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Intelligent Contract Review: Why it matters

*By Gabriela Smith**

Reviewing an agreement is not an act of going through the motions to make sure that no “weird” provisions are found. It is an act of protecting your company, thinking about long and short-term impacts, and using it to grow your business.

COMPANY PROTECTION

Contracts create duties and obligations; however, these duties and obligations are not isolated acts in the life of a company. They have a direct impact and effect on cash flow, operations, hiring, planning, accounts receivable, accounts payable, and so on. They really are the life of a company. Without contracts, whether to provide or receive a service or to manufacture or design something, companies cannot do business.

Companies can and should use every contract opportunity to protect the company. Protect the company from what? Mostly from obligations that cannot be met, but also from terms that can impair growth, overexpose the company to significant liability, make the company subject to unknown (and expensive) compliance obligations, or that give the company little wiggle room if the relationship with the client becomes difficult.

For instance, think about the wonderful agreement to provide services to a household name customer that you really wanted and worked hard to get. Let’s consider that this company desires to hire your growing, privately-held, company to provide a service. Because this customer is such a big brand name worldwide, it can get away with paying lower fees, so your margin is not that great. They send you a one-sided contract, making your company liable pretty much for anything that could go wrong (unfairly), including a clause that makes you responsible for class action lawsuits involving the services of products...Nonetheless, you sign the contract without putting too much thought into it or without negotiating very much and start the relationship.

Chances are, there will be no class action lawsuit that will cost you thousands of dollars in defense legal fees. However, no one can guarantee that a class action will not happen. How could you have protected your company from this potential expensive liability? Here are some ideas: (1) limit the scope of the class action indemnity, (2) limit the timeframe covered in the indemnity, and/or (3) limit the monetary size of the indemnity. If revising the agreement is not an option, then consult with an insurance carrier and determine if they can cover this type of loss.

These are just examples. The point, however, is that contracts can bring unwanted and even unknown liabilities and a duty is owed to the company to review each and every agreement with care so as to not expose the company to unneeded dangers.

Should you refuse to sign a deal because of fear of what might happen? Absolutely not; but you need to be serious about the contracts the company signs.

The author once encountered an agreement that forced the client to “servitude:” the client had no way to cancel the agreement (except for nonpayment by the customer) and was forced to continue the relationship at the same price and for as long as the client’s customer extended the term. The agreement had been signed without a legal review. When the relationship turned sour, the client was not making a lot of money on the contract, was spending too much administrative time to track the customer’s mistakes and spent significant sums in legal fees to find a way out. The cost to fight over that contract could have been avoided with a diligent review that took care of potential exposure before the relationship even started.

SHORT-TERM AND LONG-TERM IMPACTS

When reviewing an agreement, the company should ask itself some questions. Here are some examples:

- Are there any assumptions related to this contract? (i.e. Does the company depend on third parties to fulfill the contract requirements? If so, are the third parties available? What is their pricing? And so forth.). Depending on the assumptions, the company may need to revise the terms of the agreement.
- Are there third-party obligations that are impacted by the agreement? (i.e. is there a need for specific cash flow cycles such as weekly, by-weekly, monthly payments? The agreement should reflect these obligations.
- Will pricing be flexible to account for inflation?
- Is the industry subject to sudden change such that the volume of work under the contract could diminish suddenly? In that case, the company should consider negotiating clauses that limit or diminish the negative impact of the sudden changes.

These are a few examples that show why contracts should be reviewed with care and taking into consideration various aspects of the company. The person negotiating the agreement and working with the attorney should be knowledgeable and prepare to make decisions that can have a long-lasting effect on the company.

GROWING THE BUSINESS

Contracts are living creatures and a well drafted agreement should line up the company for future growth, a good customer relationship, and either diminished potential liabilities or “understood” potential liabilities (i.e. liabilities that will not be a surprise and that the company can live and grow with).

Spending on legal fees because of a bad contract that was signed without seeking appropriate legal review is bad business. The legal fees should be spent in the front-end, before creating binding contract obligations.

WHO REVIEWS THE CONTRACT

Finally, a word of caution about who reviews the agreement. Many company executives are well versed in contract terms and are excellent negotiators. They should review the agreement because they will need to flag concerns and make sure that the commercial terms are appropriate. However, this does not mean that they should try to save some bucks and not call their attorney. Company executives are not up to date with the latest legal decisions affecting contracts or with new laws that may affect taxes, damages, liability, class actions, choice of forum, choice of law, and many other important terms that attorneys continue to master through experience and continuing legal education. They also may not have developed an eye for ambiguous language or terms that simply do not work well together. Doing a legal review will be a better choice and more likely to detect problems.

CONCLUSION

A good contract legal review should result in savings, security, and more stability in the relationship with the customer. Further, the contract review process should not be taken for granted and companies should be meticulous in protecting their most valuable asset: the agreements that bring in revenue and can push for growth.



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