



Contracts 101: Knowing What You Know/Don't Know Can Make All the Difference

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While VNF professionals are ready to begin work at any stage of negotiations, helping clients understand basic legal concepts is a value-add that makes good sense for everyone. This month we're providing insight into the simple contracts that exist outside of the complex/high-stakes transactions—namely negotiating form leases, simple purchase and sales agreements, and service contracts—many of which are part of non-lawyers' regular days. While no general "how-to" guide can replace contract-specific advice, the following tips for navigating basic contracts may help avoid common pitfalls.

Don't Let the Title Fool You

A document that contains the title "Memorandum of Understanding" or "Agreement" does not mean it's not a contract. Legal contracts are formed when one party offers to do something, the other accepts, and there is sufficient consideration or an exchange of value. The presence of each of these elements in a written document may form a binding contract. MOUs can be helpful precursors to contracts, but must be carefully worded if the parties do not wish to be legally bound.

Who Are the Parties?

Make sure every individual or entity with an obligation under the agreement is listed as a party and signs the contract. When contracting with an entity (e.g., corporation, LLC, LP), check the Secretary of State's website to confirm the existence of each entity. The contract should also include language that the individual signing has authority to bind the entity.

Recitals Tell the Story But Shouldn't Form the Agreement

Recitals within the introduction of a contract ("Whereas ...") can provide helpful background to explain the purpose of the agreement. But because recitals may not be sufficient to bind the parties, avoid relying on recitals to identify specific terms of the contract or obligations between the parties.

The Scope and Respective Responsibilities Should Be Explicit

Key terms of the agreement (what, when, where, how) should be explained in detail. These may include: scope of work, address and legal description of property, description of goods or product to be produced or delivered, price, and time required for performance by all parties. The goal is for someone unfamiliar to the transaction to be able to read the contract and direct the parties to perform their respective contractual obligations in a manner consistent with the parties' expectations. Always review the entirety of a contract to avoid conflicting or inconsistent obligations.

Know When and How Long the Parties Become Obligated

The contract should specify timing for performance and the length (or term) of the agreement. Be aware of conditional language ("if," "when," "so long as") that make performance contingent or conditional on the occurrence of certain events. Specify whether either party can terminate or cancel their performance under the agreement, as well as corresponding requirements and consequences to do so.

Confidentiality Must be Specified

If the parties intend for the terms or existence of the agreement to be private, confidentiality must be included as a binding term of the contract. Confidentiality may not be feasible if the contract includes a public agency, as the contract (and potentially records produced over the course of that contract) is subject to disclosure under the Public Records Act.

Addressing Default and Remedies

Actions that constitute “default” (or breach of the contract terms), should be specified in the contract along with their consequences. The default process should include whether and what type of notice is required for declaring a default, as well as opportunities and requirements to cure the default. Default remedies may be exactly prescribed (such as with liquidated damages), restricted (such as limitations on and releases of liability), or wide-reaching (such as with consequential damages). Be sure that the remedies for default are acceptable, whether you are the defaulting party or declaring default.

Understanding the Indemnification Clause

At its essence, an indemnification clause ensures that one party will protect the other against future claims or damages incurred by one party or a third party and arising out of the agreement. Typical language includes the requirement to “indemnify, defend and hold harmless from and against losses and claims, actions, and judgments.” Carefully review the scope of a proposed indemnification clause to ensure that the obligations and protections are reasonable. Indemnification clauses can (and often should) require mutual indemnification and be limited to only certain types of actions (e.g., negligent act).

Ensure Adequate Insurance Coverage

Requiring insurance coverage as a part of the contract provides effective mitigation against risk of loss in the event of personal injury or property damage arising out of the contract. Consider insurance in tandem with indemnification, rather than as alternatives. You want the indemnifying party to have sufficient funds to protect you and insurance can provide that. The amount and breadth of coverage will depend on the nature of the agreement, the risks of activities involved, and the cost of coverage. Insurance brokers can advise on appropriate coverage amounts.

Don't Forget to Read the Boilerplate

The final sections of a contract typically address issues such as Governing Law (which state laws will govern interpretation of the contract), Dispute Resolution (mediation versus arbitration versus litigation), Venue (designating the courts in which lawsuits can be filed related to the agreement, and Attorney's Fees (who will be responsible for legal costs in the event of a dispute). Don't ignore these provisions of the agreement, as they can control how parties must resolve future disputes, where you might have to travel for, and limit available remedies in the event of a dispute.

Just as everyone would love to have a mechanic, doctor, and accountant in the family, sometimes having an attorney at the dinner table is a good thing too. For those without all of the professional hats in the family, basic knowledge can go a long way, Happy contracting!

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