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An Art and a Science: Developing Agreements That Work

A fair and moderate approach to negotiations creates strategic advantages.

BY ROBERT J. BENOWITZ

TYPICALLY, one of the primary responsibilities of in-house legal staff in the general counsel's office is negotiating and drafting agreements on behalf of their organization, whether it is a public, private or not-for-profit corporation. Clients may include the CEO, CFO, CIO and senior sales, human resources and marketing staff, and even members of the board. Agreements can cover almost every aspect of the company's business including executive employment arrangements, acquisitions, outsourcing, vendor agreements, licensing and sales agreements, insurance and risk management and many other types of transactions.

Developing effective documentation for agreements is not a standardized process; rather, it is both an art and a science, with many subtle points. The goal of the in-house legal team is to work with all parties, together with outside counsel when necessary, to guard against deals that will cost more in resources, or even goodwill, than the transactions are ultimately worth.

In many instances, the in-house legal team is under tight time pressure to complete what may be complex and varied documents and can sometimes be perceived as "holding up the deal." Even legally sophisticated and experienced clients, when engaged in complicated transactions, involving finance, technology and consulting, can be alarmingly impatient. While client business teams are exerting pressure to complete a given transaction, it is the thankless task of in-house counsel to ensure that the corresponding documentation includes the salient business points, is legally sound, avoids unintended obligations and accurately reflects the client organization's business philosophy and best practices.

One counterintuitive notion that in-house legal staff should consider is that reaching a workable agreement on a timely basis can best be facilitated if relatively "fair" positions are taken on key business issues and even legal points. This does not mean that agreements should not be strenuously negotiated on behalf of the client. For each situation, there will be provisions that are non-negotiable. But other areas may be amenable to creative solutions that are not always immediately obvious.

Conveying these ideas to clients, particularly when they

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A hard-line approach may lead to protracted, expensive negotiations.

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are in the middle of a deal, is no small task. A better approach is to take a look at past agreements, particularly those that did not reach the desired outcome, and determine where these could be improved.

What follows is an analysis of some of the major types of agreements that organizations generally must develop with vendors, service providers, licensees and concessionaires, and prospective employees that demonstrate some of the issues that general counsel should consider in their negotiations.

One-Sided Agreements

When organizations begin negotiations with a one-sided set of documents, the message communicated to the other parties, whether they are a vendor, prospective employee, or even a customer, is that we, the company, will make you fight for every concession whether material or otherwise. Among other problems, this can prompt all other parties to also take a hard-line approach leading to a protracted and expensive negotiation. For example, proposed contracts presented by some technology and communications vendors sometimes have a number of substantial problems, materially affecting the usefulness of the transaction.

In these cases, counsel's client is often the chief technology officer, who is working to implement new agreements needed to bring new operations online, increase access to data, reduce costs or provide new services to customers in a more efficient manner. Generally there is a mandate to implement the new product or service needed as quickly as possible, so there is tremendous pressure on the technology staff and counsel to complete the agreement expeditiously so that staff can begin to utilize these new services.

Issues that in-house counsel must consider include licensing, installation, product customization, regulatory issues, staffing and performance as well as many others. Technology agreements often must incorporate appropriate testing and acceptance protocols and non-performance penalties, and in many settings require regulatory approvals. In order to ensure that negotiations go smoothly, in-house counsel should take a hard look at vendor supplied documents to ensure that they provide a realistic starting point.

In some cases, however, in-house counsel may be confronted with a lengthy, unwieldy and unreasonably one-sided set of documents, with which the vendor's negotiating team is very familiar. In these situations, the vendor's team understands how to utilize every provision with a view toward steering the transaction in the vendor's favor.

In the end, agreements must accomplish the client's aim while precluding any costly future litigation.

Counsel could choose to "go to war" over the vendor's set of documents, and thereby engage in protracted negotiations that may not necessarily guarantee a more positive outcome. A better alternative may be to incorporate the deal terms as discussed between the parties in a revised set of documents using the vendor's format. This approach will frequently produce economies in time and cost in attaining a set of documents acceptable to both parties.

In extreme cases, where the vendor stridently argues every point, and is unwilling to make even the smallest concessions, it may make sense to advise that the client canvass competing vendors for alternative systems and solutions. Vendors that begin from an unreasonably one-sided perspective risk losing customers and credibility, and their counsel should examine these deals to ensure that this position is not costing business in the long run.

Tame the 800-Pound Gorilla

In some cases, a client may have substantial economic leverage and could seemingly be justified in using a heavy hand to achieve its purposes during the negotiating process. However, a moderate approach, which creatively incorporates the client's key concerns, may be preferable.

For example, large corporations and other organizations often need to develop outsourcing arrangements with smaller boutique suppliers, to acquire the use of a unique technology or service that would be very expensive to develop in house.

From the perspective of the larger organization, dealing with a small supplier has a number of potential concerns. Often the new service is deemed to be crucial to the organization's business plan and product or customer development. The vendor's actual capability to deliver this service must be assured as well as its ability to expand its facilities to accommodate increased future order flow and achieve cost reductions based upon projected economies of scale.

In many instances, the tactic used to assure on-time dependable performance is to provide for substantial economic sanctions against the vendor for its failure to perform. But in some cases, financial penalties could conceivably jeopardize a vendor's financial stability, which could have the effect of negatively impacting continuous delivery of the service. Such an approach may eventually be self-defeating.

A better approach might include terms for the organization to finance a vendor's expansion if it is required to meet new demand. One creative solution is to offer financing, secured by an interest in the assets of the vendor or a pledge of its shares or some form of equity position in the vendor. The terms of this type of deal, while aggressive, will signal to the vendor that your client is ready to use its

economic leverage to fashion reasonable business-based solutions to difficult problems rather than extracting penalties.

Asset Protection — Not Everything Is Negotiable

As in-house counsel know, there are many instances in which the nature of a particular transaction, as it may impact on your client's business, will dictate which terms are and which are not negotiable. The list of terms that are considered non-negotiable should only include those that will materially affect the organization's business. For example, an organization with a well-regarded brand should put a premium on provisions that protect its image.

As an illustration, take the case of a high-end retailer that grants third-party concessionaires sales privileges in its stores, and consider some of the types of terms required. Provisions protecting trademark usage would be fairly standard. However, other less typical provisions could be just as crucial, and should be considered in these types of agreements. For example, the primary retailer should retain the right to control both the configuration of the concession area, any subsequent alterations and the right to change the concessionaire's location for comparable space. In order to maintain an appropriate ambiance, provisions requiring the concession to be kept in good repair and the right to require the dismissal of employees whose conduct is deemed to discredit the client's image or disruptive to the operation of the store, can also be critical to these agreements. Requirements for specific advertising spending and even letterhead conformity may also be necessary to protect the brand.

It is unreasonable to expect an organization to put at risk its relationship to its market or control of its business. Therefore, in-house counsel can vigorously defend non-negotiable provisions, if they meet the standard of fairness by accurately reflecting their clients' overall business philosophy and mission.

Executive Employment Agreements

Certain types of agreements, for example employment agreements, should convey a sense of the client's business philosophy. Employment agreements — particularly those with top executive prospects — should accurately convey the organization's level of commitment to an applicant.

There are many issues that are crucial to top executives, particularly since the passage of the Sarbanes-Oxley Act of 2002. Among them: An employer's demonstrated willingness to protect its key employees is more important than ever. Along with providing appropriate indemnification and "hold harmless" provisions, senior executives expect their employment agreements to include terms covering advancement of legal, accounting and other professional fees in the event of a regulatory investigation or claim against the company and/or the executive. Agreements designed to advance professional fees telegraph that the employer is willing to stand behind its top executives.

Indemnification can be a hotly contested issue and in many cases, is an absolute requirement for a candidate for an executive position. Often prospective candidates are desirous of protecting their own reputations, and will not accept employment unless they believe that their prospective employer takes this concern seriously.

Prepare for Future Transactions

When possible, general counsel should begin to develop a regular process for negotiating and drafting agreements. This will allow counsel to educate his client prior to becoming embroiled in a particular negotiation. Some suggestions follow:

- Review all agreements that are negotiated on a regular basis — such as vendor and customer documents — for any recurring issues;
- Review the provisions of any agreements that have been a "deal breaker" and consider creative alternatives;
- Consider agreements that met your client's goals, and were negotiated efficiently, to identify best practices for your organization;
- Establish bottom-line positions with the internal client before an agreement is drafted;
- Ensure that in-house legal counsel is not employing standard agreements where customized, creative solutions are required and vice versa.
- Meet with senior management to present the GC's overall procedures, strategies and philosophy of developing agreements before engaging in negotiations.

Conclusion

Providing a sense of fairness can create significant strategic advantages in negotiations handled by in-house counsel. Among other benefits, counsel can take a vigorous stance on material terms crucial to the client's business, and at the same time have the flexibility to use the creative tactics that negotiations often require. In the end, agreements must accomplish the client's aims while precluding any costly future litigation.

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