

Project Contracts

Prepared by Dr. Merna

PMG323

Lecture 9



Section 2

**DISPUTE RESOLUTION
Commercial**

Lecture 9

Section 1

**AMENDMENTS AND
ADDENDUMS**

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Amendments and addendums are similar types of documents except that the word addendum suggests merely adding new terms and amendment can mean both adding new terms and changing existing ones. Amendments and addendums alike need to be signed by both parties and responsibly filed away.

The term Addendum is sometimes misused as a substitute for “exhibit,” “attachment,” or “schedule.” By way of distinction, unlike an addendum or an amendment, exhibits, attachments and schedules do not need to be signed if they are properly “incorporated by reference” into an executed contract, amendment or addendum.

Changing Circumstances

Contract amendments are very common in business relationships. Sometimes a relationship is going well and the parties want to expand it to cover more products or services. Sometimes the opposite occurs and a party no longer wants to offer a particular product or service and wants it removed from the agreement. Renegotiation of pricing terms is another common driver of amendments and addendums.

Changes can also be requested when a company is sold. An acquirer will often try to renegotiate some of the acquired company's outstanding agreements after the acquisition closes. The acquirer may want to add or drop lines of business, cut back on or eliminate redundant services, or simply conform contract legalese to its own standards.

Addendums

Again, an addendum is a document signed by both parties that adds something to an agreement – hence the first three letters “add.” If an addendum changes anything, it should be pretty discrete. Otherwise, “Amendment” is probably the better document caption.

Addendums are commonly used to:

- establish a new price or fee schedule,
- add a new product or service,
- add a new territory or other license enhancement,
- run a special joint program, like a marketing campaign, or
- impose a new restriction or accommodate a new regulatory requirement.

Amendments - Contract Surgery

Whatever the reasons for a particular amendment or addendum, it is important to approach the task with reasonable care. Parties are often more cautious and deliberate with initial agreements than with subsequent modifications, an understandable but problematic tendency.

Contract amendments are a bit like surgery. Prior to an operation, the surgeon will look at the patient's charts, study their medical history, and talk with other doctors and family caregivers.

Before diving into a contract amendment, due care warrants reading the agreement and any amendments and possibly talking with others who more directly manage the relationship.

Amendments - Contract Surgery

These steps are necessary to understand the current status of the relationship, what is driving the amendment, the details and scope of the amendment, whether the amendment makes business and legal sense, what areas of the existing agreement the amendment impacts, and the key business and drafting issues.

Almost any material amendment to an agreement essentially warrants going through a process that is just as deliberate as the agreement's initial negotiation and drafting, although hopefully on a more accelerated time frame given the narrower issues.

Tactical Considerations

Even where you or the other party may be thinking in terms of fairly narrow or minor changes, consider how those changes relate to the rest of the agreement and relationship, and whether or not other changes should be negotiated while “the patient is open.”

These are tactical considerations that depend on the nature of the relationship, the nature of the proposed changes, the potential value of other possible changes, and the other party’s likely response.

Based on the answers to these questions, a request for an amendment from another party could be an ideal opportunity to fix or clarify terms you are not happy with, or to add terms that were missed or that were previously beyond your negotiating leverage.

Tactical Considerations

On the other hand, where the other party still holds most of the power in the relationship, sometimes the best approach is to agree to only very limited, “surgical” modifications. This is particularly true if other amendment proposals might cause the other party to push for disadvantageous revisions.

Consistency and Good Contract Management

Whatever changes are finally decided upon, they must be compared carefully against the entire original document for consistency. Are the correct defined terms used? Do you want the same or different standards applied to determine the adequacy of some new performance? Should the same penalties or rights of cure and termination apply for poor performance?

Consistency and Good Contract Management

It is also important to keep contracts and related amendments very organized. Amendments should be chronologically numbered in their captions in a manner that makes it easy to establish the order of precedence of the documents.

Too Many Amendments

Sometimes a contract will accumulate two, three, four, or more amendments. This is not necessarily a problem, but the possibility of confusion is worth considering. It is no big deal, for example, if all of the amendments cover similar, narrow pricing adjustments. But sometimes each of several amendments addresses different issues and touches different parts of the original document. Once an agreement has been amended three or four times with documents that each make two or three changes, it can become almost impossible for most readers to comprehend the agreement as an integrated whole.

Too Many Amendments

When substantive amendments are stacked upon multiple other substantive amendments, the resulting cross references can get increasingly difficult to follow. The need to read multiple documents and double check numerous cross references can make it increasingly challenging to harmonize with the original agreement and the other amendments, leading potentially to drafting errors and disputes.

Even without any drafting errors, persons unfamiliar with the history of an agreement and its handful of amendments can struggle to make sense of the tangle of documents. At this point, should you start over with a new, integrated document that harmonizes the original agreement and the amendments? This can take the form of an entirely new agreement or what might be called an “amended and restated agreement.” The term “restated” means all of the agreement's terms are in the new document, which restates or supersedes the original and its amendments.

Too Many Amendments

If the relationship is good and the other party is easy to work with, starting over on a fresh document can be the best approach. If the other party is difficult to work with, the end result might be worse than the risks associated with a confusing patchwork of amendments.

DISPUTE RESOLUTION

DISPUTE RESOLUTION

Commercial disputes are as varied as the companies, individuals, relationships, and subject matter involved in them. Disputes can be petty annoyances or company killers. Some can be handled through diplomatic efforts between CEOs or business owners. Others are sometimes resolved through negotiations following exchanges of demand letters. Those that cannot be resolved informally sometimes wind up in litigation or arbitration.

Experience is the best teacher when it comes to managing and resolving commercial disagreements, so qualified counsel should be consulted soon when troubles loom. Even when counsel is involved, though, non-lawyers familiar with a dispute should help shape and implement strategy.

Dispute Avoidance

Contract disputes can range from a series of difficult phone calls or terse letters to full blown litigation. They arise mostly over performance and payment concerns, but they can also involve issues around third party liability claims, other alleged breaches, and even tort claims outside of contract law.

Disputes are rarely profitable, except for the attorneys who resolve them. And the longer disputes last, the more costly and distracting they become.

Be Right

As emphasized from the first pages of this book, dispute prevention starts at the beginning of any new relationship. Maintain the “moral highground” and the good graces of “the law” by doing things correctly:

- (i) promise only what you can perform,
- (ii) negotiate and draft good agreements,
- and (iii) perform what you promise.

Following this advice prevents disputes and it makes them easier, faster, and less costly to successfully resolve when they cannot be prevented. Short lived disputes arise sometimes even when the facts and law are on your side, but these are usually the briefest of distractions. Nothing takes the fight out of the other side faster than a “you should settle this” reality check from their own lawyers.

Keep Emotions in Check

The facts that give rise to any contract dispute, big or small, can be frustrating and annoying. When you pay for a product or service, you expect to get what you paid for. When you timely provide a good product or service, you expect to get paid.

Commercial disputes test the patience of most otherwise cool-headed individuals. Expressing anger, frustration, and other negative emotions is a logical and even reasonable response, but hostile emotions usually polarize parties, delay resolution, and detract from the end result.

Consequently, and perhaps counterintuitively, the hothead on the team is often not the best person to take the lead in dispute resolution – at least not in the early stages.

Disputes are Just Difficult Negotiations

The emergence of a commercial dispute is a bit like landing on the wrong space in the childrens board game, “Chutes and Ladders.” Land on the wrong space and you slide backwards. When a commercial dispute arises, you go either sideways or backward, in either case, to a new “negotiation” phase of the relationship.

Listen for:

- Clues about what the other side might be willing to trade off.
- Issues they might stick on.
- Carrots you can throw into the deal to get more of what you want.

Yes, even in a dispute, it is helpful for the other side to like you – or at least not hate you. Personality types that cannot easily set aside emotions for tactical purposes are usually ill-suited to dispute resolution.

Initial Assessment

As noted at the outset, every dispute is different, including the players, the issues, the potential financial magnitude, and the range of options for resolution.

The only feature common to most disputes is that the sooner they are over, the better.

Toward that end, it helps right up front to begin objectively and thoughtfully assessing the best path through the issues to the best possible resolution.

Options can include one or more of the following:

- Playing down the issues and letting front line personnel try to work them out.
- Having the parties' respective CEOs negotiate in a series of calls.
- Exchanging demand letters and responses written by and possibly signed by counsel.
- Cooperatively engaging a third party mediator.
- Triggering contractually prescribed arbitration procedures.
- Filing a lawsuit.

Cats in trees

This analogy is instructive for assessing emerging disputes practically and non-emotionally. Here are some facts common to most real life cat-in-a-tree scenarios:

- Cats do not get stuck in high places out of malicious intent, it just happens sometimes.
- Any individuals involved, be they the cat's owners or concerned passers-by, are likely to be agitated and even difficult, including the cat.
- But eventually firefighters arrive.
- They bring no emotions or fears.
- Instead, they bring tools and problem solving skills.

In the end, however scary the situation first looked, the issues are usually straightforward and most cats are retrieved unharmed. Then everyone gets back to business.

Cats in trees

When a commercial dispute arises, see if it can be resolved quickly and informally.

- Do not be angry about the situation.
- Get on the scene quickly.
- Listen and learn.
- Defuse tensions.
- Use the lightest communications possible.
- Look for simple, mutually advantageous solutions.
- Try to resolve the situation quickly and equitably before the “cat” climbs higher in the tree, i.e., before frictions develop into a more fullblown dispute.

Cats in trees

This softer, gentler approach is often ideal where the issues are relatively narrow, their potential impacts not too severe, and possible solutions or workarounds not too costly for either party. Examples might include a deliverable that is missing a minor feature or two, an operational misstep that has a small number of shared customers complaining, or a performance commitment that has been briefly delayed through error or oversight

No matter how ugly a new dispute initially looks or sounds, a low-key, informal approach should always be considered before resorting to unnecessarily formal or hostile communications. Going back to the golf analogy above, it is important to recognize when a dispute can be resolved with a short, easy putt.

Cats in trees

Even in situations where minor performance issues or other minor concerns are worked through by talking instead of exchanging letters or emails, it is probably worthwhile to document the resolution in a slightly more formal communication with the other party.

This serves to (i) create a record to share with the other party if issues arise in the future, (ii) document and define any performance “waiver” or other accommodation for future reference, and (iii) establish one’s “good faith” conduct in the event larger issues arise.

Sand Traps

Occasionally, initial assessments reveal that a dispute probably is not going to be a short, easy putt, but more like a slightly messy shot, or three, from a sand trap – sand will fly, there will be a mess to tidy up, but hopefully the game is still salvageable.

There are often more options to consider in resolving disputes in the middle of the spectrum between easy fixes and low materiality on one end, and difficult fixes and extreme materiality on the other.

Disputes in the middle of the range can still be difficult and potentially costly for both parties, but there may be compelling reasons for not letting the situation deteriorate unnecessarily. These could include absence of viable alternatives to working with the other party, potentially serious impacts on customers or end users, serious regulatory concerns, or uncertainties around how liabilities might shake out in full blown litigation.

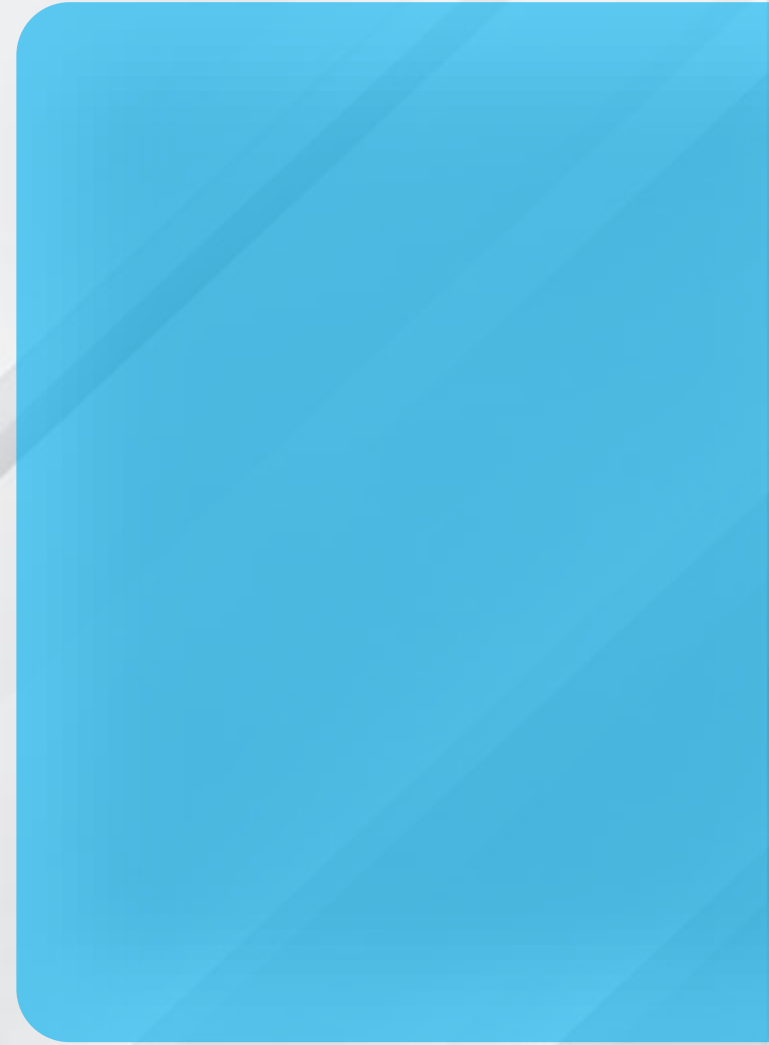
Sending in the CEOs

A tried and true approach to resolving moderately challenging but important commercial disputes is to coordinate talks between high level business principals, preferably the CEOs or owners in the case of two smaller or medium sized companies.

- Using high level principals often works well for a number of key reasons:
- They are unlikely to have been directly involved and can bring fresh attitudes and perspectives.
- Persons with broader responsibilities are more likely to see the bigger picture.
- They are more likely to be seasoned negotiators and deal makers.
- They have the latitude to make and enforce decisions.
- As company leaders, they are likely to take substantial pride in being able to solve problems.

Sending in the CEOs

The only downside to this approach, aside from distracting busy senior officers or business owners, is the possibility that the proposed solution to the dispute will involve completely unexpected concessions and compromises. When you send deal makers into a room, the end result is almost always a deal, and frequently it is a creative deal.



Exchanging Demand and Response Letters

Sometimes it is not practical or advisable to have business principals try to work through a dispute. The other company might be too big, your CEO might be a bad negotiator, or the facts and issues might simply be too complex for anything but a demand letter.

A demand letter is simply a written communication from one party or its counsel to the other party or its counsel that usually

- (i) states the party's concerns, including providing notice of breach, as appropriate,
- (ii) requests specific actions and a written response,
- and (iii) possibly even hints at one or more courses of action that might be taken absent a timely and sufficient response.

Exchanging Demand and Response Letters

The art and science behind a proper and compelling demand letter clearly warrant involving legal counsel, if not to draft the communication, to at least look over your shoulder and watch for potential tactical errors.

Before writing anything, think about the communication's optimal achievable outcome. Then write to achieve that objective and exclude anything that is not necessary or helpful toward achieving the objective, such as any pointless venting.

Even in more serious situations, communications that are prematurely combative can harden positions and, more importantly, cause the other party to rush to the courthouse. Inadvertently prompting the other party to file a preemptive lawsuit or initiate an arbitration deprives you of the substantial tactical advantages of choosing the time and place for doing so.

Exchanging Demand and Response Letters

While some attorneys recommend a more stern approach to demand letters, the author prefers what one might call “diplomatic corporate-speak” - language that is serious and clear, but also relatively dry and non-hostile. Non-threatening corporate-speak for this style of correspondence might include words and phrases like “concerned,” “disappointed,” “unfortunate,” “unacceptable,” “harmful,” “causing substantial damage,” “considering our options,” and other somewhat benign language that is clear and firm, but not judgmental or overtly threatening.

A demand letter will usually either elicit a formal written response or a request for talks. Any request for talks should be accepted and should be taken seriously as an opportunity to resolve the dispute before more expensive and more risky formal dispute resolution processes become unavoidable.

Mediation

In cases where demand letters and responses have been exchanged and the parties still are not making progress toward a mutually acceptable resolution, many attorneys and *alternative dispute resolution* advocates would suggest mediation. Mediation simply means paying a third party to play an objective and neutral role to guide the parties toward a mutually acceptable resolution.

Unlike a judge or arbitrator, they seem uninclined to bring their special knowledge or even informed opinions or judgements into the process. Instead, a common approach seems to be simply repeating back to each party the other party's positions, without helping the parties weigh or evaluate the positions.

Mediation

This approach is more geared toward getting the parties to “split the difference,” regardless of the true equities of the dispute. This is fine in cases where both parties’ positions have merit, but it is potentially less useful to a party with a strong case and substantial damages.

Professional mediators would no doubt take exception to the above generalizations, perhaps rightly so. But these are legitimate issues to consider and ask questions about when considering mediation or a particular mediator. When interviewing a mediator, consider asking how he or she deals with situations when the facts and law clearly favor one party’s position – is he or she willing to point that out to the other party and, if so, how firmly?

Code Red – Zero Sum Disputes

At the more extreme end of the spectrum are the riskiest and potentially most costly disputes. These sometimes involve what might be called a “zero sum game.” In a zero sum game, mutually advantageous solutions are less likely because one party’s potential wins usually correspond to direct potential losses for the other party.

The following are examples of more serious disputes where one or both parties face material risks of financial damages, losses, and other harms:

- A party rejects the performance of the other and refuses to pay.
- A party’s performance has clearly fallen short of expectations but that party says the performance was good and insists on being paid.
- A party falsely claims breach by the other and tries to improperly terminate an agreement against the other party’s protests.

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The following are examples of more serious disputes where one or both parties face material risks of financial damages, losses, and other harms:

- A party falsely claims force majeure and stops performing.
- An expensive data breach occurs and both parties blame each other.
- A consumer product is the subject of a governmental recall order and each party blames the other for the defect.

Code Red – Zero Sum Disputes

As a cautionary “heads up,” disputes like these frequently trigger requirements to notify insurance carriers, especially the last two bullets above. Failure to provide timely notice of potential claims against an insurance policy can result in complete or partial disallowance of the insurance coverage. When major disputes arise, insurance notice obligations and other insurance issues should be top of mind, including the possibility of nudging the other side to notify its carrier where appropriate, or even providing direct notice under an “additional insured” rider.

Get the Facts

The first step in any potentially serious dispute is to gather all of the facts, including all documentation and records. Understanding the facts from both parties' perspectives helps reveal any potential options for compromise and how to pursue them.

Collect and Protect Records

Warning: all records gathered, including emails, meeting notes, and other written communications, will be subject to discovery by the other side in any litigation. They and all other potentially relevant records must be protected from destruction if litigation is likely. Knowingly or negligently destroying records during or prior to litigation is a terrible mistake with potentially severe penalties.

Collect and Protect Records

In-house law departments protect potentially important litigation records through what is often called a “records hold” process, including internal communications that describe the records to be exempted from routine records destruction processes and how they are to be handled until further notice.

Discovery Issues and the Attorney-Client Privilege

While investigating any dispute, be cautious about creating new records, particularly timelines, notes or journals, fact summaries, summaries of conversations, investigative reports, or electronic communications of any kind. All documents not created by an attorney are discoverable in litigation.

Discovery Issues and the Attorney-Client Privilege

Letting an attorney create all new documents, on the other hand, helps keep them out of opposing parties' hands via the Attorney-Client Privilege and the Attorney Work Product Doctrine. Hopefully it goes without saying that inadvertently sharing key information about your case with the other side can be harmful in litigation.

Anytime potential disputes arise, team members should be strongly cautioned against making written statements of any kind reflecting judgments, legal conclusions or improper motivations regarding the facts or issues. Opposing counsel have wide latitude under litigation discovery rules to search through all available physical and electronic records. Loose statements that can be taken out of context or otherwise turned against their creators are always prized targets of such searches.

Use of Counsel

In dealing with situations that are more likely to end up in litigation, arbitration or other formal dispute resolution processes, consulting with counsel before proceeding further is highly advisable. But exactly *how* to use counsel is a different tactical question.

Early in a dispute, counsel can help make sense of the facts, compare them to the terms of the agreement, and objectively assess the strengths and weaknesses of the parties' positions. But when and how to involve counsel in communications with the other party is a trickier tactical question.

Keep the Lawyers behind the Scenes as Long as Possible

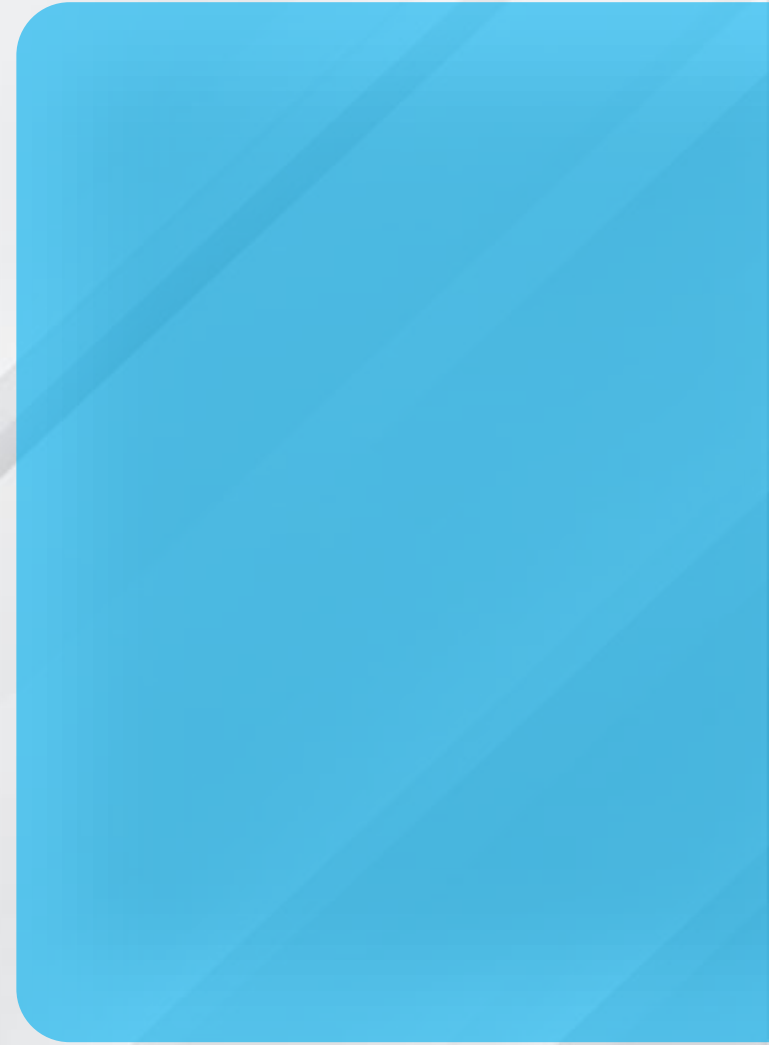
When one side gets lawyers involved, the other side will almost certainly do the same. In fact, attorneys are prohibited from “communicating with parties known to be represented” by other counsel, so it is often impossible to involve lawyers in formal communications without automatically triggering the involvement of the other side’s counsel, particularly where two larger companies are involved.

Importantly, although you get to select your own counsel, you do not get to select opposing counsel. If less-experienced or combative counsel become involved, options for a reasonable resolution can be materially limited.

Keep the Lawyers behind the Scenes as Long as Possible

For these reasons, the author's preferred approach in many situations is to stay behind the scenes initially, help frame the issues and guide the strategy, but allow the principals to talk directly to explore potential solutions.

That does not mean written communications are not also important for providing notice of breach, responding to the same, or otherwise protecting one's interests, but they should not be written in a manner that precludes more informal communications between the parties' business principals.



Suit for Breach, Declaratory Judgment Action

Few commercial disputes are worth litigating. But when litigation is one of the last tools left in the box, an unexpected law suit can be surprisingly effective at driving a positive outcome. The following “declaratory judgment” litigation strategy works best when several facts are present:

- The agreement requires or allows venue and jurisdiction in your town.
- The facts, the agreement, and the law are on your side.
- You have good litigation counsel.
- The agreement contains a “prevailing party” clause for attorneys’ fees.
- Ideally, the other party is in a different city and state.

What is a DJ Action?

When the above factors are aligned, hitting the other party with an unexpected declaratory judgment action is sometimes all that is needed to bring them to the settlement table. A declaratory judgment action, or “DJ action,” is a lawsuit that can be filed after one or both parties have begun “saber rattling” by sending notices of breach, demand letters or other communications evidencing a dispute.

In a DJ action, the plaintiff who files the suit will describe the dispute, including any unsuccessful efforts to resolve it, and request that the court issue a judgement “declaring the rights and obligations” of the parties and awarding appropriate damages. Contract disputes make up a meaningful percentage of DJ actions filed.

Courtesy Copy Prior to Filing

One element of the author's preferred strategy in using DJ actions involves sharing the draft lawsuit with the other side just hours before filing it. Again, this strategy is particularly effective when you can claim a hometown jurisdiction advantage by filing first, the facts and law are on your side, and you have a good litigator behind you.

This aggressive but often successful strategy usually plays out along these lines:

- Demand letters have been sent to or received from the other side of a contract dispute or other matter.
- Meaningful efforts to resolve the dispute have been made and documented.
- A draft "Complaint for Declaratory Judgment" is prepared, often also including specific claims for damages for breach of contract, claims for attorneys' fees and other costs, and any other applicable claims.
- Beyond the typical litigation legalese, the draft complaint will detail all of the facts warranting relief, no matter how unflattering to the other side.
- On the morning that the complaint is to be filed in the local courthouse, a "courtesy copy" is sent electronically to counsel for the other side, with a note that the complaint is being filed in the coming hours and including an offer to discuss.
- Opposing counsel often calls within the hour.

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There are multiple aspects of this strategy that help to drive quick and favorable outcomes.

- It puts the other side and its counsel in a very time sensitive situation, with imperfect information and the threat of an imminent tactical setback.
- Although nobody likes to be caught off guard and forced to make important decisions quickly, counsel is left with little choice but to call.
- Sending the courtesy copy just hours from filing ensures that the other side will not be able to file a competing complaint first in another jurisdiction, but it does give the other party a brief window to prevent the filing by resolving the dispute.

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There are multiple aspects of this strategy that help to drive quick and favorable outcomes.

- One of the incentives for not letting the suit actually be filed is the possibility that it will be seen and read by others, potentially harming the potential defendant's reputation as a commercial partner or competitor in the particular industry or sector.
- By selecting the venue and jurisdiction most convenient and least expensive for itself and gaining the upper hand in "telling the story" to a court, the party threatening the DJ action is generally in firm command of the tactical high ground, at least for the time being.
- The other side's motivation for a quick resolution will be all the greater if the agreement includes a "prevailing party" clause and it has the weaker of the two positions.

Courtesy Copy Prior to Filing

Once a courtesy copy of a well-drafted complaint has been received by opposing counsel, it usually is not long before requests to talk are received. If the parties can be brought together the same morning to try to resolve the dispute, the dispute can often be wrapped up the same day or within days.

Sometimes the other party's principals will be unavailable to weigh in on the emergency settlement talks and opposing counsel will ask for a delay in the lawsuit's filing. This can be agreed to, but only if the other party agrees in writing in a formal "standstill" agreement to not file its own lawsuit first.

In the event a standstill cannot be negotiated, the better approach is often to file the suit, while agreeing to *hold off on serving the complaint* for a few days while the parties negotiate. Although the lawsuit will still become a matter of public record, not formally serving the complaint gives the other party additional time to respond by not starting the 20 or 30 day clock for filing an answer.



Thank You