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When good negotiations go bad

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Executives sign contracts daily, sometimes without fully understanding the consequences of the obligations they have committed their company to accept.

Businesspeople and managers deal with commercial contracts each and every day. Some do so without a basic awareness of the potential effect of the fine print contained within those documents.

Traditionally, business emphasises face-to-face negotiations. However, a company's fate in any contract negotiation is determined by the translation of the negotiated bargain into the final contract.

Because it is the final document that records these negotiations, a "winning" negotiation can be turned into a loss through a combination of astute drafting on one side and a lack of attention on the other.

The outcome of litigation can often be decided by the fine print boilerplate in a contract. While many executives are know the commercial terms of an agreement, few feel competent to challenge the fine print.

Often, in business, budgetary constraints or tight deadlines (or a combination of both) prevent lawyers becoming involved at the front end of contract negotiations.

When lawyers are involved, their role is usually restricted to drafting after the conclusion of negotiations, or in the litigation that might arise.

Whether lawyers are involved or not, every executive needs a fundamental knowledge of contracts.

Ever-present threat

Executives might be tempted to think they have never yet had a problem, in total ignorance of the potential gravity of the situation in which they place themselves and their companies.

Because of this lack of understanding of contract fundamentals, it can be said that some managers literally bet their companies each time they sign a contract.

It is the duty of every chief executive to ensure that their managers have an understanding of the basic principles of commercial contracts.

The end result is a reduction in the company's risk profile, which limits the potential for bad publicity and the drain on management resources from contract disputes and litigation. Ignoring it won't make it go away.

Directors fear employees exposing the company to the risk of potentially ruinous litigation. The cost of litigation in the USA alone is in excess of $US100 billion. There are more than 32,000 lawyers today in Australia (incidentally, Britain has over 101,000 and the USA has almost one million lawyers).

Every company must take preventative steps to keep as far away as possible from the litigation minefield.

One of the most significant hidden costs of litigation is the unrecoverable expense incurred in lost management time; managers forced to spend inordinate amounts of time with lawyers, attempting in vain to recall 'who said what to whom' many years earlier. Such costs are frequently unaccounted for by corporations.

All of these consequences are the natural enemies of any businessperson.

Shades of grey

Executives need to learn to deal with the ambiguities of contract drafting and the law.

Commercial contracts can be complex and intimidating documents, so a certain level of familiarity and a working knowledge of the language of commercial contracts is a prerequisite for managers.

Executives armed with such knowledge of contract fundamentals are better able to spot issues before they become problems.

If litigation happens, that knowledge can be applied to working with the company's lawyers more efficiently. The bottom line is a tangible saving in cost and time.

Executives might argue that avoiding risk in business is impossible. But, properly understanding and managing risk is vital.

To avoid risk entirely, an executive should stay at home and hide under the bed (however, such a course may present its own dangers).

This is why the process is called risk management and not risk avoidance: seek to understand the risks, manage them and do all that is possible to minimise those risks and their potential effect.

Selling the idea

Often, the difficulty encountered in selling the benefits of any risk-prevention activity is that a company cannot recoup such investment at the end of the month.

The easiest way to sell the benefit to management is by demonstrating the effectiveness of incurring the much-lower, front-end cost to avoid overspending when the litigation occurs.

Managers should be equipped with the tools to make calculated commercial decisions, not be turned into lawyers.

Some managers chose to win new business at any price. This behaviour is often pronounced when a company tenders for new business when a manager might be tempted to ignore the potential downside by thinking that "everyone else is agreeing to this."

Entering into contracts with immediate revenue benefits can prove to be a counterproductive strategy, if such contracts are not properly scrutinised for potential risk. This is particularly the case where such contracts may contain onerous indemnities or consequential loss provisions, which can have a disastrous effect, long after the document is signed.

Fine distinction

Issues in contracts requiring evaluation can either be legal or commercial in nature. This is an important distinction.

This distinction divides issues that need to be dealt with by lawyers and those that are commercial terms requiring decisions to be made by managers. Managers should not seek to absolve themselves from all decision-making responsibility by having lawyers sign off on everything; even on issues that are not strictly legal in nature.

A deal can be jeopardised when commercial people abdicate responsibility to their lawyers or, worse still, where an overzealous lawyer decides he/she knows what is right for the company and makes decisions on commercial matters for the client.

To achieve a balance, much depends upon the ability of:

- the lawyer to know which decisions are properly commercial ones for the client to ultimately make and;

- the manager to properly brief the lawyer and realise where an overzealous lawyer might be overstepping the boundaries.

Taking matters one step further, everything is a commercial decision, although not always for a line manager to decide. When issues arise requiring decisions of corporate policy, they must then be referred to the organisation's apex for the final decision.

Managers may take the view that lawyers have a desire to complicate matters by insisting on negotiating every point to the death.

If the disasters warned of by lawyer never happen, this should be music to the manager's ears. It confirms that the lawyer and manager performed their tasks correctly.

That the seemingly endless discussions spent hammering out what may, at the time, have seemed minute points often contribute significantly to clarifying the understanding and intentions of the parties. Reaching this level of understanding between parties can often save major headaches in the long term.

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