

Considerations for Contractual Provisions Extending Statutes of Limitations*

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OVERVIEW

Like the law in many other states, subject to the exception noted below for contracts under seal, Delaware law does not permit the extension of a statute of limitations by contract. See *GRT, Inc. v. Marathon GTF Technology, LTD*, 2011 WL 2682898 at *15 n.80 (Del. Ch. July 11, 2011) (stating that a “freely made contractual decision among private parties to shorten, rather than lengthen, the permitted time to file a lawsuit does not violate the unambiguous negative command of 10 *Del. C.* § 8106 [the statute of limitations for breach of contract], but a decision to lengthen it does and allows access to the state’s courts for suits the legislature has declared moribund”); *Shaw v. Aetna Life Insurance Co.*, 395 A2d 384, 386-387 (Del. Super. 1978). While many practitioners may be familiar with this prohibition, some may not have considered the types of provisions that could be construed to run afoul of the prohibition and the implications for certain legal opinions. Practitioners who are drafting, or providing enforceability opinions on, provisions that could be construed as contractual extensions of the statute of limitations should be aware of the prohibition and, more importantly, the ways in which the issue can arise. For example, many private company acquisition agreements require the seller to indemnify the buyer post-closing for losses arising from a breach of the seller’s representations and warranties. The parties may approach this through a combination of survival clauses, notice provisions and contractual indemnification obligations. Such indemnification obligations may, by their terms, extend for a number of years post-closing and, in the case of indemnification for breach of certain representations, such as authority and capitalization, may extend indefinitely.

EXTENSION OF THE STATUTE OF LIMITATIONS BY CONTRACT

If an acquisition agreement specifically provided that the right to file suit for breach of representations and warranties was extended for specified periods, for example, three years for business representations, ten years for environmental

representations and indefinitely for “fundamental” representations, the statute of limitations issue may be readily apparent to practitioners familiar with the public policy limitation. However, the provision purporting to extend the statute of limitations contractually may do so in a more subtle fashion. For example, many agreements provide that the representations and warranties will “survive” for a specified period of time, much like the time periods noted above.

In *GRT*, the Delaware Court of Chancery interpreted a survival clause in a securities purchase agreement as a contractual statute of limitations. There, the survival clause had the effect of shortening the statute of limitations rather than extending it. The survival clause provided that certain representations survived for a one-year period and would thereafter “terminate,” together with associated indemnification rights and contractual remedies. Under Delaware law, parties may shorten the statute of limitations by contract because a shortening of the statute of limitations is consistent with the policy behind statutes of limitation.¹ Although the *GRT* Court was only required to address the effect of the one-year survival clause, the Court addressed, *in dicta*, the interpretation of a provision purporting to cause the representations and warranties to survive “indefinitely,” and explained that such a provision would constitute an impermissible attempt to extend the statute of limitations under Delaware law. The *GRT* Court instructed that, under Delaware law, such a provision would be read “as establishing that the ordinarily applicable statute of limitations governs the time period in which actions for breach can be brought.” *Id.* at *15. Thus, a Delaware court would give effect to such a provision by reading it in a manner consistent with Delaware public policy.

The “survival” provisions discussed above are often coupled with notice requirements and covenants to indemnify for breaches of the representations or warranties occurring during the survival periods.² The covenants to indemnify can relate

¹ See *GRT*, 2011 WL 2682898 at *12 n.59 (“[T]he shortening of statutes of limitations by contract is viewed by Delaware courts as an acceptable and easily understood contractual choice because it does not contradict any statutory requirement, and is consistent with the premise of statutory limitations periods, namely, to encourage parties to bring claims with promptness, and to guard against the injustices that can result when parties change position before an adversary brings suit or where causes of action become stale, evidence is lost, or memories are dimmed by the passage of time.”).

² One variation on the “survival” clause that was not directly

to third-party claims as well as claims between the parties. It is important to note, however, that, under Delaware law, the analysis of a claim for breach of representations or warranties and for damages suffered as a result of that breach caused by the diminution in value of the transferred assets is analyzed differently from a claim for breach of representations or warranties that gives rise to a third-party indemnification claim. With regard to the former, a claim for breach of representation or warranty will generally accrue at closing, such that the Delaware statute of limitations for breach of contract will begin to run at closing, absent a basis for tolling. *See CertainTeed v. Celotex Corp. Corp.*, 2005 WL 217032 (Del. Ch. 2005). With regard to the latter, however, the third-party indemnification claim may not accrue until payment is made to the third party with respect to that claim and thus the statute of limitations for that claim would not begin at closing but rather when the payment to the third party was made.

For example, if a seller gives a representation on the environmental condition of a property, representing that there is no environmental contamination, and it turns out that there is, in fact, environmental contamination and, moreover, that contamination has already affected neighboring properties owned by third parties, that breach of representation could give rise to a claim for diminution of the value of the property and also a claim for payments made to any third party for the environmental contamination. The claim for damages for the loss of value to the property as a result of the contamination would accrue at closing while the claim for damages for the amounts payable to third parties as a result of the contamination would accrue upon payment to the third party. Thus, under Delaware law, an agreement that obligates a seller to “indemnify” a buyer for losses arising from a breach of representation or warranty for more than three years may, with respect to certain claims, constitute an impermissible attempt to extend the statute of limitations by contract, while such agreement, with respect

addressed by the *GRT* Court is a provision requiring that notice be given during the survival period as a prerequisite to indemnification under the contract. The survival period in such a provision could be consistent with or shorter than the statutory period. *GRT* could be read to suggest that a survival period during which notice must be given will be construed as the same period during which claims must be filed. *But see Sterling Network Exchange, LLC v. Digital Phoenix Van Buren, LLC*, 2009 WL 2582920 (Del. Super. Ct. Mar. 28, 2008) (describing a survival period as a contractual statute of limitations but ultimately holding that the disputed claim had to be *noticed* during the survival period rather than *filed*). Even if the survival period is construed as the time period during which claims have to be noticed rather than filed, if the notice period is close to or the same as the statutory limitations period, there may be a very limited window between the giving of notice and the end of the statutory period for filing suit.

to other third-party indemnification claims, may constitute an enforceable obligation that does not attempt to extend the statute of limitations.

ENFORCEABILITY ISSUES

To the extent that a contractual provision purports to modify the statute of limitations, either expressly or through the use of a survival clause, under Delaware law, practitioners should carefully consider the enforceability of such a provision and, as discussed below, the possibility of alternative drafting to achieve the desired result. A complete assessment of enforceability would require practitioners to determine the applicable statute of limitations--a determination that would involve resolution of a number of different variables. And, given the way many contracts are drafted, it may not be possible at the outset to determine, with any degree of certainty, which jurisdiction's statute of limitations will apply.

As a starting point, practitioners should note that, in Delaware, the statute of limitations is considered procedural rather than substantive, such that the statute of limitations of the forum governs. *See Cheswold Volunteer Fire Co. v. Lambertson Constr. Co.*, 489 A.2d 413, 421 (Del. 1984); *David B. Lilly Co., Inc. v. Fisher*, 799 F. Supp. 1562, 1568 (D. Del. 1992), *aff'd*, 18 F.3d 1112 (3d Cir. 1994). Except for a cause of action that arises outside of Delaware, a Delaware court will generally apply the relevant Delaware statute of limitations, rather than the statute of limitations under the chosen law of the contract or under the law applicable in the absence of a choice of law provision. With respect to a cause of action that arises outside of Delaware, Delaware has adopted a “borrowing statute,” which provides that when a cause of action arises outside of Delaware, an action cannot be brought in a Delaware court after the expiration of the *shorter of* the Delaware statutory period *or* the statutory period of the state or country where the cause of action arose. 10 *Del. C.* § 8121. The borrowing statute essentially requires the Delaware court to determine the applicable statute of limitations in Delaware as well as the applicable statute of limitations in the jurisdiction where the cause of action arose – an exercise that may be difficult in the context of a breach of contract claim, and apply the shorter one. The policy behind the borrowing statute is to “protect Delaware’s courts from having to adjudicate stale out-of-state claims.” *Juran*, 2000 WL 1521478 at *12. By requiring the Delaware courts to apply the shorter statutory limitations period, “the General Assembly sought to prevent forum shopping to take advantage of a longer limitations period.” *Id.* However, this rule, as described below, is subject to modification by contract.

In addition to the analysis required to determine the possible effect under the borrowing statute, the determination of the applicable statute of limitations may be complicated by the

nature of the alleged injury. Certain types of claims may not fall clearly within a particular statute of limitations in Delaware. For example, in *Juran v. Bron*, the Court of Chancery struggled with the appropriate statutory period and considered the applicability of the statutory limitations period for breach of contract (three years) and statutory period for a wage claim (one year) in the context of a resolving a dispute under an employment agreement. *Juran v. Bron*, 2000 WL 1521478 at *11 n.36 (Del. Ch. Oct. 6, 2000).

Finally, the enforceability of a contractual modification of the statute of limitations may be impacted by the type of court in which the dispute is brought. The Delaware Court of Chancery, as a court of equity, does not apply a statute of limitations except by analogy through the doctrine of laches. See *Whittington v. Dragon Group, L.L.C.*, 991 A.2d 1 (Del. 2009). A court applying laches may shorten or lengthen the statutory period based on equitable considerations, but the plaintiff's failure to file in the analogous statutory period will be given "great weight" in determining whether the claim is barred. *Id.* at 9. The general rule is that "a statute of limitations for an action at law that is analogous to the action in equity will guide an Equity Court in applying the equitable doctrine of laches." *Juran*, 2000 WL 1521478 at *11. However, the statute of limitations is not binding on a court in equity and will not be applied where there are "special circumstances." *Id.*

The framework described above assumes that the action is brought in a Delaware court. If the contract does not choose Delaware as the exclusive forum or the exclusive forum provision is not enforced, the Delaware prohibition on lengthening the statute of limitations by contract and the overlay of the borrowing statute may not be relevant to the enforceability analysis. The bottom line is that it may be difficult to determine at the time an opinion is rendered which statute of limitations will control.

DRAFTING CONSIDERATIONS

From a drafting standpoint, there are a number of ways to resolve some of the uncertainty regarding enforceability. First, practitioners could consider including a specific provisions choosing the statute of limitations of a particular jurisdiction within its choice of law provision. In Delaware, a choice of law provision that includes the statute of limitations of the relevant jurisdiction will be respected so long as inclusion of the statute of limitations is "specifically noted." *Juran*, 2000 WL 1521478 at *11. Thus, if a contract provided for the exclusive jurisdiction of the Delaware courts and contained a Delaware choice of law provision that expressly included a choice of the Delaware statutes of limitation, a breach of contract claim should be governed by Delaware's three-year statute of limitations (or the

20-year statute of limitations applicable to contracts under seal, as discussed below).

Second, to the extent that parties want to permit recovery beyond the three-year statutory period, practitioners could consider drafting the obligation as a covenant requiring future performance as losses are incurred rather than as a provision requiring reimbursement for breach of representations and warranties. In *CertainTeed*, the seller had agreed to "indemnify" the buyer for claims arising from seller's breach of representations and warranties and for the buyer's losses for third-party claims relating to defective products. See *CertainTeed*, *supra*. The *CertainTeed* Court instructed that the contractual "indemnification" for breach of contract was not common law indemnification, but rather a contractual remedy for breach. By contrast, common law indemnification provides "a general right of reimbursement for debts owed to third parties." *Id.* at *3. While the claims for breach of representations and warranties accrued at closing, the common law indemnification claims would not accrue until the payment was made to the third party. *Id.* at *3, 5. Accordingly, if the contractual obligation can be drafted as a future covenant rather than as contractual remedy for an existing breach, the parties may be able to avoid the prohibition on extension of the statute of limitations by contract and still accomplish the desired allocation of risk between the contracting parties.

Finally, practitioners could consider following certain formalities to create a contact under seal because, under Delaware law, a contact under seal is subject to a twenty-year statute of limitations. See *Whittington v. Dragon Group L.L.C.*, 991 A2d 1, 10-12 (Del. 2009); *Sunrise Ventures, LLC v. Rehoboth Canal Ventures, LLC*, 2010 WL 975581 at *1-*2 (Del. Ch. 2010); *Kirkwood Kin Corp. v. Dunkin' Donuts, Inc.*, 1995 WL 411319 at *4-*6 (Del. Super. 1995). Historically, the requirements for creating a contract under seal (outside of the debt context) had received conflicting treatment under Delaware law. In 2009, the Delaware Supreme Court resolved a portion of conflict by adopting a bright line rule for individuals (rather than entities) attempting to create a sealed contract. For "an individual, in contrast to a corporation, the presence of the word 'seal' next to an individual's signature is all that is necessary to create a sealed instrument, 'irrespective of whether there is any indication in the body of the obligation itself that it was intended to be a sealed document.'"³ For entities (rather than individuals) to create a contract under seal, a greater degree of formality is required. The contract must contain language

³ *Whittington*, 991 A.2d at 21 (citations and footnotes omitted); see *Sunrise Ventures, LLC v. Rehoboth Canal Ventures, LLC*, CIV.A. 4119-VCS, 2010 WL 975581, at *1 (Del. Ch. Mar. 4, 2010), *aff'd*, 7 A.3d 485 (Del. 2010).

referencing a sealed contract in the body of the document and a recital affixing the seal and there must be extrinsic evidence of the parties' intent to create a contract under seal.

With respect to contracts under seal, practitioners should be mindful of at least two issues: First, it may be necessary to couple the provisions relating to a contract under seal with a forum selection clause agreeing to litigate exclusively in Delaware (which itself could be subject to challenge),⁴ since the statute of limitations will be governed by the law of the forum. Second, the choice of law provision should include a choice of the Delaware statute of limitations, *i.e.*, the choice of Delaware law for the statute of limitations should be "specifically noted," so that the borrowing statute does not cause the Delaware court to apply the statute of limitations of the jurisdiction in which the cause of action arose to the extent that statute is shorter than the 20-year statute of limitations applicable to contracts under seal in Delaware.

OPINION CONSIDERATIONS

For purposes of Delaware law, if practitioners are asked to provide enforceability opinions with respect to such agreements, they should be aware that provisions purporting to allow recovery for breaches of representations and warranties beyond the three-year statute of limitations applicable to contract claims may not be enforceable as a matter of public policy. From an opinion standpoint, if the potential infirmity is not addressed in the agreement, practitioners should consider specifically qualifying the opinion as to such provisions or noting that they will be subject to the applicable statutes of limitations. One possible form of opinion qualification would be to include the following statement: "We express no opinion as to the enforceability of any provision in the [Transaction Documents] to the extent it violates any applicable statute of limitations." Similarly, the qualification could provide that "we express no opinion as to any waiver of any statute of limitations." Alternatively, the opinion could identify the specific sections of the documents that raise the concern and note that the enforcement of those sections "would be subject to any applicable statute of limitations."

Although prudence may dictate inclusion of an exception along the lines described, given the uncertainty discussed above as to which statutes of limitations may apply to various claims arising under any given contract, one could reasonably take the position that an opinion recipient should not assume that the opinion giver is addressing whether or not the terms of

the subject agreement could be construed as an impermissible extension of any possible applicable of limitations, especially when the agreement does not contain an explicit provision purporting to extend the statutory period, but rather a survival clause that could, under certain circumstances, be construed to have that effect. Moreover, an opinion recipient should recognize the application of a doctrine as basic as the statute of limitations without the requirement that an opinion giver specifically reference it. As such, one could reasonably take the position that an unstated exception with respect to the application of the statute of limitations would be deemed to be a customary practice limitation implicitly included in an opinion.

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⁴ See "Special Report of the TriBar Opinion Committee: The Remedies Opinion – Deciding When to Include Exceptions and Assumptions," 59 Bus. Law. 1483, 1498-1502 (2004) (forum selection clauses).