he has handled copyright, trademark, and trade secret litigation in both federal and state court. He has also represented companies in investigations conducted by state regulators and the Connecticut attorney general.

Mr. Babbitt often represents companies in the utility industry in administrative appeals from regulatory rulings and other litigation. In this context, he has often used the preemptive power of federal or state legislation to assist utility companies in achieving their goals, despite local opposition. His experience in this area includes the Connecticut Supreme Court case that established the preemptive power of the Connecticut Siting Council over municipal zoning authorities and his defeat of attempts by antinuclear energy activists to entangle a state agency in a dispute over alleged safety violations at a nuclear energy plant. Mr. Babbitt routinely collaborates with members of our utility practice in representing our clients.

EDUCATION
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• Commonwealth of Massachusetts
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