**TOP TEN MISTAKES TO AVOID IN CONTRACT DRAFTING**

Corporate attorneys are often asked to quickly review or draft various types of contracts at a moment’s notice. Below is a high-level discussion as a resource to avoid ten of the most common mistakes made in drafting and reviewing contracts.

1. Failing to Consider Who the Proper Parties Should Be. Although naming the correct parties to a commercial contract sounds simple enough, it is incredibly common for contracts to name an incorrect legal entity. Under the law of misnomer, Texas courts may reform the contract to correct the name where (1) no one was misled by the mistake, and (2) the identity of the proper party is substantially apparent from the agreement. Even if a court may reform the agreement, conducting simple due diligence could avoid legal fees in the future. An inquiry with the Secretary of State can easily confirm the correct legal name and state of formation of an entity. Furthermore, the legal requirements to reform a contract may be more difficult to satisfy when there is confusion with similarly named entities, which is common for affiliated entities.
2. Misinterpreting Assignment and Change in Control Provisions. Provisions restricting assignment generally or in circumstances where there is a change in control of the parties to a contract are commonplace in commercial contracts. These provisions, however, are often overlooked until triggered by certain types of transactions. Anti-assignment provisions, depending on their wording, may have different implications depending on the type of transaction (e.g., purchase or sale of assets, purchase or sale of equity or merger).

When drafting anti-assignment provisions, practitioners (and parties to the contract alike) should consider the possibility that a transaction, such as an exit transaction or entry into a credit agreement, involving the parties to the contract may occur in the future, and prepare the provision with this consideration in mind. For example, an anti-assignment provision that takes into account that a party to the commercial contract may merge at some point during its tenure might include language that specifically prohibits a successor entity from assuming the obligations of the contract as a “result of merger” or “change in control.” Further, a provision that accounts for an equity transaction could prohibit assignment in the event that more than 50% of the ownership of an entity or direct or indirect affiliate of such entity changes.

Avoiding boilerplate anti-assignment provisions and reviewing them carefully at the outset of a party’s entry into a commercial contract will help to alleviate the administrative burden of obtaining consents required by a particular transaction.

1. Forgetting Other Contractual Obligations. In addition to regulatory requirements, every business operates within a landscape of contractual obligations, including organizational documents, commercial contracts and credit facility documentation, among others. Even those contracts that seemingly relate only to specific areas can, and often do, contain provisions that restrict broader operations. Outlined below are considerations in certain key areas where contractual obligations often present stumbling blocks in day-to-day management:

* *Most Favored Nations Clauses*. Typically seen in contacts for the sale of goods or services, a seller agrees under this type of provision to treat a particular buyer no worse than any other buyer. As a result, if the seller later agrees to more favorable terms, it must offer those terms to that buyer. These most often apply to pricing terms but can apply to other commercial terms, such as extensions of credit to purchase goods and payment terms.
* *Government Contracts*. Contracts with any government entity almost always contain restrictions on the counterparty beyond the scope of a typical commercial contract. These are especially common where a business operates on government-owned land, but also appear where a government entity is a customer. If operating under a concession agreement with a government entity, there are myriad restrictions on business operations, including restrictions on entering into agreements with certain counterparties.
* *Non-Competition Clauses*. If any confidential or proprietary information is shared pursuant to a contractual arrangement, a non-competition clause is likely also included. This prohibits a business from using a counterparty’s confidential information to compete with said counterparty. Non-competition clauses may also restrict sharing of confidential information internally or to other vendors, inadvertently hindering operations.
* *Credit Facility Documents*. Lenders typically require broad restrictions over business operations to ensure that loan proceeds are put to proper use. Lenders often prohibit, among other things, expenditures in excess of certain thresholds, encumbrance of assets and amendments to certain important contracts. It is important to be familiar with the monetary thresholds for prohibitions on certain transactions and amendments to certain material contracts. Further, certain other contracts may provide for a security interest in assets that collateralize a credit facility – a construction services agreement, for example.
* *Supremacy Clauses*. A supremacy clause dictates which contract will govern in the event of a direct conflict between two or more contracts. For example, a master services agreement typically contains the broad agreement between parties for certain services. As various projects arise, statements of work are issued. Statements of work should be drafted narrowly to avoid including any terms that directly conflict with the applicable master services agreement. Supremacy issues can also arise when multiple contracts exist between the same parties. Supremacy clauses between those parties should be narrowly drafted to avoid superseding agreements that pertain to unrelated subject matter.

To avoid unintended breaches as a result of any of the issues discussed above, corporate counsel should consider creating a spreadsheet database for reference categorizing the various contractual restrictions.

1. Neglecting Confidentiality Provisions and NDAs. One of the first questions that should be asked before negotiating an agreement or transaction is whether any confidential information will be shared. If so, consider whether a non-disclosure agreement (or “NDA”) or a confidentiality provision is appropriate. If it is, consider whether it should be mutual (depending on whether just one or both parties will be sharing confidential information). Where multiple parties are involved, parties should be clear as to who has the right to enforce the NDA and whether there are third-party beneficiaries. While NDAs are often perceived as protecting the disclosing party, NDAs are equally important to the receiving party in defining the scope of the receiving party’s obligations with respect to information received. Key concepts and considerations in an NDA include the following:

* *Definition of “Confidential Information.”* “Confidential Information” should only be information received “on or after” the date of the NDA to provide a definite start date from which to track obligations. If the counterparty is insistent that information previously provided be Confidential Information, a fixed start date should be included. Confidential Information should only be information belonging to, or about, the disclosing party. If Confidential Information will include information about an unaffiliated third party, consider including a representation from the disclosing party that it is authorized to disclose the Confidential Information for the purposes contemplated in the NDA.
* *Definition of “Representatives.”* “Representatives” are persons who may receive Confidential Information from the receiving party. The disclosing party’s interests are ensuring that it will be able to monitor who has received Confidential Information and maintaining control over the process. The receiving party simply wants flexibility to disclose Confidential Information to whomever it deems appropriate. Generally, the interests of the disclosing party outweigh those of the receiving party. To protect its interests, the receiving party can provide the disclosing party with a consent right to share Confidential Information with certain of the receiving party’s Representatives.
* *Terms and “tails” with respect to trade secrets.* Subject to certain exceptions, a term of two years is market for NDAs. Some states view confidentiality agreements without a specified duration as unreasonable restraints on trade if they apply to information that, while confidential, does not rise to the level of being a trade secret under applicable law. If a disclosing party wants the term of an NDA to be extended with respect to Confidential Information that qualifies as a trade secret, the disclosing party may request that the term of the NDA continue indefinitely with respect to only Confidential Information that qualifies as a trade secret.

1. Overlooking Governing Document and Third Party Consent Requirements.

A corporation can only act pursuant to authority delegated by its board of directors, subject to certain stockholder consent requirements. A limited liability company can only act pursuant to authority delegated by its members or managers. This authority is granted via statute but may be waived or modified in an entity’s governing documents, such as the certificate of incorporation, bylaws or operating agreement. Prior to entering into any commercial contract, it is imperative to verify whether approval of the applicable governing body (*e.g.* the board of directors or board of managers) or the entity’s equity owners (*e.g.* stockholders or members) is required. It is also important to verify whether the consent of any third parties (*e.g.* lenders or service providers) is required prior to entering into any contract. Consent requirements are particularly crucial if an entity is making any written representations regarding a contract being properly authorized.

1. Making Common Indemnification Mistakes.

Indemnification provisions give rise to numerous questions, outlined below, that should be considered when reviewing a contract:

* *Does the indemnification provision use the language “indemnify, defend and hold harmless”?* Many contracts use just the word “indemnify” when the parties actually intend the protection afforded by the phrase “indemnify, defend and hold harmless”. “Indemnify” is an obligation to protect another from a certain event or to reimburse another for a loss. “Defend” obligates the indemnifying party to defend against third party claims (and cover the defense cost), even if the claim itself may not have merit. “Hold harmless” is seen by certain practitioners as synonymous with “indemnify”, but others interpret it to include a release by the indemnifying party and/or protection against liabilities and the risk of loss, rather than just the loss itself.
* *Are direct claims intended to be covered?* In general, the contract should specify that direct claims are subject to the indemnification provision if the parties intend for them to be covered. Parties should consider whether they prefer that direct claims be subject to indemnification or if a breach of contract claim should be the remedy. It may be easier to make an indemnity claim, without the necessity for a lawsuit.
* *Are limitation of liability provisions tailored to work with the indemnity provisions?* If the parties have agreed to waive consequential or other types of damages in the agreement, care should be taken to consider whether those waivers should apply to indemnity of a third party claim where the third party has been awarded amounts for those types of damages.
* *Is the procedure for bringing an indemnification claim clear?* Consider whether the procedure for bringing an indemnification claim and the defense of such claim by the indemnifying party is adequately addressed. For example, is timely notice of the claim a prerequisite? The parties will likely want to balance strict requirements that might bar a claim versus hindering the indemnifying party from mounting an adequate defense. The provision should specify who will be involved in the selection of counsel, when the indemnified party is entitled to have their own counsel whose fees will be paid by the indemnifying party, and under what circumstances settlements can be made.
* *Should indemnification be the sole remedy under the contract?* Depending on whether or not direct claims are covered, the parties should determine whether indemnification should be the sole remedy under the contract. If caps, baskets, and limitations have been carefully negotiated, the parties may want indemnification to be the sole remedy to avoid being surprised by a breach of contract claim that may not be subject to the negotiated limits.
* *Are there intended third party beneficiaries?* If indemnification obligations are intended to cover third parties, such as directors, officers, owners or employees of the parties, they should be specifically identified as third party beneficiaries of the provision, or they may not be able to enforce it.
* *How long should indemnification obligations survive?*  If the indemnification obligation is intended to last beyond the termination of the agreement, the termination provision should specify that the indemnification provisions survive.

1. Mistakenly Waiving Consequential Damages and Limiting Liability. Parties to a commercial agreement are often quick to waive consequential damages out of concern that they will be liable for remote or speculative damages. Waiving consequential damages, however, may not be the best solution to prevent speculative damages. In the event parties waive consequential damages, they may eliminate their opportunity to recover damages that are often considered consequential, such as lost profits.

Texas courts consider direct damages to be those that flow naturally and necessarily from the wrong, while they consider consequential damages to be those that also result naturally, though not necessarily, from the wrong. To recover consequential damages, the damages must be foreseeable and directly traceable to, and a result of, the wrongful act. Parties should not receive compensation for damages that are so remote at the time of entering into the contract that they could not have been foreseen, regardless of any type of waiver. Therefore, practitioners preparing commercial contracts would benefit from waiving “unforeseeable” damages instead of consequential damages. In addition, if parties feel strongly about waiving consequential damages, they should consider carving out lost profits from such consequential damages. With careful drafting, parties will retain the ability to recover foreseeable consequential damages in the event one of the parties breaches the agreement.

1. Don’t Skim Over Dispute Resolution Clauses. Dispute resolution clauses are often overlooked, causing practical issues in the event of litigation. These clauses should be carefully reviewed and the following items taken into consideration:

* *Include a forum selection clause*. Selecting a forum ensures a certain amount of predictability as to how a choice of law will be applied in the course of litigation. The lack of a forum selection clause could render a choice of law provision useless.
* *Identity and subject matter*. When choosing the forum for a particular contract, consider whether either party is well-known in the community and would be sympathetic to a jury. If one party could be particularly sympathetic, the other party may prefer to include a waiver of jury trial in the dispute resolution clause. The complexity or controversial nature of a potential claim should also be considered.
* *Waivers of forum non conveniens and personal jurisdiction*. These should typically be included in all contracts, but especially if, due to negotiating leverage, a party has chosen a forum that is far more convenient to it than the counterparty.
* *Carve*-*outs for other remedies*. General dispute resolution clauses should be drafted such that they do not supersede other agreed remedies. Service contracts often provide for specific performance as a remedy and many commercial contracts provide for audit rights. These types of specific remedies should be carved out of dispute resolution provisions.
* *Waivers of remedies*. Dispute resolution clauses should explicitly state that a waiver of a remedy must be written, that failure to or delay in exercising a remedy is not a waiver and that each waiver is made only as to the specific purpose stated in the applicable waiver.

1. Inadvertently Including (or Excluding) Post-Termination Obligations. It is important to consider whether any provisions should survive the termination of the applicable agreement, and, if so, for what length of time. Typical surviving provisions include representations and warranties, confidentiality provisions, post-termination covenants and provisions relating to non-competition and non-solicitation. In a simple sale of goods contract, the buyer’s only obligation is typically to make timely payment. The seller can easily determine whether the buyer has breached and is likely to then sue the buyer for non-payment; however, the seller’s obligations are more numerous and more complicated. As a result, certain of the seller’s obligations should survive after delivery and payment, especially with respect to its representations and warranties regarding the products sold. The duration of post-termination obligations may be tied to the termination of the applicable agreement or some other event. For example, restrictive covenants in employment agreements are often tied to termination of employment and not the termination or expiration of the employment agreement.
2. Boilerplate Provision Traps. While commonly overlooked, boilerplate provisions in a commercial contract can have a significant impact on enforcement of legal documentation in the event of a dispute. Boilerplate terms that have lost meaning due to overuse may still provoke litigation over essentially meaningless variations in the language. Some examples of key points to consider when drafting boilerplate provisions are as follows:

* *Amendment and Waiver.* When drafting an amendment or waiver provision in a contract, consider the following questions: Must an amendment be written or can it be verbal? Must it be titled “amendment” or will a series of emails be sufficient to amend the contract? Who must sign the amendment for it to be valid? If a party waives a provision of a contract does that waiver last forever or just in one instance? Similar to an amendment, can a waiver be verbally agreed to or must it be formally written?
* *Merger and Integration.* The purpose of these provisions is to give legal effect to the contracting parties’ intention to make the written document the “final” expression of their agreement. With such provisions, practitioners should ensure that all relevant contracts are included, such as ancillary documents and statements of work. If these ancillary agreements are not referenced, the risk is that these documents are not enforceable.
* *Severability.* Certain provisions in a contract, such as indemnification, liquidated damages and penalties, raise public policy concerns and have a higher likelihood of being held unenforceable. To clarify the parties’ intent to remove an unenforceable provision and remain bound by the rest of the agreement, a severability provision should contemplate judicial reformation of the agreement to modify an invalid provision.
* *Notice Provisions.* Consider who should receive notice and by what method. Notice via fax may not be necessary if the parties most often use email to communicate. Practitioners should consider the most practical method of communication when drafting notice provisions so as not to create onerous requirements.

*The authors are members of Thompson & Knight LLP’s Corporate and Securities Practice Group in Dallas.*

Amy R. Curtis is a Partner, and her expertise includes public and private debt and equity offerings; tender offers, mergers, and stock and asset acquisitions; SEC reporting and general securities compliance; and general corporate, partnership, limited liability company, and contract matters.

Mitchell L. Griffith is a Partner, and he focuses his practice on mergers and acquisitions, private equity and venture capital securities offerings, corporate governance, and other corporate matters.

Susan Fisher is an Associate, and her experience includes mergers and acquisitions, private equity, securities transactions, bank and mezzanine finance, and general corporate matters.

Catharine A. Hansard is an Associate, and she focuses her practice on mergers and acquisitions, formation of portfolio companies, internal restructurings, private equity fund formation, compliance with securities laws, and other general corporate governance matters.

Emily Semands Poulsen is an Associate, and her experience includes private equity fund formation, capital investment in portfolio companies, private equity sponsor regulatory compliance, mergers and acquisitions, securities law compliance, internal restructurings, and complex corporate governance.