



## TECHNOLOGY

# 411 To Contract Negotiations

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Dec 31, 2019 at 7:59 PM



*(Image via Getty)*

The nexus between the commercial terms and the legal terms in a contract is that risk costs money and, oftentimes, the legal terms provide a remedy. The more that we play with the legal terms, to allocate risk the more likely to increase the possible remedies, the more of a boomerang effect there will be on the relationship and increased costs.

You should never start negotiating with the legal terms, “When you get a straight legal term, you’re not thinking of commercial terms. That’s a challenge. Legal terms often sound really grand but they impact the commercial aspects of the deal, as well,” she said. For example, when negotiating a warranty clause, look at the buyer’s ability to detect a defective item or nonconforming service through testing and approvals first. It is far better to catch the defect before it is accepted by the buying company, then later through a warranty claim.

### **Risk Profiling**

It is important to align your intentions around supplier performance. First, figure out what kind of supplier performance you are looking for. Then you can get back to the contract. Starting with

a risk profile is a good way to begin. Lawyers really cannot have a thorough understanding of what the risk formula (i.e., limitations of liability) they create should look like if they don't have a really good idea of the risk profile involved.



One way to create a risk profile is by asking and answering these questions: How detectable is the risk? How probable is it? How severe is it? From there, you can develop a profile. You can create an easy color-coded system with red, yellow, or green profiles corresponding to different risk levels. Work with the line of business to identify risks.

Having robust processes to identify, document, and manage the risks process is a must. Ask yourself: Are there early warning signs? How probable is it? What I want to do is look at it upfront. What protections do we need in the statement of work so that we've got the right kinds of security in place, even if that's as much as we can do?

### **Manage Risks Through Policies And Governance**

Then, through operational means, identify ways to mitigate the risks you've identified. You need to make sure that the right technical specifications are outlined. "Corrective action planning, cure notices, monthly or quarterly reports, and numerous other mechanisms are there to protect your client from unnecessary risk. look at how corporate policies can control risks. Ask yourself: Do you have the kind of audit rights that you need? Do you have the right kind of background checks in place?"

You can mitigate these risks by having operational procedures such as reviews, approvals, or acceptance-testing in place," You can also control risks through stronger corporate policies and audit rights, and things like that."

There are differences between controlling, mitigating, and allocating risks. "If you are not actually trying to prevent the loss from happening through mitigation, you need to work in control features. Look at how your statement of work is written and mitigate the risk as much as possible with technical specifications. You can control it through things like audit procedures, background checks, and insurance provisions.

## Legal Tools

Then, and only then, look at your limitation of liability and indemnification clauses—things like that. Once you have done the hard work, your exposure and liability will become clear. That is a good time to use legal tools like a limitation of liability and indemnification. But those are crude tools; they do not minimize risk. They focus on allocating the responsibility for the risk event and payment once the size of the risk is determined. They should only be used as a last resort.

“Once we’ve been able to identify the risks, you can look at specific potential liabilities, Nyden explained. “If you insert liquidated damages first, then you effectively accept risks and waive other remedies against the supplier.”

In the end, “I see a lot more companies demanding more now,” Nyden observed. “Saying that their buying organization wants higher limitations on liability, higher penalties for late delivery, more indemnification, intellectual property, and especially with GDPR,” she added. “My concern is that this is just a policy. As a contract professional, I prefer to focus on the statement of work. It allows me to address risks through operational excellence and governance.”