

Contracts 101 – Part 3

The most important and most ignored contract clauses

In the previous parts of this article we discussed the legal elements necessary for a contract to exist. The particulars of each contract will vary depending on the subject matter of the contract at issue. However, when writing or reviewing a contract, in general you want to be sure to 1) address all possible situations, and 2) make sure that there are no ambiguities. To achieve the above, you want to discuss the details of performance, termination, change in circumstances, and enforcement. However, this part of the article is not intended to teach you how to draft a contract, instead, it is meant to introduce you to common contract clauses which you are likely to run into regardless of the subject matter of the contract. These clauses, though considered boilerplate, play a critical role in contracts and can have very serious consequences, thus, it is to your advantage to understand them and use them as appropriate.

A boilerplate contract clause is one that is found in almost all contracts. Unsophisticated business people will often refer to these as the “fine print” and will tend to treat these clauses as insignificant legal verbiage. However, though sometimes these clauses have nothing to do with the substance of a particular deal, they do govern how the contract itself works and the way the contract works can be the difference between a profitable venture and a disaster. The list of boilerplate contract clauses is extensive, a discussion of the most significant of these follows.

Integration Clause

This is contract clause that basically states that the contract is the entire understanding between the parties involved and that nothing else is to be considered part of the contract. Simply put, it states that the contract is a complete expression of all of the intentions of the parties. Though this clause sounds simple and insignificant, its presence or absence can have a significant effect on any deal.

Consider for example a discussion between two business men for the sale of oranges. Alex says to Bob, I will buy 100 cases of your oranges at a 10% discount and if my customers like your oranges then I will buy 100 cases each month for two years at the same discount. Bob’s attorney drafts a contract for the sale of 100 cases of oranges at a 10% discount but by neglects to include the part about Alex’s desire to buy 100 cases each month for two years. After a year of selling oranges to Alex, Bob decides to sell to Casey at a 5% discount instead.

You can see how in this situation whether an integration clause was included in the contract becomes vitally important for Alex. If the integration clause was included, then Alex is out of luck, because the contract will be considered complete and the fact that the two year commitment was intended will not be allowed into evidence in the event of a lawsuit. However, if the integration clause was not included in the original contract then Alex will be able to tell the court about his original discussion with Bob and

about their intention for this arrangement to last for two years. In that instance Alex will have a chance of enforcing the contract for the remainder of its term or recovering breach of contract damages.

The lesson to take away from this is that if an integration clause exists in the contract, make sure that the contract addresses all of the things you have discussed during the deal. Unless the subject of your discussion is mentioned in the contract it will be barred from evidence by the integration clause.

Limitation of Liability

The next most ignored but very important boilerplate clause is the limitations of liability clause. This clause limits the damages recoverable under a contract to a certain amount. The amount can be set pretty much at random, however, depending on the subject matter of the contract, courts frequently impose a requirement that the amount be reasonable otherwise the clause will be held to be unenforceable. The importance of this clause almost needs no explanation, however, it is surprising to see how many people ignore this clause and are shocked to discover its existence when it is already too late.

Say that in the deal we discussed above, Bob included a limitation of liability clause in his contract which states that the liability of Bob under the contract shall not exceed the amount paid for the oranges in a given month, and this liability amount includes reasonable attorney's fees. Alex being a trusting fellow ignores this and happily signs the contract. Six month into the contract Alex is doing really well and signs a year and a half lease for larger space for his store intending to sell Bob's oranges for the remainder of their "two year" contract term. As above, one year into the deal Bob stops selling oranges to Alex and starts selling them to Casey. Now all of a sudden, not only did Alex lose his orange supplier but he has one year left on a lease for a larger store, thus for one more year he will be paying more rent than he was paying before... and all because of Bob. Lets assume that Alex wins the lawsuit against Bob for breach of contract and wants to get the excess rent that he now has to pay for the larger space for another year.

This is where the limitation of liability clause kicks in. In the example above the clause limits Alex's recovery under the breach of contract case to the amount that Alex pays for oranges for one month. Thus, if he pays \$1,000.00 for the oranges but the excess rent Alex has to pay for the remainder of the years is \$12,000.00, Alex will be out of luck because the maximum amount he will be able to recover will be \$1,000.00.

Limitation of liability clauses can be complex and have a lot of nuances. The lesson here is to never ignore the limitation of liability clause because it is one of the most important clauses that govern what happens once a deal has broken down.

Attorneys' Fees

This clause is a favorite for lawyers but should not be ignored by anyone. This clause generally states that if there is a disagreement about the contract, the prevailing party in a lawsuit is entitled to the recovery of his attorneys' fees. As you probably know, in the United States each side bears the cost of

its own legal representation unless specified by statute or by contract. Thus, unless this clause is included in a contract, in the absence of some specific circumstances, each side will be responsible for paying its own attorney regardless of which side wins.

Lets get back to the innocent Alex and to shrewd Bob. Bob's attorney drafted the contract and Bob specifically told his attorney not to include an attorneys' fees provision. One year into the deal Bob stops selling oranges to Alex thinking that it will cost Alex \$10,000.00 to sue Bob while he can only recover \$1,000.00 under the limitation of liability clause discussed above. If there is no attorneys' fees provision, even if Alex wins in court he will only get his \$1,000.00 while he may have to pay his attorney \$10,000.00 to win the lawsuit. If however an attorneys' fees provision was included, then Alex could win his \$1,000.00 and \$10,000.00 to pay his attorney.

More importantly however, is that this provision can serve to prevent meritless lawsuits. If for example Bob wants to countersue Alex claiming that Alex spoke badly about Bob to one of his customers. The real purpose of this countersuit will be to raise Alex's legal fees. Once the countersuit is filed, Bob can say to Alex that at best Alex will recover \$1,000.00 and pay his attorney \$10,000.00, moreover, he will have to pay his attorney another \$10,000.00 to defend the defamation lawsuit. Unless there is an attorneys' fees provision, Bob will be right... even if Alex wins both lawsuits, he will pay his attorney \$20,000.00 and not be able to get a penny of it back from Bob.

The attorneys' fees provision is often the provision which lawyers examine first when they advise their clients about the consequences of breaching a contract. In general the attorneys' fees provision prevents meritless lawsuits and makes it more risky for any party to breach a contract. Thus, if you want your contract to be solid, do not ignore the attorneys' fees provision.

As mentioned in my previous article, a contract is only as useful as the substance that it contains. A contract about the simplest of subject matter can turn out to be a complex document depending on the intentions of the parties. A contract dictates your rights and responsibilities under a particular deal, thus, you must always read and understand every part of the contract. Do not ignore a single word because if you do and the deal breaks down, chances are, you will find that the very word you ignored was the one word that you should have paid attention to.

If you have questions regarding contracts or other legal topics please email the Law Office of Michael Martinovsky at Michael@MartinovskyLaw.com.

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