

Avoiding Common Contract Pitfalls: Legal Landmines in Agreements

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Contracts are the backbone of every business relationship. Whether buying a business or entering into a new commercial agreement, many small to mid-sized businesses do not fully negotiate critical clauses within the document. Failing to fully negotiate certain language, relying on informal agreements, or failing to update commercial contracts with appropriate amendments as the relationship evolves can become a significant liability to a company.

Informal arrangements may feel efficient in the short term but can create significant issues if a dispute arises. In this edition of Search Fund Operate, we break down the most commonly negotiated (and litigated) provisions in contracts. The below is an overview of how acquirers, operators, and business owners can proactively protect themselves from exposure.

The Risk of Informal Agreements

Many business relationships begin with trust — a handshake deal, an email exchange, or a PDF template someone downloaded online years ago. But when disputes arise, courts look for formal agreements. Informal or undocumented agreements often lack enforceable provisions around risk allocation, dispute resolution, and payment mechanics. Even worse, they often fail to outline each party's actual responsibilities, deadlines, or remedies.

Tip: If a dispute reaches litigation, and there is no signed agreement or only partial documentation, courts may rely on the parties' prior conduct or applicable statutory rules that might not reflect the parties' original intentions. Inconsistencies can lead to conflicting testimony and unpredictable results.

Without formal terms, operators risk operational confusion and disruptions, customer dissatisfaction, and expensive court battles. This risk grows exponentially when the business is being sold or scaled, as buyers expect to inherit clear, enforceable rights and obligations.

Liability and Indemnification

Indemnification Clauses

Indemnity provisions shift the burden of financial responsibility for specific claims. These are some of the most heavily negotiated clauses. Poorly drafted clauses can:

- Leave you liable for the other party's negligence or misconduct.
- Fail to include third-party claims (e.g., customer injuries from vendor products).
- Omit procedural requirements for notice and defense, leaving you without control of litigation that affects your reputation.

Tip: Ensure that the indemnification clause is protective of your interests. Push for mutual indemnification, defense, and settlement rights, not just reimbursement. Also consider whether to limit indemnification to direct damages or extend it to consequential losses.

Environmental Indemnity

In certain industries — such as manufacturing, logistics, or commercial real estate — environmental risk requires special attention. Contracts should:

- Clearly allocate responsibility for environmental conditions, both known and unknown.
- Include representations about compliance with environmental laws and past environmental issues.
- Address remediation costs and third-party claims.

Tip: Require the disclosing party to provide environmental reports and clarify who bears responsibility for pre-existing contamination.

Liability Carve-Outs

Clauses that attempt to shift risk should specify whether they cover negligence, gross negligence, or willful misconduct. The broader the language, the greater the protection. Sophisticated parties often negotiate carve-outs for fraud or breaches of confidentiality.

Limitation of Liability: Know Your Exposure

Exclusion of Damages

Most contracts attempt to exclude certain categories of damages:

- Consequential damages (e.g., lost profits or reputational harm)
- Incidental damages (e.g., additional shipping or handling costs)
- Punitive damages (rare, but potentially significant in litigation)

However, these clauses must be:

- Clearly drafted and conspicuously presented in the agreement
- Consistent with governing law and not prohibited by statute
- Tied to specific breaches or defined categories of claims

Tip: Courts may strike down limitation clauses if they are hidden in boilerplate language or conflict with public policy (e.g., consumer harm or gross negligence). Careful drafting is necessary to ensure these clauses are enforceable.

Caps on Damages

Liability caps are common. These are often limited to:

- The total fees paid under the agreement over a certain period
- A multiple of the monthly or annual contract value

These types of damages caps should be:

- Commercially reasonable
- Include carve outs for egregious conduct (e.g., fraud, IP infringement)

- Reviewed for enforceability in high-risk jurisdictions (such as California or New York)

Tip: Combine caps on damages with tailored indemnification clauses and insurance requirements offer the most balanced protection.

Right to Recover Damages

Parties should not assume that silence on damages means full recovery. Contracts should affirmatively state:

- Whether consequential or incidental damages are recoverable
- Whether lost profits are compensable
- Whether the right to injunctive relief is preserved for breaches such as misuse of IP, confidential information, or violation of non-competes (if included and within a jurisdiction where enforceable)

Tip: Courts can be reluctant to award damages not clearly contemplated in the contract language.

Assignability and Change of Control

An often overlooked provision is whether contracts can be assigned to another party — a crucial issue during a business sale or restructuring. If assignment is restricted, it may require:

- Written consent from the counterparty
- Disclosure of assignee's financial information
- Attorney fees associated with any legal review prior to consenting to the assignment

Some contracts even treat a change of ownership or control as a default or termination trigger.

Tip: Failing to secure assignability can delay or derail an acquisition, especially if key customer contracts are involved. Operators should inventory and review top agreements well before a contemplated sale.

Payment Terms and Dispute Mechanics

Clear Payment Language

Contracts should specify:

- Invoice frequency and delivery method
- Payment deadlines, accepted payment methods
- Grace periods, late fees, and interest charges
- Whether payments are conditional on acceptance, delivery, or milestones
- Right to stop future delivery of services or products in the event of non-payment

Vague or missing language around payment terms is a common source of cash flow disruption. Courts often apply standard practices or industry norms — which may not reflect your business model.

Tip: Use net terms that clearly reflect the payment terms. Add provisions for disputed invoices and partial payments.

Condition of Delivered Goods or Services

Ensure the contract addresses:

- Acceptance criteria and inspection periods
- What constitutes a material defect
- Remedies for nonconforming or damaged goods
- Whether services must meet a defined performance standard

Tip: If materials are delivered late or defective, and the contract is silent, the buyer may have limited options to reject or recover costs.

Dispute Resolution

Well-structured dispute resolution clauses can minimize litigation costs and clarify where and how conflicts are resolved. These clauses should address:

- Venue and jurisdiction
- Governing law (state of choice)
- Mediation or arbitration requirements before litigation
- Scope of issues subject to arbitration

Tip: Choose arbitration only when you can afford and control it — not all arbitration is cheaper or faster than court.

Choice of Law and Venue

Failing to specify a governing law can create confusion and increase cost.

- Choose a state with predictable case law and commercial friendliness
- Clarify venue for both lawsuits and arbitration (county and state)

Tip: Courts generally uphold these clauses, but ambiguity can invite satellite litigation over which rules apply.

Recovery of Attorneys' Fees

By default, parties generally pay their own legal fees unless the contract provides otherwise. A prevailing party clause can:

- Deter frivolous lawsuits
- Improve recovery leverage for the aggrieved party
- Help offset enforcement costs in breach scenarios

Tip: Ensure the clause clearly defines "prevailing party" and whether partial victories count.

Other Heavily Litigated Provisions

Force Majeure

Since COVID-19, courts have closely scrutinized force majeure clauses. These should be specific and include:

- Pandemics, epidemics, and public health emergencies
- Cybersecurity incidents and data breaches
- Labor strikes, natural disasters, and government actions

Tip: Clarify notice requirements and what obligations are suspended or excused.

Termination Rights

Contracts should clearly state:

- Whether either party may terminate for convenience
- Grounds for termination for cause (e.g., material breach, insolvency)
- Required notice periods
- Obligations upon termination (e.g., final payments, transition support)

Tip: Courts often look to see if the termination provisions were exercised in good faith and consistent with the contract's intent.

Integration Clause

A merger or integration clause ensures that only the written agreement governs the relationship. This is a critical protection against claims of oral promises or email side agreements that contradict the final document.

Conclusion

Contracts are not just formalities — they are critical risk allocation tools. Whether you are acquiring a business, managing a commercial relationship, or selling to customers, business owners should ensure that agreements are thorough, clear, and enforceable. This will reduce litigation risk and protect your enterprise value.

For buyers and operators, reviewing all critical contracts pre- and post-close is an essential part of your diligence and compliance process. Don't assume the existing agreements are sufficient — many are not. Where possible, standardize contract templates, build clear negotiation guardrails, and involve legal counsel to spot ambiguous or dangerous provisions before they become problems.