Don't panic

A robust contract management strategy will also deliver peace of mind, say Morrison & Foerster LLP's **Chris Coulter** and **Michael Swinson**

Swimming in deep water can be an unnerving experience. A shadow looming in the depths might be a clump of seaweed or possibly something more sinister. The problem for the swimmer is that if he takes no steps to identify and mitigate the potential risk, an otherwise pleasant swim will be nerve-wracking.

Contract management can make companies just as nervous. A key function of all contracts is to help the parties identify and then manage risk. During contract negotiations, the parties will flush out the various legal, financial and operational risks associated with a transaction and then allocate responsibility for those risks in the contract. However, the process of risk identification and management can sometimes break down due to commercial pressures such as lack of time or resources. That's why it's important to put in place systems that ensure your risk management procedures remain consistent and robust.

The need to complete a contract quickly can sometimes prevent companies from properly considering all of the risks associated with a proposed transaction. One way to combat time pressure is to start from a known base by using a standard form agreement that your legal team is already familiar with.

Using your own standard form has several benefits. In particular, it gives you certainty that you are using an agreement that:

- covers all of the issues that are most important to you;
- reflects your preferred allocation of key risks;
- is familiar to and understood by your staff.

By contrast, if you start with a new agreement each time, you will need to analyse how it addresses and allocates key risks and compare this against your preferred positions. This can be a difficult and time-consuming process. Accordingly, it is worthwhile investing in a solid set of standard form documents and using these wherever possible.

When preparing standard forms, it is best to focus on agreements that cover recurring transactions. Confidentiality agreements are a classic example as they will be required at the commencement of most commercial relationships and will often need to be produced and agreed quickly so that important discussions can begin. If you can successfully propose your standard form confidentiality agreement, you can proceed with discussions knowing that the issues most important to you – eg retention of title to intellectual property (IP) and so on – are adequately covered.

Negotiating position

There will be occasions when you won't have sufficient negotiating leverage to insist on using your standard form or when you are entering a unique transaction that requires a bespoke agreement. In these cases, it will still be very useful to have a record of your preferred positions on key risk areas. If possible, these positions should be collated in a 'negotiating guideline' that is available to all staff who will be involved in negotiations.

This type of guideline will enable your senior management to specify their preferred positions on key issues and so shape negotiations across many different transactions, even though they may have time to become personally involved in only one or two individual transactions.

In addition, it will help to ensure that you maintain a consistent approach across different transactions involving different deal teams and different counterparties. In turn, this can keep you within the boundaries of your insurance cover and will help make your contracts easier to manage and administer on an ongoing basis. It will also make it easier for you to delegate negotiating responsibility to less experienced staff members, who would otherwise need support from more senior staff to determine a negotiating approach.

Where possible, your negotiating guideline should include both your preferred and fall back positions, so that the negotiating team has some flexibility and knows what concessions they can offer as bargaining chips. For example, an IT service provider's preferred position may be to not offer an indemnity against IP infringement claims. However, as a fall back, the service provider may offer such an indemnity, provided that it is subject to a general liability cap and, if pushed, may offer as a further fall back an uncapped indemnity for claims other than patent claims. By following this model, even where you need to make concessions, you will have some comfort that the concessions are within acceptable risk boundaries.

It's all in the training

Contract negotiations will often be conducted without specialist legal support. If your company is in this position, it will be helpful if the members of your negotiating team are properly trained to recognise the different types of risk that may arise

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in your contracts. If an issue is missed at an early stage, it may be possible to claw back your position. However, this invariably requires a compromise elsewhere and so it is best to spot and address risks as early as possible.

Commercial team members may easily be able to spot financial risks (eg the pricing impact that a change-of-control clause may have in a long-term services contract); however, they should be trained to identify common areas of legal risk as well (eg the differences between a contractual warranty and a condition, the consequences of granting an indemnity and so on). At the very least, this will help them to avoid conceding important points that may be difficult to claw back later and to identify situations in which they need specialist legal input.

Pass on information

After a contract is executed, it is important that the knowledge built up during the course of negotiations is preserved and transferred to the team that will manage the contract on an ongoing basis. In particular, it is important for the business to understand the different risk areas that were identified during negotiations and how these were dealt with in the contract. In addition, if the negotiating team anticipated that a particular risk would be addressed by the introduction of a new operational procedure, then the business needs to understand this and allocate responsibility for implementing the relevant procedure.

There are a number of ways in which you can facilitate the necessary knowledge transfer. These include:

- arranging for a member of the negotiating team to work with the contract management team for a transition or handover period, so that they can help get the contract managers up to speed and answer questions as they arise;
- requiring the negotiating team to prepare a 'deal guide' that explains the essential elements of the transaction and the main risk management features built into the contract;
- preparing an 'obligations calendar', which tracks the conditions that each party to the transaction must satisfy by a specific date (eg where a supplier needs to complete a set milestone within a set period or produce reports at specified intervals). The calendar will help to track contractual compliance and hence areas of risk.

The techniques described above are simple yet they are often overlooked in the heat of business negotiations. Those who find themselves swimming in deep water can calm their fears by looking carefully at their environment in order to chart their return to shore. As long as contracts are approached in a measured and diligent way, effective contract risk management should be no more difficult. ■

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