



Avoiding the 7 Deadly Commercial Contract Risks™

Making contracts succeed by identifying and mitigating contract risks

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If a contract in law is simply an exchange of commercial promises, why then are there so many expensive and bitter disputes? The answer is simple: the contracts are not negotiated and managed properly. This article is for education purposes only; see a professional for specific advice.

A major problem facing senior management with commercial contracts is the very real possibility of an employee exposing his/her organisation to potentially catastrophic serious commercial, financial and legal consequences or litigation through every day commercial contracts. With contracts becoming larger in size and in dollar value, outsourcing becoming more prevalent and staff having less time to review contracts this risk is increasing significantly.

Risk No 1 – Not identifying Key Risks

Contract risks are largely predictable if one has an understanding of the *contract lifecycle*. These risks are usually categorised as either pre- or post-signature as it is the act of signature that creates a legally binding contract. Common risks are:

- The contract does not meet the firm's needs
- Unclear understanding as to the rights and obligations of all parties
- Ensuring promised deliverables are met
- Lack of or non-compliance with enduring terms, such as warranties, confidentiality and intellectual property.

Risk No 2 – Not Knowing the Numbers

Every clause in a contract could have financial considerations, and thus staff negotiating and managing the contract should understand the numbers involved in the contract. Common financial risks are:

- Inadequate business case pricing/costing, profitability, and cash flow calculations
- Inability to read the financial statements
- Not checking if deliverables are met before payment made
- Relevant numbers not continually checked to see if the contract is still beneficial.

Risk No 3 – Not Knowing the Relevant Laws

Once the contract has been signed, it is normally too late for one party alone to change the terms. Thus, understand key relevant laws that can affect contracts *before* signing. Common risks are:

- Insufficient evidence to resolve a dispute
- Not clarifying 'battle of the forms' issues
- Not clarifying whether a Memorandum of Understanding is legally binding
- Not being specific with the 'deal terms'
- Not understanding the 'fine print' terms (such as indemnities, capped liabilities, retention clauses, confidentiality, force majeure, IP, insurance, jurisdiction, entire agreement, set off, GST)
- Behaviour that is misleading and deceptive.

Risk No 4 – Not Meeting Your Interests when Entering into an Agreement

The aim of the negotiation process is *not* to reach an agreement but to reach a good business decision. Have you got the commercial, legal and financial terms you seek to advance your interests? Some common negotiation risks are:

- Lack of a negotiation plan, including the strategic purpose of the negotiation
- Underdeveloped negotiation skills
- Not achieving terms sought that would advance the organisation's interests.

Risk No 5 – Inadequate Systems

Are key documents, including the signed contract and supporting correspondence, securely stored so they can be quickly located later? Is there an easy-to-use electronic system? Common risks are:

- Not keeping things simple
- No system to capture 'lessons learned'

- Lack of standard form contracts
 - Inadequate filing/retrieval system
 - No system to provide timely and efficient commercial, financial and legal advice
 - No system to promote 'user-friendly' contracts and prevent unauthorised variations
 - Payment not tied to milestones.



Risk No 6 – Not Taking the Management of Contracts Seriously

Many organisations do not treat the management of contracts seriously. Contracts are often handled by staff with insufficient all-round contract management experience as if they were a chore, often with serious commercial, financial and legal consequences for the firm. Common risks include:

- Not doing adequate preparation, resulting in much rework and expense
- Inadequate time and resources devoted to the negotiation and management of the contract
- Lack of basic legal, financial and commercial knowledge
- Disregarding the agreement and relationships.

Risk No 7 – Not Learning from Past Mistakes

Every organisation needs a system which coordinates the specialist knowledge possessed by employees so that it can be exploited to create benefits and competitive advantage for the organisation, and used to prevent reoccurrence of costly mistakes. Common risks are:

- Knowledge confined to individual staff
- No system to capture 'lessons learned'.

What can be done?

Organisations need to implement a well-planned and monitored risk management program, whose origin should be 'top down'. Training of staff who are involved in negotiating, advising on, writing and monitoring contracts is a vital part of this risk management strategy. Organisations that have a contract risk management strategy and process in place can save time and money and therefore have better competitive advantage in the marketplace.

What is the State of Your Contract Management System?

Go to www.TheRiskDoctor.com.au (see the Consulting Tab) for the free Risk Diagnostic to discover your **three** top contract management risks.

Free e-Newsletter

Research clearly shows that organisations that are proactive in mitigating contract risks are able to improve their competitive advantage. Contact The Risk Doctor to subscribe to his **free e-newsletter** which contains tips on identifying and mitigating contract management risks.

About Cyril Jankoff, The Risk Doctor®

Dr Cyril Jankoff is an accountant and lawyer with management (MBA) and education qualifications. He has been involved in creating, negotiating, writing, managing, terminating and litigating contracts throughout his 30+ year professional career. He is a contract risk management consultant and frequently facilitates public



and in-house courses at all levels in contract management-related topics such as:

- *Risk Mitigation for Better Management of Commercial Contracts*
- *Negotiating for Better Management of Commercial Contracts*
- *Contract Law for Better Management of Commercial Contracts*
- *Finance for Better Management of Commercial Contracts*
- *Systems and Processes for Better Management of Commercial Contracts*
- *Contract Negotiation and Drafting risks.*

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Remember

Companies make money by taking risks and they lose money by not mitigating them.

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