Do You Understand Representations, Warranties and Boilerplate Clauses?

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Do You Understand Representations, Warranties and Boilerplate Clauses?

By Leonard D. DuBoff © 2008

We wrote the book on small business law.

Most well drafted agreements contain provisions on which one or more of the parties are required to confirm certain facts. The provisions dealing with these circumstances are usually called “representations and warranties.”

A typical representation requires the party making that statement to insure that the event, fact or circumstance has or has not occurred. For example, the seller of a commercial property may be asked to confirm that there has never been a release of hazardous materials on the property, or an author may be asked to confirm that her book contains no defamatory language. Even if the seller was unaware that the prior owner had leaked hazardous materials on the property and the author was unaware that facts she obtained from her source were false, the seller and the author will each still be liable for breach of their respective agreements.

Experienced business lawyers recognize this problem and attempt to neutralize representations made by their clients by stating that they are "to the best knowledge" of the client. This modification means that the client would be in breach of the agreement only if he knew that the statement was inaccurate. On the other hand, the other party will certainly prefer that there be no "best of knowledge" qualification since, with such a clause, it will be liable if there is a problem the representing party did not know about. That is, the buyer in the example above would have no right to reimbursement from the seller for any necessary environmental clean-up if the seller made the representation to the best of its knowledge and was not aware of the prior leak. Similarly, the publisher would have no recourse against the author in the above example if the author was unaware of the factual errors. Another
problem with the qualifiers is the fact that whether or not the party making the representations and warranties knew of the problem can be difficult to establish.

The give and take of negotiating for a "best of knowledge" modifier often seems like nitpicking to a client, but the consequence of providing absolute representations and warranties can be catastrophic. Conversely, if you are the party for whose benefit the representations and warranties are being made, you may find you are liable for problems you thought would be the other party's responsibility.

Another issue is that a minor violation neither party really cares about may constitute a breach. For example, a representation and warranty that you have complied with all laws means that even an innocent violation not relevant to the contact, such as having a parking meter run out while in a restaurant having lunch, would be a breach of warranty. This problem could be avoided by limiting the representation to, for instance, your "material" compliance with "all laws pertaining to" the subject of the contract.

Clients also tend to ignore the so-called boilerplate provisions of contracts but then realize how important these provisions are when a problem arises.

Boilerplate provisions often include clauses dealing with the identification of the jurisdiction where a dispute is to be adjudicated. By agreeing to having all problems with respect to the arrangement resolved in a location other than yours, you will be forced to engage in long-distance litigation. This is often very costly, and if it is another state or country, you will be required to retain an attorney licensed to practice in that jurisdiction to assist with the dispute. The extra cost, time and difficulty in handling a dispute in a far-off place often results in parties being willing to ignore many problems unless they are so significant that engaging in the more costly and stressful far-away lawsuit is warranted. It also means that the party who has the benefit of requiring disputes to
be adjudicated in that party's home court may be more aggressive and more demanding.

Boilerplate clauses often deal with identification of the jurisdiction's law that will be applied to interpret the transaction as well. This "choice of law" provision is also significant. Laws differ from state to state and from country to country. A transaction that may be legitimate in one jurisdiction may be flawed in another. Attorneys recognize this fact and commonly demand that the law of the jurisdiction(s) in which they are licensed should apply to the transaction at hand. Problems arise when lawyers in different states or counties negotiate with each other and each wishes to have the choice of law reflect their own home jurisdiction.

Another clause that is typically found in boilerplate provisions deals with the payment of attorneys' fees. The American Rule is that each party is responsible for the party's own attorneys' fees, regardless of who is successful in the litigation. This rule has been modified by legislation dealing with issues of public interest, such as consumer protection, civil rights and intellectual property in some circumstances. In all other cases, each party is to bear its own legal fees. The law does provide, though, that the parties may agree to modify this general rule by agreeing that if a dispute arises and litigation results, the prevailing party in that litigation will be entitled to recover, in addition to all other amounts awarded, the reasonable attorneys' fees incurred in adjudicating the matter.

Most agreements are the product of negotiation, which may result in some confusion. For this reason, a typical boilerplate clause will state that the four corners of the document contain the entire arrangement between the parties and that there are no agreements other than those set forth in the written document. This type of "merger" clause is intended to prevent one of the parties from later claiming that there was a side deal modifying the arrangement. Use of a clause such as this means that the parties have got to be sure that all of the terms they negotiated and are relying on find their way into the written document. If one is omitted and a merger clause is used, the party relying on the omitted provision
will likely be out of luck when attempting to claim that it was inadvertently left but that the contract was signed anyway.

There is a dispute among lawyers and commentators regarding the benefits of arbitration over litigation. Those who favor arbitration, that is, the use of an arbitrator rather than a judge to resolve a dispute, may include an arbitration clause in an agreement. Arbitrators are professionals who may or may not be attorneys, who are selected by all parties to a dispute. The arbitrator acts as both judge and jury in resolving the case, and the decision of an arbitrator is typically binding. This means that there is generally no right of appeal unless it can be shown that the arbitrator was arbitrary and capricious. Arbitrators are paid by the parties to the arbitration, each paying a pro rata share of the arbitrator's fees. It should be noted that judges are paid by the municipality out of tax revenue, and, thus, in some respect, arbitration may be more expensive than litigation.

Mediation should be distinguished from arbitration, and some agreements contain a boilerplate clause requiring that all disputes first be mediated before either party may proceed with either arbitration or litigation. A mediator is an impartial or referee who merely assists the parties in attempting to work out a resolution of their dispute. A mediator is not a decision maker. Rather, a mediator or impartial acts as a catalyst in aiding the parties to workout an arrangement to which they can agree. The parties themselves must reach an agreement in mediation.

There are often other boilerplate clauses in well-drafted agreements that should be reviewed and understood before signing an agreement. If you do not understand what a clause means or the effect it will have on the arrangement, then you should consult with your attorney before signing the contract.

While most transactions are completed without serious problems, occasionally something goes wrong and inevitably the boilerplate proves to be very beneficial or catastrophic. It is only by understanding the
importance of these clauses that you can understand the consequences that may result when deals go awry.