Tripping over the Fine Print

How to Avoid Pitfalls When Negotiating Vendor Agreements

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Samuel Goldwyn once said, "A verbal contract isn't worth the paper it's written on." Are the days of handshake deals gone once and for all? Perhaps. Businesses and customers increasingly require written vendor service contracts as opposed to relying on verbal agreements. This trend is likely to continue given the heightened prevalence and rising cost of contract dispute litigation, as well as the increased emphasis on the importance of having clear contracts in place.

To reduce the likelihood of a contract dispute, a complete agreement should set forth the clear expectations and obligations on the contract party. Once agreed upon, a satisfactory written agreement provides both sides with a level of certainty, and thus, piece of mind. As the old adage says, an ounce of prevention is worth a pound of cure, or in this case, the avoidance of potentially significant litigation costs.

Don't Wait for it to End up in Court

Despite the fact that business owners and managers may look at lengthy agreements as burdensome, those who have been involved in a prior contract dispute find the contract-review process an essential part of their risk-reduction strategy. When it comes to negotiating vendor agreements, the end goal is conflict and litigation avoidance. The finished and executed agreement should be a complete and unambiguous document that accurately reflects the meeting of the minds between the parties without confusion, and most specifically, conflict.

There are essentially two flavors of vendor agreements that businesses will encounter. The first is an agreement by which the business is *providing* the service, and the second is where the business is contracting to *receive* a service from a vendor. While both parties may be looking at the same draft agreement, their perspectives could not be less similar.

The service provider wants to ensure:

- That the customer with whom they are communicating is authorized to purchase the services being provided on behalf of the respective business;
- That the minimum fees to be paid for such services are clear and agreeable; and
- That the agreement may be terminated in the event payments are past due.

Conversely, the recipient of the service wants to ensure:

- That they are receiving the value in exchange for what they are paying, i.e. that the contracted services adequately represent the value for the fees paid to the vendor;
- That the term (period of time) during which the services will be provided is agreeable; and
- That the contract term can be terminated if the services provided do not represent the services the customer was expecting.

Here are some of the material terms to consider when reviewing a vendor agreement:

1) *The scope of services to be performed:* Sometimes called a 'scope of work,' this sentence, paragraph, or a multi-page attachment to an agreement is arguably the most important component of the document. It is within this description that the meat and potatoes for which the services to be provided and compensated are set forth. While this may be the most important section within any service agreement, it is also frequently the most over-generalized and over-simplified. The objectives are detail and specificity. Avoid ambiguous terms, industry terms, abbreviations and undefined acronyms, each of which can lead to misunderstanding.

2) *Pricing:* In any service agreement, pricing has very likely brought the parties together initially. It is thus essential to ensure that the service agreement memorializes all concepts of service pricing. For instance, is the service fee to be paid weekly or monthly, is there an incentive or penalty for early or late completion of services, are there additional costs for which one party or the other will be responsible such as taxes, travel, or administrative expenses? These considerations are the minimum of what should be contemplated and resolved in the pricing terms of the agreement.

3) *The duration of the contract:* Often referred to as the 'contract term' or 'term,' this is the period of time upon which the parties shall be bound to perform. In any service agreement, the following must be addressed with respect to the contract term:

- When the agreement is to begin, often referred to as the commencement date;
- When it is to end or expire;
- Under what circumstances the agreement may be terminated by either party prior to the anticipated expiration date;

Commencement - An agreement may begin either upon the mutual execution of the agreement by both parties, or it may commence upon the completion of a condition or event.

Early termination - Even if an agreement specifies that, for example, it shall run for a 12-month term, there should be a mechanism in place for early termination for the breach or default by a party. As well, the parties should contemplate the compensation duties of each party in the event a contract is terminated early.

4) *Miscellaneous terms:* While there are a number of standard or agreement-specific provisions that may be relevant to the agreement, there are a few important ones that business executives should be familiar with.

Assignment: Generally the right and obligations between the parties of an agreement remain between those parties. However, if one contract party transfers their rights to a third party, this is called an assignment. It is important for all parties to understand what rights they may be able to assign relative to events such as sale, merger or consolidation of the business.

Warranty: A warranty is normally a promise by the seller of a product that the product is in good condition, or fit to perform a certain function. Some warranties may be implied or automatic as a matter of law. Other warranties may be as specified in the agreement language. When warranties are subject to a disclaimer, the seller of the product seeks to narrow its liabilities for a claim that the product is defective.

Indemnification: To indemnify another party is to hold that party harmless against loss or damage, and to promise to compensate that person in advance and in anticipation of a potential loss. This could include one party agreeing to compensate the second party for any loss (i.e. claim, demand, or lawsuit) even if such second party was at fault. Accordingly, parties should be

very careful to understand the specific obligations of both parties with respect to indemnifying the other under a given agreement.

Insurance: Care should be given to assure that both parties are knowledgeable and acceptable of the specific types of insurance and limits to which they must obtain or maintain a policy pursuant to the agreement. Generally speaking, parties should obtain commercial general liability insurance to protect against any loss resulting from a breach of any contractual provision in an agreement, and to protect against liability from damage or injury to person or property arising out of a party's performance under an agreement. Without proper coverage, the indemnification obligation existing between parties is subject only to the assets of each such party.

Despite best intentions, sometimes misunderstandings occur. Here are some practical tips to help avoid common pitfalls:

• Identify each party to the contract by its full name as it is registered in its home jurisdiction, as well as the kind of entity it is. For example, instead of 'Acme' the party should be described as 'Acme Distributing, LLC, a Massachusetts Limited Liability Company.'

• Always be mindful of the objective of the negotiation, understand the concerns of each party, and work towards mutual agreement.

• Do not be pressured into executing the agreement under the guise of a false deadline by the other side.

• Ask questions if you do not understand a provision. Terms should be spelled out using simple verbiage that is clear and descriptive.

• Expect the worst and hope for the best. Always review a contract in light of worst-case scenarios and provide rights and remedies as protective mechanisms in the agreement.

• Avoid abbreviations, acronyms, trade terms, and specify what is intended.

Remember: nothing is set in stone, and everything is negotiable.❖

This information is not a substitute for the legal advice of an attorney, which should be sought from competent legal counsel in the relevant jurisdiction.

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