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Drafting Contracts With an Eye Towards Litigation

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Whether the type of contract involves severance of a key employee, the lease of a new plant or building, construction of a project, sale or purchase of real estate or one of many other possible agreements that a corporate lawyer might encounter on a day to day basis, the general goal in most large contract negotiations is to draft contractual provisions that reflect the intent of the parties with respect to each other's rights and responsibilities. The parties' contractual negotiations tend to focus on the economics of the transaction and on key factors such as timing for performance. Thus, drafts are tailored with a focus on the economic considerations. Although risk weighs in as a factor, the clauses that address risk tend to be less negotiated and discussed because parties generally do not want to bring attention to a discussion that necessarily implicates a possible default or detailed "what if" scenarios that can create tension and distract from the goal.

Some of the clauses that provide a false sense of security but carry a high potential for creating uncertainty in litigation are so called "standard" or in some cases seem as though they vary little from one document to another. Examples of the latter are liquidated damages, indemnity and arbitration provisions. The former include assignment provisions and merger and integration clauses. Failure to include language that functions to prevent a fraud allegation in procuring the contract is also a key point that is often overlooked and can lead to costly litigation.

In order to promote negotiations that are focused on the key commercial points, proposing clauses that are well crafted with the intention of avoiding litigation or with an eye toward how that clause will affect the outcome of litigation can provide some peace of mind if the discussion is not undertaken in too much detail. Conversely, if litigation does ensue, clauses that are fair and provide certainty (as much as that is possible) may ease the cost of litigation and/or lead to an expedited resolution of disputes.

This paper will discuss liquidated damages, arbitration provisions and assignment clauses. We will offer analysis of concerns that have given rise to significant litigation and discuss why these are some of the potential minefields that lurk around the corner if not addressed early on.

LIQUIDATED DAMAGES

In order to ensure some level of certainty with regard to the amount and/or ability to recover damages for a specific breach of a contractual provision, parties often insert liquidated damage clauses within different types of agreements. The main objective is to avoid protracted litigation over whether a specific breach may lead to recovery of damages and the amount of those damages. As articulated by one Texas court, "the purpose of a liquidated damages provision is to allow a party to recover damages where, at the time of contracting, it is difficult or impossible to ascertain an amount of damages as a reasonable forecast of just compensation." *Zachry Constr. Corp. v. Port of Houston Auth.*, 2009 Tex. Dist. LEXIS 1887. Generally, liquidated damages apply to a specific type of breach of the contract and include an agreement to a pre-determined amount of damages that the parties agree is a reasonable estimate of the probable damages. In a contract for the construction of a large infrastructure project, for example, these damages most often apply when contractors, subcontractors or suppliers breach the contract by failing to complete all or a portion of the work on time. The key to drafting these types of clauses in Texas and many other states lies in ensuring that the language clearly reflects the intent of the parties to devise a mechanism that addresses that objective and that it meets the elements that Texas courts have determined are necessary to do so.

1. Don't Just Call Them LD's – Or, "Did Someone Pull a Fast One on Us"?

The fact that courts have often enforced and interpreted certain clauses as liquidated damages clauses even though they are not explicitly set forth as such sets the tone for the initial inquiry. Therefore, the first question for any party seeking to enforce or defend against an action to recover liquidated damages is to determine whether the contract in fact contains a liquidated damages clause.

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"Drafting Contract Clauses That Actually Help if Litigation Arises"