

Can you Really Anticipate Harm in a Commercial Contract?

Negotiating, Drafting and Enforcing
Remedy Provisions

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AGENDA

- I. Introduction to the law of remedies and damages
- II. Strategies and considerations for negotiating and drafting remedy provisions
- III. Enforcing remedy provisions

GOVERNING LAW AND GUIDANCE

- State Common Law
- Uniform Commercial Code: Article 2
- White & Summers, Uniform Commercial Code (2nd ed)
- Restatement (Second) of Contracts

OVERVIEW

- Purpose of damages is to protect a plaintiff's expectation interest
- Expectation damages are not limited to the amount of the contract price
- Reliance damages put the plaintiff in as good of a position as if the contract had not been made

DAMAGES AVAILABLE IN COMMERCIAL CASES

- General damages
 - Natural and probable result of defendant's actions (ex: lost profits)
- Special damages
 - Peculiar to a particular plaintiff (ex: humiliation or reputation)
- Consequential damages
 - Do not flow directly or immediately from defendant's actions, but from the results or consequences of the actions (they must be reasonably foreseeable and proximately caused)
- Incidental damages
 - Costs incurred to avoid or reduce losses after the breach

DAMAGES AVAILABLE IN COMMERCIAL CASES (CONT.)

- Future damages
 - Those that have not occurred yet, but are reasonably likely as a result of defendant's actions
- Exemplary damages
 - Compensate plaintiff for humiliation, embarrassment caused by extreme conduct of defendant
- Statutory damages
 - Only permitted by statute (ex: treble damages)
- Liquidated damages
 - Those the parties have agreed to in a binding contract

THE THREE C'S

- There must be a claim upon which damages are based and the damages are to put the non-breaching party in the same position as if the contract had been performed
- Damages have to be established with reasonable certainty
- There must be a causal connection between the conduct and the injury and the appropriate damages or compensation (“direct and proximate cause”)

THE BALANCING ACT

- The UCC recognizes, under certain circumstances, a contract may provide for remedies in addition to or in substitution for those provided in the UCC
- While unambiguous contracts must be enforced as written, “the ability to contractually limit one’s liability is not, itself, unlimited”
- An injured party must not be deprived of minimum adequate remedies

SECTION 2-719(1): CONTRACTUAL MODIFICATION OR LIMITATION OF REMEDIES

Section 2-719 provides:

- 1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages
 - a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and
 - b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.
- 2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this act.
- 3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

PROVISIONS LIMITING OR EXCLUDING DAMAGES

- Without provisions limiting or excluding damages, the default rules of law favor buyers
- Parties do not have unlimited discretion in limiting or excluding contractual damages
- There must be “at least minimum adequate remedies” or “a fair quantum of remedy” in the substituted remedies

SECTION 2-718(1): LIQUIDATED DAMAGES

UCC § 2-718(1) provides:

- Damages for breach by either party may be liquidated in the agreement, but only for an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

LIQUIDATED DAMAGES

- Contract law is designed to put the non-breaching party in the position he or she would have been in if there had not been a breach and not much better
- Penalties will not be enforced

LIQUIDATED DAMAGES: THE TEST

In order to be enforced, a liquidated damages provision in a contract must pass the following test:

1. The stipulated amount must be reasonable in light of the anticipated or actual loss caused by the breach; and
2. Actual damages would be difficult to estimate in advance or to prove after a breach

ELIMINATING CONSEQUENTIAL DAMAGES CAN BE TRICKY

Courts considering validity of an exclusion of consequential damages have reached different results:

- The different results depend on the jurisdiction's views as to whether there is an independent or an integral and interdependent relationship between the exclusion of consequential damages and the limited remedy offered
- If Interdependent: All remedies under the UCC become available when a limited remedy fails of its essential purpose, including consequential

ELIMINATING CONSEQUENTIAL DAMAGES CAN BE TRICKY (CONT.)

- If Independent – and a limited remedy fails in its essential purpose, the consequential damages limitation is not automatically voided unless it is unconscionable for the buyer to retain the risk of consequential damages upon the failure of an exclusive remedy such as a repair remedy
- Thus, a court will look to see if there is disparity in bargaining power; consequently, you should take steps to confirm in the agreement that:
 - Both parties are sophisticated and competent to allocate risk;
 - Both parties drafted the agreement; and
 - Both parties were represented by counsel

ENSURING A MINIMUM ADEQUATE REMEDY

- Something more than no remedy
- But how much more?
 - Does the remedy offered in anticipation address the actual harm?
 - What will likely happen should the provision drafted be deemed inadequate by a court and stricken by the court?

UNDERSTANDING YOUR OBJECTIVES IS THE BEST WAY TO START

- To best negotiate and draft, know what you want
- Understand your client's business
- Understand the law (contract law depends on the jurisdiction)
- Analyze and understand how the contract can be breached – and anticipate the damages caused by the breach
- Explore the available remedies under the law

DON'T FORGET RULES OF CONSTRUCTION

- Granting of one remedy does not necessarily exclude others (presumed cumulative)
- To avoid the presumption that remedies are cumulative, contracts should clearly indicate an intent to make the remedy exclusive
 - “Shall be exclusive of other remedies”
 - “As the sole remedy”
 - “The remedies enumerated therein shall be the only course to be taken thereunder”

RULES OF CONSTRUCTION (CONT.)

- Clarity
- Avoid drafting by form book or using prior agreements
- Define terms
- Use terms consistently
- Deal with each subject in one place

OTHER DAMAGE CONSIDERATIONS

- Attorney fees
 - Default “American Rule”: No fees
 - Statutory or contractual provisions
 - Recovery for “costs” generally don’t include fees
- Interest
- Mitigation
- Economic Loss Doctrine
- Double Recovery

IT MAY COME DOWN TO TIMING

- The UCC provides that notice of breach must be within a reasonable time after the buyer discovered or should have discovered the breach (§ 2-607)
- Buyers need to make certain contracts are clear on what is deemed “acceptance” and provide themselves with reasonable time to inspect
- If notice is not provided within a reasonable time, a buyer will be “barred from any remedy” (§ 2-607)

CONSIDER REDUCING THE STATUTE OF LIMITATIONS AS A LIMITATION ON REMEDIES

- Limitations periods can be shortened or reduced “to not less than one year” (UCC § 2-725(1))
- Common law provides that the shorter period must be a reasonable one
- Generally, contracts cannot enlarge limitations periods

ENFORCEMENT ACTIONS TO CONSIDER

- Exiting
- Escalating
- Litigation
- Bankruptcy

QUESTIONS?



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THANK YOU

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