Drafting a Workable Contract: Issue Spotting and Dispute Prevention

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These notes are adapted from essays at my Web site, OnContracts.com, and from my work-in-progress contract form book at CommonDraft.org

1. Introduction

One of the big complaints clients have about lawyers is that "they just don't understand the business." But it's not useful to just say, *Hey you: Understand the business!* The beneficiary of such advice might not know what to do to make that happen.

Neither is it particularly helpful to add, *Just ask questions!* It might not be obvious what questions should be asked.

So, this article presents a series of questions, with handy mnemonic acronyms, to help contract professionals and their clients — collectively, "analysts" — to perform "business reconnaissance" (a term coined by my wife, Maretta Comfort Toedt), with the goal of drafting practical contract clauses.

2. Business planning for contract drafters

2.1 T O P S P I N: Identifying threats and opportunities

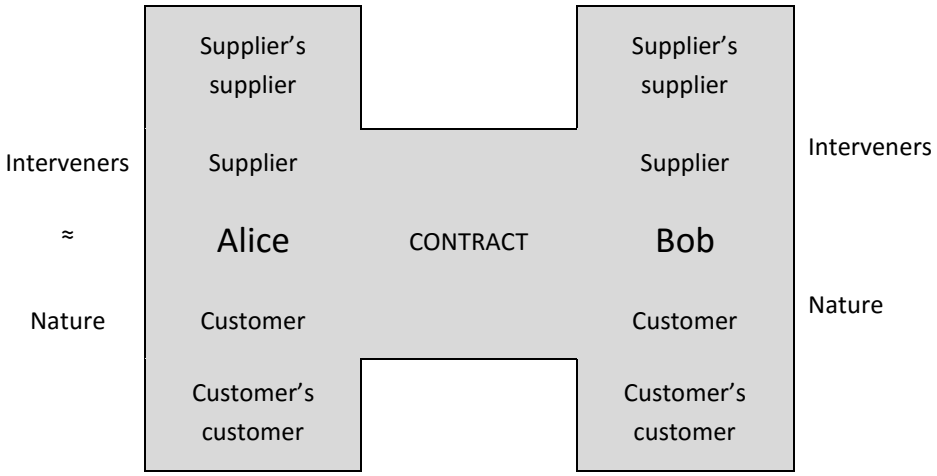
The acronym T O P S P I N can help planners to identify threats and opportunities of potential interest. (The acronym is inspired by the business concept of SWOT analysis, standing for Strengths, Weaknesses, Opportunities, and Threats.)

The first part of the acronym, T O P, refers to the ***threats*** and ***opportunities*** that can arise in the course of the different ***phases*** of the parties' business relationship. (Those phases can themselves be remembered with the acronym S N O T S: Startup; Normal Operations; Trouble; and Shutdown.)

The second part of the acronym, S P I N, reminds us that various threats and opportunities can be presented by one or more of the following:

(Continued on next page)

- S: The participants in the respective ***supply chains*** in which the contracting parties participate, both as suppliers and as customers, direct and indirect. If the parties are "Alice" and "Bob," then we can think of Alice's and Bob's respective supply chains as forming a capital letter H, as illustrated below:



T O P S P I N: What threats and opportunities might these various "players" present?

- P: The individual ***people*** involved in the supply chains, who have their own personal motivations and interests;

- I: ***Interveners*** such as competitors; alliance partners; unions; governmental actors such as elected officials, regulators, taxing authorities, and law enforcement; the press; and acquirers. Don't forget the *individual people* associated with an intervener, all of whom will have personal desires, motives, and interests;

- N: ***Nature***, which can cause all kinds of threats and opportunities to arise in a contract relationship.

ICE-CREAM EXAMPLE: Mother Nature might create a threat — and an opportunity for competitors — if an ice-cream manufacturer's products were to become contaminated with listeria bacteria.

2.2 I N D I A T I L T: Deciding on responsive actions

Once planners have compiled a list of threats and opportunities of interest, they should think about the specific actions that might be desirable — or perhaps specific actions to be prohibited — when a particular threat or opportunity *appears* to be arising. Many such actions will fall into the following categories:

- I: ***Information*** to gather about the situation in question;

- N: ***Notification*** of others that the threat or opportunity is (or might be) arising. Refer to the SIN part of the TOP SIN acronym above for suggestions about players who might be appropriate to notify.

- D: ***Diagnosis,*** i.e., confirmation that the particular threat or opportunity is real, as opposed to being an example of some other phenomenon (or just a false alarm).
- I: ***Immediate*** *action,* e.g., to mitigate the threat or to seize the opportunity.
- A: ***Additional*** *actions*, e.g., to remediate adverse effects or take advantage of the opportunity.

ICE-CREAM EXAMPLE: Consumers have been known to become ill, and a few have died, after eating ice cream that, during manufacturing, became contaminated with listeria bacteria. The grocery store's planners might want to use the INDIA checklist to specify in some detail how the ice-cream manufacturer is to respond to such reports, with requirements for notifying the grocery store; product recalls; and so on.

Some plans are likely to require advance preparation. Planners can use the T I L T part of the acronym to decide whether any of the following might be appropriate:

- T: Acquisition of ***tools*** — such as equipment, information, consumables, etc. — for responding to the threat or opportunity.
- I: Acquisition of ***insurance*** (or other backup sources of funding).
- L: Posting of a ***lookout,*** that is, putting in place a monitoring system to detect the threat or opportunity in question.
- T: ***Training*** of the people and organizations who might be called on to respond to the threat or opportunity.

2.3 W H A L E R analysis: Fleshing out the action plans

In specifying actions to be taken, planners will often want to go into more detail than just the traditional 5W + H acronym (standing for who, what, when, where, why, and how). Planners can do this using the acronym W H A L E R:

- W: ***Who*** is to take (or might take, or must not take) the action.
- H: ***How*** the action is to be taken, e.g., in accordance with a specified industry standard.
- A: ***Autonomy*** of the actor in deciding whether to take or not take the action. Depending on the circumstances, this might be:
    - No autonomy: The action in question is either mandatory or prohibited, with nothing in between.
    - Total autonomy: For the action in question, the specified actor has sole and unfettered discretion as to whether to take the action.
    - Partial autonomy: The decision to take (or not take) the action must meet one or more requirements such as *reasonableness* (be careful: that can be complicated and expensive to lit-

igate); *good faith* (ditto); *notification* of some other player, before the fact and/or after the fact; *consultation* with some other player before the fact; or *consent* of some other player (but is consent not to be unreasonably withheld? A claim of unreasonable withholding of consent could itself be one more thing to litigate.)

- L: ***Limitations*** on the action — for example, minimums or maximums as to one or more of time; place; manner; money; and people.
- E: ***Economics*** of the action, such as required payment actions (each of which can get its own WHALER analysis), and backup funding sources.
- R: ***Recordkeeping*** concerning the action in question (with its own WHALER analysis).

2.4 Finally, ask the investigator's favorite two-word question

When I was a baby lawyer at Arnold, White & Durkee, I worked a lot with partner Mike Sutton, who is now the senior name partner at intellectual-property litigation boutique Sutton, McAughan & Deaver in Houston. One of the many things Mike taught me was that when interviewing or deposing a witness, a useful, all-purpose question consists of just two words: ***Anything else?*** That question can help planners make sure they've exhausted the possibilities that should be addressed.

3. Contract clauses to preserve relationships and prevent lawsuits

Business relationships can be fragile things. When drafting a contract, it can be useful to include specific provisions to help cultivate a good working relationship and reduce the odds that a dispute will cause the parties to drift helplessly into a lawsuit.

(NOTE: Examples of all of the clauses discussed below can be found at CommonDraft.org.)

3.1 Status-review conference calls upon request

Many business-contract disputes could be avoided if the participants would just talk with each other every now and then. In particular, it's often extremely helpful to hold such a conference immediately after — or better yet, before — a missed deadline or other poten-tial breach.

Sure, this is just Management 101. But it can't hurt for the contract to include a reminder.

3.2 Consultation in lieu of consent

Sudden, unexpected moves by one party to a contract can make the other party nervous. For example, the business relationship between a service provider and a customer could be damaged if the

serv-ice provider were to suddenly replace a key person assigned to the customer's work with-out notice.

The usual, sledge-hammer approach to dealing with this problem is to contractually require the provider to obtain the customer's prior consent before taking such an action. The provider, though, will usually push back against such a consent requirement, because:

- The provider will be reluctant to give the customer a veto over how it runs its business.
- Moreover, it could be a management burden for the provider to have to check every customer's contract to see what internal management decisions required prior customer approval.

As an alternative (and compromise), the provider might be willing to agree to consult with the customer before taking a specified action that could cause heart-burn for the customer. That way, the customer would at least get notice, perhaps an explanation, and an opportunity to be heard, which can make a big difference in the customer's reaction and to the parties' business relationship.

For example, a software-development contract could say that, for example, "Except in cases of emergency, Service Provider will consult with Customer at least 10 business days in advance of replacing the lead software developer assigned to the Project." That will at least get the parties talking to one another, which can help avoid strains in their business relationship.

3.3 Escalation of disputes to higher management

Some lawyers believe that a dispute-escalation requirement can increase the chance of an amicable settlement. Getting different, more-senior people involved in the dispute can sometimes bypass individual animosities, hidden personal agendas, and other foibles; this can help break an impasse.

3.4 Early neutral evaluation

When a legal dispute arises, the parties' lawyers can some-times tell their clients what they think the clients want to hear. (In part this may be because lawyers — especially male lawyers — tend to be overly optimistic about whether they're going to win their cases.) That can hamper getting disputes settled and the parties back to their business (if that's possible).

Consequently, if a contract dispute starts to get serious, an early, non-binding "sanity check" from a knowledgeable neutral can help the parties and law-yers get back onto a more-productive track before positions harden and relationships suffer — not to mention before the legal bills start to mount up.

3.5 Mini-trial of disputes to parties' senior management

Mini-trials, in which the parties' lawyers put on a one- to two-hour "trial" to senior executives of the parties (and perhaps a neutral facilitator), are thought to enhance the prospect of settling disputes.

(The head of litigation for a global services corporation told me that this was his favorite tool of dispute resolution.)

4. Hand-grenade clauses that can blow up in a drafter's face

Some contract drafters reflexively load up their agreement drafts with clauses that (they think) will favor their clients, without stopping to think what might happen if the roles were reversed – or if the other side has more bargaining power. Here are a few examples.

4.1 Trump Corporation's form of lease agreement gets turned around on it

Trump Corporation ("Trump") is a real-estate landlord, among other things. According to AmLaw Daily, years ago Trump's lawyers took one of the company's lease agreements, changed the names, and used it for a deal in which Trump was the *tenant* and not the landlord. Later, Trump found that the lease agreement gave the tenant significant leverage. Ouch …. *See* Nate Raymond, *Trump Misses Rent Payments …,* http://goo.gl/B72TIr (AmLawDaily.Typepad.com) (accessed Apr. 27, 2015) (Hat tip: ContractProfs Blog.)

4.2 Tilly's class-action case — a company sets the bar too high for its own good

Tilly's, Inc. and World of Jeans & Tops, Inc. ("Tilly's") had an employee sign an employment agreement (the "2001 employment agreement") containing an arbitration provision. That agreement included a carve-out for statutory claims (which thus could be brought in court, not in arbitration). Importantly, the 2001 employment agreement also stated that any modifications to the agreement would need the signatures of three executives: The company's president; senior vice president; and director of human resources.

In 2005, the company had its employees sign an acknowledgement of receipt of an employee handbook containing a different arbitration provision — which didn't contain the carve-out for statutory claims. The acknowledgement, though, didn't contain the three executive signatures needed to modify the 2001 employment agreement. As a result, Tilly's found itself facing high-stakes litigation by a class of plaintiffs, whereas it had thought it would be arbitrating low-stakes claims individually. See *Rebolledo v. Tilly's, Inc.*, No. G048625 (Cal. App. 4th Div. July 8, 2014) (unpublished; affirming denial of motion to compel arbitration).

4.3 One-way NDAs can backfire

With a one-way nondisclosure agreement, only the (original) disclosing party's information is protected, and so any disclosures by the receiving party might be completely unprotected, resulting in the receiving party's losing its trade-secret rights in its information.

That's just what happened to the plaintiff in *Fail-Safe, LLC v. A.O. Smith Corp.,* 674 F.3d 889, 893-94 (7th Cir. 2012) (affirming summary judgment for defendant): The plaintiff's confidentiality agreement with the defendant protected only the defendant's information; consequently, the plaintiff's afterthought disclosures of its own confidential information were unprotected.

5. Conan O'Brien's lawyers win by letting a sleeping dog lie

The scene: You're in a contract negotiation, representing The Good Guys Company. The other side, Nasty Business Partner Inc., insists on requiring The Good Guys to get NBP's consent before assigning the agreement. NBP has all the bargaining power; The Good Guys decide they have no choice but to go along.

Trying to salvage the situation, you ask NBP for some additional language: "Consent to assignment may not be unreasonably withheld, delayed, or conditioned." But NBP refuses. **Have you just screwed your client?**

In some jurisdictions, The Good Guys might have benefited from a default rule that Nasty Business Partner Inc. had an implied obligation not to unreasonably withhold consent to an assignment of the contract. See, e.g., S*honey's LLC v. MAC East, LLC*, 27 So.3d 1216 (Ala. 2009); *Pacific First Bank v. New Morgan Park Corp*., 876 P.2d 761 (Or. 1994).

But you asked for an express obligation — only to have NBP reject the request — and The Good Guys signed the contract anyway.

A court might therefore conclude that the parties had agreed that NBP would not be under an obligation not to unreasonably withhold its consent to assignment — that NBP could grant or withhold its consent in its sole discretion. This is pretty much what happened, on somewhat-different facts, in both the Shoney's LLC and Pacific First Bank cases:

In the *Shoney's LLC* case, the contract had an express provision allowing the non-assigning party to use its sole discretion in deciding whether to consent to an assignment. The Alabama Supreme Court held that this clause trumped the general requirement of reasonableness.

In the *Pacific First Bank* case, the lease agreement in suit included a consent-not-to-be-unreasonably-withheld requirement for certain sublet arrangements, but it did not include a similar requirement for assignments. The Oregon Supreme Court held that this amounted to an implied agreement that for assignments, the landlord was free to grant or withhold consent in its discretion.

You might remember that TV talk-show host Conan O'Brien's stewardship of The Tonight Show proved disappointing to NBC. The network decided to move Jay Leno back into that time slot and

bump Conan back to 12:05 a.m. This led Conan to want to leave the show and start over on another network — but if he had, he would arguably have been in breach of his contract with NBC.

Conan's contract apparently did not state that The Tonight Show would always start at 11:35 p.m. Conan's lawyers were roundly criticized for that alleged mistake by ex-Wall Streeter Henry Blodget and some of his readers. See *Conan's Lawyers Screwed Up, Forgot To Specify "Tonight Show" Time Slot* (Jan. 11, 2010), especially the reader comments following the article.

But then wiser heads pointed out that Conan's lawyers might have intentionally not asked for a locked-in start time:

- The Tonight Show had started at 11:35 p.m. for decades; Conan's lawyers could have plausibly argued that this start time was part of the essence of The Tonight Show, and thus was an implied part of the contract.

- Suppose that Conan's lawyers had asked for the contract to *lock in* the 11:35 p.m. start time of The Tonight Show, but that NBC had refused. A court might then have interpreted the contract as providing that NBC had at least some freedom to move the show's start time.

- Indeed, NBC might have responded by insisting on just the opposite, namely a clause affirmatively stating that NBC was free to choose the start time. Given that NBC had more bargaining power than Conan at that point, Conan might then have had no choice but to agree, given that he wanted NBC to appoint him as the host of the show. And in that case, there'd be no question that NBC had the right to push the start time of the show back to 12:05 p.m.

Ultimately, Conan and NBC settled their dispute; the network bought out Conan's contract for a reported $32.5 million. This seems to suggest that NBC was concerned it might indeed be breaching the contract if it were to push back The Tonight Show to 12:05 a.m. as it wanted to do. As an article in *The American Lawyer* commented:

> ... If O'Brien had asked that the 11:35 p.m. time slot be spelled out in any agreement—and had NBC refused—the red pompadoured captain of "Team Coco" would be in a weaker position in the current negotiations.
>
> "If you ask and are refused, or even worse, if you ask and the other side pushes for a 180, such as a time slot not being guaranteed, you can end up with something worse," [attorney Jonathan] Handel adds. Without having their hands bound by language in the contract on when "The Tonight Show" would air, O'Brien's lawyers are in a better position to negotiate their client's departure from NBC.

Brian Baxter, *Legal Angles Abound as Conan-NBC Standoff Nears Endgame* (Jan. 20, 2010).

Judging by the outcome, it may well be that Conan's lawyers did an A-plus job of playing a comparatively-weak hand during the original contract negotiations with NBC.

The lesson: Be careful what you ask for in a contract negotiation — if the other side rejects your request but you do the deal anyway, that sequence of events might come back to haunt you later.

6. Prepare for litigation: Include demonstrative exhibits in the contract

Remember the cliché about a picture being worth a thousand words? Nowhere is that more true than the courtroom. That's why in litigation, lawyers and expert witnesses often use so-called demonstrative exhibits — diagrams, time lines, charts, tables, sketches, etc., on posters or PowerPoint slides — as teaching aids to help them get their points across to the jury during testimony and argument.

In a lawsuit, the jurors might or might not be allowed to refer to the parties' demonstrative aids while they're deliberating. Jurors normally take "real" exhibits — like a copy of the contract in suit — into the jury room with them and refer to them during deliberations. Judges, however, sometimes won't allow the jury to take *demonstrative* exhibits with them, on the theory that the jurors are supposed to decide the case on the basis of the "real" evidence and not on documents created solely for litigation by the lawyers.

True, in U.S. federal-court cases, Rule 1006 of the Federal Rules of Evidence allows summaries and the like to be admitted into evidence. Trial judges, however, have significant discretion over evidentiary matters; if a judge decides that a particular demonstrative aid should not be given to the jury for use in its deliberations, it's usually the end of that discussion.

If you plan ahead when drafting a contract, your client's trial counsel might later be able to sneak a demonstrative aid or two into the jury room through the back door — no, through the front door, but at the back of the contract — as "real" evidence, not just as a demonstrative exhibit, to help the jurors understand what the parties agreed to.

Ask yourself: *Is there anything I'd want the jurors to have tacked up on the wall in the jury room* — for example, a time line of a complex set of obligations? If so, think about creating that time line now, and including it as an exhibit to the contract. The exhibit will ordinarily count as part of the "real" evidence; it should normally be allowed back into the jury room without a fuss.

Of course, before the contract is signed the parties would have to agree to include your stealth demonstrative exhibit in the contract document. But their reviewing your exhibit for correctness could be a worthwhile exercise — and if their review makes them realize they don't agree about something, it's usually better if they find that out before they sign.

There's always the risk of unintended consequences: The demonstrative exhibit you create today might not create the impression you want to create in a jury room years from now. But that risk is there when you write the contract itself.

Your time line, chart, summary, diagram, etc., doesn't necessarily have to be a separate exhibit: modern word processors make it simple to include such things as insets within the body of the contract.