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# Contract Basics: Key Provisions And Common Pitfalls

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Whether you are drafting a contract for your organization or reviewing another company's contract, there are key terms to look for and some terms to avoid. Any time you or your organization takes action or makes a payment in exchange for something of value, a legal contract has been created. Most purchase orders, bills of sale, and employment agreements, for example, are legally enforceable contracts. Following is a summary of important terms when drafting contacts.

## Key Terms to Look For

These terms or provisions are key to a well-written and enforceable contract.

**Goods/Services** – The contract should contain a detailed summary of the goods and/or services. When drafting or reviewing the summary, keep in mind that if you are the buyer, you want the summary to be as comprehensive as possible; if you are the seller, you want to make the summary clear and identify items that are not included but may be available at an additional cost. Often these details can be included as an exhibit to the contract.

**Compensation** – The contract should clearly state the compensation amount for the goods and services or a formula for determining compensation (for instance, $10 per widget). The contract should also provide when the compensation is due. As with all things involving money, it's always best to argue about money when you are holding it rather than when the other party is holding it. Holding on to payments allows for leverage if you are purchasing goods and services and they are not provided properly.

**Exits** – Just like any room needs an exit, so does the contract. There typically two types of exits in contracts: termination for cause and termination for no cause (sometimes referred to as "termination for convenience"). The "for cause" exit is triggered if either party is in breach of an obligation under the contract, such as not delivering the widgets by the due date. The exit allows for termination as a result of breach. Some contracts give the breaching party time to "cure" or "fix" the breach before the exit can be used. For "no cause" terminations, the exit can be triggered by one or both parties with a given notice period, such as 60 or

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90 days, in advance of the termination date. Regardless of which exit is used, the provider of goods and/or services is entitled to be compensated for all work performed up to the date of termination.

**Indemnification** – This is an important risk management technique that should be included in every contract. Essentially the provision says, "Take responsibility for your services/goods. I'm paying you to do a job, I expect the job to be done right, and if you mess up and we both get sued, you will 'hold me harmless' from any financial liability as a result of your negligence." It serves to shift risk to the party that can best control risk. Let's say your organization hires a manufacturer to produce water bottle bearing your organization's logo. The water bottles turn out to be contaminated, someone gets sick and everyone gets sued. It is determined that the water bottles were not manufactured properly. With an indemnification provision, the manufacturer would have to make sure you are not financially harmed by the lawsuit, i.e., hire attorneys to defend the lawsuit on your behalf and pay any damages awarded against you.

**Insurance** – It is important to ensure that the party providing goods and services carries liability insurance and the contract should refer to the types of and coverage amounts of insurance. A certificate of insurance should be provided as well.

**Non-Assignment** – You are contracting with a company to provide goods or services because it is their company. If their company gets bought out the day after the contract is signed, you may not want to do business with the new company. As such, a non-assignment provision typically provides that neither party may assign its rights or responsibilities under the contract without the prior written consent of the other party.

## Key Terms to Avoid

If a contract you are reviewing or drafting contains these terms or concepts, it may be worth a second look.

**Prevailing party attorney's fees** – It is the general rule in the United States that each party pays for its own attorney's fees when there is a dispute. As such, contracts do not need to specify payment of attorney's fees. However, often you may see a provision that says if there is a dispute arising out of the contract, the prevailing party is entitled to recover its attorney's fees from the non-prevailing party. Basically it's a nice way to say that the loser pays the winner's attorney's fees as well as its own attorney's fees. The risk is high that this provision will be part of any settlement discussion and the party that claims they are owed money will use it to force the other to settle.

**Dispute resolution** – Many contracts include a provision regarding dispute resolution. Often this provision refers to which state law will govern the contract and which courts have forum to hear the dispute. But other contracts specify that disputes be resolved by mediation or arbitration. Because each of these options can have significant impact on the dispute and the cost to resolve the dispute, you should consider first consulting your legal counsel before agreeing to any type of dispute resolution process to determine which, if any, dispute resolution option is best for your organization.

**Limitation of liability** – These provisions are often found in "ALL

CAPS" in contracts as they are required to be conspicuous to the reader. Essentially, the language serves to limit a party's liability for certain types of damages (such as indirect and consequential damages or lost profit) and/or tries to "cap" liability at the dollar amount that would have been paid under the agreement. So, $10,000 for 100 widgets means that if there is a claim regarding the quality of the widgets, the most you could recover from the manufacturer would be $10,000.

**Date by which suit must be filed** – Some contracts state that if there is a dispute arising under the contract, it has to be filed within a specified time frame after contract completion, such as one year, or it is not valid. Often disputes do not arise right away and it would be best to consider avoiding putting your organization "on the clock" in case it receives notice of a claim one year and one day after the contract completion.

**Jury trial waiver** – Under most types of litigation, parties are able to request a jury trial. However, some companies do not want to take the risk of a runaway jury so they ask the other party to "waive" the right to a jury trial. This type of language also needs to be carefully considered, given that you don't know what kind of dispute will arise and whether a jury trial would benefit you.

Regularly reviewing current contract language with counsel and working with them to find out which provisions best fit your needs is a must for any organization's to-do list.

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