

**TIPS FOR GETTING THE MOST FROM YOUR COMMERCIAL CONTRACTS
-- ARE YOU GETTING WHAT YOU BARGAINED FOR ?**

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The Importance of a Regular Contract Review Process

In difficult economic times like these, one practical step that every manufacturer can take to ensure that its operations remain as profitable and successful as possible is to conduct a review of its commercial contracts. Every manufacturing company has contracts with suppliers, customers, vendors, service providers and professionals. Too often, after a contract is negotiated, it is simply put in a file cabinet and never looked at again. Most companies, rightly, focus on the relationship with their supplier, customer or other contracting party in terms of day to day management activities, but too often this results in missing some key benefits that have been negotiated and in failing to properly manage contract performance. A contract review maximizes the likelihood that these negotiated benefits are realized. Your review should also give some consideration to whether the company's present contracts in fact adequately meet some of the basic metrics to be expected from a commercial contract.

Have a Centralized Location for Your Contracts

Even though contracts are the means by which every manufacturer does business and form the critical foundation of every supplier relationship, too often companies do not know the expiration date of their contracts and sometimes cannot even readily locate them. These problems should be addressed as part of this exercise – through a central

repository for easy retrieval of every contract and the use of a simple data base in which key contract information is entered.

Check Whether You Are Getting the Benefits Promised in Your Contracts

A primary goal of any contract review is to assess whether your suppliers, vendors (and sometimes even customers) are living up to their side of your contract with them. This includes asking (and obtaining answers to) the following types of questions:

- Are you receiving the correct pricing and any applicable discounts?
- Do the categories used in the invoices you have been receiving match the categories in the contract?
- Have any items been wrongly categorized in the invoice that were specifically identified for different treatment in the contract?
- Do your contracts contain key dates by which certain actions need be taken? (some agreements automatically renew unless terminated on a specific date – don't let a contract renew by default without considering whether the relationship should be ended or its terms renegotiated).

Insurance and Indemnity

You should also evaluate whether you have appropriately allocated risk in your contracts and whether you have obtained all promised documentation. Two subjects that should have been considered and included in any supplier contract are insurance and indemnity. To the extent possible, you should have secured both a promise of indemnity (i.e., a promise to defend and indemnify your company if it gets sued after purchasing a product or service from the supplier) as well as a promise of insurance. A well-negotiated risk

allocation provision should require your supplier to make your company an “additional insured” on the supplier’s liability policy and to provide you with a certificate of insurance to that effect. Accordingly, your contract review should include making sure that you now have all the relevant documents and certificates called for by these provisions. These documents should be maintained in the same centralized location as your contracts, or in some other easily accessible place. Don’t wait for a catastrophic accident to find out that the promised insurance was never obtained.

Check Key Terms

Next, be sure to review certain key terms in your contract. Some companies choose to have long-term agreements with some or all of their suppliers. Others elect to use just a purchase order. If there is a long-term supply agreement, make sure that it has been signed – too often parties actually forget to have an agreement signed even after they spend hours of lengthy negotiations agreeing to its terms. Also, check the duration of the contract and make sure that if there are annual price downs, you have been receiving the benefit of reduced pricing at the appropriate negotiated intervals. If you don’t have a long-term supply agreement with a particular supplier, the contract review is a good time to consider whether one is desirable.

Update Terms and Conditions

If a contract is in the form of a purchase order, it too should be signed. Make sure that all purchase orders were sent to the supplier for signature (and returned) and that you have the signed purchase orders in your files. If you don’t have a signed purchase order and there is a dispute with that supplier, you will likely be confronted by the argument that your contract is invalid because it violates the statute of frauds.

You should also determine whether the terms and conditions of any of your purchase orders need to be updated by issuing a new purchase order (one way of doing this is to post your company's terms and conditions on your website which can be referenced in any purchase order -- this can be done at minimal cost and will ensure that the same terms govern all of your supplier relationships).

Duration and Quantity Terms

Some of the specific terms that you should check in your contracts are those relating to duration and quantity. If a purchase order does not have a duration term, it can be terminated by either side on commercially reasonable notice (typically measured by the reasonable time it should take to locate another supplier). Consider whether this is now satisfactory notice given any changes in your business and whether the risk of not utilizing a duration term in a long-term agreement is still worth undertaking. All contracts must have a quantity term except for so-called "requirements contracts" and "output contracts." If you are relying on a purchase order to ensure that you have adequate supply of a particular product, and expect your supplier to provide you with all of your needed quantities, make sure that the purchase order contains the words "requirements" or "all." Otherwise, particularly in times of escalating material costs, you face the risk that your supplier may try to re-negotiate the price on the grounds that he did not expect to have to supply all the quantities that you are seeking.

Cancellation and Liquidated Damages Provisions

Finally, take note that most New England states permit parties to negotiate what damages can be collected in the event of a breach or termination of a contract. You should make sure that your contract or purchase order contains a termination provision or liquidated

damages provision that places appropriate limits on any damages that can be claimed by your supplier and/or that sets out what types of charges are payable if a purchase order is cancelled.

Conclusion -- A Regular Contract Review Improves Productivity

Conducting this type of contract review on a regular (annual or bi-annual) basis will dramatically improve your present cost controls and allow you to implement and/or recover substantial negotiated benefits from your contracts.

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