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Maximize Your Contract's Exculpatory Provisions

Law360, New York (July 15, 2013, 12:19 PM ET) -- When faced with exculpatory provisions that limit or even nullify their damages, plaintiffs often attempt to avoid these provisions by arguing that the contract did not adequately incorporate them or that pages were missing at the time of contracting.

Three recent federal opinions illustrate how contracts should be constructed to avoid plaintiffs' tactic of post-incident, à la carte selection of contractual provisions. Counsel should keep these decisions in mind when drafting multipage contracts that include exculpatory provisions and also when litigating cases involving the issue of whether a contract adequately incorporated certain, case-dispositive provisions.

In Nirvana International Inc. v. ADT Security Services Inc., Nirvana alleged that ADT's security system failed to detect a burglary that resulted in thieves stealing approximately $2.4 million in jewelry from Nirvana's jewelry store.[1] Nirvana alleged that the signature on the contract's sixth page was a forgery, and, as a result, a provision limiting Nirvana's recoverable damages in the event of a breach to $1,000 did not apply.

Nirvana also argued that even if its signature was not forged, and its conduct in failing to notify ADT of its alleged rejection of the contract's terms and conditions amounted to an implied acceptance, the exculpatory provision still did not limit Nirvana's damages because the contract's first page failed to adequately incorporate by reference the contract's terms and conditions on Pages 4 through 6.

Similarly, in Travis v. ADT Security Services Inc., Travis alleged that ADT failed to perform its obligations under an alarm-monitoring contract by failing to adequately respond to an alarm signal from Travis' residence, and, as a result, unknown individuals stole more than $45,000 in personal property.[2] Travis attempted to avoid the contract's limitation-of-damages provision by alleging that the contract he signed did not contain Pages 3 and 4, the pages that contained the exculpatory provision.

Finally, in Lawson v. ADT Security Services Inc., Lawson alleged that ADT was responsible for $83,150 in damages to his residence caused by a fire because ADT allegedly failed to contact the police, fire department or Lawson's emergency contacts after receiving a signal from Lawson's fire and security system.[3] Like Travis, Lawson denied that the contract's exculpatory provision limited his recoverable damages because he had allegedly never seen the page containing the limitation provision.

The primary issue in all three cases was whether the parties' contracts included the exculpatory provisions. The courts answered "yes" in all three instances.

In doing so, the courts placed particular emphasis on the fact that the first page of every contract (which contained the customer's signature) included a provision stating that the customer knew that additional pages accompanied the first: "You acknowledge and admit that before signing you have read the front and back of this page in addition to the attached pages which contain important terms and conditions for this contract, including but not limited to paragraphs 5."[4]

Moreover, the courts also noted that each page of the contract was numbered at the bottom with "x of 6," making clear exactly how many pages the contracts contained.[5]

Contracting Best Practices

The strict enforcement of exculpatory provisions provides businesses with the ability to mitigate risks and anticipate litigation costs through well-drafted contracts. Nirvana, Travis and Lawson make clear that no matter what tactics plaintiffs use to avoid their contractual obligations, they will nevertheless be bound by a legal exculpatory provision if the contract adequately incorporates it.

The following drafting practices are recommended:

- The first page of the contract should reference any additional pages that accompany the first page.[6]

- To be safe, the reference should be in all capital letters, in bold print and as close to the party's signature as possible. Be mindful that some states, such as New York, will enforce valid terms and conditions appearing after the signature page only if the signature page references them above the signature line.[7]

- Moreover, the incorporation language should specifically reference the most important provisions, such as provisions for waiver of subrogation, warranty disclaimers, limitations of liability, limitations on time to sue, insurance requirements and indemnity clauses.

- Also, to avoid subsequent confusion as to how many pages the original contract contained or the adverse party "losing" a key page, each page should be numbered "x of [total number of pages]", and you should design the contract so that provisions appear on the front and back of every sheet of paper.

The Most Effective Defenses

If litigation subsequently arises, and — as plaintiffs did in Nirvana, Travis and Lawson — a party claims

that the contract does not contain the exculpatory provisions, counsel seeking to enforce the provisions should do the following in briefing to the court.

- First, attach the contract to the motion so that the court can see the contract's language and layout.[8]

- Second, quote the incorporation language in the motion,and note how the language is distinguishable from the surrounding text by appearing in all capital letters and bold print.

- Third, summarize in a section how the contract's layout makes clear that the contract contained the exculpatory provision. For instance, note the page numbers ("x of 6"), describe how the contract was printed double-sided, so key provisions appear on the back of pages containing provisions that the opposing party claims are part of the contract, and, if you think it would help, include a graphic demonstrating the contract's layout.[9]

- Finally, support your factual description of the contract with case law from your jurisdiction holding that additional terms referenced by the contract are deemed incorporated even if the opposing party has allegedly never seen them.

Even the best exculpatory provision offers no benefits if the contract does not incorporate it. As the Nirvana, Lawson and Travis decisions demonstrate, parties often attempt to avoid their contractual obligations by claiming, among other things, that the contract did not include a key exculpatory provision because the party did not see it, the contract did not contain the page with the exculpatory provision at the time of contracting, or the contract did not adequately incorporate the provision.

The decisions discussed above illustrate how a contract may adequately incorporate an exculpatory provision and the importance of doing so.

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[1] 881 F. Supp. 2d 556 (S.D.N.Y. 2012), aff'd (2d Cir. May 15, 2013).

[2] 884 F. Supp. 2d 629 (E.D. Mich. 2012).

[3] 899 F. Supp. 2d 1335 (M.D. Ga. 2012).

[4] Travis, 884 F. Supp. 2d at 636; Lawson, 899 F. Supp. 2d at 1339; see also Nirvana, 881 F. Supp. 2d at 560 ("SECOND AND THIRD PAGES ACCOMPANY THIS PAGE WITH ADDITIONAL TERMS AND CONDITIONS").

[5] See Travis, 884 F. Supp. 2d at 635 ("the pages that Plaintiff admits he saw and signed indicate that they are '1 of 6,' '2 of 6,' '5 of 6,' and '6 of 6.' Common sense and logic led the Court to question why Plaintiff would have signed a document indicating that it consisted of six pages, only having read and understood four of the six."); Nirvana, 881 F. Supp. 2d at 560-61 ("each sheet indicated that it was 'n of 6' sheets").

[6] See, e.g., Travis, 884 F. Supp. 2d at 636 (finding that where additional terms are referenced, "the parties are bound by those additional terms even if they have never seen them. Failure of a party to obtain an explanation of contractual terms is ordinary negligence which stops the party from avoiding the contract on the ground the party was ignorant of its provisions.") (quoting Constr. Fasteners, Inc. v. Digital Equip. Co., No. 185679, 1996 WL 33348735, at *2 (Mich. Ct. App. Oct. 22, 1996)); Sasso v. Travel Dynamics, Inc., 844 F. Supp. 68, 73 (D. Mass. 1994) (finding that plaintiffs had sufficient notice of additional pages where the cover page instructed them to read "attached pages"); Kendall v. Am. Haw. Cruises, 704 F. Supp. 1010, 1017 (D. Haw. 1989) (determining that the title page alerted plaintiffs to inquire about missing pages where the page containing a time limitation was missing); Ray Tucker & Sons, Inc. v. GTE Directories Sales Corp., 571 N.W.2d 64, 68–69 (Neb. 1997) (holding that signee was placed on notice of absent page because of the "specific and obvious reference" to such terms on the signature page).

[7] See, e.g., Winter Bros. Recycling Corp. v. Barry Imports E. Corp., No. HUCC 391-08, at *4 (N.Y. Dist. Ct. 2009) ("the failure to provide a first page incorporating reference as to additional terms and conditions provided on a separate page, vitiates all representations after the signature page . . . . Terms and conditions coming after a signature can be incorporated by reference as long as same is indicated on the signature page prior to the signature.")

[8] Although analysis of a Rule 12 motion is typically limited to the complaint, parties may attach the contract to their Rule 12 motions. Indeed, in ruling on a motion to dismiss, courts may consider the complaint and documents that are referenced in the plaintiff's complaint or that are central to plaintiff's claims. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007). Where the claims rely on the existence of a written agreement, and plaintiff fails to attach the written instrument, "the defendant may introduce the pertinent exhibit," which is then considered part of the pleadings. See e.g., QQC, Inc. v. Hewlett–Packard Co., 258 F. Supp. 2d 718, 721 (E.D. Mich. 2003).

[9] ADT's Appellate Brief in Nirvana v. ADT Security Services, Inc. contains an example of how to use a graphic in a motion to illustrate a contract's layout for the court. See No. 12-3445, at p. 5. Click on the "Original Image" link at the top left of the webpage to view a .pdf of ADT's brief that contains a graphic illustrating the applicable contract's layout.