

WELCOME

Lecture Five

Introduction

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**COMMON
CONTRACT TERMS**

Lecture Five



Introduction

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Although every contract is unique, most are likely to contain similar looking headings and address many similar rights and obligations, depending on the type of agreement, the subject matter, and the industry.

Below are some common heading and sub-heading variations that can be used as a high level “contract checklist” when reviewing another party’s proposed agreement or creating your own.

Facts and Circumstances

The objective in this chapter is to highlight common contract provisions and some of the key issues to consider when reviewing or negotiating them.

This discussion is not exhaustive. Every industry and contract type has its own unique issues that the reader can best learn about by studying similar agreements and consulting with counsel.

Facts and Circumstances

Further, the sample contract language chosen throughout this chapter should not be considered optimized for all purposes, nor should it be considered or relied upon as legal advice. In fact, the sample language shown is often more basic and even-handed than language one might expect to see from sophisticated parties with superior negotiating leverage.

Headings and Sections

Not every contract has to include all of the headings shown below or the content associated with them, as discussed below. Sometimes, for example, multiple items are lumped into a single section near the end of an agreement captioned “General” or “Miscellaneous.”

Other times, contracts are intentionally silent on one or more issues, such as remedies. As will be discussed in this chapter, tactical omission sometimes makes sense if the other party is likely to insist on very unfavorable language if an issue is called to their attention.

Long versus Short Contracts

In general, less significant or less risky contracts can be shorter, less detailed and even less protective. This is something lawyers, themselves, often fail to appreciate.

“Over-lawyering” agreements by trying to make them overly protective for one party often provokes aggressive drafting responses from the other party or from their counsel. “Drafting wars” between attorneys being paid “by the word” can add unnecessary expenses and delays without producing a better deal.

Long versus Short Contracts

Over-lawyering a deal or document can also lead to deal failure. The author has cut short negotiations several times where it was clear that the other side's lawyer was too focused on obsessive-compulsive drafting and insufficiently focused on getting a deal done.

Do Not Let the Perfect be the Death of the Good

Lawyers and non-lawyers alike need to remember to not let the perfect be the death of the good when it comes to commercial transactions and other types of deals. While drafting compromises can increase business and financial risks that need to be weighed, the inability to efficiently make deals and conduct business, itself, creates very real business and financial risks in the form of lost opportunities. Success in business often requires being nimble and somewhat risk tolerant.

Do Not Let the Perfect be the Death of the Good

From a seller's perspective, for example, it is worth considering whether a template agreement that is long or one-sided might unduly hinder new business. A simpler template that produces substantially more revenue may work out better in the long run, even if the likelihood and potential severity of disputes is somewhat greater.

The author generally favors this approach, in the belief that rapid business growth means greater profitability and financial resources that will more than offset, and even help pay for, most risks that might arise from somewhat even-handed contractual terms.

Lecture Five



Common Terms

COMMON TERMS

Title/Caption

The first element of most contracts is its title or caption. Some are short, like “Licensing Agreement” or “Joint Marketing Agreement,” and others provide additional information, like the parties and the effective date -

“Raw Log Supply Agreement between Big Tree Timber and Straight Board Lumber, Dated December 7, 2017.”

Common terms

Title/Caption

For administrative reasons, it is helpful to use titles that accurately describe the type of relationship involved. Consistent use of titles helps keep things organized by making contracts easier to file and retrieve.

“Raw Log Supply Agreement between Big Tree Timber and Straight Board Lumber, Dated December 7, 2017.”

Opening Paragraph/Recitals/Background

Just below the title, most contracts contain an introductory paragraph identifying the parties, their respective addresses, entity types, states of incorporation, and sometimes the agreement's "Effective Date." Here is a typical opening paragraph:

This Purchase and Supply Agreement ("Agreement"), dated January 27, 2017 (the "Effective Date"), is made between Washington Driftwood Art, Inc. ("Driftwood Art"), incorporated in the state of Washington, and headquartered at 805 State Route 109, Moclips, WA, 98562, and Googly Eyes, Inc. ("Googly Eyes"), incorporated in the state of New Jersey, and headquartered at 101 Industrial Way, Benson, New Jersey, 87625.

Opening Paragraph/Recitals/Background

Stating an agreement's effective date in the opening paragraph seems more logical and convenient than burying it in the body of the agreement under "Term" or "Definitions," as some drafters prefer.

This Purchase and Supply Agreement ("Agreement"), dated January 27, 2017 (the "Effective Date"), is made between Washington Driftwood Art, Inc. ("Driftwood Art"), incorporated in the state of Washington, and headquartered at 805 State Route 109, Moclips, WA, 98562, and Googly Eyes, Inc. ("Googly Eyes"), incorporated in the state of New Jersey, and headquartered at 101 Industrial Way, Benson, New Jersey, 87625.

Recitals or “Whereas” Clauses

Although contracts often omit the caption “Recitals,” many still include one or more paragraphs near the beginning that start with the word “Whereas.” Recitals or whereas clauses often serve to briefly describe each party’s business and the parties’ objectives or intentions for entering into the business relationship.

WHEREAS, BuyFromMe.com (“BuyFromMe”) operates and maintains a web site, located at www.buyfromme.com (the “BuyFromMe Website”), through which it offers online retail marketing and sales fulfillment of consumer products;

Recitals or “Whereas” Clauses

WHEREAS, BuyFromMe.com (“BuyFromMe”) operates and maintains a web site, located at www.buyfromme.com (the “BuyFromMe Website”), through which it offers online retail marketing and sales fulfillment of consumer products;

WHEREAS, Magic Hairbrush Co. (“Magic Hairbrush”) is a manufacturer of popular, sparkly hairbrushes that wishes to establish a means of online distribution in the United States; and WHEREAS the Parties wish to advertise and sell Magic Hairbrush Co.’s line of sparkly hairbrushes to customers who visit the BuyFromMe Website;

Recitals or “Whereas” Clauses

WHEREAS, BuyFromMe.com (“BuyFromMe”) operates and maintains a web site, located at www.buyfromme.com (the “BuyFromMe Website”), through which it offers online retail marketing and sales fulfillment of consumer products;

WHEREAS, Magic Hairbrush Co. (“Magic Hairbrush”) is a manufacturer of popular, sparkly hairbrushes that wishes to establish a means of online distribution in the United States; and WHEREAS the Parties wish to advertise and sell Magic Hairbrush Co.’s line of sparkly hairbrushes to customers who visit the BuyFromMe Website;

Recitals or “Whereas” Clauses

NOW, THEREFORE, in consideration of the promises and mutual agreements contained herein, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:....

Well-drafted recitals clauses enable any reader of a contract to quickly understand who and what is involved and what the parties intend to do.

Although recitals should not be overly detailed, in more complex or novel agreements it is smart to draft them with an eye toward providing a court, arbitrator, or other third party insights into the parties' intentions and expectations in case issues of misrepresentation, interpretation, or ambiguity arise.

Recitals or “Whereas” Clauses

NOW, THEREFORE, in consideration of the promises and mutual agreements contained herein, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:....

As emphasized in Chapter One, Contract Law, much of the law of contracts has evolved to guide courts in determining the “intent of the parties” when disputes arise.

Definitions

In many contracts, important words, persons and concepts are “defined” as they are first introduced. Software license agreements, technology services agreements, manufacturing agreements, and other agreements covering sophisticated subject matter commonly include a separate Definitions section, where certain terms are defined in one place, in alphabetical order, like the following:

Definitions

Defined Terms. As used herein, the following terms have the following meanings:

(a) "Affiliate," whether capitalized or not, means, with respect to a specified person, any person which directly or indirectly controls, is controlled by, or is under common control with the specified person as of the date of this Agreement, for as long as such relationship remains in effect.

(b) "BuyFromMe Marks" means trademarks, service marks, and any other such marks developed by BuyFromMe, including "BuyFromMe," "BuyFromMe Now," and "BuyFromMeALot," as well as any links or icons used to direct users from the Magic Hairbrush Website to the BuyFromMe Website.

Definitions

Defined Terms. As used herein, the following terms have the following meanings:

(c) "Confidential Information" means all business information disclosed by one party to the other in connection with this Agreement unless it is or later becomes publicly available through no fault of the other party or it was or later is rightfully developed or obtained by the other party from independent sources free from any duty of confidentiality. Without limiting the generality of the foregoing, Confidential Information shall include Customer Information, and the details of Customer's computer operations, and shall also include Provider's Proprietary Items.

Definitions

Defined Terms. As used herein, the following terms have the following meanings:

Confidential Information shall include the terms of this Agreement, but not the fact that this Agreement has been signed, the identity of the parties hereto, or the identity of the products licensed under a Product Schedule.

(d) "Copy," whether capitalized or not, means any paper, disk, tape, film, memory device, or other material or object on or in which any words, object code, source code or other symbols are written, recorded or encoded....

Definitions

This approach to defining key terms works well unless drafters get carried away and define too many terms. The presence of a Definitions section sometimes tempts drafters into intellectual hand-holding beyond what is necessary or helpful. If used, a Definitions section should make an agreement easier to understand and navigate, not more difficult.

Obligations of the Parties/Services

The critical connection between a clear “obligations” section and robust “remedies” is sometimes hard to appreciate until problems arise. An agreement can include very reassuring remedies for breach, including refunds, setoffs or payment deferrals and rights of termination, but even the most favorable looking remedies can be rendered practically meaningless in the absence of clear performance requirements.

The parties’ obligations to each other can appear under a variety of captions like those above and be presented in various ways, although the range of logical choices will sometimes be dictated by common industry practices.

Obligations of the Parties/Services

One straight forward approach is to include a caption called “The Parties’ Obligations” and sub-captions like “Party A’s Obligations” and “Party B’s Obligations,” followed in each case by text which spells out that party’s obligations or directs the reader to where to find them.

Under this approach, for example, Party A’s obligations might be to “Pay the Fees described in Schedule A to this Agreement,” while Party B’s obligations might be to “Perform the Services described in Schedule B, captioned Marketing, Website Hosting and Order Fulfillment Services.”

Obligations of the Parties/Services

The following is an example of a short “obligations” section:



**The Parties'
Obligations.**

Best Marketing Concepts, Inc. (“BMC”), by its acceptance of this Agreement, agrees to furnish to Subscriber the BMC services described in Schedule A herein (the “Services”).

Subscriber agrees to take and to pay for the Services as described in Schedule A, subject to the terms and conditions set forth in this Agreement.

Obligations of the Parties/Services

The following is an example of a short “obligations” section:



The Parties'
Obligations.

Schedule A in this example assumes a high level of importance. It must be every bit as clear and comprehensive as if the discussion occurred in the main body of the agreement. When the specifics of performance are less complex, it may be best to include them in the body of the agreement, as in this example:

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

TechGizmo's
Obligations.



(i) TechGizmo will ensure that ACME's central warehouse is stocked with sufficient quantities of all goods sold in the online store. TechGizmo bears full responsibility for any order processing delays caused by product shortages.

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

TechGizmo's
Obligations.



TechGizmo will provide an electronic file to ACME each day by 9:00 p.m. East Coast Time containing the following:

a. complete and accurate name and address of each customer who made purchases;

b. as to each customer, the items purchased, including product code and number of items;

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

ACME
Fulfillment's
Obligations:

(i) ACME will receive and process the above described daily file from TechGizmo and ship the products ordered by individual customers to the address provided no later than the next business day, according to the shipping method selected by the customer.

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

ACME
Fulfillment's
Obligations:

(ii) ACME will ensure that all products shipped are packed in a manner reasonably designed to minimize damage in transit; such packaging methods shall be consistent with industry best practices.

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

ACME
Fulfillment's
Obligations:

(iii) ACME will handle all customer inquiries consistent with the Customer Service Standards attached hereto as Exhibit A.

(iv) ACME will handle product returns as described in Exhibit B, Product Return Policies and Procedures.

Obligations of the Parties/Services

The following is an example of a short “obligations” section:

ACME
Fulfillment's
Obligations:

ACME will take commercially reasonable steps to protect TechGizmo's inventory under its control from all risks of loss or damage and shall carry insurance as described herein under “Insurance.” Notwithstanding the foregoing, provided ACME has discharged its duties hereunder with reasonable care, all risk of loss to TechGizmo's inventory shall at all times remain with TechGizmo.

Obligations of the Parties/Services

Are the performance obligations of the parties described in sufficient detail here? Answering this question requires thinking through what each party will have to do on a day-to-day basis to make the relationship work.

Given the difficulty of anticipating every possible issue, parties to a contract should be alert during the early stages of implementation for additional items to be agreed upon through written amendments or addendums.

Obligations of the Parties/Services

Anticipate Performance Concerns

However organized, the parties' obligations to each other should be clear, accurate and comprehensive. As already noted, it is easier to make another party perform as you expect if those expectations are in writing.

More importantly, if proper performance is not defined, weak performance likely will not constitute a breach of the agreement, making remedies such as offsets, price reductions, or even termination unavailable. Few things in business are more frustrating than failing to anticipate performance concerns that seem obvious in hindsight.

Obligations of the Parties/Services

Anticipate Performance Concerns

Careful drafting of the parties' obligations usually requires asking oneself and one's colleagues thoughtful questions about areas of potential disagreement, confusion, mutual mistake, performance shortcomings, and other such concerns that might arise in a new business relationship:

What is it we are assuming or taking for granted that might be viewed differently by the other party?

What exactly are we paying for?

And by omission or explicit exclusion, what should we not expect?

Obligations of the Parties/Services

Anticipate Performance Concerns

Careful drafting of the parties' obligations usually requires asking oneself and one's colleagues thoughtful questions about areas of potential disagreement, confusion, mutual mistake, performance shortcomings, and other such concerns that might arise in a new business relationship:

When must the work or other performance be completed?

What does completion look like?

What are the specifications against which successful performance will be measured?

Obligations of the Parties/Services

Anticipate Performance Concerns

Careful drafting of the parties' obligations usually requires asking oneself and one's colleagues thoughtful questions about areas of potential disagreement, confusion, mutual mistake, performance shortcomings, and other such concerns that might arise in a new business relationship:

Where specialized skills are involved, is it important that specific, named personnel perform or supervise the work, or otherwise remain involved and available?

Are we making assumptions or anticipating conditions, the nonoccurrence of which will justify the other party's non performance, partial performance, or delayed performance?

Obligations of the Parties/Services

Anticipate Performance Concerns

Careful drafting of the parties' obligations usually requires asking oneself and one's colleagues thoughtful questions about areas of potential disagreement, confusion, mutual mistake, performance shortcomings, and other such concerns that might arise in a new business relationship:

Are “change orders” or other performance modifications possible or anticipated? How will they be priced? How will they be prioritized by the performing party?

Are support services provided? If so, how are they priced and what are the service level standards?

Obligations of the Parties/Services

Anticipate Performance Concerns

When another party objects to detailing their obligations and when negotiating tensions start to arise around those issues, non-lawyers are sometimes tempted to back down and agree to “high level” performance descriptions. Capitulation to poorly detailed performance obligations usually also involves falling for the other party’s oral assurances that the details will be amicably worked out by the parties as they go.

It is perilous to believe that critical performance details will be successfully worked out once the ink is dry.

Obligations of the Parties/Services

Anticipate Performance Concerns

When technical specifications or design elements truly do need to be worked out collaboratively, the best approach is to describe that specification development process in the agreement, bind the parties to a completion timeline, agree that the resulting performance details will become an enforceable addendum to the agreement, and provide for a right of termination in case the parties are unable to timely agree on performance details.

Although there is no perfect substitute for experience, one way to learn techniques for describing performance obligations is to analyze a number of contracts in the same industry.

Obligations of the Parties/Services

Service Level Agreements

Performance obligations in technology contracts and in various types of services agreements often also include a separate schedule of commitments under the caption “Service Level Standards” or “Service Level Agreement.”

These Service Level Agreements, or “SLAs” for short, often include metrics for specific aspects of performance, timelines for responding to “service level failures,” and monetary and/or termination penalties for service level failures.

Obligations of the Parties/Services

Service Level Agreements

SLAs often cover things like how quickly customer service phones will be answered, the percentage of time that web based platforms will be available and glitch-free, and the speed with which product returns will be processed for dissatisfied online purchasers.

Consider whether any part of another party's performance can be quantified and how corrective action and fee credits or offsets might be triggered by various types and degrees of performance failures. Consider what penalties will be necessary either to inspire appropriate performance or to compensate for performance failures.

Obligations of the Parties/Services

Service Level Agreements

Rights of termination can be triggered based upon a certain number of SLA failures, total “system downtime” within a particular time frame, or some other calculation relevant to a party’s potential performance shortcomings.

In the example above involving ACME Fulfillment, SLAs might specify that 99% of orders will be shipped by the following business day, that customer returns will be processed within certain timeframes, that customer calls will be answered within a certain number of seconds, and that customer concerns will be satisfactorily resolved within a certain number of hours or days. Fee credits or offsets might then be triggered by specified percentages of late shipments, percentages of calls returned late or answered slowly, or percentages of customer complaints not timely resolved.

Obligations of the Parties/Services

Seller Concerns

It is important for a seller or other party with substantial performance obligations to carefully consider whether the occurrence or non-occurrence of certain assumptions or contingencies might cause performance to become more difficult or costly. If costs of raw materials necessary for performance are volatile, for example, a seller should consider providing for price increases that are tied to increases in raw materials costs. Everything is negotiable prior to signing. That is when to think through assumptions and contingencies.

Obligations of the Parties/Services

Seller Concerns

In contracts for construction projects, these are often called “escalation” clauses, and they often provide for increased compensation to contractors when market prices for certain materials such as cement or lumber increase beyond specified levels. Similar provisions should be considered by any seller where market prices for key materials or components could otherwise make an agreement “uneconomic.”



thank
you!