

Project Contracts

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PMG323

Lecture 3



Chapter

01

Common Mistakes



While understanding contract law is certainly helpful in drafting and negotiating contracts, the most common and costly mistakes tend to involve simple errors in due diligence, judgment and drafting, and giving up too easily on important issues. The following mistakes are common sources of commercial disputes. Avoid them to prevent costly litigation, missed opportunities and wasted resources.

Performance before agreement

Whether based on mutually euphoric “good faith” or naive reliance on an LOI, one of the worst mistakes is having one or both parties begin performance before a final agreement is in place. Those who do this often see themselves as entrepreneurial risk takers.

The predictably bad outcomes often make such decisions seem impulsive and undisciplined in hindsight.

Performance before agreement

Here are some of the justifications you might use yourself or hear from others when pre-agreement performance is happening or being considered:

“The parties trust each other enough to move forward in good faith; the contract will come together in due time.”

“We’ll keep working on the contract, but the work has to start now to meet the project deadline.”

Performance before agreement

Here are some of the justifications you might use yourself or hear from others when pre-agreement performance is happening or being considered:

“The other party is a business partner, not a vendor. I’m not worried about the contract.” “Concern over the contract will show lack of trust and jeopardize the relationship.”

“An LOI will give us an opportunity to see how the other party performs before we sign.” “We’ll get a better deal once the other side feels committed.”

Performance before agreement

Starting performance prior to having an agreement often takes organizations backward from where they started, or at least sideways. This is because, by the time the mistake is realized, the organization may have to first dig out of a mess before it can start over.

Walking away from a failed relationship might involve more than just walking away from already incurred sunken costs and critically delayed opportunities - the other party may also have valid claims for additional compensation. Additionally, rights to any jointly created intellectual property may need to be sorted out between the parties, through amicable means or otherwise.

Performance before agreement

Managing Impatience



Impatience is the most common factor in proceeding without a final agreement. The decision to charge ahead before an agreement is in place often comes under tight deadlines, and sometimes when a difficult issue or two remain unresolved after two or more turns of a draft agreement.

Eventually, though, these very issues may bring about the relationship's undoing. Putting off difficult issues does not make them easier to resolve. Often, in fact, the opposite will be true. Once the relationship has started, the other party may have less incentive to compromise, particularly if you have already written checks or performed your part.

Performance before agreement

Managing Impatience

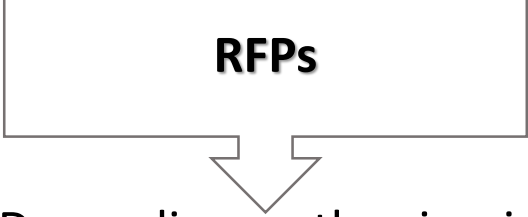


Prevent impatience from impacting contract negotiations in the first place by accepting and embracing the fact that it is quite common for sophisticated parties to exchange multiple drafts of important documents as they reach compromises and narrow their differences.

Eventually, though, these very issues may bring about the relationship's undoing. Putting off difficult issues does not make them easier to resolve. Often, in fact, the opposite will be true. Once the relationship has started, the other party may have less incentive to compromise, particularly if you have already written checks or performed your part.

Failing to shop and compare

RFPs

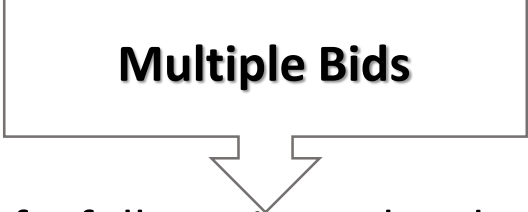


Depending on the size, importance and complexity of an expected relationship, it is generally wise to look at more than one option before entering into serious negotiations. At the conservative end of the spectrum, significant relationships are often preceded by a “Request for Proposals” or “RFP.”

This is a document sent to prospective providers of a needed good or service that describes in detail the requested good or service, specifying exactly how interested parties are to respond and by when.

Failing to shop and compare

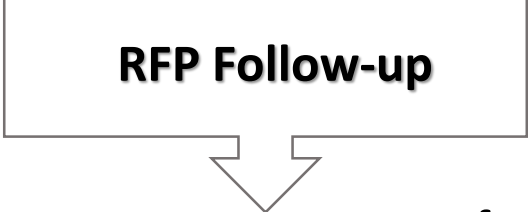
Multiple Bids



If a full RFP is too burdensome, it is still wise to follow the traditional rule of getting two or three bids for any commercial procurement of goods or services. At a minimum, going through either process will help an organization assess its objectives and expectations and prepare it for incorporating those in a final agreement.

Failing to shop and compare

RFP Follow-up



Answers to RFPs are often carefully written. They should be carefully studied and follow-up information should be requested where answers seem incomplete, evasive or otherwise miss the mark. Depending on the nature of the proposed arrangement and your level of certainty or uncertainty about the abilities, facilities and reputation of the parties involved, you may want to perform additional due diligence by visiting and inspecting facilities, talking with customer and creditor references, and pulling reports on financial condition, judgments and the like.

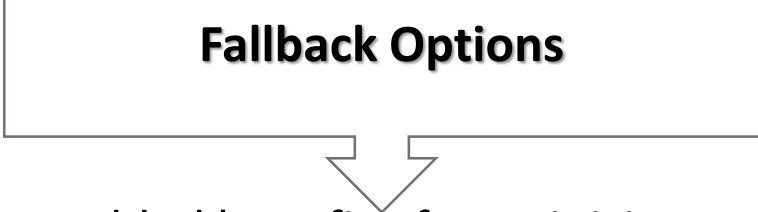
Failing to shop and compare

Incorporate RFP into Final Agreement

Lastly, consider adding a party's finalized RFP response as an exhibit to any agreement entered into with them, along with language in the agreement making the RFP response part of the agreement.

Failing to shop and compare

Fallback Options



An added benefit of scrutinizing and engaging with more than one prospect is that, if contract negotiations do not go well, you may have a viable fallback option. Even if you do not resort to that option, the knowledge that you have an option will make you a better negotiator.

Inadequate Descriptions of Performance Obligations

Detailed Performance Obligations



Performance shortcomings are surprisingly common in business. Sellers of goods and services can disappoint for any number of reasons, including over-promising, corner-cutting, staffing problems, phasing out a product line or service, selling a product line or service to another company, and simple incompetence or lack of diligence.

As a result, performance concerns are possibly the top source of commercial disputes. Every contract should clearly and completely describe each party's performance obligations.

Inadequate Descriptions of Performance Obligations

Detailed Performance Obligations



These descriptions should include all of the details that the parties have discussed, and particularly all of the representations the other party has made, either directly or indirectly through representations of their staff members or through their advertising or marketing materials.

As noted above, if the other party provided a written RFP response, consider attaching it to the agreement if it contains the best description of the other party's obligations and possibly also specific representations and warranties.

Inadequate Descriptions of Performance Obligations

Get in writing



It is much easier to make another party perform as you expect if those expectations have been clearly written into the contract. In the end, it does not matter what the sales or “business development” person told you if it is not in the agreement. As discussed in Chapter Five, Common Contract Terms, most contracts contain a clause captioned along the lines of Entire Agreement that specifically disclaims the enforceability of any written or oral promises or representations made but not incorporated into the agreement.

In the face of resistance to detailing performance obligations, sometimes it helps to tell the sales person or other negotiator that, while you believe and trust them, others in their organization and in your organization will also be required to understand and administer the agreement in the future, so the details need to be in writing.

Inadequate Descriptions of Performance Obligations

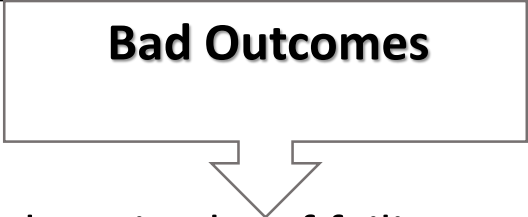
Aversion to Detail is a Red Flag



Another party's refusal to add detailed performance obligations to an agreement is always a red flag. Take it as a clue that the other party does not intend to perform as you are hoping or expecting. Rarely does a party's performance exceed their written commitments. Many get burned by assuming others will perform at a high level for reputational reasons. Reputational concerns, unfortunately, are not always the driving force one would expect.

Inadequate Descriptions of Performance Obligations

Bad Outcomes



The mistake of failing to detail performance obligations causes some of the worst contractual nightmares. If proper performance is not clearly defined, poor performance likely will not constitute a breach of the agreement, making remedies such as offsets, price reductions or termination unavailable. Paying full price for the wrong product or service is a bad outcome. If the agreement is for an extended term, the only recourse may be to negotiate a large termination fee just so you can walk away and pay a new provider all over.

Weak or Nonexistent Remedies

As noted above, poorly drafted performance obligations are possibly the top source of commercial disputes; weak or non existent remedies could be a close second.

Unlike some areas of contract negotiation, Remedies is a difficult topic to reduce to simple, actionable pearls of wisdom. As noted above, there are many types of remedies; there are also an infinite number of ways to draft them, disclaim them, and limit them. And while the law generously provides for all kinds of damages for contract breaches, the almost universal tendency of sellers is to vigorously resist detailed remedies provisions and to disclaim and limit liabilities.

Weak or Nonexistent Remedies

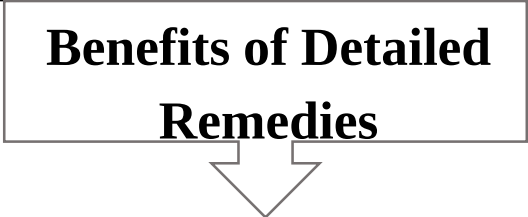
The typical seller negotiating position is essentially, “Why should we agree to damages that could greatly exceed the value of the agreement?”

Such sellers are often unmoved by typical buyers’ responses such as, “If the losses were foreseeable and you caused them, why not?” Well-coached sellers often come back with comments like, “We simply cannot agree to unknown and potentially ruinous liabilities; we cannot be your insurer.”

The correct response to this type of rebuttal is often “Maybe not, but your insurer can and should be our insurer for any liabilities caused by your performance.”

Weak or Nonexistent Remedies

Benefits of Detailed Remedies



Despite these negotiating and drafting challenges, it is a mistake to give up too quickly. Pushing sellers for the right remedies is worth the effort and the inevitable friction.

Even though the law theoretically provides damages for breach whether specifically agreed to or not, contractual breach remedies can make the difference between success or failure in a commercial relationship.

Weak or Nonexistent Remedies

Benefits of Detailed Remedies



Contracts with clear and meaningful remedies provide (i) incentives for better performance, (ii) leverage for forcing faster performance corrections, and (iii) greater certainty regarding the outcome of potential litigation or other dispute resolution processes, all of which reduce the likelihood of disputes in the first place.

Poor Vetting of Vendors, Suppliers and Others

Selecting companies and persons to do business with requires good judgment. A tightly drafted contract does not provide absolute protection from business, legal, financial, regulatory, or third-party liability risk.

Contractual protections from such risks usually depend on the strength and solvency of the other party and, less frequently, any available insurance.

Consequently, success in forming business relationships requires great care. Be on guard to identify and avoid con artists, blustering sales persons, and others who may mean well, but who simply lack the integrity or intellectual capacity to avoid making promises they cannot honor.

Poor Vetting of Vendors, Suppliers and Others

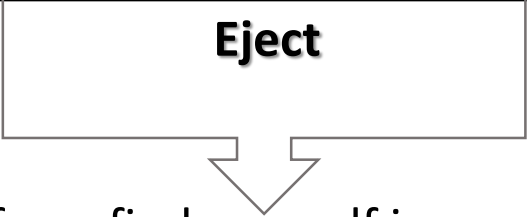
Clues

Whatever the titles of the individual or individuals with whom you are dealing – CEO, founder, head of business development - there are certain signs of trouble that should not be ignored.

Too slick or too friendly? Disinterested in details?
 Pressure to sign quickly and/or pay up front?
 Unwilling to put promises made orally in writing?
 Trust your eyes, your ears, your brain, and your gut.

Poor Vetting of Vendors, Suppliers and Others

Eject



If you find yourself in a relationship with a con artist or over promising incompetent, promptly exercise any and all available remedies and rights of termination under your contract.

Do not get further duped or guilted into “working through the problems.” Doing so could limit or eliminate what remedies remain by creating issues of waiver, modification, detrimental reliance or “quantum meruit.”

Blindly Accepting “Standard Contracts”

Unless you are looking at a “click-wrap” software agreement or the standard terms and conditions for a credit card, always assume that you can propose edits! When necessary, insist on doing so. Unfortunately too many non-lawyers give up very easily in the face of resistance over making changes to “form” or “standard” agreements.

Reputable companies that are serious about providing value and growing their businesses often have acceptable standard agreements. You might need to strike the clause subjecting you to the courts and boost the remedies section a bit, but that may be all. Other times, substantial revisions are required. You may need to get past the other party’s insistence that the standard agreement is not negotiable.

Duration Too Long or Too Short

Do not make the mistake of accepting the first “term” or “termination date” drafted into an agreement dictating its duration.

Contracts can often be for as long or as short as you need them to be. If you have doubts about a person or company, set up an agreement as a 90 day test with an option to extend.

Duration Too Long or Too Short

But keep in mind the increasing pace of change when signing contracts for longer than one year, particularly contracts that involve technologies, goods or services that may soon be obsolete or a lot cheaper.

One year contracts that renew annually if neither party opts out with proper notice work well for many types of relationships, provided it is okay if both parties have the ability to terminate each year rather than renew.

Always make sure processes and systems are in place to allow for timely evaluation of contracts with upcoming automatic renewal notice deadlines.

Poor Document Change Tracking and Proofing

A negotiator must keep track of what is agreed to in negotiations and the responsive changes that have been made in the draft document. When the other side sends a new “mark up” of an agreement, always carefully check their revisions against what has been agreed to.

Sometimes revised documents resemble the discussions, and sometimes they do not.

Problems can often be attributed simply to bad drafting – not everyone is equally talented at capturing oral points of agreement in clear, accurate text. But if you sign a document and later find out it does not say what you thought it said, you are out of luck.

Although some courts might refuse to enforce changes furtively slipped into a document by the other side at the last minute, obtaining such vindication through the courts is uncertain and costly.

Chapter

01

Negotiating



Negotiating training

Although careful drafting is important, key ground is often won or lost in discussions before and during drafting. The same skills used by poker players and savvy car buyers also work well in business negotiations.

Almost anyone can learn the basics of effective negotiation. A great way for anyone to improve their negotiating skills is to attend a reputable negotiation strategy seminar.

These tend to focus on:

how to plan and prepare for negotiations by deciding what you want to achieve, knowing your priorities, and knowing your alternatives, particularly your “BATNA,” or “best alternative to a negotiated agreement;

Negotiating training

These tend to focus on:

- how to assess the other party's position – their strengths, weaknesses, priorities and alternatives;
- how to test and validate your assumptions about the other party's position;
- how to frame the other party's perception of issues in order to find areas for compromise; and
- how to identify issues where both parties can trade off.

Negotiating training

If you negotiate on a team of two or more, try to make sure less experienced team members receive training also, since success or failure is often determined by a negotiating team's weakest link.

Once your less skilled colleague reveals your lack of viable alternatives, the importance of specific issues, your real or imagined timing constraints, or other weaknesses in your position, it is very difficult to re-set the talks.

The other side naturally becomes more aggressive and inflexible. Good negotiation training can prevent rookie mistakes from ruining deals and careers.

Demeanor and Attitude

Just like in poker and car buying, your demeanor, character and attitude all impact contract negotiations. In every negotiation, you should be professional, courteous and reasonable. In most cases, you will get more of what you want if the other party likes and respects you. It is often not helpful, however, to be overly chatty in trying to win the friendship of the other side.

Whether they realize it or not, chatty negotiators come across as weak and often provide important clues to the other side. It is best to watch what you say without seeming aloof or arrogant.

Body language

Negotiate in a consistently thoughtful, emotionally neutral, and confident manner to avoid tipping your hand on issues of importance or weaknesses in your position.

Approach every negotiation with a positive attitude, but with the mindset that you can walk away if necessary. This almost always results in a better business deal than being emotionally predisposed to getting a deal at all cost. The more eager or desperate party almost always ends up conceding more and getting less than the party willing to “think about” the issues for a day or two.

Body language

Whether we realize it or not, how we feel is often telegraphed to the other side through our expressions, words and body language. Fidgeting, hand-clasping, leg bouncing, heel or toe tapping and face touching all signal nervousness that the other side can use to its advantage.

To project confidence and trustworthiness, relax, smile, maintain eye contact, keep your feet planted on the ground, keep your hands relatively still, lean in a bit, maintain an open posture, and speak in a pleasant, non-confrontational manner.

Get the other side talking

The most productive way to avoid chatting too much to your own detriment in a negotiation is to get the other side talking and listen attentively. As we know, people love to talk about themselves and what is important to them. The more you let someone talk in a negotiation, the more they will probably like you and trust you, and the more you will learn about negotiating with them.

Prepare by researching the other side and thinking about your questions to them in advance.

Get the other side talking

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.

Be prepared for the possibility that the other side is less concerned about the details of the specific deal in front of you and more focused on getting additional or different business from you down the road, or even just referrals to others for similar business.

Assume nothing. You will almost always learn more from listening carefully than from talking too much about your own concerns or views.

Negotiating chips

It is usually helpful to raise at least one or two issues or concerns that are secretly of lower importance than others. These can be thought of as negotiating chips to be given up strategically if necessary, while holding firm on issues of greater importance.

Do not risk your credibility by lying about how important these peripheral issues might be, but touch on them and keep them on the list until it is useful to trade them for other concessions.

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Negotiating chips

Do not risk your credibility by lying about how important these peripheral issues might be, but touch on them and keep them on the list until it is useful to trade them for other concessions.

If, for example, timing of performance is less important to you than price, hold the line on price but eventually offer some timing flexibility if that is important to the other side.

Negotiating chips

Do Not Negotiate Against Yourself

“Negotiating against yourself” involves offering concessions in exchange for nothing. It is the opposite of effective negotiation, and it can take on several forms and occur at different points in a negotiation.

Perhaps most commonly it involves offering a price for your goods or services and then offering a lower price before a counter offer has been received. Another common example involves over-anticipating the other party’s concerns or positions and offering concessions before they are requested.

Negotiating chips

Do Not Negotiate Against Yourself

Interestingly, those prone to this negotiating error often do so later in talks after winning key points by throwing in unnecessary and unrequested concessions, usually with some vague expectation of increased good will.

Once terms have been agreed upon, the best approach is simply to say something like – “This all sounds good. We will incorporate the points we have agreed upon and circulate another draft of the agreement.”

Conflicts of Interests

Some companies and other organizations set themselves up for bad deals by having persons with financial incentives that are tied to signing “deals” negotiate those deals on their own. It is great to be on the other side of such situations, like when a business development person needs to meet a year-end quota or bonus goal. The conflicted sales person will concede almost any point you raise. When a member of your own team tips their hand about needing the deal, it is hard to undo the damage.

Because of this common compensation dynamic, it usually makes business sense to negotiate important agreements in “good cop – bad cop” teams – i.e., the friendly “let’s get the deal done” business person and a manager, controller, CFO, or in-house counsel who takes the blame for sticking on important financial or technical issues. Once the deal is done, the friendlier negotiators can take the lead in mending fences if necessary.

Protection of Confidential Information

Before any negotiation or pre-negotiation discussions begin, you must decide whether or not to require the other party to sign a “non-disclosure agreement,” or “NDA,” to protect trade secrets, business opportunities, and other confidential information from improper use or sharing with third parties.

In reviewing or drafting an NDA, it is important to confirm several key points:

The description of what constitutes “Confidential Information” is broad enough and specific enough to protect what is important.

The duration of the protection is sufficiently long, particularly for trade secrets.

The exceptions to non-use and non-disclosure do not provide opportunities for abuse or inadequate protection.

Protection of Confidential Information

As a general rule, if you are providing any sensitive information to the other party, you should require the other party to sign a reasonably restrictive NDA before exchanging any information.

In addition to other concerns regarding protecting business plans and other intellectual property, important state and federal legal protections for trade secrets are lost unless reasonable measures are taken to ensure their confidentiality, including through the consistent use of NDAs.

Protection of Confidential Information

NDA Hazards

Enforcing NDA obligations requires costly litigation and there is no guarantee you will ever even know about any abuse of your confidential information before it is too late to prevent harm. Consequently, resist the temptation to over-share confidential information even when an NDA has been signed.

Additionally, more challenging questions can arise when you are negotiating with a third party that might be a direct or indirect competitor. A designer or manufacturer that works with your direct competitors is one example of an indirect competitor.

Protection of Confidential Information

NDA Hazards

In such cases, consider the possibility that an NDA might be wrongfully or unreasonably asserted later to stop you from pursuing a pre-existing plan or to challenge you for an alleged unpermitted disclosure.

As an example, say your company is planning to design and offer a new product and, by coincidence, you meet with a design firm or manufacturer in your industry that might be able to help. You meet, see some designs, but decide not to work with them. If you signed an NDA, when you subsequently launch your own product, that firm might incorrectly assert that you violated the NDA by using confidential information they shared with you.

Protection of Confidential Information

NDA Hazards

This risk is tricky and probably warrants consultation with counsel. Strategies for mitigating the risk include:

- (i) refusing to sign the NDA due to the possibility that both parties may be working on potentially competing products or services, or
- (ii) more commonly, stating explicitly in the NDA that neither party will be precluded from the future development of any products or services currently in design or development, whether or not it learns about similar plans from the other party.

Get Technical Documents and Specifications Early

If negotiations are likely to lead to a deal, start the agreement drafting and review process as soon as reasonably practical. A timely and disciplined approach to deal documentation gets the fullest possible range of issues and information on the table before time is wasted on a potentially bad deal or unsuitable partner.

Negotiations that drag out with little urgency around a written agreement can lead to the untimely discovery of deal-stopping issues once agreement drafts finally circulate.

This means pushing for the creation of any technical exhibits, schedules, specifications, or similar documents necessary to document a deal, but only if it also makes sense to do so from the perspective of protecting confidential information, as discussed above.



Thank You