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DALLAS MAIN OFFICE
1999 Bryan St., Suite 825, Dallas, TX 75201
(214) 744-9300 • (800) 456-5484
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4 Contract Clauses You Don't Know How to Draft

by ROBERT B. GILBREATH

Appellate specialists have a luxury transactional lawyers don't enjoy. When parties fight over a contract provision and the trial court decision results in an appeal, they get to spend hours researching how courts have construed the provision that led to the litigation. Some recent cases I've worked on have uncovered a few things attorneys need to know when drafting litigation-out conditions precedent, anti-assignment clauses, choice-of-law clauses, and limitation-of-remedies clauses for arbitration. Counsel who follow these guidelines maybe won't need an appellate lawyer.

CONTRACTS

1. The litigation-out condition precedent. These clauses provide that the parties' obligations to consummate a deal are subject to a condition precedent that there is no pending litigation related to the transaction. If the goal is to limit this condition to the non-existence of a proceeding brought by a governmental authority, rather than a private party, the clause must make this clear. If it doesn't, then a party that decides it wants out of the deal—but would lose the escrow by backing out—can sue the other party and claim that the no-pending-litigation condition precedent has failed because, well, there is pending litigation. I've seen it happen. And if the goal is to encompass litigation by both governmental authorities and private parties, be sure to specify that litigation by the parties to the contract does not count. In a recent case, a Texas appellate court ruled that the litigation-out condition precedent was ambiguous because it could reasonably be interpreted to apply only to legal actions by governmental authorities, but could also reasonably be interpreted to apply to other types of actions. The lesson: take the time to carefully think through and draft a litigation-out condition precedent, lest it be misused by the other party.

Be aware that some courts hold, absent contractual language to the contrary, that violating an anti-assignment clause does not make the assignment ineffective, it merely gives rise to a claim for any damages caused by the assignment.

2. The anti-assignment clause. These clauses protect a contracting party's right to select the persons with whom it deals. But if not drafted correctly, the clause won't prevent the other party from assigning a claim arising out of the contract. Courts have held that a general anti-assignment clause does not prevent a party from assigning a claim after performance under the contract has been completed. Section 322 of the Restatement (Second) of Contracts states the same rule. Here's an example of a general anti-assignment clause that was held not to prevent assignment of a right arising out of due performance or the right to collect damages for breach: "[N]either party shall assign this Agreement or any rights under this Agreement to any other person without the prior written consent of the other."

To prevent the assignment of both the duties under the contract and claims arising out of the contract, specifically state that neither may be assigned without written consent. Also, be aware that some courts hold, absent contractual language to the contrary, that violating an anti-assignment clause does not make the assignment ineffective, it merely gives rise to a claim for any damages caused by the assignment. You may want to specify that any assignment is void.

3. The choice-of-law clause. Let's say the parties want Delaware law to govern their agreement and disputes arising out of the agreement. Delaware law has different statute-of-limitations periods than Texas for various claims. Lawyers might assume that by selecting Delaware law, they've also selected its limitations periods. They'd be correct, but the law isn't as clear as it should be on that point. Some courts believe that even though another state's substantive law controls, the forum state's law setting the applicable limitations period still controls.

Under §187 of the Restatement (Second) of Contracts, however, if there is a choice-of-law clause selecting another state's law, then that state's limitations period should apply as well. Someday a Texas court will so hold. Until then, however, specify whether you want to include the selected state's limitations periods. Also, state whether the choice-of-law clause will apply to extra-contractual claims, such as fraud, arising out of the parties' contractual relationship. Draft the choice-of-law clause too narrowly, and a court might well hold that it does not apply to tort claims arising out of the contract.

4. The limitation-of-remedies provision for arbitration. Arbitration clauses are probably the most frequently-litigated contract clause of all time. One issue that has been cropping up lately is the ability to limit the arbitrator's power to award certain remedies. To limit the remedies the parties may recover in arbitration, an attorney should state that limitation in the arbitration clause itself, not in some other part of the contract. When an arbitrator disregards a limitation on remedies, courts are more likely to sustain a challenge to the arbitration award if the limitation is stated in the arbitration clause itself. And because courts are so hesitant to interfere with an arbitrator's ruling, attorneys need to state very clearly that they are limiting the arbitrator's power and authority. For example, instead of saying "attorney fees are not recoverable," you should say, "the arbitrator may not award attorney fees to either party."

These clauses represent the subject matter of just some of my more recent appeals. There will always be litigation over contracts, but following these suggestions for choice-of-law clauses, anti-assignment clauses, litigation-out conditions precedent, and limitation-of-remedies provisions for arbitration might help keep an attorneys out of court, or at least lay the groundwork for a quick summary judgment. TL

Robert B. Gilbreath is a partner in Hawkins, Parnell Thackston & Young in Dallas. He is board certified in civil appellate law by the Texas Board of Legal Specialization.