ACC Northeast: Managing Litigation Risk in Contract Provisions

PRESENTED BY

Thomas J. Sullivan, *Partner* | Shook, Hardy & Bacon

Stefon David, *Associate* | Shook, Hardy & Bacon

Marc Polk, Head of Litigation and Enterprise Risk, BeiGene

1

Damages Limitation Provisions

General Purpose

- Contractual limitations on damages are of critical importance
- Allows parties to assess more effectively and better control business risks arising from a commercial transaction.
- Courts assume that parties have bargained-for these limitations and such risks are baked into the agreement
- Typically, in damages limitation, we will see Agreements that bar a host of damages such as incidental, consequential, punitive, and so on – with some caveats.
  - Ex. "NEITHER PARTY SHALL BE LIABLE TO THE OTHER FOR ANY INDIRECT, SPECIAL, CONSEQUENTIAL, INCIDENTAL OR PUNITIVE DAMAGE WITH RESPECT TO ANY CLAIM ARISING OUT OF THIS AGREEMENT (INCLUDING WITHOUT LIMITATION ITS PERFORMANCE OR BREACH OF THIS AGREEMENT) FOR ANY REASON."

Reminders – law school refresher

- **Expectation or General Damages**
- **Uniform Commercial Code**
- **Incidental Damages**
- **Consequential Damages**

General Damages

Expectation Damages (or "regular" damages)

- Cash that would put the promisee in the same position as if the promisor had performed the contract.
- Expectation damages thus require the breaching promisor to compensate the promisee for the promisee's reasonable expectation of the value of the breached contract, and, hence, what the promisee lost.
  - *Siga Techs., Inc. v. PharmAthene, Inc.*, 132 A.3d 1108, 1130 (Del. 2015), as corrected (Dec. 28, 2015) (expectation damages must be proven with reasonable certainty, and "no recovery can be had for loss of profits which are determined to be uncertain, contingent, conjectural, or speculative.")

Uniform Commercial Code (UCC)

Uniform Commercial Code

- Model Code jointly created by two non-governmental bodies.
- Does not have force of law unless adopted by specific jurisdiction:
  - New York – adopted majority of UCC
  - Pennsylvania/Delaware – few sections of UCC
- Still can be useful even where not adopted.

UCC § 2-710

Seller's Incidental Damages

- Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

UCC § 2-715

Buyer's Incidental and Consequential Damages

- 1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.
- (2) Consequential damages resulting from the seller's breach include
  - (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
  - (b) injury to person or property proximately resulting from any breach of warranty.

Key Issue

- There is one sub-category of damages that is frequently litigated over: Lost Profits

- Lost Profits Defined: May either be general or consequential damages, depending on whether the non-breaching party bargained for such profits. *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.*, 988 N.Y.S.2d 527 (N.Y. 2014).

Key Cases

- In Delaware, lost profits is an accepted means of quantifying expectation damages in a breach of contract action.
  - Lost profits can be a form of expectation damages, especially where a contract expressly allocates profit sharing.
  - "no recovery can be had for loss of profits which are determined to be uncertain, contingent, conjectural, or speculative"
- What about New York?
  - It depends…

Case Law: *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.*, 988 N.Y.S.2d 527 (N.Y. 2014).

- Plaintiff, a distributor of medical devices, entered into an exclusive distribution agreement with Defendant, a manufacturer of coronary stents. The agreement barred among other things, recovery of consequential damages. Defendant recalled its stent, and Plaintiff sued for breach of contract, seeking the lost profits from the stents' resale.
- Defendant moved for summary judgment on damages, contending that any lost profits from the resale constituted unrecoverable consequential damages. The trial court concluded that the lost profits were consequential, as did a unanimous First Department panel.
- Lost profits, the First Department held, "only constitute general damages where the non-breaching party seeks to recover money owed directly by the breaching party under the parties' contract."
- The Court of Appeals disagreed. It concluded that the "bright-line rule" applied by the First Department "violates the case-specific approach we have used to distinguish general damages from consequential damages." It rejected the idea that "lost resale profits can never be general damages simply because they involve a third-party transaction." *Id*. Instead, lost profits, including those from third-party transactions, may constitute general damages where the "non-breaching party bargained for such profits and they are 'the direct and immediate fruits of the contract.'"

Case Law: *Biotronik A.G. v. Conor Medsystems Ireland, Ltd.*, 988 N.Y.S.2d 527 (N.Y. 2014).

"The Direct and Immediate Fruits of the Contract"

- In determining that Plaintiff's lost resale profits were general damages, the court relied heavily on factors unique to the parties' agreement.
- (1) The agreement was not a "simple resale contract" where one party buys a product at a set price to re-sell at market price; instead, the parties' relationship resembled a "quasi-joint venture" where the parties shared both risk and reward.
- (2) The agreement's pricing formula incorporated Plaintiff's net resales from previous quarters and required Plaintiff to pay a percentage of its net resales to Defendant.
- Thus, the Court of Appeals concluded that Plaintiff's claimed damages were in some measure governed by, and flowed directly from, the breached contract.

Drafting Damages Provisions

Do not merely state that “consequential” damages are to be excluded. Spell out the specific categories of damages to be excluded.

- Consider Drafting provisions like:
  - How does the agreement function – what are parties’ respective “fruits of the contract”
  - Defining "consequential damages" to include any benefit the distributor would receive as a result of its sale or other disposition of the product that is the subject of the distribution agreement.
  - Putting a numeric cap on damages in the limitation-of-liability clause (e.g., "In no event shall manufacturer's liability for breach of this agreement exceed, in the aggregate, $_____[VALUE OF CONTRACT/SALES ETC].
  - Giving a manufacturer the right to terminate the agreement for convenience upon 60 days’ notice so that any "lost profits" claim will be limited to the notice period.
  - Completely eliminating consequential damages “whatsoever” or “of any kind or nature whether as expectation damages or consequential damages”—typically these agreements are enforceable for commercial loss.
  - Expressly state that lost profits are excluded expectation damages

2

Dispute Resolution/ Arbitration Provisions

Arbitration

BENEFITS

- Fairness
- Timeliness
- Cost
- Confidentiality
- Finality

DISADVANTAGES

- Not appealable
- Limited Discovery (if any at all) – could be a positive
- No specified Rules of Evidence
- Lack of consistency
- Is it really cost efficient/cheaper?

Contract Example 1

Should the designated executive officers of the Parties be unable to resolve such Dispute within [***] after such Dispute has first been referred to them, then the Dispute shall be finally settled by binding arbitration by a panel of [***] arbitrators pursuant to the then-current Commercial Arbitration Rules of the American Arbitration Associations ("**AAA Rules**"), except where they conflict with this Section 12.1(d) shall control. Each Party shall nominate [***] arbitrator and the [***] Party-nominated arbitrators shall then nominate the [***] arbitrator, who shall serve as the presiding arbitrator, within [***] after the second arbitrator's appointment. The arbitrators shall not be [***] and each arbitrator shall have at least [***] of pharmaceutical industry experience. At the request of a Party, the arbitral tribunal shall have the discretion to order the disclosure of specified documents by the Parties. Such a request shall identify the document(s) with a reasonable degree of specificity and establish the relevance of the document(s) to the arbitration.

Contract Example 2

Any dispute, claim or controversy arising out of, relating to or concerning in any way this Agreement or the parties' business relationship, whether sounding in contract, tort, or otherwise, shall be fully and finally settled by binding arbitration administered by the American Arbitration Association pursuant to the Commercial Arbitration Rules, except that claims by Seller for Buyer' s non-payment of the purchase price of products sold by Seller may be brought before any U.S. or foreign judicial court of competent jurisdiction. Any arbitration shall be conducted in [location] in [language]. If the total amount in controversy is less than $500,000.00, the arbitration shall be conducted before a single arbitrator; if the total amount in controversy is equal to or greater than $500,000.00, the arbitration shall be conducted before a panel of three arbitrators. The parties agree that this arbitration agreement affects interstate commerce and that the Federal Arbitration Act, 9 U.S.C. § I, et seq., applies. The arbitrator(s) may award declaratory or injunctive relief only in favor of the individual party seeking relief and only to the extent necessary to provide relief warranted by that party's individual claim. Judgment upon the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. Legal fees, including, without limitation, reasonable attorneys' fees and costs of arbitration, shall be awarded to the prevailing party in the arbitration. Any dispute, claim or controversy as to the arbitrability of a matter shall be decided by the arbitrator(s); however, the arbitrator(s) shall have no power to determine the class arbitrability of any dispute or the enforceability of the class action waiver set forth in Paragraph 21 of this Agreement. If the class action waiver set forth in Paragraph 21 is determined to be unenforceable, then all terms of this Paragraph 20 shall be null and void.

Arbitration

- **Include Class Action Waiver?**

- **Consumer Facing Companies/Class Action Waivers** - Claims may only be brought by a party in its individual capacity and not as a plaintiff or class member in any purported class or representative proceeding, and the arbitrator or arbitrators may not consolidate more than one person's claims or otherwise preside over any class or representative proceeding.

Key Issues: Enforcement + Severability

- Who decides Enforcement of Arbitration Agreement
- Generally, Arbitration clauses will have delegation provisions that delegates certain issues to the Arbitrator
  - Application of agreement; interpretation of Agreement
- Do these provisions actually hold up?
- According to the 3rd Circuit –It depends…
  - If there are questions about the making of an agreement to arbitrate, then the Court will resolve the issue unless the parties clearly and unmistakably delegated those issues to the Arbitrator. And even then, those issues will only be delegated unless the formation/validity of underlying written contract is at issue. *MZM Construction Company, Inc. v. New Jersey Building Laborers Statewide Benefits Funds*, No. 18-3791, 19-3102 (3rd Cir. Sep. 14, 2020).
    - 3rd Circuit joins several sister circuits in adopting the view that courts retain the primary power to decide questions of whether the parties mutually assented to a contract containing or incorporating a delegation provision under section 4 of the FAA. *Id.* at 402.

What happens if Arbitration provision is found void or unenforceable?

- Arbitration agreements are “severable” and independently enforceable from the rest of the contract. Moreover, a clause delegating a question to an arbitrator may also be severable from the arbitration agreement. *Zirpoli v. Midland Funding*, LLC, 48 F.4th 136, 143-44 (3d Cir. 2022)

Drafting Arbitration Considerations: Key Contract Terms

- Whether all disputes are to be arbitrated (e.g., “all disputes arising out of and/or relating to this R&D agreement”) or whether there are to be any carve-outs (e.g., “all disputes arising out of and/or relating to this license agreement other than patent validity and enforceability”),
  - See Contract Ex. #2
  - “except that claims by Seller for Buyer’ s non-payment of the purchase price of products sold by Seller may be brought before any U.S. or foreign judicial court of competent jurisdiction”
  - Sometimes parties carve out breaches of confidentiality or Intellectual Property disputes.
- The qualifications of the arbitrator (e.g., former judge, an attorney who has conducted at least ten arbitrations to award, and who has a degree in biology, bioengineering, chemistry, or chemical engineering).
- Parties often underestimate how certain procedural aspects of arbitration provisions can result in increased costs.
- Mediation Provision/Procedure.

Drafting Arbitration Considerations: Key Contract Terms

- Consider including language about streamlined discovery or discovery limits:
  - Sample Clause for Discovery:
    - "Each party will, upon written request of the other party, promptly provide the other with copies of all relevant documents. There shall be no other discovery allowed."
    - "The parties may only engage in discovery to the following extent: Each party shall be entitled to serve twenty (20) document requests and each party shall only be entitled to notice and take no more than three (3) depositions of seven (7) hours of less each. Third party depositions are not permitted, except for expert witnesses. No interrogatories or requests to admit shall be permitted."
- Consider which arbitration organization – AAA/JAMS/ICC

ACC Association of Corporate Counsel NORTHEAST

3

Commercially Reasonable Efforts (CRE)

Commercially Reasonable Efforts (CRE)

CRE is a component of many agreements and one of the most frequently litigated contractual terms.

What's the Standard:

Outward-Facing

- Applies an **industry-standard** requirement or looks to others in the industry to define diligence.
- This is typically pro-manufacturer or licensor, who can point to extra steps that the distributor or licensee did not take that other participants in the industry would have.
- Example: "Commercially Reasonable Efforts" generally means the efforts consistent with the past practice of similarly size/staged pharmaceutical companies with respect to similarly situated pharmaceutical products.

ACC Association of Corporate Counsel NORTHEAST

What's the Standard:

Inward-Facing

- Applies the licensee or distributor's own internal standard to determine what is commercially reasonable, i.e. more deferential to the discretion of the party obligated to use CRE.
- Pro-licensee or distributor, because they can simply point to their own internal practices. Often allocates more discretion to party obligated to perform.
- Example: "Commercially Reasonable Efforts" means, the efforts to be expended by a Party with respect to any objective, such reasonable, good faith efforts to accomplish such objective as such Party would normally use to accomplish a similar objective under similar circumstances without regard to other products in such Party's portfolio.

How Have Courts Applied CRE Clauses?

InspiRX, Inc. v. Lupin Atlantis Holdings SA, 554 F.Supp.3d 542 (S.D.N.Y. 2021)

Summary judgment for defendant because there was no evidence that it failed to use commercially reasonable efforts to sell the products.

- Good example of a company that complied with an outward-facing "commercially reasonable efforts" clause in the contract.
- This is a situation where the CRE was so broad and deferential to the licensee it ultimately "backfired" against the licensor. Plaintiff contracted with Defendant to distribute new Product that Plaintiff had developed—Inspira Chamber (VHC – valve holding chamber to facilitate aerosolized medicine).
- Provision: "Shall not be less than other similarly situated companies…exercising reasonable business judgment."
- Key facts: Sale of product flat-lined over multi-year relationship; D changed marketing strategy, reducing sales force and budget; D met with P to try to address issues; D could only contract with one retailer, and then terminated when FDA regs changed requirements for the product's identifier. D marketed its other brands and increased sales force for those.
- **Holding:** CRE does not mean perfect efforts. D had discretion and made efforts to try to market the Product for which Plaintiff had regulatory responsibility. D is not required to market to its detriment.

What if Agreement is Silent on CRE?

When CRE is not defined in contract, courts generally hold that "[t]he standard for satisfying commercial reasonability under New York law is a fairly lenient one."

- A "commercially reasonable efforts" clause "requires at the very least some conscious exertion to accomplish the agreed goal, but something less than a degree of efforts that jeopardizes one's business interests."
- A CRE clause is not a "hell or high water" clause tying the signatory to use all efforts possible, no matter the cost.
- It is well-settled that CRE clause does not require the signatory to act against its own interests.
- Even if Defendant did breach the technical terms of the provision, it may not be liable if the breach was immaterial.

What if Agreement is Silent on CRE?

- Delaware courts have described "commercially reasonable efforts" or "best efforts" as obligating the parties to cooperate in challenging circumstances. In *Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 159 A.3d 264 (Del. 2017) (in the absence of specific CRE definition), the Delaware Supreme Court stated that these standards required the parties "to take all reasonable steps to solve problems and consummate the transaction."

- Under Delaware law, "reasonable best efforts," requires a party to (i) have "reasonable grounds to take the action" it takes and (ii) seek "to address problems with its counterparty."

CRE

Akorn, Inc. v. Fresenius Kabi AG 2018 WL 4719347 (Del. Ch. Oct. 1, 2018),

Akorn: Facts

- **2017:** Fresinius Kabi AG agreed to acquire Akorn, Inc. The merger agreement made extensive representations about compliance with regulatory requirements and committed to use commercially reasonable efforts to operate in ordinary course of business (from signing the agreement to closing).
- **2018:** Fresenius terminated the Merger Agreement citing data integrity problems at Akorn, the costs of remediation, and the decline in Akorn's business performance.

Akorn: Akorn's conduct

- Departed from ordinary course of business operations after Merger Agreement was signed without Fresenius's consent:
  - Canceling regular audits, assessments, and inspections of certain facilities;
- Did not maintain a data integrity system;
- Submitted regulatory filings to the FDA based on fabricated data;
- Failed to conduct investigation when in receipt of whistleblower letters;

Akorn: Court Decision

- **Holding:** Fresenius proved that Akorn suffered a general material adverse effect (decline in Akorn's performance… company-specific problems rather than industry-wide conditions). Moreover, Akorn failed to Use CRE to operate in the ordinary course of business: "Under the Merger Agreement, Akorn was obligated to use commercially reasonable efforts to operate in the ordinary course of business in all material respects. As interpreted by the Delaware Supreme Court in *Williams*, this standard required that Akorn "take all reasonable steps" to maintain its operations in the ordinary course of business. The record establishes that Akorn breached that obligation in multiple ways." *Id.* at 88.

Akorn: Court Decision

- Akorn's Failure to Use CRE was material
  - "Using the standard of materiality discussed above, Akorn's breaches of the Ordinary Course Covenant were material. In the context of the Merger Agreement, the breaches of the Ordinary Course Covenant departed from what Fresenius could reasonably expect and changed the calculus of the acquisition for purposes of closing." *Id.* at 89.
  - Akorn should have prioritized the remediation of its data integrity systems once reports were received. It submitted fraudulent data to the FDA in 2017 and 2018.
  - FDA regulatory requirements were an important part of the merger agreement. The agreement used the language "in all material respects." Fresenius could refuse to close if Akorn did not continue to operate in the ordinary course of business with respect to regulatory compliance. Akorn's representations of compliance were untrue.

Drafting CRE Considerations

- Consider defining CRE in contract.
  - The amount of specificity and examples included can shape the litigation.
- Clarify whether failure to follow CRE results in a material breach. *See Lupin*, ("And even if Lupin did breach the technical terms of this provision, there is nothing that suggests that any breach was material.")
- Consider interaction between clauses
- Consider governance clause as another route to ensure appropriate efforts.
- Consider amount of deference provided to obligor
  - According to *Lupin*, the amount of deference is significant. If the licensee has sole discretion, then it may make it harder for the licensor or the manufacturer/developer to say their efforts were not commercially reasonable.
- Consider respective benefits of outward-facing or inward-facing standard.
  - Will depend on your circumstances. If you are a distributor/supplier or the one tasked with CRE, you may want a more in-ward facing clause and vice versa. Document efforts or lack thereof and communicate with counter party to try to stay on the "same page" and to avoid surprise claims/defenses

4

Venue Provisions

Venue/ Forum Selection

Why it matters?

- Effective to limit forum shopping
- Convenience
- Interplay with choice of law. Choice of law really matters.

Reminders – law school refresher

- **Venue v. Forum**: Venue is the specific location within the state. Forum could mean a few different things, including whether the selected court is a federal or state court, or whether arbitration controls
- **Personal Jurisdiction**: requirement that a given court have power over the defendant, based on minimum contacts with the forum.
- **Subject Matter Jurisdiction**: requirement that a given court have power to hear the specific kind of claim

Contract Example 1

Any dispute, controversy or claim (whether such claim sounds in contract, tort or otherwise) arising out of or relating to this Agreement (or the breach, termination or validity thereof), or arising in any way out of the relationship of the Parties, will be settled by a ‘bench’ trial … in the courts of Westchester County, New York.

Contract Example 2

Each party irrevocably agrees that any legal action, suit or proceeding against it arising out of or in connection with this [Agreement] or in the transactions contemplated hereby or thereby or the inducement of any party to enter herein or therein (whether for breach of contract, tortious conduct or otherwise and whether predicated on common law, [equity,] statute or otherwise) shall be brought exclusively in the United States District Court for the Eastern District of Pennsylvania, or, if such court does not have subject matter jurisdiction, the state courts of the Commonwealth of Pennsylvania located in [INSERT NAME OF COUNTY] (the Pennsylvania Courts) and hereby irrevocably accepts and submits to the exclusive jurisdiction and venue of the aforesaid courts in personam, with respect to any such action, suit or proceeding. The [parties agree that the] Pennsylvania Courts are the most appropriate and convenient courts to settle any such dispute and each party waives objection to the Pennsylvania Courts on grounds of inconvenient forum or otherwise as regards proceedings arising out of or in connection with this [Agreement.]

Key Issues

- Ambiguous venue provisions
- Evading the venue provision through “clever” drafting

Key Cases: *Carl Zeiss Microscopy, LLC v. Vashaw Sci., Inc.*, No. 19 CV 3540 (VB), 2020 WL 85195, at *1 (S.D.N.Y. Jan. 2, 2020).

- Plaintiff, manufacturer of microscopy, sued its non-exclusive seller in SDNY for breach of contract.
  - "Any dispute, controversy or claim (whether such claim sounds in contract, tort or otherwise) arising out of or relating to this Agreement (or the breach, termination or validity thereof), or arising in any way out of the relationship of the Parties will be settled by a 'bench' trial … in the courts of Westchester County, New York."
- The Court reasoned because "courts of Westchester County, New York" could be the federal court and state court, the provision was ambiguous.
  - If the parties wanted to limit to state court, then they could have done so by precluding the federal forum.
  - Construed ambiguity against the drafter.

Key Cases: *Werner v. 1281 King Assocs., LLC*, 260 A.3d 147 (Pa. Super. Ct. 2021)

- Interpreting the phrase "arising out of" in a forum selection clause to simply mean "but for" or a "causal connection" between the allegations and the contract
  - The plaintiff sued the defendants in Philadelphia County for injuries received while making a delivery on the defendants' premises.
  - The defendants asserted that the agreements contained a forum selection clause prescribing venue in Franklin County
  - The Superior Court interpreted the "arising out of" language in the forum selection clause to mean "causally connected with."
  - Therefore, the Court applied the forum selection clause and transferred to Franklin County.

Drafting Venue Considerations

A well-drafted forum selection clause brings certainty about the location of litigation arising out of a contractual relationship

- Consider federal court v. state court
  - This includes consideration of subject matter jurisdiction
- Location of witnesses and evidence
- Most courts consider them prima facie valid
- Specify the transactions contemplated by the agreements
- Specifically include equitable claims
- Does it cover extra contractual claims
- Be aware of personal jurisdiction issues based *on Mallory*. *Mallory v. Norfolk Southern Railway Co.*, 600 U.S. 122 (2023).

5

Indemnity

Contractual Indemnity

Contract Example 1

Indemnification by Party X. Party X shall defend, indemnify, and hold Party and its Affiliates and their respective officers, directors, employees, and agents (the "Party Y Indemnitees") harmless from and against any and all Third Party claims, suits, proceedings, damages, expenses (including court costs and reasonable attorneys' fees and expenses) and recoveries (collectively, "Claims") to the extent that such Claims arise out of, are based on, or result from (a) the performance by or on behalf of Party X or its Affiliates of any obligations of Party X with respect to Licensed Compounds or Licensed Products (only as to the Licensed Compound contained therein) under this Agreement, including activities conducted pursuant to the Deliverables Plan, (b) the breach of any of Party X's obligations under this Agreement, including Party X's representations, warranties, and covenants set forth herein, (c) the willful misconduct or negligence of Party X or its Affiliates in performing under this Agreement, or (d) if applicable, the Development, Manufacture or Commercialization of any Terminated Products by or on behalf of Party X or its Affiliates or (sub)licensees. The foregoing indemnity obligation shall not apply to the extent that (i) the Party Y Indemnitees fail to comply with the indemnification procedures set forth in Section 9.3 and Party X's defense of the relevant Claims is actually prejudiced by such failure, or (ii) any Claim arises from, is based on, or results from any act or omission for which Party Y is obligated to indemnify the Party X Indemnitees under Section [].

Contract Example 2

Indemnification by Party Y. Party Y shall defend, indemnify, and hold Party X and its Affiliates and their respective officers, directors, employees, and agents (the "Party X Indemnitees") harmless from and against any and all Claims to the extent that such Claims arise out of, are based on, or result from (a) the Development, Manufacture or Commercialization of Licensed Compounds or Licensed Products by or on behalf of Party Y or its Affiliates or Sublicensees, (b) the breach of any of Party Y's obligations under this Agreement, including Party Y's representations, warranties, and covenants set forth herein, or (c) the willful misconduct or negligence of Party Y or its Affiliates in performing under this Agreement. The foregoing indemnity obligation shall not apply to the extent that (i) the Party X Indemnitees fail to comply with the indemnification procedures set forth in Section and Party Y's defense of the relevant Claims is actually prejudiced by such failure, or (ii) any Claim arises from, is based on, or results from any act or omission for which Party X is obligated to indemnify the Party Y Indemnitees under Section [].

Indemnification Overview

- Allows a party to customize the amount of risk it is willing to undertake.
- Actual or contingent losses/liabilities? (*Pfizer* case)
- Drafting an effective provision may allow for:
  - Indemnified party to recover losses like attorney's fees (uncommon under common law indemnification)
- Indemnifying party to reduce its liability by incorporating:
  - Liability caps
  - Materiality qualifiers
  - Baskets – Tipping/Deductible

Indemnification Overview: Language

- Indemnification event – defining the circumstances or events that trigger obligation.
- Indemnifying parties – who is responsible for compensation and who receives the compensation
- Amount of Indemnification – specifying the maximum compensation
- Scope of Indemnification – setting parameters for the types of losses and damages covered
- Exclusions / limitations – exceptions and limits to the obligation

Often Excluded

- Indemnification provisions that may exclude indemnification for claims resulting from the indemnified party's own action:
  - Ordinary/Gross Negligence
  - Bad faith or willful misconduct

Nexus Phrasing

- Phrases such as, “caused by,” “related to,” and “resulting from” connect the recoverable damages to the covered events or conduct. The phrasing is negotiated by the parties to dictate the scope and timing of the indemnity claim.
- Indemnifying Party → narrow language, “[to the extent] caused by,” “solely result from”
- Indemnified Party → expansive language, “related to”
- Middle ground → “arising from”

Nexus Phrasing

- If indemnification covers the indemnifying party's breach of the agreement, consider whether the breach should be limited by one or more qualifiers:
  - Material Breaches – Prohibit the non-breaching party from recovering damages unless it can prove that the nature of the subject matter of the breach was material (i.e., was the breach material to trigger indemnification?)
  - Liability Baskets – Shields indemnifying part from having to indemnity an otherwise covered claim unless and until the amount of losses resulting from covered claims exceeds a defined amount
  - Threshold Example – Triggered by Dollar Amount: Indemnifying Party shall not be obligated to pay for any Losses under Section ___ ([Buyer/Seller/Mutual] Indemnification) until the amount of all such Losses exceeds, in the aggregate, $___ or the total amount paid [or payable] by the Buyer to the Seller under this Agreement [in the [____] [year/month] period preceding the event giving rise to the indemnification claim], whichever is [greater/less] [(the "Threshold")], in which event Indemnifying Party shall pay or be liable for all such Losses from the first dollar. [Notwithstanding the foregoing, the Losses that arise out of or result from[, in whole or in part,] any claim (whether direct or indirect) based on any of the circumstances set forth in Section ___ ([Buyer/Seller/Mutual] Indemnification) are excluded from the Threshold calculation, and Indemnifying Party is liable for all such Losses from the first dollar.]]
- Further, limiting the indemnity obligation to cover only claims arising in certain jurisdictions

ACC Association of Corporate Counsel NORTHEAST

Nexus Phrasing

- *Pfizer, Inc. v. Stryker Corp.*, 348 F.Supp.2d 131 (S.D.N.Y. 2004).
- *Wildcat Drilling, LLC. v. Discovery Oil and Gas, LLC.*, 2023 WL 6304449 (Ohio 2023).
- *Peranzo v. WFP Tower D Co. L.P.*, 162 N.Y.S.3d 3 (1st Dep't 2022).
- *LPPAS Representative, LLC v. ATH Holding Company LLC*, 2020 WL 7706937 (Del. Ch. Dec. 29, 2020)

Contractual Indemnity

An Agreement for contractual indemnification may not contain language or words of broad, general import, and must be clear and unequivocal as required by *Ruzzi v. Butler Petroleum Company*, 588 A.2d 1 (Pa. 1991).

Contractual Indemnity

Moreover, in PA, agreements can include a provisions that covers losses due to the indemnitee's own negligence.

If parties intend to include within the scope of their indemnity agreement a provision that covers losses due to the indemnitee's own negligence, "they must do so in clear and unequivocal language. No inference from words of general import can establish such indemnification." *Molettiere v. Brittany Square CVS, Inc.*, 2013 WL 11267078, at * 3 (Pa. Super. Ct. 2013).

Drafting Considerations

Check forum state's status on Anti-Indemnification Statute… For example, in PA, agreements that require indemnification for indemnitee's negligence need to do so in clear and unequivocal language.

- When drafting, stay away from "general import" such as:
  - All claims
  - Any and all liability
  - To fullest extent
  - Any and all
  - Consider limitations / carve backs to indemnification, e.g., "except to the extent arising from Indemnitee's [or an Indemnitee's] negligence/willful misconduct/breach of this Agreement]. Exclusions – e.g., willful/gross negligence. But are there others, e.g. False Claims Act, RICO, Antitrust
  - Consider interplay of mutual indemnification clauses. And note: there are good reasons why they would not contain mirror image language!

6

Force Majeure/ Impracticability

What Is It and Why Is It Necessary?

- While once thought of as just a boilerplate paragraph thrown into a contract, because of COVID and weather events FM clauses have now become the center of a lot of litigation.
- A force majeure clause allocates the risk of loss if performance is hindered, delayed, or prevented because of an event that the parties could not have anticipated or controlled.
- It provides a contractual defense, in the form of an excuse to performance. The scope and effect of which will depend on the express terms of a particular contract.
- Seeing many claims of force majeure as a means to trigger renegotiations
- Generally, economic hardship alone is often not considered a Force Majeure event
- UCC § 2-615 Commercial Impracticability – Understand Duties (Allocation/Cover)

Four Enforcement Points

1. It must define the breach for which a promisor seeks to be excused.
2. It must define the "force majeure event" itself.
3. It must require (and define) the causal connection between these two.
4. It must explain what will happen if performance is excused.

FORCE MAJEURE/IMPRACTICABILITY

Key Issues + Cases

Described Force Majeure Event

Norfolk S. Ry. Co. v. New York Terminals, LLC, No. CV 2:14-07664, 2017 WL 4005158, at *4 (D.N.J. Sept. 12, 2017).

FACTS

- Movement for summary judgement; demurrage charges
- Most notably, Norfolk argued that NYT's FM defense fails because it waived this defense by failing to comply with the FM clause in Norfolk's tariff and because the inclement weather was not the sole cause of the demurrage

COURT

- "Well known" weather
- FM clause
- Treating tariff as if it were a contract
- Failure to adhere to the terms of tariff

Causation: Motions

SPI Pharma, Inc. v. Roben Mfg. Co. Inc., No. CV214746ZNQDEA, 2023 WL 4197181, at *4 (D.N.J. June 27, 2023).

FACTS

- Defendant agreed to design, fabricate and deliver thirteen tanks and one evaporator for Plaintiff, nutritional supplement company
- Intended purpose of the agreement
- Around August 2019 – Defendant disclosed to Plaintiff that it was facing certain delays due to supplier issues, a labor shortage, and equipment problems.

HOLDING

- Because Defendants failed to provide written notice of a FM Event, and has not raised a genuine issue of material fact with respect to pandemic's severity in August 2019, the Court finds that Defendant's untimeliness cannot be excused by FM clause.

Beyond the Control *Watson Laboratories Inc. v. Rhone-Poulenc Rorer Inc.*, 178 F. Supp. 2d 1099 (C.D. Cal. 2001).

BACKGROUND

- Plaintiff entered into supply agreement with defendant, with a forced majeure provision
- Defendant Subsidiary's facility was shut down due to FDA, therefore Defendant could not supply the Plaintiff's requirements of a hypertension drug
- Plaintiff sued defendant for breach of contract; defendant raised defense of forced majeure

COURT

- Acknowledged that there was little doubt that the shutdown was ordered by the government.
- However, the court held that, under California law, a party may only invoke the defense of force majeure if the triggering event was "beyond the reasonable control of either party."
- Because the shutdown was within the control of Defendant, the court would not excuse nonperformance due to the force majeure clause.

Drafting Force Majeure Considerations

- From the pandemic, we learned courts seek to discern whether the parties have expressly or impliedly allocated risks and rely on extra-contractual theories only sparingly….
- Scrutinize force majeure events
  - Forward looking – evaluate why you may not be able to satisfy contractual obligations
- Consider including mitigation language.
- Consider allocating risk of government shutdown—if business unable to operate, build in protections to give client relief.
- Build in expansive definition of public health crisis, including pandemics, epidemics, viral outbreaks, environmental/weather events, and so on.
- Interplay with common law
- Documentation is critical
- Specify rights and obligations in event of declaration of FM (e.g., does continuing FM give rise to termination right, or end exclusivity?)
- Add any carve-outs to FM? (e.g., perhaps COVID-related matters should not be basis of an FM if a COVID pandemic is already underway when contract is signed).

7

Termination Provisions

Termination Provisions: Purpose

- Outlines the conditions or grounds under which parties can terminate the contract.
- Why are termination provisions important?
  - Gives certainty to when a party's obligations are discharged.
  - Additionally – outlines party's rights to materials/documents/licenses/ confidentiality concerns
  - Specifies surviving obligations. Can also specify post-termination transition or close-out obligations.

Termination Provisions: Key Issues

- Renewal Triggers
- What is the effect of termination?
  - Effect on sublicenses
  - Returning or destroying confidential documents and materials
- Grounds for Termination:
  - Material Breach
  - Convenience
  - Bankruptcy

Drafting Termination Considerations

- If no termination provision, the non-breaching party is only discharged for a material breach
  - The problem is then, what is a material breach?
    - Spell out occurrences that make continued performance intolerable for your client to avoid uncertainty about whether the client's obligations are discharged
- Who walks away with what?
- Allocate post-termination risks and responsibilities
- Survivability clauses –
  - To ensure contractual obligations that by their nature continue even after termination actually do so.
- When do you need to give notice?
  - If it is a supply agreement, do you get a "last time buy"?

Termination

- Ending a contract prior to its full performance.
- Termination does not affect liabilities of the parties for breaches of the contract that occurred prior to the contract being terminated.
- Ways to Terminate:
  - Termination for cause (default) – A party's right to terminate its contract may be negotiated in the terms of the contract itself (general principles of contract law apply)
    - Available in response to material breaches
  - Termination for convenience – May originate only from the terms of a contract which provide for termination (no contractual principles)
    - Some jurisdictions vary on good faith etc.:
      - Plaintiff conceded that New York courts permit a party to use an unconditional termination clause "without court inquiry into good faith or motive." This is consistent with the rule that "a party has an absolute, unqualified right to terminate a contract on notice pursuant to an unconditional termination clause without court inquiry into whether the termination was activated by an ulterior motive" *Watermelons Plus, Inc. v. New York City Dept. of Educ.*, 980 N.Y.S.2d 80, 81 (2d Dept. 2010).

Termination

- *Portal Instruments, Inc. v. LEO Pharma A/S*, 2023 WL 4640163 (S.D.N.Y. 2023).
  - Parties entered into a collaboration and license agreement to jointly develop a variety of drug delivery systems. In consideration of licenses and rights, Defendant made a one-time payment and agreed to royalty payments based on annual net sales of all products sold, as well as other milestone payments.
  - Pursuant to Defendant's election to develop one of the products, it owed development fees to Plaintiff. Defendant made the first 7 payments and then sent Plaintiff a termination notice.
  - Plaintiff contended that Defendant owed an installment payment during the notice period, but prior to effective date of termination.
  - Holding: Court granted Defendant's motion to dismiss on grounds that once the election to cease development of the product was made, no installment payments were due. Future installment payments ceased with termination.

8

Merger + Integration

Merger and Integration

- Integration/Merger clauses acknowledge a final agreement between two or more parties. The document is placed at the end of a contractual agreement and supersedes all other agreements.
- Merger clauses, sometimes called zipper clauses, are contractual provisions stating "that there are no representations, promises or agreement between the parties except those found in the writing." Restatement (Second) of Contracts § 216 cmt. e (1981).
- Example: Integration. This Agreement and the instruments referenced herein supersede all previous understandings or agreements among the Parties, whether oral or written, with respect to the subject matter of this Agreement and such instruments. This Agreement and such instruments contain the entire understanding of the Parties with respect to the subject matter hereof and thereof. No understanding, representation, promise or agreement, whether oral or written, is intended to be or shall be included in or form part of this Agreement unless it is contained in a written amendment hereto executed by the parties hereto after the date of this Agreement.

Integration

- If the parties intend their writing as a final expression of one or more terms of an agreement, the agreement is integrated.
- Partial Integration: Final expression of some, but not all, terms of the agreement. Prior or subsequent agreements that contradict the writing are discharged. However, it does not do away with prior or subsequent agreements that are consistent with additional terms, not contradicting the writing.
- Complete Integration: Intended by parties as a complete and exclusive statement of the terms of the agreement. Similarly, prior or subsequent writings that are contradictory are discharged. Complete integration differs by discharging any prior or subsequent agreements that are within the scope of the agreement – such as additional terms that don't contradict the writing.
- Restatement (Second of Contracts §§ 210, 213, 215, and 216 (1981).
- Practical tip: counsel your business on what this means: Conversations, even emails, RFP responses, etc. are not enforceable unless expressly incorporated into the Agreement.

Parol Evidence

- Attorneys and clients alike understand the necessity of reducing most agreements to a final writing that will embody the parties' whole deal. The purpose behind the parol evidence rule "is to prevent parties to a written contract from seeking to vary its terms by reference to side agreements, or tentative agreements reached in preliminary negotiations."
- Prior oral agreement that contradicts the terms of written contract… the prior oral agreement is inadmissible regardless of whether it is partial or completed integration.
- Parol evidence "only determines which terms of the agreement a court will deem to constitute 'the contract' between the parties. It is not a rule of interpretation. Rather, it defines the subject matter of interpretation. 1-24 Corbin on Contracts Desk Edition § 24.04 (2017).

Middletown Concrete Products, Inc. v. Black Clawson Co. , 802 F.Supp. 1135 (D. Del. 1992).

- Principles:
  - In determining the applicability of the parol evidence rule, a court must first determine whether there is an integrated agreement. *See* *Restatement (Second) of Contracts* § 209(2) at 115 (1981). If a court concludes there is no integration, the parol evidence rule does not apply and evidence of contradictory prior or contemporaneous agreements may be introduced. "An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement." *Id*. at § 209(1). Professor Farnsworth has noted, "[n]o particular form is required for an integrated agreement, and the writing need not be signed by either party." E. Allan Farnsworth, *Contracts* § 7.3, at 471 (2nd ed. 1990) (footnotes omitted) [hereinafter Farnsworth]. "Whether a writing has been adopted as an integrated agreement is a question of fact to be determined in accordance with all relevant evidence." *Restatement (Second) of Contracts* § 209 cmt. c. Case law explaining how courts actually determine the intent of the parties is scant. Often courts simply assume a contract is integrated and move on to determine whether that contract is merely final as to the terms it contains or is the complete and exclusive final agreement of the parties.
- *Middletown Concrete Products, Inc. v. Black Clawson Co.*, 802 F. Supp. 1135, 1142 (D. Del. 1992).

Drafting Considerations For Merger Clauses

- Include Merger Clause:
  - In the event of litigation, failing to have a merger clause opens the door to the admission of any and all evidence about side agreements and extra-contractual promises that were meant to be discharged.
- Not Conclusive under the Applicable Law: Jurisdictions are split, some hold them to be conclusive or "generally conclusive," while other courts say they are not conclusive but may factor into the question of integration depending on the facts.
  - *IIG Wireless, Inc. v. Yi*, 22 Cal. App. 5th 630, 640 (2018).
  - *Bonfire, LLC v. Zacharia*, 251 F. Supp. 3d 47 (D.D.C. 2017).
  - Merger clause is given effect by designating choice of law provision
- Excluding Fraud - Generally, evidence of fraud is admissible even in the face of a completely integrated agreement containing a garden-variety merger clause.

SHOOK

HARDY & BACON