

Contract Clauses: What Every Business Owner Should Know

When two parties enter into a contract they create a legally enforceable agreement based on mutual obligations and understanding. Within a written contract, there are often numerous legal terms and conditions that may seem overly confusing or complex for an average person to understand. Rather than ignoring or skipping these sections, it is extremely important to fully read and understand what they are detailing. The consequence of neglecting these provisions could very well lead to unknowingly breaching the contract and facing a lawsuit that could cost thousands more in attorney fees, damages, and court costs.

This article intends to highlight and decipher some of the most common clauses that appear in a typical business contract. These basic provisions, called boilerplates, are included in agreements to protect the contracting parties. Even though most contracts include boilerplates, many people do not read nor understand contract language.

Merger and Integration Clause

A merger and integration clause is one of the most important and common provisions in a standard contract. It states that the contract expresses the final and complete understanding of the parties. It is important to make sure that all promises and agreements are documented because any other oral or unwritten agreement or promise may be impossible to enforce. In the event that there is a dispute between the parties, the judge will only use what is in the written contract to make a judgment. For example, if a buyer for an automobile claims that the seller orally agreed to provide oil changes for the life of the car but the seller denies he ever said that, this clause forces the judge to only take into consideration their written agreement when deciding whether the seller would be liable for the claim.

The purpose of the clause is to prevent parties from arguing that the agreement was later altered or is not consistent with prior agreements. It is important to make sure that all elements are specifically and entirely stated, leaving no items open to interpretation or ambiguity.

Indemnification Clause

An indemnification clause is used as a mechanism to protect one party from the actions or negligence of the other contracting party. Since you cannot control the actions of others, it is important to include this clause in order to protect you from the negligence (failure to use reasonable care) or willful misconduct of the other party. Indemnification clauses are very common in service contracts, especially when there are contractors and subcontractors performing the work. For example, a company hosts an event at your hotel. Due to faulty construction, one of their displays falls and hurts one of their patrons. In simple terms, under the

indemnification clause, the other company is responsible for damages to the injured patron. If the patron decided to sue your hotel instead, the other company may be legally obligated to pay for your legal defense.

Generally, indemnification clauses require that the benefit be reciprocal. Properly drafted indemnification clauses protect both parties from each other and aid in the recovery of attorneys' fees, legal defense costs, and court costs. They are usually carefully and precisely constructed with very detailed language. It is important to design the clause for your specific situation because when you enter into agreements with other businesses, you run the risk of being responsible for their actions.

Time is of the Essence Clause

Many contracts deal with time sensitive matters. Under this clause, there may be a breach of contract performance if the contract obligations are not completed within a reasonable or specific amount of time. This is common in construction contracts where missed deadlines can have severe repercussions. For example, a construction company is building a new sports stadium. Even though they agreed that "time is of the essence" and to have the job completed by the first game of the season, they missed the deadline and the team has to cancel the first game. With this clause, the construction company will be liable for loss of revenue that the team incurs from canceling the game.

Sometimes, the parties agree to complete the work within a reasonable time, but no guarantee is given about the specific time the work will be finished. This is used when parties face unknown variables and specific time of completion cannot be estimated. If time is not of the essence it should be specifically discussed in the contract to prevent any discrepancy between the parties.

Severability Clause

A severability clause allows for the contract to remain valid even if a part of it is deemed void or unenforceable by a judge. Without the severability clause, the entire contract could possibly be voided if just one section is found to be invalid. With a severability clause, a section that is discovered to be invalid can be corrected to fit the original intention. The remainder of the contract is still in full effect and valid. For example, a simple spelling error, misuse of a punctuation mark, or small grammatical mistake in the writing of the contract would not discharge the entire agreement with the use of this clause.

Non-Waiver Clause

A non-waiver clause is used to allow the contract to remain fully enforceable even if one party allows the other party to breach a provision of the contract. For example, a rental contract calls for a late penalty on payments made after the deadline, but the owner never demands the fee, even though the renter is always late. After a certain amount of time the owner may not be able

to recover the fees in the event there is no non-waiver clause. The acceptance of the violations of the contractual agreement may eventually change the enforceability of the specific provision. This is because the two parties agree to a new term of the contract through their behavior. With a non-waiver clause, even if the owner does not demand the fee for a period of time, he/she can still eventually require it to be paid since it was a breach of the agreement.

Liquidated Damages Clause

A liquidated damages clause states that if a party breaches certain terms of the contract, they will be required to pay the other party a certain amount of money as compensation for damages. For example, a late fee on a utility bill or a cancellation fee on a cell phone contract could be considered liquidated damages. This clause is effective since it can be difficult to calculate the actual damage a party incurs from the non-compliance of the other party.

The liquidated damage should approximately be equal to the true damage. Typically, disproportionate liquidated damages clauses compared to the actual injury will not be upheld in court. For example, it would be unreasonable for a landlord to demand \$1,000 a day as a fee for late rent if the amount of rent for one day is substantially less. If the liquidated damages are borderline unreasonable, the judge is likely to side with the party enforcing the damages. As the party on the other end of a liquidated damages agreement, it is crucial to carefully review and negotiate the liquidate damages clause because you could be placing yourself in a very risky and dangerous situation by agreeing to the other party's terms.

Acceleration Clause

An acceleration clause allows a party to immediately demand full performance if the other party breaches the agreement. For example, an acceleration clause in a home mortgage agreement may allow the lender to demand the entire balance be due immediately if the home owner is late on just one payment. This clause is common in many loan contracts that demand repayment in installments over a period of time, i.e., automobile, mortgage and personal loans. As the recipient of a loan, it is important to be aware of the ramifications of an acceleration clause. If you happen to breach the contract or miss a payment and you are not able to fully pay off the balance of the loan, you could have the item repossessed and lose any equity you have in it. If you are the other party, it is important to include an acceleration clause in order to protect your assets and shield yourself from additional risk.

Summary

Never sign anything if you do not fully understand and agree to the terms and conditions of the contract. Neglecting to do so could very well put you in great risk of breaching the agreement and vulnerable to a lawsuit. In general, all terms and conditions in a contract are negotiable. By not reviewing and disputing a provision when necessary, you allow the other party to protect themselves while not protecting yourself. Ignorance and misunderstanding the language of the contract is not a legitimate defense in a court of law.

If you come across a section you do not understand, have a qualified attorney review the details of the agreement in order to ensure you are not signing anything that could put you in unnecessary or unknown risk. To protect yourself and your business, it is recommended you obtain the services of a qualified attorney to negotiate and revise the agreement on your behalf. A small investment in attorney fees at the onset could potentially save you thousands in legal defense costs later.

By Samira R. Alimohammad, Managing Attorney, and Lance Collett, Marketing Manager

Samira R. Alimohammad is an Attorney with the Law Office of Rehan Alimohammad, PC. With over seven (7) years of experience as Counsel for multi-national corporations, Mrs. Alimohammad has expertise in contract negotiation, drafting and revision, in addition to all other aspects of corporate law. Our office also handles all tax law and legal issues. Please visit our website at www.attorneyrehan.com, or call our offices at (281) 340-8550 or (800) 814-3920.

Disclaimer: This article provides basic general information and is not meant as specific advice regarding a person's individual case. Many other terms and conditions related to contracts and contract law have been omitted and this article is in no way comprehensive. For specific questions and/or advice, a qualified attorney should be consulted. This article does not create an Attorney-Client relationship. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)