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Protect Yourself with Well-Designed Business Contracts

Sheila Mather, President and Founder of *ProximusPro*, a leading edge web-design and business strategy group, says that "A well-designed business contract is like an insurance policy: you pay the premiums hoping you will never have to call on the insurance."

She's right. And she ought to know. Her business is all about designing creative solutions that work for her clients. A well-designed business contract is something like an insurance policy. People buy, say, auto insurance or fire insurance, hoping they never have to place that call to the insurance company or file a claim. They do this to manage and contain their risks. Business contracts are a lot like that. But business contracts do far more than manage or contain risk. A well-designed business contract can create certainty, reduce costs *and* mitigate risks. And you only pay the premium once.

What Could Possible Go Wrong?

In 2005 I wrote an article titled *The Perils of Do-it-Yourself Business Contracts* published in the June 27, 2005, issue of the **Ottawa Business Journal** < *Link* >. That article focused on a "home-made" employment agreement that ended up costing the company that wrote it up almost $30,000 in bonuses it did not expect to have to pay its salesman. Why? Because the words "profit margin" used in the contract were ambiguous and not clearly defined. As a result, the parties assumed very different terms governing payment of bonuses. In cases like this where the words used in the contract are vague, ambiguous or not clearly defined, the law typically sides with the party that did *not* write the contract on the principle that he who wrote the contract ought to have done a better job spelling it out more clearly.

Other examples abound in my practice, almost weekly. Recently, for example, a tradesman consulted me. He and his crew had done work on a business establishment without a written contract because he knew the owner. They had agreed on a price, he supplied the materials, completed the job, and now needed to pay his subcontractors. After several repeated efforts, unreturned phone calls, and unsuccessful face-to-face meetings, it became clear to him that he was not going to be paid the $18,000 they had agreed to without legal help. One might call it selective amnesia, revisionist history (or crookedness) on the part of the owner of the renovated business. One thing it was *not*

was shoddy workmanship because the owner had repeatedly praised the work. Another recent example involves the purchase by a client of ours of software that never lived up to oral representations made by the supplier. Problem is that these oral representations never made it into their written contract with the software supplier. To make matters worse, the software supplier's written contract contained one of those "Entire Agreement" clauses that explicitly excludes prior promises and representations. None of these perils would have occurred had the client consulted an experienced business lawyer before signing the contract. The potential cost to our client: $50,000. I could continue, but you get the drift. Bottom line: things *can* go wrong; things *do* go wrong. And when they do, it can be very costly. That's when you want the "insurance", i.e. the security, that a well-designed business contract can offer.

Contracts: The Bread and Butter of Enterprise

Business people enter into contracts every day. Without contracts no business could survive very long, whatever industry it's in, whether retail, manufacturing, technology or professional services. They buy and sell goods, services and/or supplies; they license software and/or other technologies; they exchange confidential information; they lease premises and equipment; they contract manufacturing and/or distribution; they enter into sales and marketing arrangements with other businesses; they form corporations and require shareholder agreements; and they hire employees and contractors. Each of these transactions and countless others requires some form of contract. These contracts include:

- Agreements of Purchase and Sale
- Assignment and Transfer Agreements
- Alliance Agreements (Strategic Alliances, Sales & Marketing Alliances, etc.)
- Confidentiality Agreements
- Consignment Agreements
- Contract Manufacturing Agreements
- Collaboration & Cooperation Agreements
- Consulting Agreements
- Distribution & Reseller Agreements
- Employment and Human Resources Agreements
- Franchise Agreements
- Intellectual Property Assignment & Transfer Agreements
- Internet-based Agreements (Hosting, Website Services, etc.)
- Joint Venture Agreements (JVC, JVP or CJV)
- Lease Agreements
- Loan & Security Agreements
- Manufacturing & Distribution Agreements
- Marketing & Sales Agreements
- Non-Disclosure Agreements
- Operations Agreements
- Partnership Agreements
- Procurement Agreements
- Professional Services
- Promissory Notes
- Project Agreements
- Purchase and Sale of a Business
- Reseller Agreements
- Shareholder Agreements
- Software Licensing & Technology Transfer Agreements
- Sourcing Agreements
- Supply Agreements
- Trade Secret Agreements
- Website Design & Development Agreements

… and so many more. Each of the above can take many different forms having regard to the specific business requirements of the parties.

The "peril" identified and discussed in the OBJ article was a small business trying to save a few bucks by drafting their own

employment contract. I see this all the time in my business. Many of my clients come to me because they got caught in the design of their own business contract. Others come to me because they never put the contract in writing in the first place for a whole host of reasons, including the fact they knew the other party, they ran out of time, were short on cash flow, or never had a written contract in the past, so why now?

The Perils of Old Precedents or Web-Downloaded Contracts

Another "no-no" I see is Small-Medium size enterprises trying to save a few dollars by using and re-using old precedents or downloading contracts from the web. In the hands of a skilled draftsman, old precedents (we refer to these sometimes as "templates" or as "boilerplate") and web-downloaded contracts can be useful starting points. But not even an experienced lawyer with many years of practice would dare use such precedent without careful and meticulous analysis and re-working. Here's why.

We have, for better or for worse, created for ourselves a remarkably complex, unforgiving and litigious society. A client very recently wrote me an e-mail after I sent him comments on a *Non-Disclosure Agreement* he was being asked to sign: "Who would have thought life was so complex?" he asked. My answer: "… sadly, it was never intended to be so complex. We (humankind) have made it so..." But, to paraphrase Parmenides, the 6th Century B.C. Greek philosopher, "It is what it is". And because it is what it is smart business people enter into each business and commercial transaction with their eyes open. Others rush in blindly where even the most intrepid and informed fear to tread.

The most poignant reason for shying away from the use of old precedents or untested web-downloaded contracts is that they were designed to capture a different business deal from the one you are proposing to get into. First, more often than not, you don't know *who* drafted that old precedent or web-downloaded contract.How experienced were they? What training or expertise did they have? But, second, even if you do know who, and even if they are or were highly skilled and experienced, it goes without saying that they created that document, that contract, for a different "deal", with different parties, at a different time, and in a different context. They created it based on certain assumptions about the surrounding circumstances, the laws as they existed then, and the objectives they were driving to achieve at that time. How much of this context applies to your business deal today? Have the laws affecting the business arrangement changed since that old precedent was drafted? Are the objectives still the same? Are these parties, these stakeholders, as reasonable or collaborative as the parties to the old contract, or are they more demanding or litigious?

The Real Purpose of a Contract

The central purpose of a contract is to capture the "business deal" on paper. The business contract, whatever form it takes (see above list for starters), should set out as fully as possible what you know today and what each of the stakeholders is looking for from the deal, i.e. their reasonable expectations, either about the transaction itself, the relationship, or both, thereby reducing the risk of mis-understanding or future disputes, and the costs associated with untangling that mess later. Those costs are not limited to the financial; they include lost opportunity, agency and associated emotional costs, lost productivity and potential irreparable harm to previously significant relationships.

While old precedents and web-downloaded contracts might offer a useful starting point, it doesn't take more than a few minutes of careful reading to discover for yourself either that you don't like what a number of

those clauses in the precedent say, or, worse, you don't understand what they mean. And you're about to sign up to it. Yikes!

Context Matters

Today more than ever, words alone are not sufficient to provide legal protection. Words do not exist in a vacuum. They take their meaning from the context in which they are used. In other words, *context* has become as important as *content*.

What does this mean? It means that when it comes to who is right and who is wrong in a legal dispute over the meaning of words in a contract, the courts are increasingly looking at the context, i.e. the surrounding circumstances, that existed at the time the contract was entered into, to infuse meaning into the words in the contract. Or, as one legal writer put it: "Using a wall of words to block claims is not as effective as it once was". When I went to law school, the reigning paradigm was that the words the parties used to express their intention were all that mattered (or very close to it). Today the context in which those words are used has become just as important as the words themselves. This context is sometimes referred to as the "factual matrix". And it is critically important. After all, contractual interpretation is, for the most part, an exercise in giving effect to the intention of the parties. That intention is found both in the words used and the context in which they are used. Contractual interpretation, rightly understood, involves a consideration and reconciliation of both.

The challenge for the person drafting the contract is to know what contextual matters count. It is not self-evident. Knowing what matters in a contract, what you should include and exclude, and how to express it to capture the true meaning, intention and expectations of the parties, is an art that is acquired with informed experience. The experience of a seasoned business lawyer with many years of practice and business clients is almost indispensable. He or she will have seen similar contracts, similar situations, many times before. He or she will know what the risks are, what needs to be included, and how it needs to be worded so you don't end up on the short end of a costly mistake because you *thought* you knew what you needed. Take it from me, you probably don't know. After all, how many of us know what we don't know?

Closing Thoughts

To close, the value of a well-designed business contract is multi-fold:

(a) It offers peace of mind, not unlike that which comes from having auto or fire insurance in place;
(b) it provides a road map for you to follow when questions arise about a business transaction or relationship; and
(c) it creates certainty, reduces costs and mitigates risk.

To borrow again from the insurance metaphor: don't get caught in a fire with no fire insurance or with insufficient fire insurance. And don't get lulled into a false sense of security by a "home-made" contract that doesn't offer the protection you need. As Sheila Mather points out, homeowners might have their insurance policies in place, but the electrical wiring or fire detection equipment in their house may not be up to code. Where will that leave you if a fire strikes? The same is no less true of a contract that fails to include those protection mechanisms you need when things go awry in your business deal. Where will that leave you?

R. Nadeau
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