Where A Litigator's Advice Can Improve Agreement Drafting

By **Adrienne Koch**

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Virtually any litigator who handles contract disputes likely has thought on occasion: "I wish they'd consulted me when they drafted this provision."

But short of having every provision of every agreement reviewed (a step that may be warranted for some transactions but would amount to gross overkill for many), how can transactional counsel and in-house lawyers determine when to consult a litigator at the drafting stage?

It is obviously not possible to identify in advance every contractual provision that might be the subject of litigation. In a complex transaction, the possibilities could be endless. But certain kinds of provisions — such as those involving choice of law, choice of forum, attorney fees, the calculation of damages and defaults — will come into play in connection with a broad range of substantive disputes.

Moreover, if these are invoked, it often means the parties are in litigation or at the very least heading in that direction. For this reason, these are provisions transactional counsel and in-house lawyers should particularly consider having reviewed by a litigator familiar with the law that will apply if they come before a court.

The Pitzer College Case

Pitzer College v. Indian Harbor Insurance Company[1] illustrates this point. There, the college sued its insurer seeking a declaration that it was required to indemnify Pitzer for certain environmental remediation costs. The insurance company argued that it had no such obligation because the college had not given timely notice of the claim.

The validity of that defense depended in large part upon a choice of law analysis. Under the law of California (where the suit was brought), an insurer seeking to avoid liability based on late notice of a claim must prove that the late notice "substantially prejudiced its ability to investigate and negotiate payment for" the claim.[2] But the policy at issue specified that it was governed by New York law.

Under New York law, insurance policies issued and delivered within New York are subject to a notice-prejudice rule similar to California's, but policies issued and delivered outside New York (as this one was) are subject to a different rule that denies coverage whenever timely notice is not provided.[3]

Finding New York law applicable in light of the contractual choice of law provision, the lower court granted summary judgment in favor of the insurer. The college appealed, arguing that California's notice-prejudice rule was a matter of fundamental public policy that could not be overridden by a choice of law provision. The United States Court of Appeals for the Ninth Circuit certified to the Supreme Court of California the question of whether the rule barred enforcement of the choice of law provision in this case.[4]

The California Supreme Court held that the notice-prejudice rule is indeed a matter of fundamental public policy.[5] This, however, did not end the inquiry.

Whether the rule would apply in this case would depend upon "whether California has a

materially greater interest than New York in determining the coverage issue, such that the contract's choice of law would be unenforceable because it is contrary to our fundamental public policy."[6] It left that issue for the federal court to decide.

Based on this ruling, the Ninth Circuit vacated the judgment that had been entered in favor of the insurer and remanded the case to the district court for further proceedings to determine whether California had a materially greater interest than New York — and, if so, whether the insurer could show actual prejudice from the late notice (as would be required under California law).[7] As a result, the college's claim survives at least for now, and the insurer is once again at risk.

What Is the Lesson?

By inserting a New York choice of law provision in its insurance contract with a California entity, the insurer in Pitzer College created an argument that California's notice-prejudice rule should not apply. That may have been the most it could do to escape the application of that rule.

The college, for its part, may have had little practical choice but to accept that provision and litigate over its enforceability. But the case illustrates the importance of anticipating how certain kinds of provisions will play out in court.

The choice of law provision gave rise to a dispute that required analysis of not only the law of the state whose law was ostensibly chosen (New York), but also the law of the state whose law might otherwise apply (California). It also required an understanding that the subject matter of the contract might trigger fundamental policy concerns that could arguably trump the parties' contractual choices.

The record does not make clear whether or to what extent the parties anticipated these issues when they negotiated the contract; if they did, however, the litigation will be that much easier for them to address and digest — both in terms of actual litigation strategy and in terms of business impact.

Could the parties have known in advance that this specific dispute would arise? Probably not. But a choice of law provision, by definition, becomes relevant only in the event of litigation or threatened litigation. It is therefore the kind of provision about which transactional counsel should seriously consider consulting a litigator. At the very least, such consultation might help avoid surprises.

There are many other kinds of surprises that might be avoided if litigation input is sought in the drafting stage. Attorney fee provisions, for example, are unenforceable under the laws of some states, and may be substantially rewritten under the laws of others.[8] Counsel drafting such provisions would be well advised to gain an understanding of how they will be treated in the courts of any state where they might be litigated.

Similarly, although it is common in a commercial lease to provide that rent will be abated under certain circumstances, depending on the facts and the applicable law such a provision may in some instances be deemed an unenforceable penalty.[9] Again, counsel drafting such provisions may wish to pay special attention to how they will be treated by the relevant courts.

What these provisions — and numerous others, such as forum selection clauses, indemnification provisions, default provisions and arbitration provisions — have in common

is that they are likely to be invoked in circumstances where a litigation, or at least a dispute, has arisen. This makes them especially likely to be litigated.

Conclusion

There is no way to anticipate every possible dispute when drafting a contract. Any provision — especially key operative ones — might ultimately be the subject of litigation. In some instances, the transaction might demand litigation review of the entire agreement.

Where that is not warranted, consulting with litigation counsel regarding the provisions that are most likely to be invoked when something has gone wrong is one way to ensure that the contract is drafted to best protect the client from unwelcome surprises.

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[1] 8 Cal.5th 93 (2019).

[2] 8 Cal.5th at 101.

[3] Id. at 99.

[4] See id. at 97.

[5] Id. at 105.

[6] Id.

[7] Pitzer College v. Indian Harbor Ins. Co., 779 Fed. Appx. 495 (9th Cir. 2019).

[8] See, e.g., Hand Cut Steaks Acquisitions, Inc. v. Lone Star Steakhouse & Saloon of Nebraska, Inc., 298 Neb. 705, 734-35 (Neb. 2018) ("Since the 1800s, this court has refused to enforce contractual provisions providing for the award of attorney fees for the prevailing party ... [C]ontractual agreements for attorney fees are against public policy and will not be judicially enforced.") (citation and internal quotations omitted); Ruiz Fajardo Ingenieros Asociados S.A.S. v. Flow Internat'l Corp., 2019 WL 2766721, *1 (W.D. Wash. Jul. 2, 2019) (citing Washington statute that "convert[s] unilateral [contractual] attorney fees provisions into bilateral provisions" because under Washington law "public policy forbids one-way attorneys' fee provisions").

[9] See, e.g., Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc., 232 Cal.App.4th 1332, 1359-65 (2015); cf. Duane Reade v. Stoneybrook Realty, LLC, 882 N.Y.S.2d 8, 9, 63 A.D.3d 433, 434 (1st Dept. 2009).