REDUCTION OF RISK IN BUSINESS COMMUNICATIONS

1. Goals: No unintended contracts or contractual commitments created.
No unknown liability risks incurred.

2. General Problem: Words that you intended to be used and understood in a purely marketing, administrative or other non-legal context can be used against the company in a legal context as contractual statements if the company gets into a dispute with a vendor, customer, employee or prospective employee. Language in Statements of Work, (SOWs), Request For Proposal (RFP) responses, proposals, presentations, offer letters as well as emails and letters to customers, prospects and hire candidates is always at risk and always requires due care in drafting.

a. How: Absolute words, for example, such as "*insure*" or "*guaranty*", "*best*", "*most*" or expressions such as "*we are your partner*" or "*we will make sure*", "*we will do all that is required*" or "*you shall receive*", and "*you shall save*"" when used in an SOW or a proposal in order to build a level of confidence and comfort in the customer, can be interpreted to mean absolute obligations of the company when lawyers for the other side get involved after a dispute arises. If an absolute obligation is what you meant … great. If not there can be a big problem. The first thing any lawyer will do when representing a client in a dispute will be to review all the exchanged documents between the parties in order to find language that will support his client's position. If his client is claiming that the Company breached its obligation to deliver a certain level or type of result, the lawyer will review all documents looking for words or statements such as the ones above.

b. Basic Avoidance in a Contract: I will add to any contract that I review a clause known as an Integration Clause. This clause states that the words on the pages of the contract represent the entire agreement between the two companies and all documents, statements and expectations that came before or anything else exchanged between the parties is superseded or just does not count. The purpose is to stop the lawyer for the other side from combing through our letters, emails and documents to find loose words that he can use against us. However, if prior presentations or documents are to be attached as Exhibits to the contract, they become legal documents by virtue of the attachment, the Integration Clause does not cover them, and they must be reviewed to make sure they are clear, objective, unambiguous and commits the company to known obligations. Significant exception: disputes will often arise prior to the signing of a formal contract and in such cases there will be no Integration Clause and all the exchanged documents can be the basis for implying a contract.

3. The Legal Principles: Because we are trying to avoid unintended contracts from being created out of our writings, presentations and proposals there are three basic legal provisions of a contract that we need to be concerned about in reduction of risk context. In other words, what

Bruce L. Galaro, Esq. – Business Law Group – 203-797-1600

kind of binding legal statement can a careless proposal statement become? Here are the big three: covenants, warranties and representations. A covenant is a promise to do or not to do something. A warranty is a statement of fact with regard to the quality or character of the services to be delivered. A representation is a statement by the seller with regard to some existing fact or circumstances which is relied on by the customer in signing the contract. All are legally binding and enforceable. In an intended legal setting all need to be clear, concise and unambiguous.

a. Legal Examples

Covenant: *"the Company shall not provide the Company consulting training to any ABC or ABC Affiliate employee without such written notice and employee designation by ABC."*

Warranty: *"the Company warrants to ABC that the Company Products shall, for a period of ninety (90) days following the date of the delivery of such the Company Products to ABC, operate in conformance with the specifications with respect to all material operational and functional capabilities and features as set out in the written documentation …"*

Representation: *"the Company is free to enter into this Agreement, and the Company has full legal power and authority to enter into this Agreement, to make the license grants and transfer of information as provided herein …."*

If the Company does not follow the rules for the delivery of the training as noted above, if the products do not operate as noted above, or if there is some undisclosed constraint on the deal, the Company is in default of the Agreement and subject to damages. Because we know exactly what standards we are to be held to, we accept the liability for failure because we know the risk. However, this is not the case when marketing or sales statements are deemed by a court or opposing counsel in a settlement negotiation to be covenants, warranties or representations.

b. Sales and Marketing Examples:

1. *"the Company will do all that is required to make this implementation a success."* (Potential Covenant) … or in an offer letter to a hire candidate … *"the Company will provide you with all the resources and tools to make you a success."*

(As a covenant this means that if the acquisition of new technology or the use of additional personnel or re-performance of all services are required for success, then we have to do them. In a fixed price contract this is devastating. Also note that "success" is

Bruce L. Galaro, Esq. – Business Law Group – 203-797-1600

not defined in either case which can be a disaster as the ending point for all our efforts is not known. In the offer letter this language is an open invitation to any discharged employee to claim breach of contract because the company did not provide the employee with the required tools and resources which was why the employee was not a success which was why the employee was terminated.)

Better: Nothing. The statements above re-state the obvious. Isn't this what we will do in any implementation or hire? Why state it and create a vague obligation?

2. *"Our methodologies and services will provide a substantial reduction in the cost of your field operations."* (Potential Warranty)

(As a warranty this can mean that if there is not a "substantial reduction" (whatever that means) in plant costs, we may be required to pay over to the customer the amount that should have been saved.)

Better: *"Our methodologies and services are designed to provide a substantial reduction in the cost of our client field operations."*

3. *"the Company is a dynamically growing global company providing best-of-class software services to Fortune 500 companies worldwide."* (Potential Representation)

(As a representation this means that if we are not global in operations and facilities, are not racking up double-digit annual revenue growth rates, and our services to this customer were not "best-of-class" (again, whatever that means), and the customer can claim he relied on the fact that these were all true statements when made, then we can be held in breach and subject to damages.)

Better: *"the Company is a fast growing company providing industry-recognized software services to blue-ribbon list of Fortune 500 companies worldwide."*

4. The Trap of the RFP Response: A company can unknowingly allow sales and marketing language to become legal obligations in responding to an RFP. Customers will quite often have a provision in a contract that incorporates the vendor response to the RFP and thus makes all statements in the response part of the contract. Another slightly devious way of doing this is to have a statement in the RFP that the vendor response is part of the contract and a statement in the contract that incorporates all of the RFP itself. A particularly paranoid customer will have a statement buried somewhere that provides that all proposals, presentations as well as the RFP response are incorporated into the final contract. The purpose of this is from the customer's perspective is to hold the vendor's feet to the fire by making them "legally responsible" for all statements made prior to the execution of the contract. From our perspective, this is very

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dangerous as it blurs the distinction between sales and marketing language and legal language and as a result creates an unknown risk. All statements in the RFP response or other pre-contract documents which may have been written from a marketing or sales perspective are now transformed into legally binding contract language which can be breached if not performed or not true.

Obviously I will remove these types of provisions when I find them after a review of a proposed contract or the RFP; however, lawyers do not usually review RFPs (and the customers know this) so it is important for the Company personnel to pay careful attention to the terms of the RFP and to contact me when these types of "viruses" are found.

The Assumptions, Exceptions and Limitations Statement: A good practice to follow is to always add an Assumptions and Exceptions section ("A&E") to an RFP response. This concept is loosely derived from attorney opinion letters that perhaps you have seen. The attorney writes his/her legal opinion with regard to a particular transaction, and then follows it with a laundry list of assumptions, exceptions, limitations and qualifications that eliminate any potential gray areas and subjectivity. CPAs and banks are also notorious for this. An RFP A&E, however, need not be that extreme but should at least state (i) any assumptions that you used to come up with dates and numbers in the response, (ii) any exceptions to the applicability of the services or of any results stated in the response, and (iii) any limitations to the scope of the services or the response including, for example, a statement that the response is not meant to be the final contract between the parties and if awarded the business all terms, conditions, and exception shall be set forth in a separate contract.

5. Basic Rules of SOWs: SOWs (if properly drafted) are made part of and governed by the terms and conditions of a master contract, and when signed by both parties become a binding contract. This is a good thing for both parties, but care must be exercised in the choice and use of the SOW language. Many companies do not understand the nature of SOWs and do not treat SOWs as the binding legal contracts that they are; the misconception is they are an informal document describing what the vendor will do. Not so. If we state in an SOW that we will complete a gap analysis no later than July 1, that statement becomes a contractual obligation of the company that can subject the company to damages if not met. If we state a certain result will be obtained upon the completion of the services and that result is not obtained, we are in breach of the contract and subject to damages.

Language of an SOW must be objective, clear, logical in its sequence, and cannot include any sales or marketing prose such as generic descriptions of the Company capabilities and resources, or statements as to customer expectations or intended results, unless a specific, intended result is one of the milestones or deliverables that are part of the SOW.

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SOWs should be dry and unexciting documents. Never use subjective, marketing or sales-oriented language in an SOW; always use objective language that precisely describes the who, what, when where and how of the services that the Company will perform for the customer. Any other excess or flowery language can do nothing but cause confusion and come back to hurt us.

SOW Example 1: "The Phantom English Subsidiary". In this case the client's staff dropped a fluffy description of the company and its capabilities (taken from a marketing brochure) into the SOW as an introductory section. It was standard motherhood and apple pie, but it described the company as having certain worldwide capabilities that it no longer possessed (we had sold off the UK operations during the prior year). During the resolution of a contract dispute for this deal, this fairly innocuous marketing statement morphed into a legal representation that the other side allegedly relied upon when signing the SOW and the contract, and a claim of damages was made because they needed international capabilities (notwithstanding that the need for international capabilities never once came up in the negotiation of the contract between the companies). The failure of the company to review and pay attention to the boilerplate language allowed it to became a very convenient tool to be used by the other side to negotiate a better settlement.

SOW Example 2: "I can't raise prices for five years??" The SOW stated that the pricing that was listed in the SOW "*was fixed for the term*". The problem was the word "term" was not defined in the SOW. The master contract had a term of 5 years, but it was the intention of the company that each SOW that was issued against the master contract would have a different term depending upon the nature of the project. The problem was the company did not pay attention to the drafting of the SOW and because nothing in the SOW stated the intended 12 month term of the SOW, they were forced to honor the SOW pricing for all similar services for 5 years. Ouch!

SOW Example 3: "No matter what happens to your data … we are liable!" This breath-taking little beauty found its way into an SOW for a computer equipment co-location SOW. "*With security in the forefront of all co-location and network management customers' minds, XYZ has taken significant measures to incorporate all the necessary security elements within our data center and network management operations to keep your data secure.*" I did notice it and deleted it during my review, but think about what this quasi-marketing statement really says. First it states the company has incorporated "all necessary security elements" in its operations. "Necessary" determined how and by whom? If there is ever a breach of security then the customer can infer that all necessary elements in fact were not incorporated and hence the company is in breach. Secondly, it states the company will "keep your data secure". This is an absolute covenant and one that should not be made as some things are outside the control of the company. This statement was a disaster waiting to happen. The better, safer and more appropriate

Bruce L. Galaro, Esq. – Business Law Group – 203-797-1600

language solution here was to state in objective terms the level of security procedures and security devices that the company employs in its data centers without any elaboration of benefits to the customer.

6. Some General Rules of Risk Avoidance:

a. Sit on the other side of the table. Can the statement I have just written be interpreted by the customer as an unqualified obligation on the part of the Company? If yes, is that our intent? If, no … change it.

b. Always use either an A&E clause in an RFP response or a proposal, or in the alternative, make sure you provide in the body of the document all assumptions, exceptions, qualifications and limitations as needed with regard to benefits, analysis and conclusion stated in the document.

c. All estimates must be noted or labeled as estimates so as not to be deemed to be covenants.

d. Specifically provide in a proposal who at the Company has the authority to commit the company. This avoids the problem of the client relying on an unauthorized statement to our detriment.

e. All prices must have an end date for validity so they do not live forever. All dates need to be as specific as possible. "The beginning of the first quarter" is too vague.

f. Avoid absolute words such as "guaranty", "insure", "best", "most" unless you intend to honor the commitment and understand the risk.

g. If you are sending what is intended to be an interim document to a client or prospect for their review and comment, you must label the document as "Draft" or "For Discussion Only" either in a footer or as a watermark.

h. Never put anything in an email that you would not want to see as part of the final contract or as an exhibit in a lawsuit. Never assume emails with a client or prospect are informal communications. While it is sometimes difficult to turn an email into a contractual commitment, they are commonly used to show the intent of the company when a matter is in dispute and in this context can be very dangerous.

Bruce L. Galaro, Esq. – Business Law Group – 203-797-1600