7 DEADLY SINS OF CONTRACT DRAFTING
CONSTRUCTIVE INTERPRETATION AND INTERPRETATIVE CONSTRUCTION

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CHAPTER 15

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Hull's family has been a predominant force in the security and corrections industry for more than one hundred years. His great-grandfather founded the Southern Steel Company (world's largest manufacturer of jail/prison hardware) in 1897 in San Antonio, and it remained family-owned and run until 1981. Hull literally 'grew up' in the security industry, and has represented clients across the United States and internationally, in most every phase of public and private projects.

Government contracting, project finance and related disputes and litigation have been at the heart of Hull's international practice for more than three decades. The majority of Hull's work has been devoted to representing clients who do business with local, state and federal entities in the development, financing, construction, refinancing, dispute resolution and operations of public projects and their privatization across the United States, as well as in Israel, Great Britain, and Costa Rica.

Hull has been a leader in improving education for lawyers for 25 years, has served the State Bar of Texas in many leadership roles, and was one of the three founders of the San Antonio Bar Foundation. Hull also claims to be a "part-time professional" magician, and recently served as President of the Texas Association of Magicians.

Education & Honors

- Baylor University, Waco, Texas, BBA, 1974
- Baylor University School of Law, JD, 1976
  - 1st Place - Baylor Mock Trial Competition (1976)
  - Outstanding Advocate Award (1976)

Admissions

- Texas
- United States District Court, Western, Southern and Northern Districts of Texas

- United States Court of Appeals, Fifth Circuit
- U.S. Claims Court, Washington, D.C

Selected Professional Activities

- San Antonio Bar Foundation – Co-Founder and Fellow (1984 to date)
  Trustee (1984 to 1987)
- State Bar of Texas –
  Chair of Board of Directors (1987 -1988),
  Director (1985 – 1988)
  Executive Committee (1986 – 1989)
  Chair – MCLE Committee (2000 – 2004)
  Continuing Legal Education Committee (2008 – 2011)
  Texas Young Lawyers Association – Chair of Board of Directors, 1998-1999
- Texas Center for Legal Ethics and Professionalism
  Trustee (2004 - 2007)
  Vice Chair, Board of Trustees (2005 - 2007)
  Member (1995 to Date)
- Texas Bar Foundation
  Chair of the Fellows (2006 -2007)
  Vice Chairman of the Fellows (2005 – 2006)
  Secretary of the Fellows (2004 - 2005)
  Sustaining Life Fellow (1984 to date)
  Fellow (1980 to date)

Other Activities

- Texas Association of Magicians (Member 1967 to date)
  President 2009/2010
  Chair – 2010 TAOM Convention
  Vice President 2008 /2009
  Order of Willard (Member 2009)
- Society of American Magicians (Member 2004 to date)
  Chair – International Insurance Committee (2006 - 2009)
  Member, Assembly #206 – Austin, Texas (2004 to date)
  President (2008 & 2009)

- International Brotherhood of Magicians (Member 2005 to date)
  Member, Ring 18 – San Antonio, Texas (2007 to date)
  Member, Ring 60 – Austin, Texas (2005 to date)

Publications and Presentations

Hull is a prolific writer and speaker on legal topics including contract drafting, indemnification, financing, and ethics. He is one of the country's most sought after legal education speakers, having

given more than 200 presentations in Texas, California, Florida, Hawaii, Colorado, Washington, Arkansas, Tennessee, and the District of Columbia. Selected publications and presentations during just the last few years are listed below.

2012 "*7 Deadly Sins of Engagement Letters",* Live Webcast, State Bar of Texas

"*7 Deadly Sins of Settlement Agreements",* Live Webcast, State Bar of Texas

"*7 Deadly Sins of Settlement Agreements,* Advanced Trial Strategies – New Orleans, State Bar of Texas

Author, **"*Design/Build Handbook – with forms and checklists*",** 2012

2011 "*7 Deadly Sins of Boilerplate",* Entertainment Law Institute 2011, State Bar of Texas

"*Landmines in Deal Documents",* Business Torts Institute 2011, State Bar of Texas

"*Update on Heavy Duty Contract Drafting",* Advanced In-house Counsel Institute, 2011
State Bar of Texas

"*7Deadly Sins of Boilerplate",* 29th Annual Colorado Advanced Real Estate Seminar Real Estate Section of the Colorado Bar Association

"Top 5 Things To Consider Before Building a Jail", Panelist, Texas Jail Association

Webcast Panelist, *"Risk Transfer Provisions in Commercial Contracts"*
Strafford Publications

"*7 Deadly Sins of Boilerplate",* Essentials of Business Law 2011, State Bar of Texas

2010 Webcast Panelist, *"Risk Transfer Provisions in Commercial Contracts"*, Strafford Publications

"Drafting and Enforcing Complex Indemnification Provisions", The Practical Lawyer, August 2010 – Co Author

"Drafting Indemnification Provisions for LLC's and Partnerships", Partnerships and Limited Liability Companies, University of Houston Law Foundation

"Seven Deadly Sins of Boilerplate", Business Strategies, State Bar of Texas

2009 Webcast Panelist & Course Director, *"Drafting and Enforcing Complex Indemnification Provisions"*, ALI-ABA

2008 "*Protecting and Piercing the Corporate Veil – How to Protect the Owners; How to Get the Responsible Party*", Advising Small & Mid-size Businesses, University of Houston Law Foundation

"Failure to Fund and Unfunded Obligations", Suing, Defending and Negotiating with Financial Institutions, State Bar of Texas

Webcast Panelist & Course Director, *"Indemnification: Drafting Complex Provisions"*, State Bar of Texas

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7 DEADLY SINS OF CONTRACT DRAFTING

Constructive Interpretation and Interpretative Construction

By: D. Hull Youngblood, Jr.[1]

Admittedly, the classic Seven Deadly Sins[2] do not ordinarily impact the process of drafting a contract. With that limitation however, the dramatic title is appropriate since the focus of this article will be upon seven issues that arise in drafting contracts that can present significant challenges for practitioners and their clients. This is not intended to be an all-inclusive treatise on every consideration in drafting contracts, for every type of transaction.

This paper will analyze and discuss 7 topics regarding contract drafting that can impact the effectiveness, predictability and enforceability of an agreement. There are many other topics that deserve comment, so this paper will seek to include references to other resources useful to a practitioner in drafting, interpreting and construing contracts in many different types of transactions.

PREFACE:

Interpretation vs. Construction.

Contract Interpretation: The ascertainment of the meaning of the words used by the parties, and applying appropriate standards to determine the meaning of the words. This is similar to determining the intended definition of specific words used.

Contract Construction: The determination by a Court, as a matter of law, of the legal meaning of the entire contract.

In short, interpretation involves ascertaining the meaning of the contractual words (a question of fact), while "construction" involves determining the legal effect of those words (a question of law).[3]

Sin #1 – The Sin Of Who's Who.

Specifically describing the parties to a contract may seem to be a simple task, but in many cases, this simplicity can be deceptive. While describing the signatories to the contract should be an initial focus of any drafting project (get the name exactly right, and make sure you are describing the correct entity) it is the other issues related to party descriptions that can cause problems.

Indemnitor and Indemnitee.

For example, when negotiating the identity of the parties to be indemnified, the indemnitor's goal is usually to limit the universe of the indemnities. Conversely, the indemnitee (or its affiliates) typically seeks to expand the class as much as possible, and to include as many entities as possible in the definition of Indemnitor, to insure there is a financially viable obligor in place when a claim for defense or indemnity is asserted.

The balance is typically struck with actual signatory parties and various representatives of each, being included as Indemnitees, and very few entities being included as Indemnitors. Additionally, critical third-parties are commonly specifically included as Indemnitees. These may include owners (where the contact is a subcontract and the owner is not a party to the contract) or non-party business brokers that structured the transaction, while being independent contractors rather than agents.

The protection of the Indemnitors duty to provide a defense and indemnity is not limited to only those parties that sign the contract. It is standard practice in settlement and transactional indemnity provisions to include the employees, officers, directors, etc. of the Indemnitee. The amount of specificity used to describe these various classifications of Indemnitees may ultimately determine whether they are afforded the protection of the indemnity provision. Essentially the persons to benefit from the indemnity must be "specifically designated" because a court is "precluded from extending an indemnity paragraph to parties not

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[2] Wrath, greed, sloth, pride, lust, envy, and gluttony.

[3] See 11 Williston on Contracts, Sec. 30:1 (4th Ed.); Boilerplate Terms, Rules of Interpretation, etc., Curt M. Langley and Jason T. Martin, Corporate Counsel Update, 2003

specifically designated therein", and must construe the indemnity paragraph to provide a common sense reading.[4]

> The typical definition of "Indemnitees" or 'Indemnitors" included in an indemnity agreement, might include:
>
> "Amalgamated Meatball and all of its employees, agents, representatives, officers, directors, affiliates, shareholders, owners, members, managers, attorneys, subsidiary corporations,[5] and advisors.

While most of these identifying labels provide some element of specificity (e.g. identification of who was and was not an employee on a particular date) general terms such as "agent" and "representative" present some difficulties. For example, the term 'agent' and 'representative' clearly imply that the intended indemnitee had the authority to officially act for, and on behalf of the indemnitee. Most consultants in modern day transactions are engaged as 'independent contractors' who have the authority to determine the details of their performance, but do not have the authority to act for or bind their Customer, as a true 'agent' would have. An independent contractor, who is not specifically mentioned as an indemnitee, by name or classification, is not properly included in the class of entities generally regarded as "agents" or "representatives".[6]

The ability to reasonably determine if a person or entity is includable in a described class seems to be the determining factor. For example, the term "officers, directors, employees and joint owners" has been held by at least one court to be sufficiently precise, but those listed classifications did not include a "consultant" to the Indemnitee, so the consultant was not entitled to indemnity.[7]

Third Party Beneficiaries

To be a third-party beneficiary of a contract, the contact must express intent to benefit that party or an identifiable class to which the party belongs.[8] Absent express declaration of such intent, it is strongly presumed that the third party is not a beneficiary and the parties contracted only to benefit themselves.[9]

It is common to see boilerplate provisions stating that the parties do not intend to create any third party beneficiaries,[10] and in those circumstances, generally no entity, other than the signatory parties, would have the standing to enforce the agreement (including any obligation to provide a defense or indemnity.) Thus, only the signatory parties (such as the buyer or seller of the business sold) will have the right to force the indemnitor to perform its contractual obligation to indemnify the other "non-signatory" indemnity beneficiaries. This can present some significant enforcement difficulties for the non-signatory beneficiaries.

A signatory to a contract containing an indemnification provision (such as the buyer of a business) has the standing to enforce the right to be indemnified, just as that party has the standing to enforce any other provision in the contract.[11] If both a signing Indemnitee and a non-signing Indemnitee are seeking Indemnity, then the signing party can bring the action for indemnity and include a prayer for relief for all the non-signing Indemnitees. However, where only the non-signing Indemnitee is at risk (or has suffered damage) the law of Texas as to who can seek redress for those rights of a third-party beneficiary Indemnitee is unfortunately, not so clear. One Texas case[12] has adopted the position of the

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[4] *Melvin Green, Inc. v. Questor Drilling Corp*. 946 S.W.2d 907, 910 (Tex.App.-Amarillo, 1997) *Kenneth H. Hughes Interests v. Westrup*, 879 S.W.2d 229, 232 (Tex.App.-Houston [1st Dist.] 1994, writ denied).

[5] The term 'subsidiary corporation has been held not to include limited liability companies, in that they are not corporations. "The limited liability company (LLC) is not a partnership or a corporation but rather is a distinct type of entity that has the powers of both a corporation and a partnership." http://www.sos.state.tx.us/corp/businessstructure.shtml.

[6] *Gordon v. CRS Consulting Engineers, Inc.*, 820 P.2d 492 (Utah Ct. App. 1991) Engineer, whose contract with State specifically stated he was an independent contractor with no authority to bind the state or act as its agent, was not covered by the General Contractor's obligation to indemnify the State and its agents.

[7] See, e.g., *Melvin Green, Inc. v. Questor Drilling Corp.*, 946 S.W.2d 907, 911 (Tex. App.-Amarillo, 1997).

[8] *Brunswick Corp. v. Bush*, 829 S.W.2d 352, 354 (Tex.App.—Fort Worth 1992, no writ); *MCI Telecomms. Corp. v. Tex. Util. Elec. Co.*, 995 S.W.2d 647, 651 (Tex. 1999).

[9] *MCI Telecomms.*, 995 S.W.2d at 651; *Brunswick*, 829 S.W.2d at 354; *Foster, Henry, Henry & Thorpe, Inc. v. J.T. Constr. Co.*, 808 S.W.2d 139, 140 (Tex.App.—El Paso 1991, writ denied).

[10] There are some circumstances where the failure to include such a "no third party beneficiary" provision could cause substantial problems for the parties. Contracts that relate to services provided to large litigious groups (inmates, patients, utility customers, etc) might require such a provision to eliminate the potential claims that the contract provides the non-signing individuals with implied rights to certain levels of performance under the contract.

[11] In general, only the parties to a contract have the right to complain of a breach thereof. *Copeland v. Alsobrook* 3 S.W.3d 598, 608 (Tex.App.-San Antonio, 1999).

[12] "…we conclude that the Restatement of Contracts is the correct statement of the law on this issue, …" *Delaney v. Davis* 81 S.W.3d 445, 450 (Tex.App.-Houston [14 Dist.], 2002).

Restatement (2nd) of Contracts[13] and takes the position that the signing Party can bring a claim for damages suffered by a non-signing Third-party beneficiary. But non-signatory Indemnitees are not signatories to the contract and, might not have standing to assert claims under the indemnity provisions that specifically mention them. The Restatement (2nd) of Contracts[14] creates a duty upon the promisor (Indemnitor) to perform the promise. This might be implied to create a direct right in the Third-party beneficiary to enforce its rights to performance.

If the signatory Indemnitee party has been merged into the indemnitor, or if the indemnitee and the third party beneficiaries are no longer on good terms (e.g. terminated employees), the third-party non-signatory parties may have a right to indemnity, but no practical means of enforcement. Likewise, once an acquisition transaction has closed, it is not uncommon for employees, officers and directors of the acquired target to lose their employment or position, as in a R.I.F. or for cause. In either event, the Indemnitor/buyer may not wish to provide a defense (or indemnity) for former employees, officers or directors for many reasons, and only the seller has the standing to seek specific enforcement of the defense and indemnity provisions.[15] If the Selling entity has been merged into the buyer or if the signatory Seller now has a delicate on-going relationship with the buyer, the signatory Seller may not wish to complicate its relationship with the Indemnitor/Buyer by seeking specific performance of the defense/indemnity provisions, for the benefit of others. Several options may be available to resolve these enforcement issues.

First, the departing employees, officers and directors can request contractual indemnity in their severance agreements, which however, may include a release of all claims against the Indemnitor. One must consider the value of the indemnity over time, versus the potential value of a claim against the employer/Indemnitor. Additionally, indemnification provisions in an employment or severance agreement, cannot be changed unilaterally (as can by-laws or articles of formation), and the protection they provide can be enforced directly by the Indemnitee against the Indemnitor.

Second, one solution (from the third party beneficiary's perspective) is to explicitly make these non-signatory third party beneficiaries signatories to the Agreement, but solely for purposes of enforcing the defense, advancement and indemnification provisions. However, in doing so, the ability of the signatory parties to amend all other provisions of the agreement (outside the indemnification provisions) should be protected so as not to require the consent of the third party beneficiaries to make changes to the agreement that do not affect the rights of the non-signatory Indemnitees.

The following is suggested language for providing third-party beneficiary indemnitees the right to enforce their indemnification protections, without being signatories to the agreement:

> Except as expressly set forth herein, this Agreement is intended solely to benefit the parties executing this Agreement, and is not intended to provide or create, either directly or indirectly, any right or benefit for any person or other entity that is not a party to this Agreement. However, each member of the "Owner Group", as defined in Section X-Indemnity, is a beneficiary of this Agreement, and each of them is authorized and entitled to seek enforcement all of the rights and benefits provided to them pursuant to Section X-Indemnity, of this Agreement; save and except that no member of the "Owner Group" is required to approve, consent to, or execute any amendment to this Agreement before such Amendment will become effective, except when such amendment seeks to change any term or provision of Section X-Indemnity. If an amendment of this Agreement does not seek to change any term or provision of Section X - Indemnity, then such amendment shall be effective when it is in full compliance with Section XX – Amendment and Modification, and is executed by the parties executing this Agreement.

Additionally, when considering whether a third-party beneficiary is provided coverage under an indemnification agreement, Courts have applied the

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[13] See *Restatement (2nd) of Contracts* §§ 305 cmt. a, 307 cmt. b (1981) recognizing in such a case that: (1) only nominal damages can be recovered by the promisee; (2) the promisee cannot recover damages suffered by the beneficiary; but (3) the promisee may be awarded specific performance if it is an otherwise appropriate remedy.

[14] A promise in a contract creates a duty in the promisor to the promisee to perform the promise even though he also has a similar duty to an intended beneficiary. REST 2d CONTR § 305.

[15] See *Doe v. Texas Association of School Boards, Inc*. 283 S.W. 3d 451 (Tex. App- Fort Worth, 2009) where there were sufficient references to the TASB in a settlement agreement that obligated TASB to abide by several of its terms, that the court found the parties intended for TASB to be a third-party beneficiary with standing to enforce the indemnification provision, even though TASB was not a signatory to the settlement agreement.

principle of *contra proferentum*[16] which is the rule of construing documents against the drafter of the document. The application of that rule is intended to protect the reasonable expectations of people who did not participate in the drafting of the agreement, but who may have relied upon its terms in deciding whether or not be become an employee, officer, contractor, etc.[17]

Sin #2 – The Sin of Recital Limbo.

A "recital" is "[t]he formal statement or setting forth of some matter of fact, in any deed or writing, in order to explain the reasons upon which the transaction is founded."[18] While it has been held that "the recital of facts binds both the parties to the deed and their privies"[19], recitals are not strictly a part of the contract unless it appears that the parties intended them to be such.[20] Therefore, if there is language in the agreement, that leads the reader to believe the parties intended to be bound by the recitals, in essence, the statements are no longer recitals, but have become covenants of the agreement, just as the other agreed upon terms and covenants bind the parties. However, assuming that the recitals are not intended by the parties to be part of the binding terms of the contract, unambiguous recitals can be instructive to a Court when the contracts operative terms are ambiguous.[21]

As a general rule, recitals in a contract will not control the operative clauses thereof unless the latter are ambiguous; but they may be looked to in determining the proper construction of the contract and the parties' intention. Recitals in a contract should be reconciled with the operative clauses, and given effect, so far as possible; but where the recital is so inconsistent with the covenant or promise that they cannot be harmonized, the latter, if unambiguous, prevails. In other words, recitals, especially when ambiguous, cannot control the clearly expressed stipulations of the parties; and where the recitals are broader than the contract stipulations, the former will not extend the latter.[22] In Gardner v. Smith[23], the Court summarized the rules of recital construction as follows:

> "While recitals, as a general rule, are not strictly any part of the contract, unless it appears that the parties intended them to be such, they may be looked to in determining the proper construction of the contract or the intention of the parties, at least when the language expressing their contractual relations is ambiguous, uncertain, or indefinite. *So, if the recitals are clear and the operative part is ambiguous, the recitals* govern the construction. [Italics ours.] Where the language of the covenants or promises in a contract is more comprehensive than that of the recitals, the intent is to be ascertained from a consideration of the entire instrument."

Illustrative Cases:

In Furmanite Worldwide, Inc. v. NextCorp, Ltd., 339 S.W.3d 326, (Tex. App. 2011), a change order in a construction contract was at issue. The opening paragraph of the last change order stated:

> This Change order amends the existing Client Service Agreement (the "CSA")

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[16] "Against the party who proffers or puts forward a thing." *Blacks Law Dictionary* 393 (4th 1969).

[17] See generally *Stockman v. Heartland Indus. Partners, L.P.* 2009 WL 2096213, 5 (Del.Ch.) (Del.Ch., 2009) where the doctrine was applied to a partnership agreement that was in place before additional partners were admitted.

[18] McMahan v. Greenwood, 108 S.W.3d 467, 484 (Tex. App. 2003); Black's Law Dictionary 1270 (6th ed.1990); *see Universal Health Servs., Inc. v. Thompson,* 63 S.W.3d 537, 543 (Tex.App.-Austin 2001, pet. granted) ("We can look at recitals to ascertain the intent of the parties in executing the contract, especially where the contract's operative terms are ambiguous."); *see also AFD Fund v. Midland Mgmt.,* No. Civ.A. 3:02CV0055–D, 2002 WL 731813, at *6–7 (N.D.Tex. Apr. 22, 2002) (holding that recital could not be read as enlarging unambiguous terms of agreement).

[19] *See Lambe v. Glasscock,* 360 S.W.2d 169, 172 (Tex.Civ.App.-San Antonio 1962, writ ref'd n.r.e.); *McDaniel v. Cherry,* 353 S.W.2d 280, 284 (Tex.Civ.App.-Texarkana 1962, writ ref'd n.r.e.) (citing *Williams v. Hardie,* 85 Tex. 499, 22 S.W. 399, 401 (1893)). Angell v. Bailey, 225 S.W.3d 834, 842 (Tex. App. 2007)

[20] *Illies v. Fitzgerald,* 11 Tex. 417, 424 (1854); *Gardner v. Smith,* 168 S.W.2d 278, 280 (Tex.Civ.App.—Beaumont 1942, no writ).

[21] "Universal contends that language in the preamble to an agreement or in a recital is not controlling. We can look at recitals to ascertain the intent of the parties in executing the contract, especially where the contract's operative terms are ambiguous. *See Gardner,* 168 S.W.2d at 280 (citing 17 C.J.S. *Contracts* § 314, p 733, now 17A C.J.S. *Contracts* § 317, p 340). Moreover, the quoted language forms a part of the contract, and we must examine all parts of the contract to determine the intent of the parties. *See Forbau,* 876 S.W.2d at 133. Universal Health Servs., Inc. v. Thompson, 63 S.W.3d 537, 543 (Tex. App. 2001) rev'd sub nom. Universal Health Servs., Inc. v. Renaissance Women's Grp., P.A., 121 S.W.3d 742 (Tex. 2003); "While recitals, as a general rule, are not strictly any part of the contract, unless it appears that the parties intended them to be such, they may be looked to in determining the proper construction of the contract or the intention of the parties, at least when the language expressing their contractual relations is ambiguous, uncertain, or indefinite. *So, if the recitals are clear and the operative part is ambiguous, the recitals* govern the construction. [Italics ours.] Where the language of the covenants or promises in a contract is more comprehensive than that of the recitals, the intent is to be ascertained from a consideration of the entire instrument." Gardner v. Smith, 168 S.W.2d 278, 280 (Tex. Civ. App. 1942)

[22] 17 C.J.S., page 733, subject, Contracts, § 314

[23] 168 S.W.2d 278, 280 (Tex. Civ. App. 1942)

> between NextCorp, Ltd. ("NextCorp") and Furmanite Worldwide, Inc. ("Client") dated December 1, 2002. The date of the CSA is hereby amended to be August 31, 2006, and any reference to the "first year of the Agreement" contained in the CSA shall hereafter mean the first full year following the date inserted in the immediately preceding sentence. Unless otherwise provided herein, all terms, conditions and provisions of the CSA shall remain in full force and effect and apply equally to the provisions of this Change Order.

The Court held that "[N]one of these provisions is a mere recital because none is "[a] preliminary statement in a contract or deed explaining the reasons for entering into it or the background of the transaction, showing the existence of particular facts." Instead, each statement is a substantive contractual provision controlling the parties' relationship.[24] Likewise, the former opening paragraph of the change orders was not a recital paragraph:

> This Change order amends the existing Client Service Agreement (the "CSA") between NextCorp, Ltd. ("NextCorp") and Furmanite Worldwide, Inc. ("Client") dated December 1, 2002. This Change Order shall commence on or about October 25, 2004. Unless otherwise provided herein, all terms, conditions and provisions of the CSA shall remain in full force and effect and apply equally to the provisions of this Change Order.

The Court concluded that "Each statement in this paragraph is a substantive contractual provision."[25]

In BCH Dev. Corp. v. Bee Creek Hills Neighborhood Ass'n,[26] the sole phrase on which the neighborhood association relied for its contention that all lots are restricted to residential use was contained in a "whereas" clause in the recital portion of the 1981 covenants:

> "Whereas, Declarant ... desires to create thereon a residential subdivision...."

The Court held that the operative clauses in the 1981 covenants are not ambiguous and do not deal with land use restrictions at all. Rather, the operative clauses in the 1981 covenants show that the declarant's intention was solely to create duties of membership and fee assessments for upkeep and repairs in the subdivision. The manifest intention of the declarant is reflected in the specificity of the operative clauses; therefore, the clause found in the recital cannot extend the operative clauses to include a residential-only restriction.[27]

In finding that the recital at issue was not a contract provision, but merely a recital, the Court relied upon the fact that the recital was not a determinative statement. The Court held:

> Moreover, the terms of the recital relied on by the neighborhood association are not clear and unambiguous. Commercial use of a small number of lots, especially those lots least suited for residential use, would not render a subdivision "nonresidential." Thus, the recital that the declarant "desires to create a residential subdivision" is not inconsistent with the creation of a subdivision that has a relatively small number of commercial properties, as long as the subdivision retains an essentially residential character.[28]

In All Metals Fabricating, Inc. v. Ramer Concrete, Inc.,[29] Ramer argue that the first paragraph in the contract was a contract recital and not an operative agreement of the contract. All Metals argued that the provision was not a mere recital but rather operative language. The language in question is out below:

> WHEREAS, Subcontractor agrees to furnish all labor, tools, equipment, supervision, services, materials and supplies necessary to perform, and to perform all work set forth in 'Paragraph 2' hereof, in connection with the construction of ALL METALS FABRICATING, 200 ALLENTOWN, ALLEN, TX (owner), hereinafter called the Owner, in accordance with the terms and

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[24] 339 S.W.3d 326, 337 (Tex. App. 2011)

[25] Id.

[26] 03-96-00416-CV, 1996 WL 727385 (Tex. App. Dec. 19, 1996)

[27] The Court stated the rules of recitals as: Recitals, especially when unclear, cannot control the clearly expressed stipulations of the parties; and where the recitals are broader than the contract stipulations, the former will not extend the latter. *Id.* A recital phrase may not extend clearly expressed operative stipulations. Additionally, recitals are not actually part of the document unless the parties intended them to be such. *Id.* The foregoing rules have been widely recognized as the standard for construing recitals in contracts. *See* 17A C.J.S. *Contracts* § 314 (1963).

[28] BCH Dev. Corp. v. Bee Creek Hills Neighborhood Ass'n, supra.

[29] 338 S.W.3d 557, 560-61 (Tex. App. 2009)

> provisions of this Subcontract Agreement, and of the Plans, Drawings, Specifications, General Conditions and Special Conditions and other Documents forming or by reference made a part of the Contract between the Contractor and the Owner dated August 4, 1999, all of which shall be considered part of this Subcontract by this reference thereto and the Subcontractor agrees to be bound to the Contractor and the Owner by the terms and provisions thereof.

The Court gave the following summary in finding that this was not a recital, but constituted irrevocable notice to the Subcontractor that he was subject to other agreements.

> It is the duty of the Court to consider the entire writing and attempt to harmonize and give effect to all the provisions of the contract by analyzing the provisions with reference to the whole agreement. *Frost Nat'l Bank v. L & F Distribs., Ltd.,* 165 S.W.3d 310, 311–12 (Tex.2005). A recital is a formal statement or setting forth of some matter of fact, in any deed or writing, in order to explain the reasons upon which the transaction is founded. *McMahan v. Greenwood,* 108 S.W.3d 467, 484 (Tex.App.-Houston [14th Dist.] 2003, pet. denied). Recitals are generally not part of a contract unless the parties intended them to be, and will not control a contract's operatives clauses unless those clauses are ambiguous. *Gardner v. Smith,* 168 S.W.2d 278, 280 (Tex.Civ.App.-Beaumont 1942, no writ). The recitals may be looked to in determining the proper construction of the contract and the parties intent. *Id.* The paragraph above does not specify or explain the reasons for the transaction, rather it notifies the parties that the contract between the owner and contractor is a part of the agreement. *EMC Mortgage Corp. v. Davis,* 167 S.W.3d 406, 415 (Tex.App.-Austin 2005, pet. denied). It also notifies the subcontractor that he is bound to the contractor and the owner by the terms and provisions of the contract documents. Even if the first paragraph is considered a recital, it should be reconciled with the operative clauses and given effect, so far as possible. *Myers v. Gulf Coast Minerals Management Corp.,* 361 S.W.2d 193, 197 (Tex.1962). The subcontract clearly shows Ramer agreed to be bound to both the contractor and the owner pursuant to the terms of the original contract.

Sin #3 – The Sin of Lex Loci Contractus

Choice of Law

Parties or their counsel may argue for "their" state to provide the applicable law, but from a practical viewpoint, when signing day arrives, many times it is the party with the money that gets its way, and chooses what law applies. Typically it is the identification of the State that gets all the attention, and the result usually includes the following terms:

> *This Agreement shall be governed by and* interpreted *in accordance with the substantive (and not conflicts) laws of the State of Ohio, U.S.A*

Most parties, and their counsel, probably believe that this concludes all the effort needed to draft a proper choice of law provision. However, there is more to be considered.

The parties will probably be surprised to learn that under this provision, Ohio law may NOT apply to a tort action that arises under the contract.[30] Thus, the carefully negotiated provision would be applicable to contractual claims between the parties, but an action sounding in tort, such as a fraud in the inducement claim, might not be subject to Ohio law.

More precise language, focused on the coverage of the choice of law provision, should insure that both contract and tort claims arising from the agreement are subject to the jurisdiction cited in the choice of law provision:[31] Such a clause might include the following terms:

> *The substantive laws of the State of Ohio (and not its conflicts of law principles) govern all matters arising out of, or relating to, this Agreement and all of the transactions it contemplates, including without limitation its validity, interpretation, construction, performance and enforcement.*

This type of language states that the selected jurisdiction is to apply to matters arising out of, or relating to, the agreement, which provides a much broader scope of coverage than the first provision above. Generally courts enforce choice of law provisions, but as explained

[30] *See Valley Juice Ltd., Inc. v. Evian Waters of France, Inc.,* 87 F.3d 604, 612 (2d Cir. 1996); *Maltz v Union Carbide Chemicals and Plastics Co., Inc.,* 992 F. Supp. 286, 297-298 (S.D.N.Y 1998).

[31] *See Caton v. Leach Corp.,* 896 F.2d 939, 943 (5th Cir. 1990).

above they are still perplexed by how to deal with the scope of coverage of those provisions. When confronted with the issue, courts seek to find the intent of the parties from the four corners of the contract.[32] If that is the test, the parties should clearly state their intent so that the interpreting Court will not have to look far for an expression of that intent.

Sin # 4 – The Sin of Contractual Gluttony

Cumulative Remedies:

Assume that sophisticated parties have negotiated a complex merger or asset purchase agreement. As is common in such situations, the indemnity provisions are aggressively negotiated by both parties, resulting in a lengthy section of the agreement that includes the protections provided by complex indemnity provisions (e.g., hurdles, baskets, caps, notices, sharing expenses, length of survival). The parties expect to be protected by these terms that have been so carefully negotiated. The whole purpose of the complex negotiations on these topics was to provide certainty and limits to the remedies that parties have for claims arising in the future from the transaction at hand. For example, in this situation it is common for the indemnitor (usually the seller) to be comforted by the fact that it cannot be obligated to pay more for a claim of breach of a warranty from the indemnitee (the buyer), than is provided in the cap on liability contained in the agreement.

The indemnitor's comfort in those cleverly drafted indemnity protections will be short-lived, however, when the indemnitee brings a breach of contract action for 100 times the cap on liability spelled out in the indemnity agreement. Or perhaps the remedy sought is rescission of the underlying agreement, while the claimant was limited to only monetary damages in that very agreement.

How often have the following words appeared in sophisticated agreements, as added-in, boilerplate stapled on at the last minute?

> Cumulative Remedies. All remedies under this Agreement are cumulative and are not exclusive of any other remedies available to the Parties.

Or perhaps the concept of cumulative remedies is presented in a more verbose provision such as:

> Rights and Remedies Cumulative: The rights and remedies set forth in this Agreement are not intended to be exhaustive and the exercise by either party of any right or remedy does not preclude the exercise of any other rights or remedies that may now or subsequently exist in law or in equity or by statute or otherwise.[33]

This is the sort of language that might appear in standard boilerplate provisions. It is short, simple and so clear that no revisions appear to be necessary. This is the archetypical, commonly used, cut-and-pasted-at-the-end, provision. Yet, it can render entirely powerless the most complex indemnity provisions.

A cumulative remedies provision can, wholly unintentionally, provide the claimant with specific contractual authority to avoid the limitations of the carefully drafted indemnity provisions, where no such remedy was actually intended. The result is the assertion of claims that the opposing party certainly would not have expected, including some of these unexpected results. If the indemnity (or any specifically negotiated remedy) provisions required the indemnitee to bring any claim within one or two years, the indemnitor could now be faced with common law and statutory claims that might not be filed for 2, 4, 6, 10 or 15 years, depending upon the jurisdiction.[34]

Where the indemnity provisions precluded any claim against the indemnitor until at least $1,000,000 (or more) in damages had been incurred (to avoid *de minimus* problems), if a cumulative remedies provision was also included, then the indemnitor could be faced with claims and litigation for any amount that the claimant chooses to demand. Additionally, if all remedies are available, then the limits on damages agreed upon are no longer effective. For example, the right to recover attorney's fees in a contract action could increases the amount of every claim that is asserted against the indemnitor.

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[32] *See* Symoeonides, *Choice of Law in the American Courts in 1996: Tenth Annual Survey*, 45 Am. J. Comp. L. 447, 489 (1997).

[33] *See Negotiating and Drafting Contract Boilerplate*, Tina Stark, ALM Publishing, 2003, p. 215

[34] *6 year statute of limitations on contract actions*. Arizona –Ariz. Rev. Stat. Ann. § 12-541 et seq.; Colorado - Colo. Rev. Stat. Ann. § 13-80-102 et seq. (West); Georgia - Ga. Code Ann. § 9-3-20 et seq. (West); Hawaii - Haw. Rev. Stat. Ann. § 657-1 et seq. (LexisNexis); Massachusetts - Mass. Gen. Laws Ann. ch. 260, § 1 et seq. (West); Michigan - Mich. Comp. Laws Ann. § 600.5801 et seq. (West); Minnesota - Minn. Stat. Ann. § 541.01 et seq. (West); Nevada - Nev. Rev. Stat. Ann. § 11.010 et seq. (West); New Jersey - N.J. Stat. Ann. § 2a:14-1 et seq. (West); New Mexico – N.M. Stat. Ann. § 37-1-1 et seq. (West); New York - N.Y. Civ. Prac. Laws & Rules § 201 et seq.; *10 year statute of limitations on contract actions*: Illinois – 735 Ill. Comp. Stat. Ann. 5/13-201 et seq. (West); Indiana – Ind. Code Ann. § 34-11-2-1 et seq. (West); Iowa - Iowa Code Ann. § 614.1 et seq. (West); *15 year statute of limitations on contract actions*: Kentucky - Ky. Rev. Stat. Ann. § 413.080 et seq. (West); Ohio - Ohio Rev. Code Ann. § 2305.03 et seq. (West).

The parties might include an "exclusivity of remedies" provision, requiring that any claim covered by the indemnity provisions (or any other carefully negotiated remedy) may only be asserted by and through those terms. A typical exclusivity provision may include the following terms:

> Exclusivity of Remedies. The Parties acknowledge and agree that the remedies provided and set forth in Article X. Indemnification, shall be the Parties' sole and exclusive remedy with respect to any claim arising from, or related to, the subject matter of this Agreement. The Parties agree that Seller is to have no liability or responsibility whatsoever to Buyer for any Claim or Losses of any nature, except as set forth in this Agreement. No party shall be able to avoid the limitations expressly set forth in this Agreement by electing to pursue some other remedy.

Without an exclusivity provision, a party could, in many circumstances, avoid all the carefully negotiated protective provisions and limitations on liability included in the indemnity provisions.

Essentially, an exclusivity provision restricts a complainant's access to claims under common law and statutory law, as well as claims founded in tort and equity, and forces the claimant to be bound by each of the limitations on the indemnitor's liability that were negotiated and agreed upon in the indemnity provisions. A clear statement that the indemnity provision was intended to be the exclusive remedy can limit a plaintiff's claim to just the relief that was bargained for in the agreement.

The final word in protection for an indemnitor and the clearest delineation of the upper limit of an indemnitor's liability is for the parties to agree that a right of set off against future payments (such as a promissory note), or claims against funds in escrow, are the sole and exclusive remedies available to a claimant.

If, however, an agreement contains both an "Exclusivity of Remedy" and a "Cumulative Remedy" provision, depending upon their precise wording, the rules of contract interpretation and construction may not resolve the obvious conflict, and the reviewing tribunal may find that the contract is ambiguous.

Sin # 5 – The Sin of Reliance

Even with an "Exclusivity of Remedies" provision in place, some disgruntled parties to a transaction may try to avoid the contracted for limitations on their claims, and assert claims that are based upon matters that occurred outside the agreement. If the complained of representation is contained within the agreement (containing the Indemnity and Exclusive Remedy provisions), the defendant will assert that the plaintiff's claims will be governed by those claims processes set forth in the agreement. When the complained of representation is NOT contained in the four corners of the agreement regarding the transaction, a plaintiff will assert that its claim is not limited by the provisions of the agreement.

To avoid the problems with extra-contractual representations, parties frequently bargain for "*anti-reliance", "merger" or" integration"* provisions[35] in negotiated agreements. The general purpose of such provisions (regardless of the name) is to make clear what information the contracting party did and did not rely upon when entering into the transaction. In essence, a merger clause invokes by the protection of the parole evidence rule, by declaring that the contract is final, complete, and without any need for additional data for interpretation.[36]

The parole evidence rule is not a rule of evidence at all, but a rule of substantive law.[37]
The parole evidence rule exists under both the common law of Texas and Article 2 of the Uniform Commercial Code.[38] The parole evidence rule generally prohibits the enforcement of and/or the introduction of extrinsic evidence regarding any inconsistent agreement that occurred prior to or contemporaneously with a subsequent writing intend as the parties' final written expression of their agreement with respect to the transaction.[39]

The absence of a merger clause in a written agreement does not preclude the application of the parole evidence rule. However, by failing to include a merger clause in a written agreement, the parties leave it to a judge to decide if the parties to a contract intended the

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[35] A "merger clause" is "[a] provision in a contract to the effect that the written terms may not be varied by prior or oral agreements because all such agreements have been merged into the written document." *Black's Law Dictionary* 989 (6th ed.1990). It is also commonly referred to as an "integration" or "anti-reliance" clause.

[36] Burleson State Bank v. Plunkett, 27 S.W.3d 605, 615 (Tex. App.-Waco 2000, pet. denied).

[37] Marantha Temple v. Enterprise Products, 893 S.W.2d 92, 101 (Tex. App.-Houston [1st Dist.] 1994, writ denied). See also TEX. BUS. & COMM. CODE § 2.202 (Vernon's 2000).

[38] Marantha Temple, 893 S.W.2d at 101; TEX. BUS. & COMM. CODE § 2.202.

[39] See Marantha Temple, 893 S.W.2d at 101; Massey v. Massey, 807 S.W.2d 391, (Tex. App.-Houston [1st Dist.] 1991, writ denied). See also TEX. BUS. & COMM. CODE § 2

subject writing to be the final, integrated expression of their agreement, sufficient to invoke the parole evidence rule. By including a sufficient merger clause in all contracts, each party to the contract can much more effectively guard against another party's attempt to vary, contradict or add to the terms contract through the use of extrinsic evidence.[40]

To enhance certainty in contracting and eliminate the threat of tort claims based on oral statements or an open-ended universe of information, Delaware, Texas and other states now permit parties to disclaim reliance on fraudulent representations outside of the written agreement.[41] Such provisions are often referred to as an "anti-reliance" provision, in that if reliance upon specified representations is disclaimed, then claims of misrepresentation are effectively barred, because the claimant cannot prove the essential element of reliance required to be successful in the claim. However, the more specific an anti-reliance provision is, the more likely is its enforcement by a court. A standard boilerplate integration clause may not be enough.[42] If an indemnity provision is drafted to cover claims that include breaches of representations and warranties, then a properly drafted merger/anti-reliance clause may preclude a claim of misrepresentation based upon extra-contractual representations. A typical anti-reliance or merger clause may include the following terms:

> This Agreement (including the "Transaction Documents" specifically referenced herein) constitutes, represents, and is intended by the Parties to be the complete and final statement and expression of all of the terms and arrangements between the Parties to this Agreement with respect to the matters provided for in this Agreement. This Agreement supersedes any and all prior and contemporaneous agreements, understandings, negotiations and discussions between the Parties and all such matters are merged into this Agreement. The terms of this Agreement are not to be interpreted, explained or supplemented by evidence of trade usage or prior course of dealings. Each of the Parties acknowledge that none of them has made, and is not making, any representations or warranties whatsoever, express or implied, regarding any subject matter provided for in this Agreement, except as specifically set forth in this Agreement. In entering into this Agreement, no Party has relied, in any way, upon any express or implied agreement, representation, warranty or statement of any other Party except for the representations and warranties specifically set forth in this Agreement. Through all phases of the negotiation and execution of this Agreement, and all the issues that have arisen relating to this Agreement prior to the execution hereof, the Parties have been represented by competent counsel of their own choosing. Each Party has had substantial opportunities to consult with its counsel regarding each and every term of this Agreement, and has freely done so as they have deemed necessary. Each of the Parties acknowledges that they have relied solely upon their own judgment in entering into this Agreement.

Secondary Sources for Anti-Reliance Provisions. It is common practice to enter into a letter of intent or non-disclosure agreement, at the earliest stages of many transactions. Often such early stage agreements clarify when the parties agree to be bound and upon what they are relying. It is also common for the final agreement in a transaction to incorporate the protections of the non-disclosure agreement, and for the terms (and therefore the protections) of the non-disclosure agreement to continue in effect after the final closing and funding of the transaction. Many non-disclosure agreements include comprehensive anti-reliance provisions, which all parties seem to agree upon in early stages of negotiations.

One recurring consideration in this and other areas of contract construction is the equality of bargaining power and sophistication of the parties. Courts (especially Texas Courts) seem to fall back on these issues to justify or support their opinions, especially where a party is found to have escaped liability. In Texas, assuming an overlay of clarity, equal bargaining power, and informed arm-length transactions, indemnity for gross negligence is enforceable.[43] The rationale for this holding is that parties may agree to exempt one another from future liability for negligence so long as the agreement does not

[40] See Ragland v. Curtis Matthews Sales Company S.W.2d 577, 578 (Tex. Civ. App.-Waco 1969, no writ).

[41] See *Abry Partners*, 891 A.2d 1032, 1057 (Del. Ch. 2006) ; *Kronenberg v. Katz*, 872 A.2d 568, 593 (Del.Ch.2004); See generally Steven M. Haas, *Contracting Around Fraud Under Delaware Law*, 10 Del. L. Rev. 49 (2008); *Schlumberger Technology Corp. v. Swanson* 959 S.W.2d 171, 181 (Tex.1997).

[42] *Kronenberg*, 872 A.2d at 593

[43] For example, in Valero Energy Corp. v. M.W. Kellogg Constr. Co., 866 S.W.2d 252 (Tex.App-Corpus Christi 1993, writ denied), the court held that a "[w]aiver and indemnity provision absolving contractor of all liability sounding in products liability and gross negligence in connection with construction of addition to refinery did not offend public policy where both owner and contractor were sophisticated entities.

violate the constitution, a statute, or public policy.[44] When the parties to the contract are private entities bargaining from positions of substantially equal strength, the agreement is usually enforced.[45] And even when the indemnity protects a party from their own gross negligence, such a fairly negotiated provision, between sophisticated parties, does not offend public police.[46] However, an exculpatory provision may be declared void, if one party is so disadvantaged that it is essentially forced to agree to the provision.[47]

The Supreme Court of Texas has recently expounded on their reliance on this 'sophisticated party' doctrine in El Paso Field Servs., L.P. v. MasTec N. Am., Inc.[48] There the Court stated:

> As in *Lonergan*, "the parties were each competent to contract, and there is no circumstance indicating the slightest unfairness in the transaction." 104 S.W. at 1065. While MasTec was new to this type of construction project, it is a sophisticated party and presumably had experienced attorneys review the contract. *See Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex.1997) (allowing sophisticated parties to contractually preclude a claim for fraudulent inducement); *see also Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 350 (Tex.2011). And there is nothing to suggest that the contractual provisions at issue here are unique or novel. Sophisticated parties, like all parties to a contract, have "an obligation to protect themselves by reading what they sign." *Thigpen v. Locke*, 363 S.W.2d 247, 253 (Tex.1962). Ultimately, this contract "constitute [s] the allocation by market participants of risks and benefits" regarding the pipeline's construction. *Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 220 (Tex.2003). "The Court's role is not to redistribute these risks and benefits but to enforce the allocation that the parties previously agreed upon." *Id.* (citing 11 Richard A. Lord, Williston on Contracts § 31.5 (4th ed.2003)).
>
> We have an obligation to construe a contract by the language contained in the document. We have "long recognized Texas' strong public policy in favor of preserving the freedom of contract." *Fairfield Ins. Co. v. Stephens Martin Paving, L.P.*, 246 S.W.3d 653, 664 (Tex.2008); *see also Wood Motor Co. v. Nebel*, 150 Tex. 86, 238 S.W.2d 181, 185 (1951). "Freedom of contract allows parties to ... allocate risk as they see fit." *Gym–N–I Playgrounds, Inc.*, 220 S.W.3d at 912. Contract enforcement is an "indispensable partner" to the freedom of contract. *Fairfield*, 246 S.W.3d at 664. Were we to hold in MasTec's favor, and conclude that El Paso must bear the risk of unknown underground obstacles under this contract, we would render meaningless the parties' risk-allocation agreement and ultimately prohibit sophisticated parties from agreeing to allocate risk in construction contracts. *See Gym–N–I Playgrounds, Inc.*, 220 S.W.3d at 912; *Italian Cowboy Partners*, 341 S.W.3d at 333 (instructing that we examine the entire writing and harmonize all provisions, rendering none meaningless). That result would undermine the longstanding policy of this state.

The evaluation of what proof is required to show that both parties were sophisticated, or that one of the parties was not disadvantaged, is mentioned sparingly by the Courts.[49] Perhaps proof that the party is an accredited

[44] Allright, Inc. v. Elledge, 515 S.W.2d 266, 267 (Tex.1974); Crowell v. Housing Auth. of the City of Dallas, 495 S.W.2d 887, 889 (Tex.1973); Derr Constr. Co. v. City of Houston, 846 S.W.2d 854, 859 (Tex.App.-Houston [14th Dist.] 1992, no writ); Interstate Fire Ins. Co. v. First Tape, Inc., 817 S.W.2d 142, 145 (Tex.App.-Houston [1st Dist.] 1991, writ denied).

[45] Elledge, 515 S.W.2d at 267; Crowell, 495 S.W.2d at 889; First Tape, 817 S.W.2d at 145.

[46] Valero Energy 866 S.W.2d 252.; The validity of an "as is" agreement is determined in light of the sophistication of the parties, the terms of the "as is" agreement, whether the "as is" clause is freely negotiated, whether it was an arm's length transaction, and whether there was a knowing misrepresentation or concealment of a known fact. Procter v. RMC Capital Corp., 47 S.W.3d 828, 833 (Tex. App. 2001)

[47] Elledge, 515 S.W.2d at 267-68; Crowell, 495 S.W.2d at 889.

[48] 389 S.W.3d 802, 811-12 (Tex. 2012), reh'g denied (Feb. 15, 2013)

[49] Here, sophisticated parties represented by counsel in an arm's-length transaction negotiated a settlement agreement that included clear and broad waiver-of-reliance and release-of-claims language. Because that agreement conclusively negates reliance on representations made by either side, any fraudulent-inducement claim, lodged here to avoid an arbitration provision, is contractually barred. We enforce the parties' contract as written. Forest Oil Corp. v. McAllen, 268 S.W.3d 51, 52-53 (Tex. 2008); Texas courts should uphold contracts negotiated at arm's length by "knowledgeable and sophisticated business players" represented by "highly competent and able legal counsel," a principle that applies with equal force to contracts that reserve future claims as

investor as defined by the Securities & Exchange Commission would be sufficient.[50] Proof of experience in the relevant industry has been held to be sufficient.[51] However, general business experience does not seem to be sufficient.[52]

One case has also held that clarity, sophistication, and representation by counsel and are not sufficient in these circumstances, but the parties must have also had the ability to alter the complained of contract provision, and apparently choose not to do so (arm's length transaction or proof of actual negotiation of the term in dispute).[53]

Sin # 6 - The Sin of Inadequate Defense

The Duty to Defend. There is no standard indemnity provision. Or at least, there should not be a standard indemnity provision. The unfortunate truth is that boilerplate indemnity provisions provide the worst balance of very high risk, and traditionally very poor drafting. For example, a typical boilerplate indemnity provision may be similar to the following:

> Indemnitor shall defend, hold harmless, and indemnify Amalgamated Meatball, Inc., its employees, officers, directors, owners, shareholders, agents, contractors representatives, subsidiary corporations, and advisors (the "Indemnitees") from all claims, lawsuits, damages, judgments, costs, fees and expenses (including but not limited to reasonable attorneys' fees) caused by a breach of this Agreement.

This provision includes the obligation to provide a defense of a claim. However:

- There is no discussion about who selects counsel, or how the defense will be conducted.
- There is no discussion about when the indemnitor can settle a claim.
- There is no language regarding what the indemnitees are to do, if the indemnitor does not take on the defense of a covered claim.
- How do the "other" indemnitees enforce their rights under this agreement?

to contracts that settle all claims. Forest Oil Corp. v. McAllen, 268 S.W.3d 51, 58 (Tex. 2008)

[50] "Accredited Investor" as that term is defined in Rule 501 of Regulation D of the Securities Act of 1933, as amended.

[51] Langford served as the seller's broker and Larsen acted on his own behalf as a real estate agent/sales person, by and through his then employer, Doc Blanchard Realty. Thus, the record supports the conclusion that the contract was negotiated by parties of equal bargaining strength in an arm's length transaction. When the Larsens signed the real estate contract and the disclosure agreement, they were not represented by counsel. However, this fact is somewhat discounted because David Larsen by the nature of his occupation has training, experience and expertise in real estate transactions. Thus, like Langford, he was familiar with the documents involved and the legal consequences of each. Larsen v. Carlene Langford & Associates, Inc., 41 S.W.3d 245, 252 (Tex. App. 2001); See also Springs Window Fashions Div., Inc. v. Blind Maker, Inc., 184 S.W.3d 840, 874 (Tex. App. 2006) Moreover, there is no dispute that the parties dealt at arms' length and that Blind Maker's principal, Hicks, was a sophisticated businessman. Hicks had earned an M.B.A., as well as a masters in engineering. He had been in the blinds business since 1981, overseeing a company with annual sales in the tens of millions of dollars. Hicks, furthermore, had assistance of counsel to review the FLA and was able to negotiate changes to other provisions. Blind Maker signed not one but two iterations of the FLA,[28] each of which reflected negotiated terms. We also find it significant that, by May, Hicks had already begun to question Springs's

[52] As to whether the agreement was negotiated by "similarly sophisticated parties as part of the bargain in an arm's-length transaction," Woodlands argues that Jenkins is a sophisticated business man. While Jenkins, being the general manager and founder of a business, is familiar with contracts, his primary duties are on the technology side of his microprocessor product design firm. Jenkins is not a structural engineer and does not normally read building constructions plans. Certainly, Jenkins was not a "knowledgeable real estate investor who owned an interest in at least thirty commercial buildings," nor was he president of a commercial property management firm, and neither "had [he] bought and sold several large investment properties on an 'as is' basis," as had the buyer in *Prudential.* 896 S.W.2d at 159. Woodlands Land Dev. Co., L.P. v. Jenkins, 48 S.W.3d 415, 422 (Tex. App. 2001)

[53] We hold that the totality of the circumstances does not support enforcing the disclaimer when the only factors that are present are clarity, sophistication, and representation by counsel because all three focus on the public policy concern that the party may be unable to understand the terms of the disclaimer but not the concern that the party may be unable to alter the terms of the disclaimer. *Cf. Forest Oil,* 268 S.W.3d at 58 (enforcing "freely negotiated" agreement to bar claims); *Schlumberger,* 959 S.W.2d at 179 (stating that parties should be able to "bargain for" agreement that precludes further disputes between them). Something more is required—either negotiated terms or an arm's length transaction—both of which focus on the party's ability to alter the disclaimer's terms so that a party voluntarily surrenders its rights to a fraud claim. One of these two factors can be satisfied by demonstrating that the party who agrees to the disclaimer either (1) did in fact negotiate the contract terms or (2) had the ability to negotiate terms because the parties dealt with each other at arm's length.[30] *See Kane v. Nxcess Motorcars, Inc.*, No. 01–04–00547–CV, 2005 WL 497484, at (Tex.App.-Houston [1st Dist.] Mar. 3, 2005, no pet.) (mem. op.) (reviewing enforceability of "as is" clause in pre-*Forest Oil* case based in part on whether parties had "disparity in bargaining power" and whether agreement was "freely negotiated"). Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 384-85 (Tex. App. 2012) Review Granted, Judgment Set Aside, and Remanded by Agreement January 11, 2013

Most indemnity provisions include the time-worn language that one party agrees to "*defend, indemnify, and hold harmless*" another party.[54] While there is a group of authorities that assume that "indemnify" and "hold harmless" may be synonyms[55], the duty to "defend" is a separate and distinct responsibility, and requires individual treatment. The Texas Supreme Court has explained that "[a]n insurer's duty to defend and duty to indemnify are distinct and separate duties. *Thus, an insurer may have a duty to defend but, eventually, no duty to indemnify*."[56]

Providing an example of how these two duties might diverge, the court said "a plaintiff pleading both negligent and intentional conduct may trigger an insurer's duty to defend, but a finding that the insured acted intentionally and not negligently [i.e., not within the policy's coverage] may negate the insurer's duty to indemnify."[57] Therefore, *Griffin* makes it clear that a party's duty to defend may arise even when it is later determined that the party has no duty to indemnify.

The terms of a contract that would explain and eliminate disputes about the duty to defend have no application to the duty to indemnify. So those two duties should be addressed separately in the "Indemnity" section of the contract. An obligation to indemnify occurs, if at all, only AFTER the defended claim is resolved, whether by judgment or settlement. Only after the obligation of the indemnitee to pay is fixed, does the duty to indemnify arise.[58]

The indemnity provision set forth above requires the indemnitor to provide a defense against a judgment, costs and fees (there is no defense to be asserted against damages found by a trier of fact, and incorporated into a final judgment awaiting payment). If the duty to indemnify does not arise until the damages are established by the resolution of the claim, then it is non-sensical to require a party to provide a defense against damages (contained in a final judgment)– it cannot be done. It ***is*** possible to provide a defense against a claim or a lawsuit before it is reduced to a judgment to be paid, but one cannot provide a defense against damages that are included in a final judgment..

A party can provide a defense against claims and can indemnify another person or entity from a loss, cost, expense, damage or judgment. So the language as written could result in this provision being found ambiguous. A court might ask: "If a party cannot provide a defense against damages, why was that obligation included in this agreement?"

Hold Harmless**.** If the indemnity provision includes the term "hold harmless" then providing a defense may be handled differently. In Texas, at least two courts have held that the term "hold harmless" is synonymous with a "duty to indemnify."[59] Under this interpretation, the phrase obligates the indemnitor to assume all expenses incident to the defense of any claim and to compensate an indemnitee for all loss or expense.[60] Other courts, however, have defined the term "hold harmless" as identical to a "release."[61] In other contexts, Texas courts have been quick to explain the differences between agreements that "indemnify" and those that "release" and that they are used in completely different contexts.[62] To further complicate the situation, Texas courts have held that "typical indemnity language is 'indemnify, save, protect, save/*hold harmless*.'"[63] In contrast, the typical operational contractual language used in a release is "release, discharge, relinquish."[64]

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[54] In New York, D&O Polices will not be approved by the New York Insurance Department Office of General Counsel, if they do not include duty to defend provisions. See Opinion No. 08-10-07 issued on October 16, 2008.

[55] See "Hold Harmless" below for a discussion on the differing opinions about the meaning of the phrase "hold harmless".

[56] *Farmers Texas Mutual County Insurance v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997) emphasis added;

[57] Id.

[58] See *Holland v. Fidelity & Deposit Co. of Maryland*, 623 S.W.2d 469, 470 (Tex.App.-Corpus Christi 1981, no writ.); *Tubb v. Bartlett*, 862 S.W.2d 740, 750 (Tex.App.-El Paso 1993, writ denied).

[59] The phrase "hold MG harmless" from any loss, claim, or expense arising out of construction of the Gonzales home was held to be solely an agreement to indemnify and was not a release. *MG Bldg. Materials, Ltd. v. Moses Lopez Custom Homes, Inc*., 179 S.W.3d 51, 64 (Tex. App. -San Antonio, 2005, pet. denied); *Bank of El Paso v. Powell*, 550 S.W.2d 383, 385 (Tex. Civ. App. –El Paso 1977, no writ). ("'Hold harmless' means to assume all expenses incident to the defense of any claim and to fully compensate an indemnitee for all loss or expense * * *.") The net effect of the agreement was that the customer agreed to indemnify the Bank for any loss it incurred, but not to discharge the liability of the Bank. [citations omitted]".

[60] *Powell*, 550 S.W.2d at 385

[61] *Mays v. Pierce*, 203 S.W.3d 564 (Tex. App. -Houston [14th Dist.] 2006, pet. denied); *Cole v. Johnson*, 157 S.W.3d 856, 862 (Tex. App. -Fort Worth 2005, no pet.).

[62] *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex., 1993).

[63] *Derr Constr. Co. v. City of Houston*, 846 S.W.2d 854, 858 (Tex. App. -Houston [14th Dist.] 1992, no writ).

[64] *Id.*; *MG Bldg. Materials, Ltd.*, 179 S.W.3d at 64. (Emphasis added)

Some other jurisdictions hold that the phrase "hold harmless" is synonymous with indemnity[65] (meaning typical indemnity from damages) while other jurisdictions find that "hold harmless" is broader than typical indemnity from damages and find that "hold harmless" is essentially indemnity from liability *which includes an obligation to advance costs* and expenses to the indemnitee at the time the amount becomes fixed, before those are incurred or paid by the indemnitee.[66] "Hold harmless" has been held to mean that the indemnitee "should never have to put his hand in his pocket in respect of claim covered by the terms" of the hold harmless agreement.[67]

In an apparent effort to make sense of some of this senselessness, one commentator has posted:

> I believe that "Indemnify and hold harmless" is just another vestige from when contracts were written in both Law French/Latin ("indemnify") and Middle English ("hold harmless") … . It's no more or less significant than a sticker on a bag with the words "trash" and "basura."[68]

The confusion can be avoided by "saying what you mean, and meaning what you say." As one commentator explains, it may be best to eliminate the phrase "hold harmless" from all agreements, since its meaning is subject to such confusion and differing judicial interpretation.

> I recommend that you rid your contracts of the phrase indemnify and hold harmless. Most lawyers unthinkingly use indemnifies and hold harmless as synonyms. And I've found that lawyers who instead think those concepts can be distinguished don't agree on what they actually mean. So using both indemnify and hold harmless is not only wordy, it's pernicious, in that an unhappy contract party might be tempted to take advantage of uncertainty over meaning by claiming that indemnify or hold harmless, or both, convey some unlikely meaning that bolsters that party's case.
>
> Here's a clearer approach: Instead say indemnify against any losses and liabilities and address in separate provisions the procedures for defending nonparty claims. That would ensure that you've addressed whatever meaning might rationally, or not-so-rationally, be attributed to indemnify or hold harmless.[69]

If the specific contract language in question is clear, then a party can seek reimbursement or perhaps advancement of defense costs for a covered claim under the indemnity provision and the confusion of using "hold harmless" can be eliminated. For example, the following contract language (utilizing the definitions set forth above) may be useful in establishing the right to demand advancement of defense costs without using the term "hold harmless":

> Any Losses (including but not limited to attorneys' fees and expenses) incurred by Indemnitee in defending Contractor Defended Claim shall be paid by the Contractor in advance of the final disposition of such Claim within thirty (30) days after receipt by the Contractor of (i) a statement or statements from Indemnitee requesting such advance or advances from time to time, and (ii) an undertaking by or on behalf of Indemnitee to repay such amount or amounts, only if, and to the extent that, it shall be Proven that Indemnitee is not entitled to be indemnified by the Contractor as set forth in this Agreement or otherwise. Such undertaking shall be accepted without reference to the financial ability of Indemnitee to make such repayment. Advances shall be unsecured and interest-free.
>
> Definitions:
>
> "Arising From" means arising from in any manner, directly or indirectly, out of, or in connection with, or in the course of, or incidental to, or as a consequence of.

[65] *Wilson Leasing Co. v. Gadberry*, 437 N.E.2d 500 (Ind. Ct. App., 1982). ("It has been held that a hold harmless clause, a form of indemnification, covers the cost of defending a claim and is intended to fully compensate an indemnitee for all loss and expense of defending a claim or litigation."); *Olympic, Inc. v. Providence Wash. Ins. Co. of Alaska*, 648 P.2d 1008, 1011 (Alaska 1982).

[66] *Stewart Title Guarantee Company v. Zeppieri*, [2009] O.J. No. 322 (S.C.J.) from the Ontario Superior Court.

[67] *Id.*

[68] Comment of Mike Naughton, *Revisiting 'Indemnify and Hold Harmless'*, (November 13, 2009) at www.Adamsdrafting.com.

[69] *See Revisiting 'Indemnity and Hold Harmless',* (May 10, 2009) at www.Adamsdrafting.com.

"Claims" means all claims, requests, accusations, allegations, assertions, complaints, petitions, demands, suits, actions, proceedings, governmental inquiries and investigations of any and every nature, (including but not limited to subpoenas, expressions of interest, audits and all other phases of inquiries and investigations), and causes of action of every kind and description, including but not limited to any and all Claims sounding or arising, in whole or in part, in tort, contract, statute, equity or strict liability.

"Contractor Group" means Contractor's employees, officers, directors, owners, managers, shareholders, agents, representatives, subsidiaries, affiliates, independent contractors, consultants, and subcontractors, and the employees, agents, and representatives of such subcontractors

"Owner Group" means Owner's employees, officers, directors, owners, managers, shareholders, agents, representatives, subsidiaries, affiliates, independent contractors, consultants, and subcontractors, and the employees, agents, and representatives of such subcontractors.

"Contractor's Conduct" shall mean any act, failure to act, omission, professional error, fault, mistake, negligence, gross negligence or gross misconduct, of any and every kind, of any member of the Contractor Group, arising from:

(i) Any workers' compensation claims or claims under similar such laws or obligations related to this Agreement;
(ii) Performance of this Agreement (or failure to perform);
(iii) Breach of this Agreement; or
(iv) Violation of any laws.

"Contractor Defended Claim(s)" shall mean all Claims asserted against or involving any member of the Owner Group which allege, in whole or in part, that any Losses were caused by, or Arise From, in whole or in part, Contractor's Conduct.

"Losses" shall mean each and every injury, wound, wrong, hurt, harm, fee, damage, cost, expense, outlay, expenditure, payment, funding, settlement, or loss of any and every nature, including, but not limited to all:

(i) loss, injury, diminution in value, or damage to any entity, property or right;
(ii) loss, injury, damage or death to any person;
(iii) any investigation, administrative services, travel costs, housing expenses, hourly cost of personnel providing services, consultants, independent contractors, attorneys fees, witness fees and expenses, expert witness fees and expenses, filing fees, court cost, arbitration cost or fee, postage, telephone charges, copying costs, data retrieval, processing and storage costs, exhibit development and production costs, support personnel costs;
(iv) payments, funding and other expenditures in settlement or compromise;
(v) all other costs, fees, expenditures and expenses, of any nature, arising, in any way, from any Claim; and
(vi) any fine, debt, penalty, deficiency, obligation, diminution of value, and any incidental or consequential damage.

"Proven" shall mean that a court of competent jurisdiction has entered a final unappealable judgment on a Claim adjudging an entity or person liable for a monetary judgment.

Sin#7 – The Sin of Latin Confuscation.

Primary Rules of Contract Interpretation.

1. The Main Purpose Doctrine.

The Main Purpose Doctrine provides that when interpreting the meaning of an agreement, the primary intent and purpose of the parties must prevail and the court may not re-write the agreement. With the primary intent and purpose in mind, plain words will be given their plain meaning, while technical terms or words of art will be given their technical meaning.

2. The "Four Corners Rule."

A contract will be read as a whole and every part must be interpreted with reference to the whole document and in such a way as to give effect to the main purpose of the agreement. Furthermore, when interpreting the meaning of the contract, the court should not look beyond the four corners of the contract in order to interpret the meaning. When the contract contains pre-printed, typed and handwritten words which are arguably conflicting or ambiguous; preference should be given in the following order: (1) handwritten, (2) typed, and then (3) pre-printed words.

Secondary Rules of Contract Interpretation.

1. Ejusdem Generis.

The rule of interpretation *ejusdem generis* means that where there is a listing of specific things followed by more general words relating to the same subject matter, the more general words will be interpreted as meaning the same class of things in the more specific listing.

2. Expressio unius est exclusio alterius.

The term *expressio unius est exclusio alterius* is a maxim of interpretation that the expression
of one thing is to the exclusion of another.

3. Noscitur a Sociis Doctrine.

The doctrine of *noscitur a sociis* means that "words are known from their associates." In other words, the context and subject matter of a contract may indicate that the ordinary and plain meaning of a word was not intended by the parties. Accordingly, application of this doctrine may determine that a word of otherwise clear meaning has been incorrectly used by the parties in the agreement.

4. Lawful, Effective and Reasonable Interpretations Are Preferred.

Consistent with the doctrines providing that all parts of a contract should be given effect where possible, an interpretation which renders the contract lawful, effective, and reasonable is preferred over interpretations which render the contract unlawful, invalid, or impossible to perform.

5. Interpretation Should Take Into Account Circumstances Existing At Contract Formation.

In order to interpret the main purpose and primary intent of the parties, a court should take
into account the circumstance existing at the time and place of its execution.

6. Contra Proferentem: Ambiguities Are Construed Against The Drafting Party.

The party drafting the contract should always include a provision that the general rule of construction that any uncertainty in a contract will be construed against the drafter will not apply to the subject contract. In Texas, a contract is generally construed against its drafter. Temple-Eastex, Inc. v. Addison Bank, 672 S.W.2d 793, 798 (Tex. 1984). This is particularly true in cases where the drafter will be relieved from liability. Manzo v. Ford, 731 S.W.2d 673, 676 (Tex. App.-Houston [14th Dist.] 1987, no writ.). However, this is merely a general rule of interpretation and the parties are therefore free to agree that the rule shall not apply.