Checklist of Items to Know and Do in Contract Drafting and Why©

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Whether you are drafting a business purchase-sale agreement, a sales or service agreement, a supply or distribution agreement, a trademark or intellectual property license, employment or other type of business agreement, there are certain things you should know. Here is a list of some of them and the reason why they are important:

1. **The Deal is Not the Thing; it is the Contract**. You don't get the product or property that is the subject matter of your contract. You get what the agreement says you get, i.e. the seller's representations and warranties. For example, if you buy something "AS IS" you run the risk of getting nothing useful or beneficial.

2 **A Contract is an Agenda.** Fortune favors the vigilant**.** Yes, a contract finalizes the terms of the deal. But prior to that each side starts with its list of things wanted. These terms are not just deal points for a term sheet; they are the party's Agenda. Sometimes the apparent or stated reason for a contract is not the real reason. Or included in the terms presented are some that bestow on the party an unfair outcome at great cost to the other party. Unless one is aware that terms may have multiple meanings and outcomes, and reviews the terms presented with that fact in mind, the contract may prove to be disastrous. More than once my client has been the intended victim of a fraudulent scheme where the terms of the deal were not as represented but had hidden meaning and unexpressed outcome which amounted to theft.

3. **A Contract is about risk allocation**. Many terms of an agreement are not about money – at least not immediately – but about risk; that is "who takes the fall" if something goes wrong.

a. For example, the delivery term, "F.O.B. seller's dock" means the buyer has the risk of loss of or damage to, the product from the time it leaves the seller's shipping point. The farther delivery the greater the risk. This is particularly true in international contracts where risk includes weather, trade sanctions and customs.

b. The indemnity clause is another important allocation of risk. The effect of an indemnity clause is to extend the period of liability beyond the sale itself.

i. Does the seller have to pay the buyer's attorney fee costs in defense of a warranty or trademark claim by a third party? If so, when: from the beginning? or at the end?

ii. Are the types of risk clearly defined?

c. Knowledge: The representations and warranties, which are so important, as explained in item # 1 above, can be expanded or limited by "knowledge."

i. “Actual knowledge” means the if the representing party (usually the seller) did not know something at the time (whether it should have or not) then it is not liable if the representation urns out to be false.

ii. “Inquiry knowledge” means the duty to ask or to look in the filing cabinet or computer file to find out. In this case, even if the representing party seller did not actually know something, if the fact or answer was available through reasonable inquiry then the representing party is liable.

Almost every contract term involves the allocation of risk between the parties. It is a zero-sum game. What one party gains, the other loses. And the result of risk can be financial loss. With risk “what happens tomorrow” is very important.

4. **Use and pay attention to definitions**.

a. Definitions are part of the agreement. For example, a *force majeure* clause -- which allows delay in performance due to unforeseeable, typically catastrophic, circumstances, e.g. a hurricane damages the manufacturing plant –can be defined to include in its meaning less catastrophic events like labor or supply shortages. If you are the seller this can mean the difference between being the defendant in a lawsuit or not.

b. In the U. S. the parties, even attorneys, are often sloppy about definitions. It is not unusual to have key terms undefined. Because definitions go the heart of the deal, this is a major mistake. It would also be unthinkable in Germany where half of the contract negotiation can be about the definitions.[1]

6. **Review the boilerplate terms**. No term in a legal agreement is “boilerplate.” In writing “boilerplate” refers to a unit of writing which can be used again and again without change. The last section, often labeled as “Miscellaneous” of most attorney-drawn contracts is referred to as boilerplate and is often not reviewed by the parties, and perhaps not even their attorneys. As with definitions the failure to review and use boilerplate terms to your advantage – or to eliminate their advantage – can be a momentous blunder.

This a subject of an article by itself, but here are some examples:

a. Entire agreement. This means that a dispute can only arise out of the terms written in the agreement.

i. But what if the other party “lies through its teeth” to get you to sign the agreement then correctly points out that prior representations are not actionable? The way to prevent this is to make sure that the provision does not go on to say: “Neither party is relying on any representation or understanding not stated in this agreement.

[1] A local collections attorney would say “If I am not collecting for you, I may be collecting from you.” Here, I would say if you are not defining the terms for you then they may be defining the terms against you.

ii. On the other hand you will want the “no prior representations” clause if you want to be sure that prior discussions are not cited as representations, which because now false, would allow the party to (try to) rescind the agreement.

b. Governing law. The agreement will typically state that the agreement is governed by the state law of the contract drafter.

i. Because state laws vary this is typically important. For example, Arizona does not allow an employer to impose a ten year-state of Arizona non-compete clause, nor will it allow the court to require the clause to be enforceable. (the reason for this is that otherwise the employee always loses). But other states still allow this. An even more extreme example is, as cited above, is California law which does not recognize employee non-compete agreements at all. Obviously, in the employment context whether or not California law governed the agreement would determine whether was even valid. So, whether you draft the employer or employee this choice of law term can be very important.

ii. A variation of the above is where the contract cites as governing law the law of a state in which neither party is located or has a connection. Delaware may be chosen for business contracts because Delaware is known for its expertise in business matters. Or, a purchasing party may choose the law of Texas because its Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA") is favorable to the purchaser. Again, the choice of law can govern the outcome so choose wisely.

c. Venue and Jurisdiction. As with governing law the contract may specify the home state and county of the contract drafter as the place where law suits may be filed. Generally, if the specified county and state are not your own, then you face travel time and costs plus the need to hire out of state counsel. This is leverage for the home state party. For this reason, one should be sure the venue and jurisdiction clauses are acceptable. That being said, often one contract party has superior bargaining power and can impose the venue and jurisdiction terms on the other party.

d. Arbitration. Arbitration is a private legal proceeding. It is conducted in the conference room instead of the court room. Typically, arbitration rules specify a truncated time period for the legal action. And, arbitration awards may be less than what would be awarded by a jury.

i. Arbitration can be good for the business that wants its legal disputes kept out of the public record, and which wants what are typically shorter and less expensive proceedings overall. This could be product or service provider.

ii. On the other hand if the case is large with thousands of emails or documents and multiple parties the discovery (i.e. disclosure statements, depositions, request for admissions, etc.) allowed by court proceedings might be a better option.

e. These are just some of the so-called “boilerplate” provisions which can be tailored to your advantage or disadvantage, so deserve your time and attention.

6. **Use a business lawyer**. I know this sounds self-serving but think about it:

a. The lawyer knows what is not in the agreement, but should be – the what I call "The Document Looks OK to Me Fallacy."

b. Being state licensed the lawyer knows the law and business practices of the state. You can take advantage of state law, e.g. the enforceability of employee non-compete agreements in Arizona, and avoid bonehead mistakes, like using a form document in California which does not recognize employee non-compete agreements. The attorney will also know if the contract is up to date. If the contract, or its source, are more than five years old, you are probably do for a review.

c. The lawyer can tailor the contract to the deal, your business or customer. You avoid trying to use a one size fits all contract for multiple states, businesses and customers.

d. If the lawyer has practiced in the area for a while, e.g. has 20 or more years of experience in business law matters, he/she may have handled 100's of cases like yours. There is no extra cost for this benefit and it is foolish not to have the voice of experience.

7. **Last Word.** Neither the list of items nor their examples above is complete. But these are some of the important facts about contracts you should know. The take away is to review the terms of an agreement carefully then takes your questions to your business attorney. Your attorney cannot only answer your questions but show you other things you may want to change or be aware of – what I call the "Landmines."

Good luck!