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Terms of Engagement: What Does All that Contract Legalese Really Mean and How Can We Better Teach it to Our Students?

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TERMS OF ENGAGEMENT: WHAT DOES ALL THAT CONTRACT LEGALESE REALLY MEAN AND HOW CAN WE BETTER TEACH IT TO OUR STUDENTS

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For many companies, the purchase of an Enterprise Resource Program and the related hardware marks a significant investment in an organization's time, money, and business model. At the same time, those software companies that offer an ERP solution undertake significant risks when entering contracts to provide their services and goods. With this situation in mind, the contract between the two companies provides an excellent opportunity to instruct students about the implications and usage of the various elements used within such agreements. Prior literature on the subject of contracts only presents a broad range of important and useful instructional notes and articles on how to improve the teaching of the subject matter. Accordingly, this article offers a more comprehensive discussion and analysis of some of the most important and common substantive terms incorporated into a software and hardware agreement.

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I. INTRODUCTION

Teaching the law of contracts has always been one of the most fundamental tasks that law professors carry out. Truly, no legally successful business transaction can be realized without a commanding knowledge of contract law. Still, most of the time in the classroom focuses on teaching the elements of a contract accompanied by illustrative appellate level cases rather than explaining and discussing what the important terms and clauses in a typical contract really mean. Knowing the important terms that appear in most contracts and how they relate to contract law can add a significant and essential dimension to contract law pedagogy.

Improving the teaching of contract law has historically driven the energies and talents of business law professors. The *Journal of Legal Studies Education*, for example, has presented a broad range of important and useful teaching notes and articles on how to improve the teaching of contract law.[4]

[4] See generally James M. Highsmith, *Charting Sales Contract Performance After Seller's Tender: An Instructional Aid,* 2 J. LEGAL STUD. EDUC. 78 (1983) (discussing, through the use of a flow chart, the intricacies of creating and performing a sales contract under U.C.C. Article 2). James M. Highsmith, *Charting Sales Contract Performance After Seller's Tender: An Instructional Aid*, 3 J. LEGAL STUD. EDUC. 132 (1985) (presenting a chart and instructions on how to teach performance of a sales contract). Wayne Brooks, *Use of a Logic Tree to Explain Transfer of Risk of Loss and Transfer of Title Under the U.C.C.*, 3 J. LEGAL STUD. EDUC. 67 (1985) (presenting a logic tree to help teach the transfer of risk and title under Article 2). Marc Lampe & Craig B. Barkacs, *Adding An Ethical Dimension in the Teaching of Contract Law*, 11 J. LEGAL STUD. EDUC. 227 (1993) (discussing the application of ethics as a means of better understanding the moral foundation of contractual principles). Sharlene A. Mcevoy, *A Contract Writing Exercise*, 14 J. LEGAL STUD. EDUC. 81 (1996) (applying a hypothetical in which a recently graduated but unemployed student, must negotiate a contract with her parents defining their relationship after she returns to live at home again). Peter S. Shedd, *Let's Make a Deal: To Sign or not to Sign: A Two-Part Model for Incorporating Negotiation into a Legal Studies Course*, 14 J. LEGAL STUD. EDUC. 87 (1996) (presenting a teaching note in which a senior athletic director in a major university and a sports drink company negotiate a contract). Susan M. Denbo, *Contracts in the*

This paper seeks to take a more in-depth examination and discussion, than has previously appeared in the legal studies in business literature, of the some of the most important and common substantive terms incorporated in a sales contract. The aim is to provide instructors the information they need to teach business law students what these contractual terms really mean. Moreover, the paper furnishes a detailed hypothetical meant to lay out some of the behind-the-scenes strategies underlying negotiations incorporating the terms. The contract terms which will be presented and discussed in Parts II and III, are: (1) Approval and Payment, (2) Length of the Contract, (3) Notice and Cure, (4) Implied Warranties, (5) Limitation of Liability, (6) Indemnity Clause, (7) Arbitration Clause, (8) Attorney Fees, (9) Choice of Law, (10) Choice of Forum, (11) Confidentiality Clause (12) Assignment and Delegation, (13) Force Majeure (14) Integration Clause and (15) Time Is of the Essence Clause.

While the foregoing list is admittedly not exhaustive, the terms represent a fair sample of the more important and common clauses found in business contracts. Moreover, the hypothetical presented in Part II generally embodies actual negotiation scenarios that were carried out by the authors during the course of their professional experiences in many industries including the representation of software vendors as well as those purchasing such systems. As such, an instructor in the classroom can use it as an appropriate real world example.

Classroom-Providing Undergraduate Business Students with Important "Real Life" Skills," 22 J. LEGAL STUD. EDUC. 119 (2005) (presenting "real life skills" by having students represent opposite sides of an employment contract negotiating a covenant not to compete.) Cris De La Torre & Garth Allen, *The Battle of the Forms-There is a Purpose*, 23 J. LEGAL STUD. EDUC. 195 (2006) (presenting a discussion and accompanying flow chart to illustrate a better way to teach U.C.C. 2-207 "Battle of the Forms").

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A. Background Scenario-The Transaction

It is a rare business today that does not enter into some kind of agreement for the purchase, installation and implementation of computer equipment and software. For that reason, this kind of transaction was selected to offer to our students, many of whom are interested and proficient in high technology. Thus, the hypothetical is one that they can relate to and even perhaps experience some day. This transaction is also useful since the buying and selling of computer equipment and software is often complicated by a significant chasm between the functionality that a company believes they are buying and how the system actually performs, which creates challenging negotiation scenarios.

B. Background of the Industry

In order to understand the relative importance of the various contractual provisions, which are about to be discussed, it is also helpful to understand the historical and industry context in which the agreement is being negotiated. Today, an enterprise resource planning or ERP system describes the integrated collection of computer programs that automates a company's central business operations for an entire organization.[5] The ERPs of today trace their roots to the entry of the computer in the end of the 1960s where they became common in the workplace as an efficient way to capture and process the fundamental business operations of an organization. Lead by IBM, the computer and software industry provided businesses with efficiency increasing equipment for word processing, accounting, scheduling and other standard business functions that had traditionally been completed by hand. These singularly designed software applications functioned independently and were not integrated into any type of a cohesive system.

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[5] RALPH M. STAIR & GEORGE W. REYNOLDS, PRINCIPLES OF INFORMATION SYSTEMS 382 (Cengage 10th ed. 2012).

Again lead by IBM, the technology industry attempted to forge a new method to integrate a number of these functions by introducing a hardware and software solution known as MRP (Materials Requirement Planning). The systems were intended to redefine the process under which manufacturing companies could centrally schedule raw material deliveries and quantities given sales-based assumptions.[6] Of course, the initial systems were prohibitively expensive to purchase and operate, and were prone to malfunctions.[7] Still, the concept of an automated central system to deal with the complexities found in each of the independently operating systems found across the different departments in a given company provided new opportunities for further efficiencies and could support decision on optimal sourcing or cost accounting.

Although IBM continued to play a lead role, in the early 1970s a German company called Systemanalyse und Programmentwicklung (SAP) began to produce and market software for an integrated business solutions re-branded as Enterprise Resource Planning (or ERP).[8] Soon thereafter, Oracle Corporation was founded in the United States centered on the emerging ERP field.[9] PeopleSoft came into the market in the 1980s and, of course, Microsoft became a competitor as well.[10] Finally, a number of smaller, independent technology companies entered the market with their own brand of ERP products, niche based to a particular industry.

Currently, essentially all major companies, like our hypothetical XYZ Co., operate under an ERP system. The purchase of the hardware and ERP software, as well as its installation and the training for the

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[6] *See Materials Requirement Planning*, INVESTOPEDIA, http://www.investopedia.com/terms/m/mrp.asp#axzz1bMExmavQ (last visited December 30, 2011); *see also ERPHistory,* ERP AND MORE!, http://www.erpandmore.com/erp-reference/erp-history/ (last visited December 30, 2011).

[7] ERP AND MORE.

[8] *Id.*

[9] *Id.*

[10] *Id.*

organization, are usually multi-million dollar undertakings that take many months of planning, testing, and implementing as well as an intimate knowledge of a company's operational business model to accomplish the many goals. Accordingly, the success or failure of this system can have a major impact on the company's operational and financial position; since it is the backbone of the business and supplies much of the data used for critical decisions.

Today, the market of ERP suppliers has consolidated and is now dominated by SAP, Oracle and Microsoft.[11] Still, a handful of smaller companies remain in the market as niche players. For the purposes of this exercise, Elite Computing was created to be a small ERP niche competitor. Given the relative size of the proposed contract for a smaller company like Elite, this potential sale presents for it a very important opportunity. Yet, given the difficulty of a successful installation and implementation of an ERP system, if Elite does not have sufficient protections in the contract it is taking a substantial risk for an organization of its size.

Creating a small player like Elite is also relevant because the smaller players tend to focus more on the contract negotiations. Companies like SAP normally would not allow many changes to their standard agreement if they were negotiating with XYZ, and would typically only do so if it was trying to make a world-wide ERP sale to a multinational company with a large capitalization. Thus, it is a smaller player like Elite that might be able to provide XYZ with an ERP system that would keep it competitive in the market at half the price that SAP or Oracle (especially Oracle!) would charge. In the end, based on the authors' collective and extensive experiences in negotiating these kinds of transactions from both perspectives, the Elite vs. XYZ scenario, discussed next, is exactly the type of context in which the parties would spend real time and effort trying to find a middle ground.

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[11] *Id.*

C. Parties to the Contract

XYZ is a large manufacturer of widgets with corporate headquarters in Chicago, Illinois and plants and offices around the country. It normally buys thousands of computers a year to develop and inventory its products. Elite Computing is a manufacturer of specialized software and computer hardware located in San Jose, California. Landing XYZ as a new customer would be a major coup for Elite. Accordingly it is willing to compromise on some terms, but of course, does not want to give its product away either. XYZ knows that it has a good bargaining position because there are a number of major competitors to Elite in the computer market that would also like to have its business. Thus, XYZ feels it has the power to make tough proposals to gain advantageous terms while Elite must work hard to minimize its exposure to the risks posed by XYZ's proposals. Elite, however, does have a growing reputation as an innovative company with a good service record as well as offering competitive prices, and so is perceived as a potentially high-quality vendor.

The instructor may wish to begin the lecture stating that Elite Computing is sending XYZ Co. a form or boilerplate contract to commence the negotiation of the contractual terms. XYZ, responds by requesting that the contract be sent in Word format knowing that there will likely be a great deal of give and take due to the complex nature of this new business relationship. Elite expects the request so quickly agrees to do so. Both parties know that this relationship will involve a "battle of the forms" and so both must be prepared to propose and respond to a number of important terms. [12]

Each party also has in place a procedure it calls a *Contract Summary* form that must be completed prior to the contract's execution. The

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[12] This paper is not an attempt to present a pedagogical piece on the *Battle of the Forms* legal process found in U.C.C. §2-207 but rather focuses on the substantive nature of the terms themselves subject to this process. *See* KENNETH W. CLARKSON ET AL., BUSINESS LAW 366-67 (12th ed. 2012) (discussing U.C.C. § 2-207 and the battle of the forms). *See also* DE LA TORRE & ALLEN, *supra* note 1, at 195-216.

form lists the responsible persons at each company, including both management and legal. The Contract Summary requires the responsible parties to the negotiation to list the important terms it will present as well as to be able to answer pertinent questions which may crop up in negotiations. This is to insure that the issues have been critically assessed before the contract is finally signed.

Because of the nature and complexity of the transaction, both parties agree that after the successful negotiating of each term, it will be placed into a non-binding *letter of intent* ("LOI"), also called an "agreement to agree." Since the LOI is not intended to be a binding contract but rather as a means to organize a complex and ongoing negotiation, once the LOI is executed its terms will be incorporated into the final expression of the parties as a binding agreement.[13] Lastly, the contract will be divided into two parts: "Key Terms" and "Miscellaneous Terms" so that students will recognize their relative importance.

II. KEY TERMS FOR NEGOTIATION

1. *First Negotiated Term: Approval and Payment Clause*

One common and important term negotiated in a typical sales or service contract is contained in the approval and payment clause. This term attempts to manage to one party's advantage the quality of the performance that it desires and expects from the other side. The general problem, however, is that other than a few specific items, such as those that are readily quantifiable (i.e., gold at .998 percent) there is usually no simple way to set forth the required level of quality in a contract. Thus, in most contracts it is important for a party, particularly the buyer, to insist upon a clause that provides some level of approval and further to condition final payment upon its acceptance.

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[13] *See, e.g.*, Bradley Real Estate Trust v. Dolan Associates, 266 Ill. App. 3d 709, 640 N.E.2d 9 (1994). *See also* Georgette C. Poindexter, *Letters of Intent in Commercial Real Estate*, 28 REAL EST. L.J. 195 (2000).

Approval and payment terms are routine in many negotiations. An instructive example for business law students occurs in construction contracts. These agreements nearly always include retainage, which utilizes a security approach that allows the owner of a project to withhold a portion of the earned progress payment to minimize its exposure to specific types of risk.[14] The main reason for the retainage custom revolves around the principle that allows the withheld money in possession of the owner to satisfy claims against a contractor without necessitating a lawsuit for collections.[15] Still, this sort of approach is also negotiated commonly in many other contracts and will be used as the basis for the first round of negotiations.

XYZ's Proposal: For buyers, such as XYZ Co., which presumably buys thousands of computers a year for its far-flung enterprises, it is obviously important to negotiate in the preliminary draft of the computer purchasing agreement, an approval and payment term. Accordingly, it states that it will withhold 50 percent of the payment with the remaining 50 percent paid upon final, written acceptance only after it is "totally satisfied" with the computers.

Elite's Response: Assume that Elite finds this term to be too risky. It feels that XYZ will withhold the money unreasonably or even make things up to delay, rather than pay the total price. Elite's management relays this concern to its negotiators. There must be limits placed on XYZ's ability to get out of the contract.

XYZ'S Response: To appease Elite, XYZ agrees to add to its acceptance: "payment will not be unreasonably withheld." As a result, even after the computer equipment is installed XYZ Co. does not have to make the final payment until it agrees that the system performs to the level that Elite Computing has promised.

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[14] JUSTIN SWEET & MARC M. SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 22.03 (Thomson 8th ed. 2009);
[15] *Id.*

Elite's Response: Elite Computing still feels there are unreasonable risks in accepting this term even with XYZ's assurance that the last payment will not be unreasonably withheld. For example, it may have a concern that XYZ Co. could still feign dissatisfaction and never make the final payment.

XYZ's Response: In this instance, XYZ Co. counters by promising in the contract that it will not *use* the computer equipment/specialized software (other than for testing) until it gives final approval and makes the final payment. This compromise appears to be fairly negotiated, since it provides that XYZ Co. likely will give its final approval more quickly, even if there are small annoyances remaining. XYZ needs the system for operating its business and has already paid half of the price. While not optimum, this provision still affords XYZ Co. some leverage to force Elite Computing to make the system function as promised by initially testing the system and then withholding final payment until XYZ is satisfied with the tests. This arrangement gives both parties more certainty and therefore lessens their risk. This term is put into the letter of intent.

2. *Second Negotiated Term: The Length of the Contract and Implementation*

In many sales' scenarios it is quite beneficial, particularly for buyers, to have the option of getting out of a contractual relationship as quickly as possible as well as some type of ability to recoup its investment in the venture should the performance become delayed. In other words, short term contracts can be less risky than being bound to an onerous, long-term contractual commitment and conversely long-term agreements can, for various reasons, be dangerous. For XYZ it is concerned that once it signs a long-term contract with Elite, it will become more difficult to keep Elite motivated without some type of end date. It has found in previous relationships that soon after a long-term contract is signed it begins to take a back seat to those companies which Elite will go after next. Moreover, like many suppliers, Elite typically rewards employees who land new contracts more generously than employees who are merely maintaining existing relationships. Thus, XYZ wants to keep the association fresh by making sure the terms of the agreement are relatively short with some type of mechanism that does not penalize but dissuades Elite from delaying performance.

Second, XYZ is concerned that in today's fast-paced, competitive market, a good deal today may be the wrong product and/or wrong price tomorrow. Moreover, if Elite Computing does not perform well (while not rising to the level of a breach) XYZ Co. wants to be able to get out of a deal as quickly as possible without being sued while maintaining its ability to recover its investment. Hence, the best way for it to keep its options open is to negotiate the shortest possible length while adding a "Liquidated Damages" clause.

XYZ is aware of at least one downside to shorter term contracts: cost uncertainty. With a long-term contract XYZ will know definitively what something will cost over time. XYZ, after researching the potential relationship, also has come to the conclusion that Elite Computing will be a dependable supplier of a high quality computing system and so, would prefer to engage it as its supplier over other bidders.

Furthermore, XYZ recognizes that it must carefully propose the Liquidated Damages clause because it might be considered a penalty by the courts if the amount is not founded on a realistic estimate of the injury it will incur due to Elite's possible nonperformance. This means XYZ must carefully avoid asking for an exorbitant amount in an unreasonable timeframe while developing some type of model to determine how much it will cost the company that will also sufficiently discourage Elite from failing to deliver on time. Therefore, for both parties there are important interests to protect and a possible middle ground will likely have to evolve between a long and a short term contract.

XYZ's Proposal: XYZ proposes a term that "for any or no reason, with 30 days written notice, Buyer may terminate the contract." With this language, XYZ essentially has a constant month-to-month agreement by being able to terminate the contract at will.

Elite's Response: Elite is understandably concerned about the consequences of an at-will termination clause. Still, the Elite management team is aggressively attempting to sell its computing equipment to a very important buyer in a highly competitive market. By landing the XYZ contract it can also demonstrate to other potential customers the attractiveness of its computer systems. Thus, it knows that in such a case, a buyer like XYZ Co. may be in a position to insist on the clause.

Moreover, during the courtship of a contract negotiation, the Elite management had asserted that XYZ will be completely satisfied with its product. This makes it more difficult to explain why it cannot be bound by a 30-day out clause, which XYZ characterizes as merely a guaranty of continued satisfaction.

Elite's negotiators, however, continue to believe that the term is still too one-sided. Thus, in response, they bargain for a mutually binding term; either side can terminate in 30 days. This is not a surprising move and appears to be fair on its face making it difficult for XYZ to refute.

XYZ's Response: XYZ is now concerned that Elite can also terminate the agreement. It now must look at the consequences of losing what it considers to be a reliable and high quality vendor. The risk is this gives Elite the chance in the future to demand a price increase or to make other changes in the contract's terms whenever it wants since it too can terminate the contract at will. However, in its research XYZ finds that that there is competition in the computer systems market and is quite sure that Elite needs a continuing stream of guaranteed revenue. For this reason, although never sure, it feels that Elite will not likely exercise its right to terminate. As a result, XYZ lets Elite know in the negotiations that it is amenable to this provision.

Elite's Response: Elite's top management is now pondering the new terms which allows both sides to terminate at will with 30 days' notice. Management, however, is still concerned that if it is bound by this term that the company will be vulnerable to startup costs. These are added and special costs associated with the kinds of equipment XYZ seeks to buy which it estimates will cost Elite about $100,000. Thus, if XYZ should choose to terminate the relationship early, Elite would suffer a significant loss. Still it feels that it can recoup its loss and attain a 10 percent profit if the relationship lasts at least 18 months. Accordingly, Elite' negotiators explain their concern to XYZ and propose the following conditional termination term: "after the first eighteen months, either side may terminate for any or no reason within 30 days written notice."

XYZ's Response: XYZ is concerned about the 18 month length of the term. It appears to it that it may be somewhat arbitrary and speculative, but is aware of Elite's situation and wants to keep the negotiations going. Thus, it makes the following proposal: if XYZ chooses to terminate before Elite's startup costs are recouped, it will repay the direct start up costs prorated over the initial 18 month period. XYZ's management realizes that it will still cost the company something to terminate, but at least it still has the option of getting out when it wishes. For example, it might arrive at a place in their relationship where paying the remainder of the startup costs is less than it would cost to contract with a new, perhaps less expensive supplier.

XYZ's Proposal: Assume that negotiations break down because XYZ's upper management does not want to sign off on the obligation to pay the startup costs. Still, Elite wants the business so is open to new proposals. Accordingly, XYZ proposes signing a one-year contract, with four, one-year options to extend. By doing this, Elite Computing must "re-win" XYZ Co. as a client each year, and if circumstances change (i.e., the supplier becomes less dependable or a better supplier comes into the market) at the end of each year XYZ Co. can simply decline to pick up the option and thus be free to go elsewhere. In addition, having a date in which an option decision is approaching gives XYZ Co. the opportunity to negotiate a better deal without the uncertainty of not having a contract. Lastly, it will not be bound to pay start-up costs.

Elite's Response: Elite sees some advantages to having XYZ's business for at least a year. That way it can plan accordingly and will not have to suffer any "surprises" that would occur from being subject to an at will termination. Still, Elite's higher ups are not happy with this proposal because of the risk of losing start-up costs if XYZ chooses not to extend the contract for a second year since 18 months is necessary to recoup the startup costs. Upon further reflection, Elite's management decides that all of these proposals are simply too risky.

XYZ's Proposal: Assume that negotiations break down again between XYZ and Elite. XYZ now realizes that its aggressive approach is not working, but it would still prefer Elite as its computer supplier and does not want to lose it simply because of this one, albeit important, term. Thus, it proposes a three-year term with the right to terminate the contract for cause as well as a Liquidated Damages clause of $10,000 per week that Elite goes beyond the contract end date up to $500,000. This means that either side only has the right to terminate within three years if the other side fails to perform a material part of the contract, and Elite could be forced to pay XYZ should it not complete the work on time.

The first obstacle in this new proposal is defining the word *material*? Obviously it is an ambiguous word, but it implies that the failure must be significant and be an important part of the contract in order to justify termination. This may seem redundant to our business law students since, as a matter of law, an agreement can be terminated by either side "for cause". But a real and important issue exists which involves defining what cause is and the procedure for terminating such an agreement which XYZ wants to control as much as possible.

After consulting with its in-house counsel the XYZ negotiators know that a material breach is the failure by a party to substantially perform an "important" part of a contract.[16] Of course, what is and is not "important" is a significant distinction. If Elite Computing fails to perform a "material" part of a contract, XYZ has the right to terminate the agreement and thereafter does not have to perform its side of the contract. If the provision is not "material," it may have a claim for damages, but generally cannot terminate the agreement. Thus, if XYZ does not specify what is material it is left to guess how a court would decide the issue which could take years and cost thousands of dollars. Thus, XYZ knows that the best approach is to label important parts of a contract as material. Some terms are obvious. XYZ knows that its payment for the computing equipment is always material as is Elite's primary performance of providing a certain number of computers over a period of time. Beyond that, however, XYZ knows that it must label what it considers material which now becomes a more difficult task to define.

One important aspect of the relationship is that XYZ needs to have Elite develop and install an inventory software package for it. It knows that if the system does not function properly and it cannot track its products, that such a flaw is obviously material. As an example of what could occur in this kind of relationship, say that at the bottom of the agreement it states that the software package will be compatible with an accounting system that XYZ may purchase from another company in the future. The inventory system is installed and tracks

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[16] "In determining whether a failure to render or to offer performance is material, the following circumstances are significant: (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected; (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived; (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture; (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances; (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing" RESTATEMENT (SECOND) OF CONTRACTS §241 (1981).

inventory harmoniously. A year later, however, XYZ buys the accounting package and the systems are not compatible. Say now, Elite comes in and builds a software patch, but it just does not work well. Do the plaguing compatibility problems rise to the level of a "material" breach by the inventory software company? If they do, XYZ can ultimately demand a full refund if a solution is not found and if necessary escape from the relationship by asserting this as a material breach. Still, unless it was made clear in the contract that this was a material breach, litigation may be necessary. In court Elite may argue that the compatibility clause in the contract was an "afterthought" and was only thrown in as part of a "wish list". It is true that XYZ may ultimately be able to convince a court that it was a material breach, however by that time it may have had to limp along for two and a half years with computer problems and spend over a $100,000 in attorneys' fees.

To protect against this danger, XYZ sets forth the important goals of the contract in the "Recitals" at the beginning of the contract. Accordingly, XYZ proposes, among others, that: "As a material part of this contract, the inventory system will be compatible with ACME accounting system which may be purchased in the future."

By inserting the Liquidated Damages Clause, XYZ recognizes that this type of language creates a second obstacle; but it also considers the system vital to its business decision-making processes. XYZ cannot continue to limp along with its existing systems indefinitely once it commits to Elite's software; so it must create a sense of urgency for completion where none will otherwise exist. With this in mind, XYZ's financial analysts expect internal cost savings through labor, benefits, and other efficiencies in excess of $500,000; so it can justify the amount contained in the liquidated damages very easily as a valid injury and not a penalty.

Elite's Response: Elite's management carefully examines all the recitals of what constitutes a material breach. They look reasonable and can be dealt with should any of them arise. They also give Elite notice of what problems they need to avoid and can live with these parts of the contract.

However, the liquidated damages clause provides much consternation for Elite's management but is something they have seen before. They know that their projects rarely complete on time due to the nature of their business and summarily wish to avoid them if at all possible, which rarely occurs. When they do arise, Elite uses two strategies to reduce their impact and possibility of enforcement: the elimination of a firm trigger date in the contract and an attempt to minimize the liquidated damages amount.

To accomplish the first part, Elite tries to include language that allows the parties to mutually agree upon a firm completion date six to twelve months prior to the contract's scheduled termination. This collaborative effort goes along way in servicing the customer and demonstrates that the end is near to Elite's clients. Furthermore, Elite's project manager should have a good enough handle on the project to accurately forecast its completion; since he makes routine reports to senior management concerning progress. As for reducing the liquidated damages amount, Elite prefers zero but offers a token amount at $1,000 week with a one year cap figuring that a project could not incur delays of more than a year and cost a total of $52,000 given management's oversight, which would not severely affect the job's profitability should the worst case scenario occur.

XYZ's Response: XYZ's management also realizes that delays in final implementation will undoubtedly occur, so it understands that the language that creates a trigger date for the liquidated damages to begin will need further negotiation sometime in the future. XYZ is amenable to negotiating a firm completion date as soon as possible given that the liquidated damages clause remains in place to keep Elite's implementation team focused on the project at hand. However, the absurdly low amount only covers 10 percent of the projected savings. XYZ fears this minimal amount of recognition for their injuries will not be enough to get Elite's attention should the delivery date slip.

Accordingly, XYZ's decides to meet Elite half-way at $5000 per week while accepting the other language and a 52 week limit.

Elite's Response: Elite still prefers a $1000 per week liquidated damages amount but realizes it probably cannot get XYZ to come down any more given the reduction. Elite's management understands that it will need to keep a close watch on its team's progress with XYZ's installation in order to deliver the software on time and as close to the three year contract as possible but realizes the trigger date will be negotiated with a better understanding of the project than is currently available. Consequently, the length of the term clause is now tentatively agreed upon for inclusion in the letter of intent as well as the liquidated damages clause. Still, there are more issues that need to be negotiated.

3. Third Negotiated Term: Notice and Cure

When a termination "for cause" provision is put in a contract, it is normal to set forth certain procedures to follow should there be a breach. One of the most important and common is called a "notice and cure" provision. A typical clause may state that: "If there is a breach, the non-breaching party must give the breaching party ten (10) calendar days written notice and an opportunity to cure the breach. If the breach is not cured within the 10 day period, the non-breaching party may terminate the agreement and pursue all other remedies available under the law." One of the advantages of setting out these procedures is that a party like XYZ will have clear guidelines on when Elite will begin to fix the problem before declaring a default.

XYZ's Proposal: Because XYZ's material duty is to pay on time, from its point of view the time to cure can be quite short. That is, if it somehow forgets to pay, it will not take very long to write a check or transfer funds to Elite. Accordingly, it proposes that the cure period be limited to 10 calendar days. As the buyer of goods, XYZ wants to keep Elite on a short leash. It doesn't want to experience a situation in which Elite fails to service the computer system adequately and then still be bound to the contract, for say, 90 calendar days, before it can hire someone else to cure the problem.

Elite's Response: Elite carefully looks at this proposal and asks its servicing department whether 10 calendar days to cure is enough time. They respond that it is too short and could seriously overload its current capacity especially if other customers with problems should make demands. It recommends to management that it needs at least 15 calendar days to cure, which it proposes to XYZ.

XYZ's Response: XYZ feels that it has enough backup capacity so that it can still function with the worst case scenario of 15 calendar days. This term is now also added to the letter of intent.

4. Fourth Negotiated Term: Implied Warranties

Since this relationship involves merchants in the sale of goods the law contained in Uniform Commercial Code Article 2 will automatically attach. However, the implied warranties that exist - the implied warranties of merchantability[17] and fitness for a particular purpose[18] – which XYZ inserts into the definitions section of Elite's form contract, may be contractually altered and even disclaimed through negotiation.

Due to the unique complexities of computer ERP systems, particularly of specialized software custom made for a particular company, a considerable gap may exist between XYZ buys and then how the software and hardware system, manufactured by Elite, subsequently performs. Thus, the issue of implied warranties becomes particularly important. One potential problem, for example, is that computer technology evolves so quickly that computer and software companies like Elite are simply never totally certain that their products actually will work as promised.

[17] U.C.C. § 2-314 (2011).
[18] U.C.C. § 2-315 (2011).

Elite's Proposal: Elite knows that both of these warranties exist to protect buyers of goods, like XYZ, and as a merchant which sells goods it is bound by the operation of law. It also knows, for the foregoing reasons, that it would be a serious problem if these implied warranties are not disclaimed. Accordingly, it proposes, in large bold letters that the buyer XYZ "**WAIVES THE IMPLIED COVENANTS OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE**".[19]

XYZ's Response: XYZ does not want to waive its implied warranties and is concerned of what might happen if the system doesn't function adequately for the reasons it is buying it. It decides, however, that it can work around the waiver to its advantage. First, it proposes that it will agree to it if Elite agrees to the following sentence: "Notwithstanding the foregoing, Elite warrants that the goods or service will perform as specified in the marketing documentation." XYZ also proposes a number of express warranties it wants Elite to give to it to further focus on what its expectations are.

Elite's Response: At this point Elite is hard pressed to explain why it will not allow the inclusion of the sentence after the waiver. After all, the sentence goes directly to what Elite is touting to its prospective customers in its marketing and advertising literature. As to the express warranties, these will be negotiated more specifically later since they call for specifications unique to the relationship and so have to be carefully researched and honed, and which relate to material breaches now contained in the Recital section. By creating express warranties both sides can better clarify their expectations as to the product's quality and avoid any parol evidence problems.[20] Furthermore, for XYZ it is advantageous to have Elite create express warranties since it has disclaimed the implied warranty of fitness for a particular

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[19] The language Elite uses as well as emboldening the disclaimer is in accordance with the requirements stated in U.C.C. §2-316(2) (2011).

[20] *See infra* text accompanying notes 22-23 for a discussion of the parol evidence rule.

purpose.[21] At this point, the waiver and XYZ's sentence are included in the letter of intent.

5. Fifth Negotiated Term: Limitation of Liability

A clause related to implied warranties, and therefore a term often sought by sellers of goods like Elite Computing, is that a party will not be liable for any "consequential or exemplary damages." This is to control the possibility of having to pay various damages when a party breaches a contract that includes compensatory damages but which can result in consequential damages as well. Compensatory or direct damages occur when money is lost as a direct result of the breach. Consequential damages arise when money is lost as a foreseeable consequence of the breach of the contract. A third type, exemplary or punitive damages are awarded to punish or penalize the wrongdoer. These damages are not awarded for just a breach of contract unless the breach is accompanied by tortious behavior.[22]

Elite's Proposal: Elite is obviously motivated to avoid liability for substantial damages should its systems fail to live up to expectations or for late deliveries. While it clearly cannot demand that no damages will be awarded should a breach occur, Elite can attempt to minimize its possible exposure to consequential damages and even to its highly

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[21] The implied warranty of fitness for a particular purpose, even if it were not waived, might also be difficult for a company like XYZ to demonstrate legally and could quite likely arise in scenarios involving the buying of specialized software and computer systems. For example, if during contract negotiations, Elite knows or should have reason to know the purpose for which XYZ is buying the software and XYZ reasonably relies on Elite's skills and judgment for fulfilling the purpose, XYZ can argue that it is protected by this implied warranty. However, much of this could be quite difficult to prove factually therefore resulting in possibly costly and prolonged litigation. *See, e.g.,* CLARKSON ET AL., *supra* note 9 at 425-6.

[22] *Id.* at 334-337. Examples of contracts in which a tort might also occur are the wrongful interference with a contractual relationship, intentional misrepresentation or fraud, and bad faith in insurance contracts. *Id.* at 124, 227, 337. In addition, some states recognize that a tort can arise in an employment contract in the implied covenant of good faith and fair dealing. *See K-Mart v. Ponsock,* 732 P.2d 1364 (Nev. 1987),

unlikely exposure to exemplary damages. It proposes that no matter what happens under the contract, 'neither party will be entitled to consequential or exemplary damages."

XYZ's Response: XYZ, of course, will challenge this proposal. A limitation of liability may significantly impact XYZ's leverage to force Elite to perform. Practically speaking this clause will mean that no matter what happens, all XYZ can do is get its money back and the cost of finding a replacement-that is, its direct out-of-pocket losses. Since this clause has somewhat complicated implications, the XYZ lawyers and management convene a meeting in which a hypothetical "worst case scenario" is presented. This is to help them understand and weigh the company's potential risks. The hypothetical is based on future plans to expand the company by opening a new plant which are in the planning stage.

In the hypothetical XYZ proposes to Elite an order for 200 computers to be delivered to its new plant which it plans to open by May 1. The contract will state that the computers and custom software must be delivered to XYZ by March 15 so that it can meet its May 1 deadline for the new plant opening. XYZ sends Elite a $50,000 deposit for the computers which has a total cost of $200,000. March 15 comes and goes and Elite never delivers them and cannot deliver the computers until late summer. Under such short notice XYZ hypothesizes that there a few others suppliers for the kinds of computer and software it requires to meet the May 1 deadline. Due to the importance of this equipment to the new plant's functioning, however, it must find an alternative, which it does - ABC Computing. Unfortunately, it must now pay ABC 5% over Elite's price. ABC cannot make the May 1 deadline, but is able to deliver the computers by May 15. Due to the 15 day delay, XYZ cannot open its new plant and suffers the cancellation of 10 percent of the sales it could have made had the computers been delivered on time.

Finally, a member of the finance group decides to hypothetically add one more possibility. Without XYZ's knowledge, a large and prominent mutual fund plans to buy a large block of its stock at this time. This is due to a perception that XYZ will enjoy greater success because of this and future expansions. Now, however, due to the delay, the mutual fund decides to pass because now it appears to the analysts that XYZ is poorly managed. The lost deal costs the company since its value would have been materially enhanced by the purchase and might have caught the eye of other mutual funds and Wall Street investors. So far, hypothetically XYZ would incur the following loses:

a. Direct Damages — the actual money it loses directly caused by Elite's breach which amounts to the $50,000 deposit, as well as the 5% cost increase in obtaining the computers from another source, ABC Computing.

b. Consequential Damages — as a "consequence" of Elite's breach, XYZ loses 10 percent of its sales and the lost equity and book value had the mutual fund bought a large block of its stock. If XYZ had not waived the limitation of liability it can show that Elite knew or have reason to know, the lawyers at point out, that they may be have been able to recover the amount of the lost sales that occurred as a consequence of the breach. However, unless XYZ had given Elite actual notice of the lost sales (a strategy they discuss later and hope to implement) to prove that Elite had reason to know, it will not prevail in a lawsuit, although it might be able to leverage the lawsuit for a settlement amount.[23]

Thus, looking at the hypothetical, if the limitation of liability clause excluding both parties from consequential or exemplary damages exists, Elite's only obligation would be to refund the $50,000 deposit and pay the 5% cost increase that XYZ had to pay ABC. Practically speaking, XYZ speculates that this may not be a significant threat to Elite especially if the contract is about to expire and Elite doesn't think XYZ will continue the relationship anyway. Elite simply will lose a sale that it could not perform, but XYZ would wind up losing 10 percent of its sales plus a major increase in its stock's value.

[23] See discussion of consequential damages including the seminal and classic 1854 case of *Hadley v. Baxendale,* 9 Ex. 341, 156 ENG. REP. 145 (Ct. of Exchequer 1854).

After discussing this hypothetical, XYZ management knows that there are obvious risks if it agrees to the limitation of liability clause. It knows, for example, that if the clause is kept in, should Elite miss a deadline, it can send a letter with the following language: "If Elite does not deliver the agreed upon computer equipment and software by March 15, in addition to refunding the deposit ($50,000) XYZ will incur costs estimated at 5% or more to find replacement equipment. And, due to the delay XYZ may lose as much as 10% or more of orders for its widgets. As a result, if XYZ does not receive the computers by March 15, management will instruct its legal department to file a lawsuit for all damages incurred, plus attorney fees." But XYZ also knows from its legal counsel, that under its hypothetical scenario, it would probably not receive damages for the lost sale of its stock. Even if Elite had some knowledge of the potential mutual fund investment, the concept of the loss in value due to this circumstance is too attenuated even under the concept of consequential damages. Still, there may be situations in the future where knowledge of events like this may exist in which case notice could be given allowing it to at least pursue consequential damages.

XYZ management now recognizes that such a letter would offer considerable leverage and it must incorporate a strategy to try and anticipate problems better. In this case, the prospect of paying these damages would make Elite think twice before it might breach the contract and it may double its efforts to make the deliveries on time. Accordingly, the XYZ negotiators are instructed to strike out the limitation of liability clause.

Elite's Response: Elite's management is also concerned about granting the waiver, but for opposite reasons. It also convenes a "worst case scenario" meeting with legal and management. It knows that when it designs and installs a new software system on a new property and agrees that it must be fully operational by a specified time that potentially large losses can incur. Elite knows it always incurs start up costs, and hypothesizes that it could approach $50,000 for the custom software. It is also aware of "Murphy's Law"- that if something can go wrong, it will, and the corollary to Murphy's Law for technology which states that even if it can't go wrong, it will. Some of Elite's management makes a strong case that they simply cannot take this kind of a risk for a job with such daunting start up costs. But Elite also knows it must compromise too or it may lose the whole contract on this term. A fair compromise might be to limit the consequential damages to a certain multiple of the purchase price. Accordingly, it adds the words "in excess of two times the purchase price" to the end of the contract section which states "Elite shall "not be liable for consequential or punitive damages." Elite also knows that this does not mean XYZ will automatically receive two times the purchase price if anything goes wrong. It simply means Elite is in the position of having the right to sue for consequential damages, with a cap of two times the purchase price.

Elite explains to XYZ that this gives it leverage for its planned expansion. On the other side, the potential damages to Elite do not grossly exceed the worth of the contract, making the deal palatable to it as well. This provision is agreed upon and added to the letter of intent.

6. Sixth Negotiated Term: Indemnity Clauses

Another common practice in contract negotiation is to add an indemnity clause. Generally, this clause states that if a problem arises which results in a lawsuit by a third party or an administrative fine or penalty from the government, one side will pay the defense costs and ultimately any judgment or settlement on behalf of the other party. While there are many kinds of third party actions in business relationships, in this particular transaction the most potentially troublesome concerns intellectual property. XYZ, for example, may be rightly concerned that it may be dragged into a complex and expensive lawsuit over patent or copyright infringement leveled against Elite.

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XYZ's proposal: With this in mind, XYZ inserts a clause stating that Elite will hold XYZ harmless for any claim that is brought by a third party due to the willful or negligent actions of Elite, including but not limited to, actions for patent and copyright infringement. Hence, if this occurs, Elite will pay the attorneys' fees, court costs and any ultimate judgment or settlement incurred by XYZ. This language is sometimes referred to as "intellectual property indemnity".

Elite's Response: Elite knows this provision is common and fair. It also knows that it could counter to make the term bilateral. That is if somehow XYZ engages in negligent or intentional acts in which Elite is somehow dragged into, the lawsuit it likewise will be held harmless.

XYZ's Response: XYZ knows, as the buyer of these kinds of goods, that it is quite unlikely that it would be brought into a third party action in a lawsuit against Elite and so agrees to the provision. It is added to the letter of intent.

7. Seventh Negotiated Term: Arbitration Clause

Today business contracts commonly contain clauses dealing with how disputes will be handled. One such clause is to arbitrate disputes. This provision states that any controversy arising out of the contract will be resolved by binding arbitration. This clause can have significant implications if problems arise.

Management at both XYZ and Elite are aware of litigation, having endured a number of painful and expensive lawsuits, as well the two common kinds of alternative dispute resolution approaches: arbitration and mediation. Both know that mediation involves little risk and cost because if a dispute should arise, they will appear in a meeting with a mediator and try to work out an acceptable solution. At the same time, the mediator cannot impose a remedy on them. Hence, the risk is essentially the time and the cost of the mediator. Importantly, it may work, especially if the parties are motivated to avoid litigation.

Arbitration, however, involves more risk and cost than mediation. The parties will have to pick an arbitrator after consultation and agreement between the parties. The arbitrator sets the rules, such as how much discovery will be allowed and what form the hearing will take. The hearing will be held with less technical rules and a more informal setting than a court trial. They also know that after the hearing the arbitrator decides who prevails and enters an award. The arbitrator's decision is, moreover, generally final. This is because most courts will enforce the arbitration award and turn the award into a court judgment with the force of law which means there is typically no appeal to a court. All in all, it is often thought that in comparison to litigation, arbitration is a cheaper and speedier way to avoid unpredictable juries.

But, arbitration is not perfect and some of the generalizations don't always apply. The parties know from experience that the loser may still appeal the arbitration based on sometimes spurious or trumped up grounds to try and leverage a more favorable settlement and that some winners have even agreed to pay it to avoid more lawyers' fees and time.[24] Also, they are aware that private, profit-making companies conduct arbitrations. As a result, arbitration can sometimes be longer and more expensive than expected. And, unlike the pleadings stage in a lawsuit, arbitration often can be initiated quickly and perhaps too easily. An arbitration can be accomplished by just completing a one-page form provided by the arbitration company and mailing the form to the other party without first considering a less expensive negotiation. Both companies have heard that in the worse case, arbitrations sometimes defy the positive reputation they enjoy and have turned out to be as complex, lengthy and expensive as litigation when attorneys fight over the discovery process, file motions and examine witnesses. Finally, they discuss how some arbitrators are more into helping both parties by "baby-splitting" (awarding half of

[24] For example, the loser of an arbitration can argue that the award should be set aside if the "arbitrator's conduct or "bad faith" substantially prejudiced the rights of one of the parties, if the award violates an established public policy, or if the arbitrator exceeded her or his power (by arbitrating issues that the parties did not agree to submit to arbitration). CLARKSON ET AL., *supra* note 9, at 42-3.

what each side asks for) then adequately evaluating the real merits of the dispute. For these reasons, both parties internally engage in a vigorous debate over whether they want the clause.

XYZ's Proposal: After careful deliberation among management and counsel, XYZ decides to propose an arbitration clause to Elite. In weighing the pros and cons, it appears to them that it is the correct path to follow. However, they do put in provisions that will limit the amount and time dedicated to discovery, as well as other terms to further lessen costs.

Elite's Response: Elite decides to accept the proposal for similar reasons, but also proposes that any dispute be submitted to mediation first so that the parties will not rush into arbitration.

XYZ's Response: XYZ accepts Elite's proposal to add mediation. An arbitration clause is added to the letter of intent.

8. Eighth Negotiated Term: Attorney Fees

Most business contracts contain a provision that states that if there is litigation or arbitration the prevailing party will be entitled to reasonable attorneys' fees and costs, which is generally an important provision to include in agreements.

Unlike most other judicial systems, attorneys' fees are generally not awarded under American law. Consequently, unless there is a provision in the contract or some specific statutory right applies, the general rule is that each side bears its own attorneys' fees. In this situation, both XYZ and Elite know that even though they included a binding arbitration clause, which will hopefully limit attorney's fees, there is still a remote possibility that litigation can arise despite going through arbitration first. Thus, it may be wise to propose it. In this case, both sides cannot obviously predict whether there will even be a dispute much less one in which the other side might even continue to pursue the issue through litigation.

XYZ's Proposal: XYZ proposes that the loser of the arbitration or litigation will pay the other side its reasonable attorneys' fees.

Elite's Response: Elite agrees to the XYZ's proposal, but adds that when the mediation occurs both sides will split the cost.

XYZ's Response: XYZ concurs.

The attorney's fees term is put into the letter of intent.

9. Ninth Negotiation Term: Choice of Law

It is important to provide in a contract which state's law will apply and where litigation or arbitration will be filed. This is especially true with certain types of agreements. For example, California has evolved detailed and specific laws governing entertainment contracts which can be helpful and predictive in a dispute. Thus, even if a case is litigated in a state other than California, a clause providing for California law in an entertainment agreement can significantly impact how the case goes. Moreover, as stated earlier, the parties are from different states, (Illinois and California) making this issue more important.[25]

XYZ's Proposal: XYZ proposes that if there is dispute that goes to arbitration or litigation that the law of Illinois will apply.

Elite's Response: Elite's lawyers research Illinois law and come to the conclusion that it is not that different regarding the relevant legal issues. For example, both states apply the UCC and while the UCC is not always perfectly uniform among the states, the two states' provisions are nearly identical. For this reason, and therefore not wanting to make this an issue, Elite agrees to it.
The choice of law clause is included in the letter of intent.

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[25] *See supra* discussion following the heading "*Parties to the Contract*" at 7.

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10. Tenth Negotiation Term: Choice of Forum

It is also important to provide a forum for where any lawsuit or arbitration will take place by listing a specific city and state. Any party clearly wants to take advantage of what is sometimes called the "hometown advantage." For example, an out-of-state party must work with unfamiliar attorneys with whom they have not developed a long-term relationship. This can sometimes make it difficult to control fees. Moreover, the travel time and expenses can add to the already significant cost and efforts of arbitration or litigation. All of these would work against a party sometimes requiring it to settle the costs of arbitrating or litigating.

XYZ's Proposal: XYZ proposes that if a dispute arises under the contract, any mediation, arbitration or lawsuit will be located in Chicago.

Elite's Response: Elite understandably wants the forum to be California for the reasons discussed. However, it knows that XYZ has a better bargaining position and would not accept California. Since there is little room to compromise here other than a neutral forum, such as New York State or a place more geographically positioned between the two, like Denver, Colorado, they accept Chicago as the forum.

The choice of forum clause is included in the letter of intent.

III. MISCELLANEOUS TERMS

In most business agreements, there is often a section at the end titled Miscellaneous Terms or Provisions. Typically, these sections do not address the more essential nature of the agreement and are therefore, not the subject of as intense negotiations and the key terms. Often they are located at the end of a typical form contract. However, some of these seemingly mundane issues are still quite important and so should be not only understood, but carefully negotiated as well.

1. First Negotiated Term: Confidentiality Clause

A confidentiality clause is a contract provision that requires the parties to keep certain information of the other party in confidence. Depending on the type of agreement, confidentiality provisions can be very important. In our case, XYZ and Elite may both have proprietary information that, if it gets into the hands of a competitor, might have undesired consequences.

One issue that arises is how to manage confidential information. For example, say that Elite is also concerned about what it regards as confidential information. Its contract contains general language that defines it "as non-public information about Elite that is intended to stay confidential". From what it has learned in previous contract negotiations, it also knows it needs to be managed. Accordingly, what it has done is stamp in large words *Confidential* on all information deemed private and important. By doing so, there is no ambiguity as to what is confidential information. However, after a meeting in which this clause is discussed between management and the company lawyers, it is pointed that although it has not suffered any problems yet by using this approach, great care must be used because someone may forget to stamp *Confidentia*l on certain of the documents, leaving them vulnerable to disclosure.

Thus, one of the managers proposes the following language: "Confidential Information is non-public information provided by a party which, due to the nature of such information and the circumstances under which it was disclosed, ought reasonably to be treated as confidential." The lawyers point out that this language provides less certainty, while those who must manage the flow of paper argue that it avoids the risk of allowing the other party freely to disclose the company's private information simply because someone forgets to stamp each document. After debating the issue, they agree to use the stamp, plus some additional language, but to emphasize to those in management that it must be very careful to stamp the relevant documents.

Elite's Proposal: Elite, to protect its licensed software and software system proposes language that prohibits the disclosure of it software or software within its software system or hardware design from being obtained by any third party. It also states that all language stamped "Confidential" as well as its definition of what it regards as "Confidential Information" applies to XYZ, notwithstanding whether it has been stamped "Confidential".

XYZ's Response: XYZ understands why Elite has made the proposal but also has proprietary interests in its own products; information Elite will likely obtain when it designs its software and hardware system. Thus, it proposes that the confidentiality clause apply *mutually*, that is equally to both parties.

Elite's Response: Elite accepts the mutually binding term. The confidentiality clause is put into the letter of intent.

2. Second Negotiated Term: Assignment and Delegation Clause

Many parties enter into a contract in which they reasonably expect the relationship to continue for the relevant term. As such, it can sometimes be an unexpected problem when the other party assigns certain contractual rights or delegates certain duties to a third party company. Some form contracts provide the other party the right to freely assign contractual rights, while others do the opposite. This relationship is complicated enough that it should be addressed.

XYZ's Proposal: XYZ knows that Elite must apply it own unique skills and expertise to design its computer software and systems. For this reason, Elite probably cannot delegate to another company its duty to design the system for XYZ without gaining its permission.[26] However, just so that there are no doubts, it proposes a non-delegation clause, unless it first agrees, to Elite.

Elite's Response: Elite accepts the proposal, but adds that it may "assign its rights to receive any money for its services as well as its right to receive damages, to a third party for any breach of the contract herein". These provisions are routine and are enforceable under the law even without the clause, but it again clarifies the relationship.

XYZ's Response: XYZ responds that this clause be applied to it as well to reflect the assignment rights so that they will be mutual.

Elite's Response: Elite accepts XYZ's language.
The assignment and delegation terms are inserted into the letter of intent.

3. Third Negotiated Term: Force Majeure Clause

Sometimes parties are unable to perform contractual obligations due to unforeseen circumstances which are out of the parties' control. To deal with these situations most contracts contain a provision entitled "Force Majeure" which in French means an "impossible or irresistible force" but is sometimes defined as an "act of god.' This term is common and generally appropriate.[27]

For example, in our scenario if there is an earthquake in San Jose and Elite cannot send its shipment of computers on time and therefore within the time frames contained in the contract, it is excused from performance until the damage caused by earthquake and its aftermath no longer impedes Elite's ability to make the shipment.

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[26] *See* CLARKSON ET AL., *supra* note 9 at 308-9 (discussing the legal issues pertaining to assignments and delegations).
[27] *Id.* at 376.

Elite's Proposal: Elite proposes in the Force Majeure clause, and defines what constitutes an act of god with a long list of possibilities from earthquakes to terrorism.

XYZ's Response: XYZ agree to it, aware that this is a routine clause and that there is a low probability of these kinds of events ever occurring. The Force Majeure clause is inserted into the letter of intent.

4. Fourth Negotiated Term: Integration Clause

The miscellaneous provisions often include a clause that states that the contract is considered the full and integrated agreement of the parties. Put another way, the clause provides that no prior discussions or writings can become a part of the agreement. In effect, whatever was discussed orally or in writing before the contract was executed is superseded by the final contract. Obviously, this makes it imperative that the parties include everything that they want in the final document. The integration clause, in essence, fortifies the parol evidence rule, which by law states that written and oral promises, with some exceptions,[28] made prior to or at signing that are not put in the writing in the final agreement, are unenforceable.

The parties also agree to language pertaining to subsequent modifications. Since the parol evidence rule does not exclude oral modifications made after the contract's execution, this requires that either party must also put subsequent modifications in writing. Since this clause is non-controversial and routine, both parties agree to it. It is put into the letter of intent.

[28] *See id.* at 296-98 for a more in-depth discussion of the parol evidence rule and its exceptions.

5. Fifth Negotiated Term: Time Is of the Essence Clause

A provision that states “time is of the essence” has the effect of signaling to the other party that the dates contained in the contract are “material” to the agreement. In theory, if this clause does not exist, a party who fails to perform on the date required in the contract can argue that the exact date was not a primary or material issue.

As a result, failure to meet the deadline without this language, although a technical violation of the agreement, is not a material breach of the contract. Put another way, “time is of the essence” has been accepted by the courts as the equivalent of writing “and we really mean it” next to the deadlines. As a result, when a date is missed under a contract that contains this clause, it is easier to argue that a significant or “material” violation of the contract has occurred. This gives a party the ability to actually terminate the agreement and the return of its money, if for example, the delivery of the product or service is not on time.

XYZ’s Proposal: Since receipt of the computer system at a specific time is very important to XYZ, it proposes the inclusion of this term. Moreover, to fortify and signal to Elite the importance of the term, it adds the words “As a material part of this agreement, Elite must deliver the agreed upon computer system no later than November 20, 2011.”

Elite Response: Elite’s management and lawyers are now aware how important the on-time delivery of its computer system means to XYZ. It debates whether it has the bargaining position to strike out the term, but knows the clause has become so routine in sales contracts that some buyers, as it appears to be with XYZ, are requiring the extra language to drive home the point. After a time, they agree to accept the term. The “Time if of the Essence” term is put into the letter of intent.

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CONCLUSION

It has always been vitally important for legal environment and business law students to be well versed on the black letter law of contracts. There are few legal topics as fundamental to the understanding of civil law in general and functioning of business in particular as contract law. However, learning the black letter law may not be enough to satisfy the needs of our business students when they enter and compete in the business environment. A basic understanding of the substantive nature of contractual terms and how these terms are negotiated provides another dimension to their business law learning experience that will enhance their abilities to compete in an ever changing, highly competitive and sometimes contentious workplace.