

Reading the Fine Print

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What is a Contract?

- ▶ In simple terms, a contract is an agreement that creates legally binding obligations between parties.
- ▶ A contract is usually written (express contract)
 - Napkin contracts are allowable, but not recommended. The more detail, the better.
- ▶ But a contract can also be orally made, or made through actions (implied).

What is a Contract?

- ▶ At its core, a contract should clearly and accurately memorialize the business deal between two parties
 - Every written word in a contract should have a purpose and meaning within the contract
- ▶ Once a contract is final, the intent of parties cannot be considered by a court to interpret a contract that is not ambiguous
 - Commonly known as the Parol evidence rule
- ▶ If there are terms within a contract that are unfamiliar, out of the ordinary course of business, always seek out legal help before signing.

What is a Contract?

- ▶ Parties can contract with each other for most things, but there are exceptions with invalidate a contract
 - Parties cannot contract for unlawful actions
 - Tax evasion
 - Antitrust
 - Parties cannot contract in a manner that would be against public policy
 - Contracts negating negligent acts
 - Attempting to avoid state laws

Substance of a Contract

- ▶ A contract should include
 - A statement about the purpose of the contract
 - The Parties involved (correct corporate entities names)
 - The Material Terms and Conditions (who is going to do what)
 - What happens if a contract is broken (breached)
 - What remedies do parties have upon breach
 - When does the contract terminate
 - What happens on termination (renewal options, continuing obligations)

Material Terms and Conditions

- ▶ A good contract should clearly outline the material terms and conditions of the agreement
 - What is required of each party
 - When do they have to perform their obligation
 - Any special circumstances
 - Is “Time of the Essence”
 - Term is antiquated, but still used in many form contracts
 - Simply means that time to perform is a material term of the contract
 - Example Clause:
 - **Time is of the Essence.** Time is of the essence with respect to the performance of this Agreement.

Material Terms and Conditions

- ▶ Payment terms, especially for installment payments should be very clearly set forth in the agreement
 - Note: It is helpful to write out payments as follow:
 - **Payment.** Buyer agrees to pay Seller FIVE THOUSAND FIFTY THREE DOLLARS and 00/100 CENTS (\$5053.00)
 - In cases where there is a disagreement in the payment terms due to a typo, the written statement controls over the numerical
 - Example:
 - **Payment.** Buyer agrees to pay Seller FIVE HUNDRED FIFTY THREE DOLLARS and 00/100 CENTS (\$5053.00)
 - The Buyer would only owe \$553.00.

Substance of a Contract

- ▶ When reviewing contracts, make sure that ALL the material terms are written within the contract
 - If the terms are not included, or *implied* by any party but not written, then the terms will not be considered by a court.
 - A court can only enforce what is in the contract

Breach

- ▶ A contract should also include what happens when one party fails to perform (breach or default)?
 - Breach usually requires a violation of the material terms of a contract.
 - Does either party have the opportunity to cure breach
 - What obligations to parties have to continue performance of the contract.
 - What remedies do either parties have to recover from breach.

Breach

- ▶ To determine if your contract adequately covers what to do in a breach, consider the worst case scenario, and see if your contract provides an adequate solution
 - If a buyer fails to pay you an installment, are you obligated to continue service?
 - If your company fails to make an installment payment, does the seller have the option to make the entire amount due?
 - If your company can't perform for some reason, can you provide a replacement?
 - If a service provider fails to provide service, what remedies do you have?

Termination of Agreement

- ▶ It is also important to know the length of an agreement, and when both parties obligation end
- ▶ Are there any notice requirements for a party to terminate an agreement?
- ▶ Is there any options to renew an agreement, and are there any limits on the option (exclusivity, etc.)
- ▶ Upon termination, are there any obligations parties have to each other
 - Return property
 - Confidentiality/Data Security

Confidentiality

- ▶ A number of contracts have confidentiality and non-disclosure agreements (NDA) clauses that require certain information be kept confidential and not disclosed to other parties.
- ▶ These clauses can continue past the termination of the contract, so its important to know the extent of their coverage and what information is covered.

Data Ownership

- ▶ With some contracts, there may be an exchange of data in the terms of customer contact information, etc.
- ▶ A contract should have terms to indicate who owns the data at the end of the contract, and what actions need to be taken to either return and/or destroy the data.

Representation and Warranty

- ▶ This section within a contract contains statements about the goods and/or services that parties agree too.
 - Representations are statements of fact by one party
 - Warranties are stipulations that a fact is as stated in the contract
- ▶ This section is critical, as it establishes what each party will provide in the contract
- ▶ Example:
 - **Limited Warranty**: Creststar agrees, represents, and warrants to Global Tel that Creststar, and its employees and agents, will perform their obligations hereunder in a professional, courteous, and workmanlike manner consistent with commercially reasonable standards, and with reasonable promptness, accuracy, efficiency, and diligence.
- ▶ Parties rely on representations and warranties, so a false representation or warranty can be considered **fraud**.

Limitation on Damages

- ▶ Contracts will generally limit damages to actual damages for the breach, and will not allow recovery for special, consequential, and incidental damages
 - Special Damages – economic losses
 - Consequential Damages – damages related directly to the failure of a party to perform a contract
 - Incidental Damages – expenses incurred to obtain substitute goods or services

Indemnification

- ▶ What is an indemnification clause?
 - A clause to shift the risk and costs from one party to the other to compensate for loss or damage.
 - Indemnification essentially states that if one party is sued due to the failure of another party to act, the failing party can be held liable.

Indemnification

▶ Example:

- **Indemnification**: Each Party hereto shall release, indemnify, hold harmless, and if requested, defend the other Party from and against any claims, liabilities, damages, actions, costs, and expenses (including attorneys' fees) of any kind or nature, to the extent arising from or caused by the act, omission or negligence of said Indemnifying Party.

▶ Terms:

- **Release** - a waiver of any claims against a party, if the claim rises from the act of the indemnifying party
- If A Corp and B Corp contract, A Corp cannot sue B Corp if A Corp's actions, omissions, or negligence caused the reason of the suit

Indemnification

- **Indemnify** – the indemnifying party shall indemnify, or reimburse the other party for losses it incurs due to a claim
 - A Corp. has to pay for B Corp. defense, and losses if B Corp. is sued by a third party due to A Corp. negligent action.
- **Hold Harmless** – a statement that the indemnifying party shall claim, in any action, that the other party caused no harm
 - If A Corp is sued by a third party, A Corp cannot claim that B Corp caused the injury, if A Corp's action did so
- **Duty to Defend** – a statement that the indemnifying party shall defend the other party in a claim brought by a third party
 - If B Corp is sued by a third party, A Corp will step in their shoes and defend the action

Indemnification

- ▶ Indemnification is as complicated as it appears, but a lot of indemnification actions are handled by insurance carriers.
 - Some contracts will request parties be added as additional insured to policies to further protect their interests.

Indemnification

- ▶ Things to look out for:
 - Indemnification does create substantial financial liabilities, especially with promises to pay legal fees, so be aware of the potential risks
 - Be wary of “one sided” indemnification clauses where a party will shift all risk to another party
 - Terms such as “even if such injury or damage is caused solely by the indemnitee’s negligence”
 - Some states automatically invalidate these statements via law, but some do not – important to review with lawyer

Force Majeure

- ▶ Force Majeure clauses allows for parties to relieve their contractual obligations when an extraordinary event beyond their control occurs
 - Extraordinary event beyond a party's control is defined very narrowly
- ▶ Examples:
 - Natural disasters (fires, earthquakes, floods)
 - War
 - Riots/Rebellion/Revolution
 - Nuclear contamination
 - Labor strikes
 - Terrorism

Force Majeure

- ▶ As force majeure clause allow for the immediate termination of the contract, it will create substantial issues for parties that depend upon that performance

Changing a Contract

- ▶ Contracts contain an amendment clause, which usually allow changes when written, and signed by both parties
- ▶ This can be useful to extend the term of a contract without having to renegotiate a contract, or adjust to market conditions
- ▶ Always consider the benefits and risks of renegotiating a new contract rather than amending a continuing contract, especially if market conditions have changed

Enforcement Provisions

- ▶ Contracts contain a number of provisions to what happens when there is a breach
- ▶ **Governing Law**: Statement that tells Parties which state law applies.
 - The governing law generally has to be in a state that the parties are located or operating within
 - Also, this provision may be overridden by certain laws for public policy purposes (i.e. non-compete agreements)
 - “without regard to its conflict of laws principles” – statement that preempts an argument in court related to conflict of laws theory

Enforcement Provisions

- ▶ **Forum:** A Statement that establishes where Parties may sue related to the contract
 - Like governing law, there has to be a connection to the location where suit may be filed.
 - Be aware of the forum, as you may need to retain counsel outside your usual lawyers for certain forums
- ▶ **Alternative Dispute Resolution:** A statement that limits enforcement to mediation and arbitration by parties.
 - Mediation and arbitration tends to be a more expedited process than a traditional lawsuit
 - These provisions are mandated by federal law to control

Enforcement Provisions

- ▶ **Attorney's Fees and Costs**: A statement that notes that a losing party may incur the costs of a prevailing party
 - This type of provision can be costly to a smaller party depending on the complexity of an issue.

Minor Provisions

- ▶ These provisions are usually standard practice and don't affect the performance of the contract
- ▶ **Notices** – where all notices are to be sent, including notices of default, and other correspondence
- ▶ **“Executed in Counterparts”**: Allows for contract to be executed by multiple signatures not on a single signature page
- ▶ **Severability/Survivability** – If part of a contract is invalid for legal reasons, the rest of the contract may continue to operate

Minor Provisions

- ▶ **Entire Agreement**: Statement indicating that the contract is the complete and total agreement between parties
- ▶ **Signing Authority**: Statement indicating that the person signing the agreement has the actual authority to bind that party to the agreement
- ▶ **Legal Representation**: Statement that all Parties have conferred with legal counsel prior to agreeing and signing agreement

So, Should I Sign?

- ▶ After attempting to negotiate provisions, it's up to each company, along with help from their legal counsel to decide if the benefit of going forward with a contract outweighs the risks.
- ▶ Consider what your goal is to accomplish with the contract, and whether the contract accomplish the goal.

So, Should I Sign?

- ▶ In considering risk, consider the chances of nonperformance, the effects of non-performance on your company and the valuation of a contract
 - No contract is going to be perfect, but if it is good enough, its worth considering.
 - The risk posed in a contract that only has about \$5,000 value may negate the need for substantial negotiations, whereas the risk posed in a contract valued at \$5 million may require substantial more drafting.