

## Covering Your Contractual Bases: Potentially Problematic “Boilerplate” Provisions

**Patrick D. Newman**

**Tal A. Bakke**

Bassford Remele, P.A.

100 South Fifth Street, Suite 1500

Minneapolis, MN 55402

612.333.3000

[www.bassford.com](http://www.bassford.com)

Boilerplate contract terms—often presented in “take-it-or-leave-it” contracts or “contracts of adhesion”—pose very real risks to business owners of all types, including those in the recovery and remarketing trades.

The hallmark of a boilerplate clause is that the non-drafting party does not have any input in crafting its language. Instead, the provision is set up to favor of the party that drafted the contract (and is usually to the non-drafting party’s detriment).

Classic examples of potentially problematic provisions include:

- Indemnification clauses;
- Limitation-of-liability clauses; and
- Dispute resolution clauses, including fee shifting provisions, choice-of-law-provisions, choice-of-venue provisions, and arbitration or mediation provisions.

This white paper examines these contract provisions and outlines certain considerations when confronting them.

## INDEMNIFICATION (OR “HOLD HARMLESS”) PROVISIONS

Indemnification clauses shift or allocate the risk of loss or damages resulting from a third-party’s lawsuit against one of the contract parties. Indemnification provisions can be useful to clearly describe the rights and obligations of the contract parties in the event a third-party sues one or more of them. However, these clause are sometimes drafted as “one-way” provisions—meaning only one party to the contract (almost always the drafting party) is entitled to indemnification.

### *Example One-Way Indemnification Provision:*

[NON-DRAFTING PARTY] shall indemnify, defend and save harmless the [DRAFTING PARTY], and its officers, directors, employees and agents, from and against all liability, loss, cost or expense (including attorney’s fees) by reason of liability imposed upon the [DRAFTING PARTY], arising of or related to [NON-DRAFTING PARTY’S] services, whether caused by or contributed to by the [DRAFTING PARTY] or [DRAFTING PARTY’S] product or any other party indemnified herein.

### *Considerations:*

- **Be wary of “one-way” indemnification provisions.** They are designed to shift risk and potential liability to the non-drafting party, regardless of which contract party is at fault. A one-way provision can result in monetary exposure to a non-drafting party that is not actually at fault in a lawsuit or other demand or claim.
- **Keep a sharp eye out for indemnification clauses that don’t actually say “indemnification.”** Some contracts will include language with a similar purpose or impact as an indemnification clause without using the word “indemnification.” For example, look for words or phrases like “contribution,” “hold or save harmless,” and “duty to defend.” A party contractually obligated to “defend, indemnify, and hold harmless” may not only be required to pay for certain losses or damages incurred by another contract party—regardless of fault—but may also be forced to defend the other contract party or pay its attorneys’ fees and costs.
- **Attempt to negotiate.** At minimum, try to limit any indemnification obligations to indemnification for loss or damage caused by the indemnifying parties’ own conduct. Ideally, the indemnification language should be mutual and clearly describe each party’s indemnification obligations.
- **Be aware of state-specific enforceability issues.** Some states have enacted specific laws regulating contractual indemnification provisions. Consult with an attorney to understand whether a specific provision is enforceable in the applicable state.

- **Does the indemnification provision unacceptably shift risk or potential liability to you?** Understand the nature of the product or service that is the subject of the contract to better gauge the likelihood of a lawsuit or exposure to potential liability. That calculus will help set up the ultimate question: does this agreement expose me to more risk than it is worth?

## LIMITATION-OF-LIABILITY PROVISIONS

Like indemnification provisions, limit-of-liability clauses attempt to shift or allocate risk under the contract. The difference is that a limit-of-liability provision applies as between *the parties to the contract*, rather than *third-party claims* against one of the contracting parties.

A limit-of-liability provision may attempt to:

- Define or limit the types of actions for which a contract party is liable to the other;
- Place monetary limits on the amount of the contract party's liability for a given type of action; or
- Waive liability all together.

### *Example Limitation-of-Liability Provision:*

[DRAFTING PARTY'S] liability to [NON-DRAFTING PARTY] under any provisions of this agreement for damages finally awarded shall be limited to the amounts actually paid hereunder by [NON-DRAFTING PARTY] to [DRAFTING PARTY]. In no event shall [DRAFTING PARTY] be liable for indirect, incidental, special or consequential damages, including loss of use, loss of profits or interruption of business, however caused or on any theory of liability.

### *Considerations:*

- **Again, understand the nature of the service or product.** A provision that seeks to limit liability for torts in a contract for goods may be less problematic than one where the party is seeking to preclude liability for its own breach of contract. In a contract for services, a provision attempting to preclude liability for torts may be more problematic.
- **Identify provisions seeking to limit the monetary liability of a particular party.** For example, a service contract may seek to limit the service provider's liability to the cost for the service. The problem is that the cost of the service often will be insufficient to fully compensate a party that suffers damages from a breach of the contract.

## DISPUTE RESOLUTION PROVISIONS

Here is an “old saw” in the law: “There’s never a problem until there is one.” Lawyers are always planning for the problem. That’s why many contracts include dispute resolution provisions that outline an agreed-upon procedure for resolving disputes between the contract parties, should they arise.

Common dispute resolution provisions include:

- Fee-shifting clauses;
- Choice-of-venue and choice-of-law clauses; and
- Arbitration or mediation clauses.

These provisions *can* be beneficial to both parties if properly bargained for and negotiated. Trouble lurks when one-sided provisions are presented to the non-drafting party on a “take-it-or-leave-it” basis. Unequal bargaining power makes these provisions ripe for unfairness to the non-drafting party.

Consider the following issues.

### **Fee-shifting provisions:**

Litigants in the United States are generally required to pay their own attorneys’ fees and costs. This “American Rule” has two notable exceptions: (1) certain statutes<sup>1</sup> allow a prevailing party to collect their attorneys’ fees from the losing party; and (2) parties may contractually agree to pay another party’s attorneys’ fees if a dispute arises.

Contractual fee-shifting provisions are generally enforceable and may require one contract party to pay the other party’s attorneys’ fees in the event of litigation between them (or even in litigation with third-parties).

Some fee shifting provisions are “mutual” — meaning any contract party that prevails in litigation is entitled to payment of their fees by the opposing contract party. Others are “one-way” — meaning the contract only allows for one party (typically the drafting party) to recover its attorneys’ fees, but not the other way around.

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<sup>1</sup> The Fair Debt Collection Practices Act is one well-known example.

*Example MUTUAL Fee-Shifting Provision:*

In the event of any dispute between the parties concerning the terms and provisions of this agreement, or the relationship between them, the **party prevailing** in such dispute shall be entitled to collect from the other party all costs incurred in such dispute, including reasonable attorneys' fees.

**Choice-of-Venue and Choice-of-Law Provisions:**

Venue and choice-of-law provisions dictate where and how the contract parties can sue each other and which state's laws will apply. When presented as part of a "take-it-or-leave-it" transaction, these provisions may force the non-drafting party to litigate in a distant venue or be subject to unfavorable law.

*Example Choice-of-Law and Choice-of-Venue Provision:*

This Agreement shall be governed and interpreted by the laws of the State of [STATE]. [COUNTY], [STATE] shall be the appropriate venue and jurisdiction for the resolution of any disputes hereunder. Both parties hereby consent to such personal and exclusive jurisdiction.

**Arbitration or Mediation Provisions:**

Many contracts require arbitration or mediation as either the first or sole means of resolving a dispute related to the agreement. These provisions can be beneficial to contracting parties who have a good working relationship and want to create a cost-effective process for resolving disputes.

But where the non-drafting party has no input in the language of the agreement, dispute resolution provisions may substantially impair it rights, namely the right to sue in court. In certain instances, the drafting party may also attempt to limit the time in which the non-drafting party may initiate a lawsuit, arbitration, or mediation to a period *less than* the applicable statute of limitations.

*Example Arbitration Provision:*

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules. The number of arbitrators shall be three. The place of arbitration shall be [CITY], [STATE]. [STATE] law shall apply. Judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

*Considerations:*

- **Is the fee-shifting provision mutual?** Fee-shifting provisions can be beneficial to both parties if they provide for attorneys' fees to the *prevailing* party. However, one-way provisions expose the party not entitled to attorneys' fees to greater risk and litigation expense.
- **Distant venue?** Look out for choice-of-venue provisions that require you to litigate in a far-off state. These clauses can increase the expense of dispute resolution very quickly.
- **Analyze the contract under the correct law.** If the contract is subject to the law of a certain state, that law may govern its interpretation and application. Consult with an attorney to determine the applicable law and how it should be interpreted.
- **What steps are required to initiate or respond to a dispute under the agreement?** Some provisions may require a party to (1) provide notice of a dispute to the other party; (2) meet with the other party, and/or (3) mediate prior to initiating a lawsuit or arbitration.
- **Does the agreement otherwise limit the ability to commence dispute resolution?** For example, does the agreement limit the time period in which to commence a dispute resolution procedure or to sue?

## CONCLUSION

The contractual provisions discussed above appear in many agreements. When these provisions are presented as a “take-it-or-leave-it” proposition, they typically favor the party drafting the contract at the expense of the non-drafting party. Therefore, it is important for the non-drafting party to have a working understanding of these provisions, consult with an attorney to determine their applicability, and ultimately negotiate them where appropriate to mitigate risk and potential exposure.

*This information is not intended to be legal advice and may not be used as legal advice. Legal advice must be tailored to the specific circumstances of each case. Effort has been made to assure this information is up-to-date. However, the law may change frequently and it is not intended to be a full and exhaustive explanation of the law in any area, nor should it be used to replace the advice of legal counsel. Nothing stated herein creates an attorney-client relationship between any entity or individual, including American Recovery Association members, and Bassford Remele, P.A. No such relationship will be created absent an executed retention agreement with Bassford Remele, P.A.*