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Less-Risky Business: Best Practices for Contract Management

Companies are negotiating an increasing numbers of complex contracts. As the number of contracts increases, companies face a proportionate increase in the number of risks.

These risks include:

1. Corporate risk resulting from the company lacking a strong understanding of the scope of its contract portfolio and the risks associated with its contractually negotiated positions
2. The company being in breach or otherwise non-compliant with the terms of its contracts due to inadequate contract process controls
3. Loss of revenue due to inadequate enforcement by the company of its contractual rights with third parties
4. Regulatory and compliance risk due to the company's contracts having inadequate provisions to deal with compliance risks

Establishing best practices for contract management will significantly reduce these risks while significantly reducing costs and improving internal controls.

INTERNAL DUE DILIGENCE

In many respects, as a company works to improve its contracting processes, it is in fact re-engineering these processes. The first step is for the company to conduct internal due diligence to document its existing processes and workflows. Then it can conduct a thorough analysis toward improving the efficiency of those processes. Any company with a robust contracting process will attest to the fact that performing internal due diligence is key to the success of such a project.

There are a number of issues to consider when documenting existing workflows, including:

- Who in each business unit is responsible for requesting that a contract be sent to a potential counterparty?
- Who determines which person in the legal or procurement department will handle the request?
- How does the company determine which form of contract to use?
- Who is responsible for negotiating each contract and for maintaining communication with the appropriate parties?
- Who is responsible for or has approval authority to make necessary changes in each contract?
- Who is responsible for executing each contract?
- In what type of contract repository are the contracts being maintained?
- Who is responsible for uploading each executed contract into the contract repository?

Once the company has answers to these questions, it can begin re-engineering its internal processes and determine the most appropriate allocation of resources.

When employing a contract management system, implementation is only the first step. In order to measure the system's effectiveness, it is necessary to continually re-evaluate how the system is being used and whether the company is achieving anticipated efficiencies. It is also important that the system only be used by those for whom it was intended, and that there are no exceptions.

Also essential is the continual maintenance and updating of the contract management system. If the company makes policy changes or updates to its templates or playbooks, these changes must be implemented in the contract management system, workflows must be adjusted appropriately, and notice to employees and appropriate training should be provided.

Finally, the company should periodically review its workflows and processes to see if it can further improve efficiency or if it needs to address specific requests from system users.

UTILIZE A CONTRACT MANAGEMENT SYSTEM

One of the greatest risks faced by companies is that they do not have an adequate inventory of their existing contracts. At a macro level, this affects the company because it does not have a comprehensive understanding of its contractual rights and obligations. On a micro level, the company does not have a thorough understanding of the risks attendant to contractual provisions to which it has agreed.

An important step to alleviating this issue is for the company to implement a contract management system. Contract management systems are available in many forms and degrees of complexity. The decision about which type of system a company should select is based on its overall goals. More complex systems will be used when a company desires to use the contract management system to implement workflows based on its contract management processes, to use the system for contract assembly, to maintain contract templates and playbooks, and to integrate with other systems, such as Salesforce and/or ERP systems. Simpler systems could be used for companies that have a lower volume of contracts or for when the company's main goal is to maintain an inventory of contracts and an understanding of basic information such as bibliographic details and renewal and termination data.

When a company is concerned it might be losing revenue due to inadequate supervision of its contractual relationships, the contract management system could be used both to support internal initiatives to better monitor and enforce its contractual rights, and to integrate with the company's accounting system to better monitor cash flows.

Regardless of what type of contract management system a company selects, the system will only be as successful as the training the company provides to its employees and the seriousness with which the company implements the system and anticipates employee pushback.

USE CONTRACT TEMPLATES

Many companies regularly negotiate certain types of contracts again and again, such as nondisclosure agreements, license agreements, master service agreements, etc. In the typical organization, these types of agreements are negotiated as needed.

Often, the party negotiating the contract has a preferred form he or she uses, depending on the type of agreement required, and each negotiator will have a preferred form. In addition, each individual will have their preferred negotiating positions. This results in inconsistency in both the form of contract used, as well as in the contract provisions negotiated.

One way to alleviate this is for the company to develop standard contract templates for use by all of its negotiators. The easiest ways to develop a template contract is for the various negotiators to review together their forms of agreement. Based on one or more meetings, the negotiators can agree to common language for use in each type of contract. This will be the basis for the contract template. This process can be repeated for each type of agreement the company deems a template would be of value.

If the company can select appropriate form language for similar provisions within each template, this form language can be incorporated across multiple contract templates.

One benefit of using form language of this type is that it is easier for the company to identify non-standard provisions that might be negotiated into its contracts. As these negotiated template contracts are entered into the company's contract management system, any non-standard provisions can be identified and used by the company to later identify risks that it has in its contract portfolio.

For companies concerned with compliance risks, appropriate language can be included in the templates.

USE NEGOTIATING PLAYBOOKS

It is common for many companies to negotiate their contracts on an *ad hoc* basis. As a result, each individual will negotiate contract terms based on personal preferences and past experiences. This results in inconsistencies in negotiated contracts that could pose a risk to the company.

A playbook is a list of negotiating fallback positions for the company negotiators to use when negotiating company contracts. For example, many of the company's contracts could have limitation of liability provisions. The company might take an initial position that all limitations of liability are capped. However, from past negotiations and through corporate policy, the company might determine certain limitations of liability could be uncapped if raised by the counterparty, such as liability for intellectual property infringement. In this case, since the company has agreed that unlimited liability for intellectual property indemnification is acceptable, it would be included in the playbook as a fallback position for changes to the limitation of liability provision.

Determination of the content of the playbook is generally based on two factors: agreed fallback positions the company has generally accepted in the past and any company policies that might limit the flexibility of negotiators. For example, if the company decided, as a matter of policy, that unlimited liability is never acceptable in contracts, the playbook would reflect this position. If the company continues to rely on a particular fallback position, it might determine to amend the template in order to include the fallback position in its initial contractual position.

One of the key benefits to using templates and playbooks is that it becomes less necessary for the company to use expensive legal staff to negotiate its contracts. In many cases, the company

can begin to rely on legal assistants, non-lawyer contract negotiators or outsourced service providers to be responsible for generating contracts and negotiating those contracts end-to-end. This presents a huge cost savings opportunity to the company with very limited risk, because most of the risks have already been accounted for by the templates and playbooks.

BETTER PRACTICES, LOWER RISK

Implementing best practices for contract management will provide a company with a number of important benefits. Not only will the company be able to achieve significant cost savings through increased efficiency, but the resulting contracts will be of lower risk to the company.

Where a company previously might have had various types of contracts for the same purpose and taken conflicting negotiating positions, it will now have much more consistency in its executed contracts. Furthermore, by using consistent contracts and an effective contract management system, the company will be able to better track risks attendant to non-standard provisions included in its contracts, as well as contractual rights that could improve the company's bottom line through more consistent enforcement. 



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