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Advocate's View: Litigation issues in transactional documents: arbitration clauses, merger clauses and attorney's fee provisions

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"An ounce of prevention is worth a pound of cure." The words of Benjamin Franklin perfectly describe the transactional attorney's ideal role in the negotiation and drafting of contracts. In practice, complex agreements are routinely negotiated and signed within days or even hours, often (and rightfully so) with a focus on meeting deal-specific deadlines and minimizing client costs. However, these upfront time and cost savings may dwarf in comparison to the back-end litigation fees associated with a dispute arising out of the contract.

This article will address three examples of standard contract provisions that can shape litigation outcomes.

Arbitration clauses

Many contracts contain mandatory arbitration clauses. While such clauses are routinely used, there are advantages and disadvantages that should be analyzed before putting ink to paper.

For starters, the rules of evidence do not apply in arbitration proceedings and there is often no formal discovery process. While these constraints might save time, they may also frustrate resolution in the context of complicated agreements involving industry-specific performance obligations, intellectual property, numerous parties or significant sums of money. While this lack of formalities may be acceptable in the context of simpler contracts, one should avoid selecting arbitration where a cost-effective accelerated remedy already exists (e.g., summary proceedings in landlord/tenant disputes).

Perhaps most important, however, is that "an arbitrator's rulings, unlike a trial court's, are largely unreviewable." *Matter of Falzone*, 15 NY3d 530, 534 (2010). An arbitration award is subject to vacatur or modification if the arbitrator "exceeded his [or her] power or so imperfectly executed [the award] that a final and definite award upon the subject matter submitted was not made." CPLR § 7511(b)(iii). This is a highly deferential standard. The arbitrator "may even disregard the apparent, or even the plain, meaning of the words of the contract before him [or her] and still be impervious to challenge in the courts." *Matter of Lift Line, Inc.*, 2018 NY App Div LEXIS 5033, *1 (4th Dept 2018) (citations omitted). Likewise, the arbitrator may even commit factual errors or misapply the law so long as he/she "offer[s] even a barely colorable justification for the outcome reached." Id.

The finality and speed of arbitration might override such concerns. Accordingly, it is important to assess the client's needs and evaluate the available dispute resolution procedures before selecting one.

Merger clauses

A merger clause states that the contract is the entire agreement and understanding of the parties. Often its location in the agreement suggests that it is merely boilerplate language, but merger clauses serve important purposes in the event of litigation.

A merger clause restricts the types of parol evidence that can be considered in the event of a dispute about the terms of the parties' agreement. While a merger clause generally does not bar the introduction of parol evidence to clarify ambiguous language, it will typically preclude evidence related to the existence of prior and contemporaneous written or oral declarations not referenced in the contract. *See Schron v. Troutman Sanders LLP*, 20 NY3d 430, 436 (2013). In the absence of a merger clause, a dissatisfied party may fabricate new meanings and terms by referring to prior letters, emails, notes, telephone conversations and other evidence related to the contract. In an egregious case, that party may even falsify this evidence.

A merger clause should accurately define the scope of the parties' agreement. This is especially important in complex commercial transactions involving the contemporaneous execution of numerous related documents. To prevent their exclusion in potential litigation, the merger clause should specifically identify these documents as being components of a single transaction.

The merger clause is an overlooked but important tool that confirms the parties' obligations and discourages costly litigation.

Attorney's fee provisions

Clients commonly — and often mistakenly — believe that attorney's fees are awarded to the prevailing party in a lawsuit. However, as most attorneys know, New York adheres to the American Rule, which provides that each party is responsible for paying its own attorney's fees unless a statute or contract states otherwise. But, when should a contract contain an attorney's fee provision?

The answer to this question is deal-specific and highly dependent on a number of factors. For example, an attorney's fee provision in a routine residential real estate contract would be unreasonable. However, one might reasonably expect to find such a provision in a commercial real estate contract.

Generally, in evaluating the usefulness of an attorney's fee provision, one should also consider the parties' bargaining positions. Litigation is expensive and attorney's fees can often eclipse the amount in controversy when all is said and done. Thus, if one of the contracting parties is in a significantly superior bargaining position and can easily absorb litigation costs, that party might want an attorney's fee provision to use as a dangling sword to secure dutiful performance of the contract. For obvious reasons, the financially weaker party in this example may not want an attorney's fee provision. Where the parties are on relatively equal financial footing, an attorney's fee provision may serve as a useful deterrent against bad behavior and frivolous litigation.

There is no bright-line rule on the issue, but whatever the ultimate outcome, one should not insert or agree to an attorney's fee provision without evaluating the client's unique circumstances and the back-end implications.

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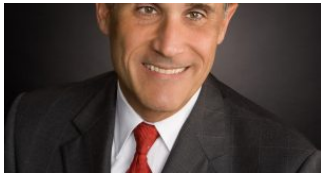

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