Ballard Spahr LLP

Contract Terms and Disputes: A Litigator's Perspective

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- Litigation Of Counsel in Ballard Spahr's Denver office and a member of the firm's Commercial Litigation, Consumer Financial Services, and Real Estate and Construction Litigation Groups
- Has a diverse litigation practice focusing primarily in the areas of real estate, business disputes, and financial services, including cases involving state and federal lending statutes and consumer protection laws.
- Experience representing lenders and developers in cases involving contract and lease disputes, fraud claims, claims under the Interstate Land Sales Disclosure Act, and cases involving state and federal lending statutes and consumer protection laws.

Discretionary Terms

- “Reasonable efforts”
- “Commercially reasonable efforts”
- “Best efforts”
- Consent may not be “reasonably withheld”

What does it mean and how does anyone determine whether they or the other party have acted with "commercially reasonable efforts" or with "best efforts“?

Discretionary Terms

- "[M]ake a reasonable, diligent, and good faith effort to accomplish a given objective." *Great Western Producers Co-op. v. Great Western United Corp.*, 613 P.2d 873 (Colo. 1980).
- Requires a party to make such efforts as are reasonable in light of the party's ability, the means at its disposal, and the other party's justifiable expectations. *T.S.I. Holdings, Inc. v. Jenkins*, 924 P.2d 1239, 1250 (Kan. 1996).
- More exacting than the duty of good faith. *See Nat'l Data Payment Sys., Inc. v. Meridian Bank,* 212 F.3d 849 (3d Cir. 2000) (citing 2 E. Allan Farnsworth, Farnsworth on Contracts, 383–84 (2d ed.1998)).

Discretionary Terms

- <u>Determination of fact</u> –
  - Court must consider the contract as a whole, the subject matter and objective of the contract, all the circumstances surrounding the making of the contract, the subsequent acts and conduct of the parties to the contract, and the reasonableness of respective interpretations advocated by the parties, as well as the extrinsic evidence as to industry standards and the parties' prior relationship and negotiations.
  - Must be evaluated in the context of the totality of the business arrangement. *Citri-Lite Co. v. Cott Beverages, Inc.*, 546 Fed. Appx. 651 (9th Cir. 2013).
  - Special meaning in industry or type of contract.

Discretionary Terms

Discretionary Terms

- Unlikely to be decided on a motion or at outset of case.
- Will likely require significant discovery of documents and depositions of all participants.
- May require one or more <u>experts</u> to testify about industry standards or provide opinion about whether actions were "commercially reasonable" or "best efforts".
- Decision is eventually in the hands of a jury.

Potential Solutions

- More measurable factors upon which the contract bases an evaluation of a party's exercise of discretion, the less likely the client will end up in litigation.
- Establishing parameters in the contract for how discretion should be exercised can lend greater clarity or certainty.
  - In a lease, consent to an assignment may only be withheld based on a review of the proposed assignee's audited financials and evaluation of compatibility with the nature and character of project/building.
  - In the construction context, a contract that requires an owner to use "best efforts" to proceed with construction could include the requirement that construction be "actively and continuously" pursued and set time limits for certain milestones.

Potential Solutions

- Obviously, sometimes it is in the best interest of the client to include discretionary language so as not to create an affirmative obligation only the requirement that the client diligently attempt to achieve an objective.

Creating Rights vs. Duties

- Careful drafting is sometimes necessary to ensure that the creation of rights does not unintentionally create a duty to exercise those rights for the benefit the other party.
- For example, a construction loan agreement might afford the lender the right to inspect the project, approve budgets and change orders, and directly pay contractors.
- The contract should also make clear that, in granting these rights, the contract does not impose on the lender the obligation to exercise them and, if exercised, the contract should make clear that the lender does so for its own self-interest, and not for the protection of the borrower.

Letters of Intent

- Letters of intent – expression of intent to move toward final commitment.
- If an LOI is meant to be non-binding, that must be made clear. If there are provisions within an otherwise non-binding LOI that are meant to be binding, such as confidentiality, then that exception must be explicit.
- A court may determine an ambiguity in the contract by looking to the intent of the parties to ascertain the meaning of the ambiguous provision.
- Subsequent conduct, however, could lead to a binding agreement.

Dispute Resolution

- Litigation, Arbitration, or Mediation?
- Mediation is not binding.
  - Parties must pay for mediator before proceeding.
  - Third party mediator may be able to broach settlement where discussions have failed.
  - Can provide independent perspective to client and opposing party.
  - May not result in resolution of dispute requiring further proceedings.

Dispute Resolution

- Arbitration –
  - Dispute presented to third party decision-maker outside court system.
  - An arbitrator's authority is derived from three sources: (1) the parties' arbitration agreement; (2) applicable arbitration rules; and (3) applicable arbitration law (*i.e*., state and federal statutes).
  - Parties have a hand in deciding two of the three.

Arbitration - Scope

- The parties are only bound to arbitrate those issues that they have specifically agreed to arbitrate. The arbitrator's authority to hear and decide any particular case or issue exists <u>only</u> by virtue of the agreement of the parties to the dispute. *Coors Brewing Co. v. Cabo*, 114 P.3d 60, 64 (Colo. App. 2004).

- Courts must interpret arbitration clauses liberally, and all doubts must be resolved in favor of arbitration. *Armijo v. Prudential Ins. Co. of America*, 72 F.3d 793, 798 (10th Cir. 1995).

Arbitration - Scope

- "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit." *United Steelworkers of Am. v. Warrior and Gulf Navigation Co*., 363 U.S. 574, 582 (1960).
- The parties' intent to arbitrate controls, and determining this intent is a question of law for the Court to decide.
- In deciding this issue, courts generally should apply ordinary state-law principals that govern the formation of contracts. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

Arbitration - Rules

- Arbitration rules and type of relief.
  - The parties should agree on the rules of the arbitration – or could result in further dispute and expense.
  - Rules of American Arbitration Association are most used rules.

Under AAA Rules, an arbitrator is given the authority to grant any remedy or relief that he/she/they deem just and equitable and within the scope of the arbitration agreement of the parties.

Arbitration – Considerations

- Why arbitration over judicial resolution of disputes?
  - Speed to resolution
  - Cost of process
  - Less formality
  - Selection of arbitrator or panel
  - PRIVACY AND CONFIDENTIALITY

Arbitration - Considerations

- Speed to Resolution
  - Median AAA Time to Trial: 8 months for 2015 construction arbitrations (13 months – 2011 commercial arbitrations)
  - General Federal Cases: 27.2 months
  - Average Time to trial in District of Colorado: 26.2 months (decrease of 6.6 months from 2014)
  - Colorado State Court – Expect up to 2 years depending on discovery needed for case.
    - State Courts have made concerted effort to expedite cases.

Arbitration - Considerations

- Less Expensive?
  - Parties must pay for arbitrator(s).
  - Pay filing fee – which could be relatively high depending on amount at issue.
    - AAA imposes filing fees based on the amount of the claim. For example, a commercial case involving $1,000,000 - $5,000,000 in damages would require an upfront fee to be paid in full at the time of filing of $8,200 and a final additional fee of $3,250. A claim of $10,000 - $75,000 would require an initial fee of $975 and a final fee of $200.
  - Can tailor availability of discovery.

Arbitration - Considerations

- Privacy and Confidentiality
- Arbitration proceedings are not part of the public record and normally are resolved confidentially outside the public eye.
  - Highly beneficial for disputes involving embarrassing allegations, testimony, or documents.
  - Better protection for confidential business matters that may not strictly qualify as trade secrets.

Drafting Considerations

- Mandatory v. Discretionary
- Scope of Arbitration – what matters will be subject to arbitration?
  - Does it include challenges to the validity, construction or interpretation of the arbitration provision?
- Cost allocation amongst the parties.
- The authority of arbitrator? What rules will apply?
- Limitation on Discovery and Motions.

Drafting Considerations

- Arbitration panel or single arbitrator
    - How is the arbitrator selected if the parties cannot agree?
- What type of relief/remedies may be granted?
    - Attorneys' Fees?
- Waiver of Trial by Jury
    - Necessary for arbitration to be binding.

Drafting Considerations

- Class Action Waiver
  - *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (holding that the Federal Arbitration Act (FAA) preempts state laws that invalidate class action waivers in consumer arbitration agreements).
  - *American Exp. Co. v. Italian Colors Restaurant*, 33 S.Ct. 2304 (federal statutory claims are subject to arbitration unless Congress has expressly said they are not rejecting attempt to create a "vindication of federal statutory rights" exception to merchant's contracts).
- Consumer v. Commercial Contract
  - Cannot conflict with statutory rights and costs must be reasonable.

Drafting Considerations

- Choice of law – which state's law will apply
  - Absent agreement in contract – conflict of laws analysis of forum state will apply
  - Colorado follows the "most significant relationship" approach of the Restatement (Second) of Conflict of Laws for both tort and contract actions
  - For contracts – some apply the law of the state where the last action to form the contract took place.
- Jurisdiction and venue

Drafting Considerations

- Consistency among agreements is important.
  - Where two or more documents are executed by the same parties at or near the same time in the course of the same transaction and concerning the same subject matter, the documents should be read and construed together as one agreement. *See Amos v. Aspen Alps 123, LLC*, 2010 WL 27401, *19 (Colo. App. 2010); *East Ridge of Fort Collins, LLC v. Larimer and Weld Irrig. Co.*, 109 P.3d 969, 974 (Colo. 2005) (holding that separate instruments that pertain to the same transaction should be read together).
- Where documents are not consistent - may not have meeting of minds to enforce arbitration. *Ragab v. Howard*, No. 15-cv-00220-WYD-MJW, 2015 WL 6662960 (D. Colo. Nov. 2, 2015).

Pre-Litigation Disputes

- Notify the insurance carrier, if applicable.
  - Most insurance policies require prompt notice of any alleged claim. You do not want the insurance company to deny the claim on the grounds that the insured did not provide sufficient notice. Moreover, if the policy provides for defense, the insurance company may have the right to select counsel to handle the dispute.
- Document all dispute related communications.
  - Including emails and notes of discussions.

Pre-Litigation Disputes

- Critical to advise client to preserve all potentially relevant evidence relating to the dispute.
  - Includes documents, notes, drafts, emails, and electronically stored information including metadata.
  - Requires temporarily stopping any regular document/email deletion activities or purging.
- Duty to preserve attaches when a person or entity has a reasonable belief that litigation may commence regarding the subject matter.

Pre-Litigation Disputes

- When is there a reasonable belief that litigation will commence?
  - When a party has notice that future litigation is likely.
  - When a party should have known that the evidence may be relevant to future litigation.
  - More than a mere possibility.
- Depends on the Facts of Each Case!

Pre-Litigation Disputes - Examples

- Defendant could not reasonably anticipate litigation after receiving a letter from the patent holder which referred to infringement and the possibility of a negotiated resolution, but made no further threat of a lawsuit. *Indiana Mills & Manufacturing, Inc. v. Dorel Industries, Inc.*, 2006 WL 1749410, *4 (S.D. Ind. 2006).
- Finding that a letter threatening to sue for antitrust violations put defendant on notice of possible litigation and triggered a duty to preserve documents. *Washington Alder LLC v. Weyerhaeuser Co.*, 2004 WL 4076674 (D.Or. 2004).

Pre-Litigation Disputes

- Consequences of Failing to Preserve
  - Courts have and will impose serious sanctions if a party does not preserve relevant evidence.
    - The Tenth Circuit has held that "a spoliation sanction is proper where (1) a party has a duty to preserve evidence because [he] knew, or should have known, that litigation was imminent, and (2) the adverse party was prejudiced by destruction of the evidence." *Henning v. Union Pac. R.R. Co.*, 530 F.3d 1206, 1220 (10th Cir. 2008).
- Monetary sanctions – payment of opposing party's attorneys' fees and potential civil penalties.

Pre-Litigation Disputes

- Adverse inference
  - The "bad faith destruction of a document relevant to proof of an issue at trial gives rise to an inference that production of the document would have been unfavorable to the party responsible for its destruction." *Aramburu v. Boeing Co*., 112 F.3d 1398, 1407 (10th Cir. 1997).
  - To restore the evidentiary balance, an adverse inference should arise even when the spoliation was merely negligent, because the prejudice to the other party is the same, regardless of the despoiler's intent. *Turner v. Hudson Transit Lines, Inc*., 142 F.R.D. 68, 75 (S.D.N.Y. 1991).

Pre-Litigation Disputes

- <u>Steps to Take</u>
  - Disable auto-delete function from e-mail system and any other purge function.
  - Notify employees who may have relevant information and instruct not to delete documents.
  - Send litigation hold letter to ensure that all potentially relevant evidence is preserved at the appropriate time.
- Litigation Hold letter is also an important step for the attorney as written evidence to avoid potential malpractice claim.

Other Considerations

- Maintain all applicable privileges.
  - Attorney-client privilege - Must be a communication made for the purpose of giving or receiving legal advice and must be kept confidential.
- Communications disclosed to third parties are not protected.
  - Advise client not to forward attorney-client emails.
  - Disclosing communication to or allowing a third party consultant to participate in the communication defeats the privilege.

Other Considerations

- Joint Defense/Prosecution and Common Interest Privilege
  - “Communications shared with third persons who have a common legal interest with respect to the subject matter thereof will be deemed neither a breach nor a waiver of the confidentiality surrounding the attorney-client relationship. The common interest doctrine applies even when there is no pending litigation and includes information shared during a common enterprise.” *Ritter v. Jones*, 207 P.3d 954, 960 (Colo. 2008) (internal quotes and citations omitted).
  - While a formal written joint defense or common interest privilege agreement is not necessary for the privilege to apply, it is often helpful to have such an agreement under the appropriate circumstances.

Questions?

If you have questions about anything covered today, please contact me:

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