

PRACTICE NOTE ON BEST PRACTICES WHEN NEGOTIATING CLIENT CONTRACTS

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Issue

Since the core business of all groups is to provide goods or services to their clients, one of their principal potential legal risks relates to the adequacy of their client contracts. Contract risk arises from the absence of adequate contractual protection in a group's provision of its products or services to its clients, either because the group has failed to enter into a written agreement setting out the terms and conditions under which it will provide its products or services, or because it has entered into a contract without adequate protection. Examples of inadequate protection include:

- Overly broad exclusivity/non-compete undertakings by group companies.
- Overly broad warranties and indemnities by group companies.
- Failure to obtain adequate warranties and indemnities from clients.
- Inappropriate transfer of ownership of intellectual property rights.
- Inappropriate payment terms.
- Inadequate termination notice and/or payment provisions during the notice period.

(Similar risks apply in other contracts – for example, with the group's suppliers or subcontractors.)

Even if the group has entered into an adequate written contract with its clients (or its suppliers or subcontractors), there is the risk that the contract will not be applied or enforced due to the group's failure to communicate the relevant contract terms to the relevant persons.

Strategy

To address these risks, a group could, for example, take the following actions:

- Develop model contracts for the sale of its products/provision of its services.
- Develop and issue policy/best practice guidelines for the negotiation of client contracts.
- Provide adequate training to managers and others on contract risks and how to manage them.
- Implement an efficient contract storage and retrieval system, with a tickler system for key contractual milestones.

Model Contracts

Even if many contracts will be based on the client's standard form, each business should develop its own model contract specific to its business ("Model Contract"). Not only will it be available to send to clients who do not insist on using their own form contracts (which may not be suitable for the products/services concerned), it will provide alternative wording for key contract provisions which can be proposed in negotiations.

In many industries, trade associations develop model contracts for use by their members which can serve as a useful reference when developing a Model Contract.

Negotiating Guidelines

In addition to the Model Contract, the group should develop confidential best practices/guidelines for negotiating client contracts ("Guidelines"), for internal use only, which set out the best case, alternative and bottom line positions for the key legal and commercial provisions in the contract. The Guidelines should be developed in consultation with the businesses to take into account the businesses' position and market practice with respect to key commercial terms such as payment terms, exclusivity, termination notice and audit rights; and with the risk manager to take into account insurance coverage. The Guidelines should be updated regularly to reflect lessons learned.

Key legal terms to be addressed in the Guidelines include:

- Limitation on group's liability to client – for example:
 - Fix monetary cap on liability for direct losses (e.g., not more than one year's revenue from contract).
 - Exclude indirect or consequential damages (e.g., loss of profits).
- Client's liability – for example:
 - Client indemnifies group against infringement claims related to its intellectual property.
- Governing law
- Dispute resolution – for example:
 - Mediation
 - Arbitration

The Model Contract and Guidelines should be endorsed by the group or business's executive committee (or equivalent management organ) and issued to the businesses by appropriate senior management – for example, by the head of each business represented on the executive committee. The Guidelines should stipulate that client contracts representing a certain level of annual revenue must be approved in advance by the legal department and the CFO of the business or group. To avoid the risk that local management will make unacceptable concessions in the heat of negotiation in order to win or keep business, the Guidelines should stipulate that there can be no deviation from the Guidelines without the prior written authorization of designated senior managers.

Who Should Negotiate Client Contracts?

The negotiating team should, if possible, consist of an in-house lawyer to deal with legal matters and a financial or account manager to deal with commercial matters – at least for major client contracts. In countries without an in-house legal presence, outside counsel may fill the legal role after having been briefed on the Model Contract and Guidelines by in-house counsel. In still other countries, it may not be practical for a lawyer to participate in the negotiation. To address that eventuality, the legal department should provide regular training for managers with respect to the legal aspects of client contracts, and make available to them the Model Contract, Guidelines and related training materials, possibly by way of the group or legal intranet.

Training

Procurement managers have long known that the effective negotiation of contracts will not only mitigate legal risks, but can also increase margins by reducing costs, and even increase revenues. These principles should be stressed in the workshops on best practices when negotiating client contracts – especially since the person on the other side of the table may well be a procurement manager.

Reduce Costs

The allocation of legal risks in client contracts (as well as in all other contracts) means the allocation of costs. The contract negotiator should therefore strive for an appropriate allocation of risk in line with the Guidelines.

Increase Revenues

When responding to Requests for Proposals, the legal department can help win new business by not risking being excluded from further consideration by raising too many detailed points in proposed contracts. Instead, it should make a general statement that the proposal is subject to negotiating appropriate terms and conditions in line with industry practice.

When negotiating client contracts, apart from implementing the Guidelines the legal department can help increase revenues in the following ways:

- Narrow the scope of services and the exclusivity obligations in order to maximize new revenue-generating opportunities.
- Shift appropriate risks (and related costs) to client.
- Insist on an appropriate monetary cap on liability.
- Think not only in purely legal terms but also in terms of the commercial impact of contract terms.

During the performance of the client contract, the legal department can help retain existing clients and secure future revenues in the following ways:

- Ensure compliance with the existing contract by communicating key contract terms to people who need to know.
- Maintain a central repository for client contracts for easy consultation.

- If a client dispute occurs, work with business people to resolve it promptly and effectively. Even if the group has no intention of suing the client, a strong position under the contract will enhance the group's bargaining power when negotiating a settlement with the client.

Conclusion

Some may argue that aggressively negotiating liability and other legal terms will cause the client to award its business to a competitor who is willing to accept the client's contract without argument. But the better view is that the professional – and always polite – negotiation of key contract terms, backed up by well-reasoned arguments – actually demonstrates to clients that the group takes its commitments seriously, and that it will be equally serious and professional in carrying out its obligations under the contract.

In short, a well thought out and disciplined approach to the negotiation of client contracts is good both for risk management and for business.

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