



## **MANAGING BUSINESS RELATIONSHIPS: A LAWYER'S PERSPECTIVE**

### **Thinking Your Way Through Commercial Agreements**

*“Business success naturally requires the establishment of effective relationships...Every relationship has a beginning, middle and an end and the best time to address the end is, of course, at the beginning.”*

### **These relationships typically involve:**

- the “deal” between the founders of the business (whether partners or shareholders);
- the “deal” between the business and its employees;
- the “deal” between the business and its independent contractors;
- the “deal” between the business and its customers;
- the “deal” between the business and its trade suppliers;
- the “deal” between the business and its bankers;
- the “deal” between the business and its landlord;
- the “deal” between the business and its equipment lessors;
- the “deal” between the business and its joint-venturers/strategic alliances; and
- the “deal” between the business and its investors.

### **What is an effective relationship from a “lawyer’s perspective”?**

- the identification and exploitation of commercial benefits;
- the identification and avoidance/management/allocation of commercial risks; and
- the expression of the allocation of benefits and risks in a written “operating manual” (i.e., a good contract should function as an “operating manual”).

***NOTE: There will always be benefits overlooked and/or potential risks that were not foreseen and/or allocated so “effective” does not suggest “perfect”.***

### **What are the benefits of establishing effective relationships?**

- may avoid/reduce cost of future dispute resolution;
- more potential disputes are addressed at the outset and the relationship has more certainty;
- assists in building trust and familiarity among strangers;
- establish clear rules on how the relationship is eventually “unbundled”;
- enhance likelihood of an amicable parting without negative reputation effects;
- establish in advance your bargaining position/leverage; and
- learn more about how the other side deals with resolving conflict from the outset.

### **What are the costs of failing to establish effective relationships?**

- costs of dispute resolution can be high;
- weaker bargaining position/less negotiating leverage;
- indirect costs i.e., loss of key management time/focus/strategy;
- personal stress, anxiety, etc.;
- possible negative reputation effects (both external and internal);
- involvement of 3<sup>rd</sup> parties (e.g., Ministry of Labour); and
- possible threat to entire enterprise.

### **How to establish an effective business relationship?**

Clearly, enhancing your negotiation skills is critical to establishing and documenting an effective relationship.

One of the most important steps in any negotiation is careful and methodical preparation.

Preparation will clearly involve understanding what is important to the other side and what are the “interests” that are likely to lie beneath the “positions” they will inevitably articulate as the negotiation unfolds.

However, another key area of preparation involves the process whereby you identify:

- (A) the nature and subject matter of the relationship;
- (B) the key benefits sought by you resulting from the relationship;
- (C) the key risks to avoid, manage and/or allocate among the parties; and
- (D) other critical aspects in relation to the establishment, management and termination of the relationship.

### **C<sup>3</sup> - A Fresh Approach:**

*In order to identify these matters, you need to ask yourself the “right questions” and follow a suitable “methodology”.*

Welcome to “C<sup>3</sup>– commercial contracts checklist”.

C<sup>3</sup> is a list of key questions you can ask yourself to aid in identifying (A) to (D) above and better prepare yourself to negotiate your important business relationships.

Also, using C<sup>3</sup> will enable you to provide more specific and detailed instructions to your counsel so that he/she can prepare a proper contract which (hopefully!) will need less “back and forth” drafting and cost you less than merely providing counsel with the usual “napkin instructions”.

The following list of non-exhaustive questions should be considered:

1. ***Who are you contracting with? Identify all parties to your agreement including all individuals and corporations.***
2. ***If you are contracting with a corporation, consider if its’ principal(s) should be providing personal guarantees of the corporate obligations?***
3. ***What is the fundamental nature of the relationship? Is it the sale/lease or rental of a product? Is it the provision of a service? Is it both? Is the relationship a “one-off” or of long-term duration?***
4. ***Ensure the relationship is properly characterized for tax/commercial purposes. If the parties are truly independent contractors, you should state that no relationship of agency, employment, partnership, joint-venturer, shareholder, etc., is being created.***
5. ***Is “exclusivity” important to either party? If so, why and consider what exclusivity means in the context of the relationship – i.e., does it relate to products, services, territory, etc.? To what extent are the parties free to deal with others in relation to the subject matter of the relationship?***
6. ***Are the parties required to participate in this relationship on a “full-time basis” or is passive involvement/ownership acceptable?***
7. ***How will or should the death, insolvency, disability or marital break-up be addressed in the relationship (if at all)?***
8. ***If an “agency relationship” is created, what right will the agent have to bind the principal? What rules of conduct will apply?***
9. ***Consider the application of any conditions. In other words, are certain important pre-conditions required to be satisfied before one or both parties are legally required to perform any specific obligations in favour of the other?***

10. ***What rules will apply to the delivery and acceptance of goods or services? Will such products or services have the benefit of any warranties or performance guarantees? When will the “deliverables” be satisfactory to the buyer?***
11. ***To what extent is insurance relevant in the relationship and what rules should apply to ensure proper insurance is in place during the term of the relationship? Consider ordinary commercial property, casualty and liability insurance as well as life, disability and critical illness insurance.***
12. ***Is confidential/sensitive information likely to be exchanged by the parties? If so, what rules will apply to the manner in which one party can use the other’s confidential information (both during/after the relationship)? If one party requires regular access to the other’s information, what rules will apply to ensure access?***
13. ***How is the pricing of the sale of products/provision of services established or calculated? Is the price fixed per unit sold, variable based on volume, variable based on time/hours of services, etc.? If pricing is variable, will one party have the right to audit the records of another to verify the accuracy of such pricing?***
14. ***How/when will the price be paid? Will there be any claw back/adjustment to the price or any reason – e.g., will the collection of receivables impact payment of commissions? What is the currency of the contract price – US/Canadian dollars?***
15. ***What consequences will result from late payment? Interest penalties? Do you need any “security” for full payment and what options are available (e.g., receivables insurance, security interest in sold goods, title retention, deposit/retainer)?***
16. ***Consider “non-price” benefits (e.g., vacation entitlements or use of motor vehicle in an employment relationship, etc.).***
17. ***Does a party have the right to be reimbursed for its expenses? If so, what rules apply to ensure this reimbursement right is not abused? When will these expenses be repaid?***
18. ***Who shall be responsible for the expenses/fees of 3<sup>rd</sup> parties (e.g., brokers)?***
19. ***If one or both parties are involved in the creation of any important intellectual property or other rights under the relationship, who will have ownership of such property and what rules of use will apply?***
20. ***How long do the parties desire the relationship to last? Fixed term or indefinite term? Any renewal rights?***
21. ***Under what circumstances should either or both parties have the right to terminate the agreement? Is a “good reason” required to terminate (i.e., breach, insolvency, etc.) or merely “for convenience”?***

22. ***What is the cost of termination? For example, how much notice is to be given or what must be paid for the right to terminate?***
23. ***What obligations/consequences should result from “termination”? For example, return of confidential information, payment of outstanding fees/expenses, application of restrictive covenants (i.e., non-compete and non-solicitation provisions), etc.***
24. ***Consider what assumed factual matters need to be verified and confirmed in writing by either party in the form of a contractual representation or warranty. For example, if title/ownership is presumed but not known, the agreement needs to address this and also address the consequences of what happens if this turns out not to be true (i.e., risk allocation).***
25. ***Consider what specific things/action items/duties each party needs to do or perform at various times during the agreement in order to make the relationship work properly. These are commonly known as “contractual covenants”.***
26. ***What income tax, GST, PST or other tax implications (e.g., foreign withholding tax obligations) arise from the sale of products and/or provision of services under the relationship? Seek tax/accounting advice to assist you to answer this question.***
27. ***For long-term relationships, consider the desirability of some form of dispute-resolution mechanism/escalation provisions (whether binding/non-binding negotiation, mediation, arbitration and/or valuation).***
28. ***What can go wrong and who should bear the risk/cost of this? Consider contractual indemnities as a means of fairly allocating the risk of various contingencies to a particular party to the agreement.***
29. ***Should any indemnification obligations be absolute or subject to qualifications/exclusions/limitations on liability? For example, exclusions for consequential losses, negligence or fraud and qualifications as to amount/quantum and time.***
30. ***What local, provincial, state or foreign laws impact on the relationship and identify who is required to comply with what laws and the consequences of failure to do same?***
31. ***Are both parties free to contract with each other or do they owe obligations to 3<sup>rd</sup> parties (e.g., former employers, other suppliers/customers, etc.) which restrict their ability to establish a new relationship?***
32. ***When dealing with a foreign party (or a party from another province), whose laws will govern the enforcement of the relationship and which courts will be entitled to resolve disputes under the agreement?***

33. *Given that one party may be very vulnerable to the other party, consider if independent legal advice for the vulnerable party is desirable?*
34. *Consider the relevance of time and if the agreement needs to impose a timetable on the performance of either or both parties' respective obligations.*
35. *To what extent can a party "sub-contract" or transfer its rights or obligations under the relationship to a 3<sup>rd</sup> party? Do you need personal performance or not?*
36. *Are electronic/digital signatures and/or delivery of important signed documentation via facsimile acceptable to the parties? Consider impact of Ontario's new Electronic Commerce Act.*
37. *If applicable, consider how the parties will agree to effect major decisions (for example, how will the profits of a joint enterprise be distributed) and who has signing authority?*
38. *Are the formalities of meetings necessary as part of the relationship and what rules will govern the calling and holding of formal meetings?*
39. *If applicable, what rules govern the liquidation of jointly-owned property or property (for example) shares of a jointly-owned business?*
40. *If applicable, is it necessary for any property or money to be held in escrow to protect one party from the other's intentional/unintentional failure to perform?*

### **C<sup>3</sup> - Cost/Benefit Analysis – What's likely to really happen?**

Note that not all of these questions will be applicable to all of your relationships and you will need to weigh the benefit of trying to address a particular "contingency" and the probability/likelihood that it may become a future "real issue" against the incremental cost of having a 100-page long contract.

It is interesting to think about how differently these C<sup>3</sup> questions will be answered in the context of different relationships such as, for example:

- shareholder/partnership agreement;
- employment agreement/independent commissioned sales contract;
- agreement to sell all of the assets or shares of a business;
- product manufacturing agreement;
- product distribution agreement;
- software development and/or licensing agreement;
- customer product sales invoice;
- commercial office lease;
- bank "terms letter"; or
- equipment lease.