



**Monday, October 1, 2012**

**11:00 AM - 12:30 PM**

## **301 – To Dig In or Give In: Risk Analysis in Contract Negotiation**

**Tammy Brandt**  
*General Counsel*  
ServiceMesh, Inc.

**Stacey Mollohan**  
*Senior Corporate Counsel*  
Travelport

**David Mowry**  
*Senior Counsel*  
Xerox Corporation

## Faculty Biographies

### **Tammy Brandt**

Tammy Brandt is the vice president, general counsel and corporate secretary at ServiceMesh, Inc. in Santa Monica, CA, a cloud application software company. She is responsible for all legal affairs of the company, including negotiating contracts, managing litigation and overseeing human resources and risk management.

Prior to joining ServiceMesh, Ms. Brandt was managing counsel at Toyota Motor Sales, U.S.A. where she was involved in marketing-related transactions, complex corporate matters, and support for the racing division. She previously worked as a corporate attorney at Jones Day and Sheppard Mullin Richter & Hampton LLP where she handled public and private acquisition transactions and related corporate and finance matters.

Ms. Brandt currently is a member of the ACC's Southern California Chapter board of directors. She received a BA from Bluffton University and a law degree from the Notre Dame Law School.

### **Stacey Mollohan**

Stacey A. Mollohan is a senior corporate counsel in the global technology group of Travelport, an international global distribution system and information technology provider. In his role, he is responsible for technology transactions, including acquisitions, licensing and intellectual property prosecution and enforcement, for one of the largest transaction processing facilities in the world.

Prior to Travelport, Mr. Mollohan held the position of patent counsel with Western Digital Corporation and was an IP and business litigator in AmLaw 100 firms.

Mr. Mollohan received his JD from the College of William and Mary in Williamsburg, VA and a degree in applied physics from Georgia Tech.

### **David Mowry**


David Mowry is senior counsel for Xerox Corporation. He works primarily on commercial lease transactions, advising clients and negotiating matters in a geography generating approximately two billion dollars in annual revenue. He also manages litigation matters, and advises clients on legal issues such as contracts, intellectual property and human resources.

Prior to Xerox, Mr. Mowry litigated at Nixon Peabody in Rochester, NY, and Coudert Brothers in New York City. He also clerked for federal district court judges in the District of Columbia and the Western District of Oklahoma.

Mr. Mowry is the outgoing chair for ACC's New to In-house Committee. He joined ACC in 2008, and has previously served on the ACC's Western New York Chapter board of directors. He regularly presents at ACC's Corporate Counsel University. Mr. Mowry has written for the *ACC Docket*, and is a regular contributor to *abovethelaw.com*.


Mr. Mowry is an honors graduate of Brooklyn Law School, an honors graduate of Emerson College, and a graduate of the American Academy of Dramatic Arts in New York City.

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## Risk Analysis in Contractual Drafting and Negotiations






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## Speakers

- Tammy Brandt - ServiceMesh
- Stacey Mollohan - Travelport
- David Mowry - Xerox


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## Introduction

- This panel discussion is about risk management in contract drafting and negotiation, and will specifically focus on risk analysis through a method of statistical modeling.
- It is a growing trend as analytical tools have evolved, but we will show how statistical modeling fits into the larger picture of a corporate lawyer's risk management duties.
  - There may be a dedicated department for Risk Management
  - Usually have substantial bargaining power—can work from your forms
  - Can afford to walk away from a deal if certain terms are not included
  - Generally more risk-averse than small companies
  - Have comprehensive insurance coverage


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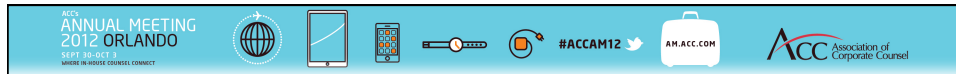


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## Know Your Paper

- Brevity is an underutilized contract tool.
- Understand your paper's terms and have an answer for every possible question. Over time, you'll be able to talk track contentious issues.
- Come up with alternatives ahead of time, if A then B. Or if B then C.



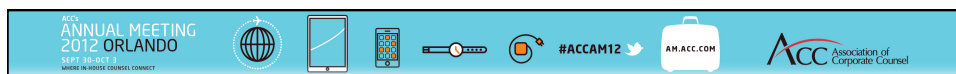
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## Benchmark

- Benchmarking is crucial, if you can get it done...This will avoid you falling into a sales trap or being unarmed in a battle of the wits...



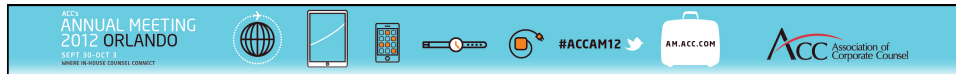
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## Necessaries

- If you draft it --- you are the buck stop. Parties, definitions of terms, Term, Subject of the Agreement, Pricing, Payment terms, Reps and Warranties (easier than it sounds), Schedules and Exhibits, Confidentiality, Liabilities and Indemnities, Merger Clause, Governing law and Interpretation, Dispute methodology, Force Majeure, Waiver of UCC self-help rights, and Termination rights (not "PENALTIES")

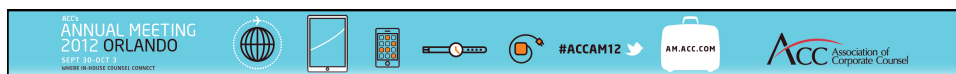


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## Know HIPAA, HITECH and GLBA

- You DO NOT have to indemnify.
- You DO NOT need extra termination rights --- can gut the termination provision in the main Agreement.
- These can be very contentious issues – be prepared.

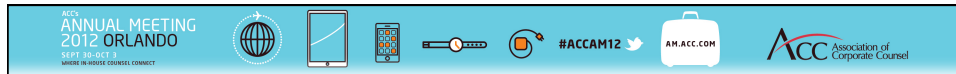


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## RFPs are NOT Contracts


- They are agreements to negotiate IF awarded the business.
- Submit a Notwithstanding letter along with a sample template of the appropriate vehicle.
- Don't be frightened of severe language; if they like your product and price, you'll be okay.




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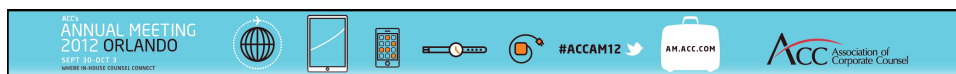


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## Control


- You control the document.
- One floats back and forth.
- CAYGO, and save as new versions.
- There is no doubt, once locked, what has transpired.
- Saves you time and stress.




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## Miscellaneous

- Casts of thousands are recipes for disaster.
- Try to get to the other attorney asap.
- Don't let Procurement act as an Attorney.
- Be Nice.




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## The Usual Way


- Be reasonable with LoL --- use risk/reward. *Limit* is the key, you're not an insurance company. Stay away from consequential or punitive damages --- direct damages ONLY.
- Indemnity is for getting you OUT of third party claims, or taking them on for your Customer. Usually unlimited. Can be used for Injury, death, IP violations, etc...These are not first party indemnities.

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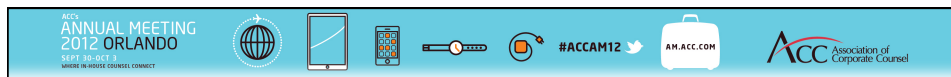
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## Risk Management in a Small Company

- Less bargaining power often means:
  - using other companies' forms (causing less uniformity)
  - the inability to walk away from potential deals
- Generally less risk-averse than large companies
- Likely lower insurance limits
- Inability to obtain certain types of coverage
- Often must revisit insurance coverage and form contracts to close deals

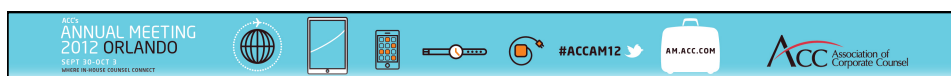


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## Risk Management and Contracts

- Creating and using standard forms can save you time and increase uniformity among your agreements
- When drafting or negotiating contracts, review industry leader contracts and empirical data
- Examples of empirical resources include ABA “Deal Points” studies and research published in law reviews and business journals
- You can better analyze and improve the terms of your contracts by using statistical modeling



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## Statistical Modeling

- Statistical modeling can help you understand and assess risks by repeatedly simulating scenarios where there is uncertainty
- Although such tools are used frequently in other fields, such as finance, most attorneys have yet to take advantage of them
- Models can be easy to learn and performed in a simple Excel spreadsheet

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## The “Monte Carlo” Method

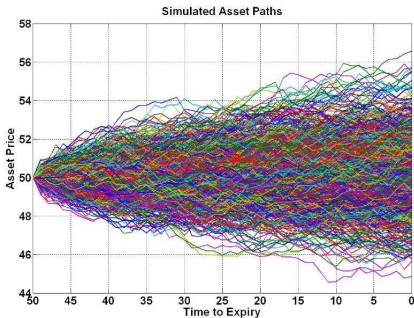
- One popular model is called the “Monte Carlo” method, developed in the 40’s by physicists working on the Manhattan Project.
- Monte Carlo experiments are computational algorithms that repeat random sampling within weighted probability distributions. This is repeated thousands (or even millions of times), and the result is a large sampling of outcomes, weighted by their probability.

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## Monte Carlo Explained

- Example: Monte Carlo is used in option pricing. The output shows thousands of possible price paths, with the more likely ones occurring more frequently.




- The rest of this presentation will work through a scenario using a Monte Carlo simulation to assess the risks in a hypothetical contract.


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## Become the Dealmaker, not Breaker

- ABCs
  - A.lways
  - B.e
  - C.ontributing
- Quantitative Legal Analysis
  - When?
    - When you need to “predict” the future
  - Why?
    - Added Value
    - Deal Support


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## Hypothetical

You represent a manufacturing company whose current subcontracting relationship is about to expire. Your procurement department is considering a new subcontractor, located in the country of Elbonia, who can offer substantial discounts. Elbonia is a developing nation, and this will be your company’s first long-term business activity within the country.

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## Framework

- Question
  - What's the question you are trying to answer?
  - Deconstruct the question into quantifiable terms
- Variables
  - Identify the relevant variables
  - Determine the range of those variables and how confident you are in those variables
- Simulation

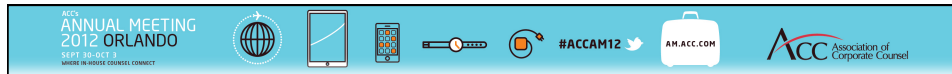
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## "Is it a good deal?"

- What's the real question here?
- Deconstruct the goal into a quantifiable question
  - "We want happy clients."
    - Better survey results?
    - Increased volume of return business?
    - Less complaints / more accolades?
- Does "good" mean:
  - Cost savings
  - Higher quality
  - Staging for a strategic alliance
  - All of the above?

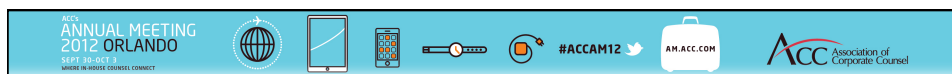


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## Cost Savings

- Identify the relevant variables
  - Try different things
- Potential Legal Cost variables:
  - Maintenance -- Costs of maintaining the new relationship.
  - Defense -- Potential liabilities arising from relationship
  - Enforcement -- Costs due to need to act against new malefactors in the area








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## Maintenance Costs

- Regulatory fees
  - Licenses, permits, etc.
- IP
  - Trademark and Patent annuities
- Ancillary Services
  - Lobbying
  - Related vendor negotiations and contracts
    - e.g., warehousing, distribution, etc.

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## Have Some Confidence

- You've established the variables, now:
  - Establish upper and lower boundaries around the range of possibility for your variables.
  - Set the ranges at levels that you are confident are right (the level of confidence is up to you).

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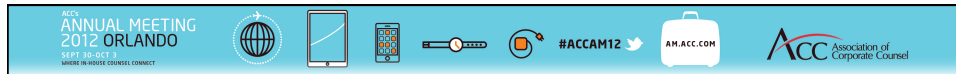


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## 90% Confidence Interval

- Confidence Interval refers to the level of precision.
- Yardstick: Bet real money
  - Would you rather bet \$100 on a raffle ticket where you have a 9 in 10 chance of winning; or that your estimate is right?
    - Raffle = You're not 90% confident
    - Your estimate = You're too confident
    - Same = Just right

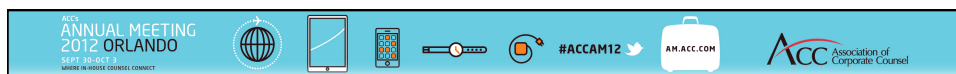


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## Where do I get these numbers?

- Do they already exist
  - Surveys? Studies? Prior ACC resources?!
- What has been my past experience
  - Personal experiences
  - Company records
  - Employee expertise
- Conduct your own survey



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## Distribution

- In statistics, the distribution generally refers to the arrangement of a value of variables showing the observed or theoretical frequency of occurrence
- Many different types of distribution based on the context of the situation

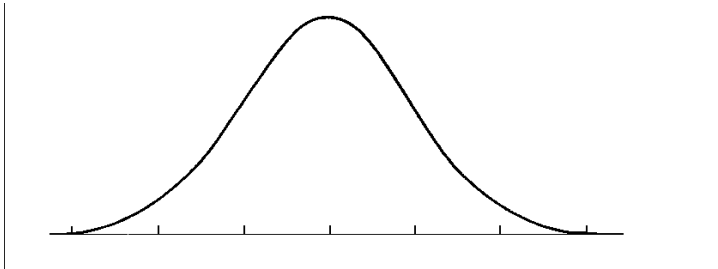


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## Distribution

- The most familiar kind of distribution is the normal distribution (e.g., the “bell curve”):



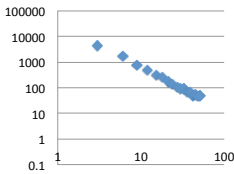
- Occurs frequently; often used in social sciences to approximate real world situations.

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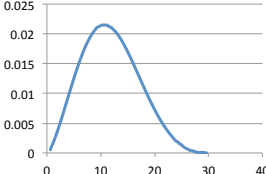
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## Distribution

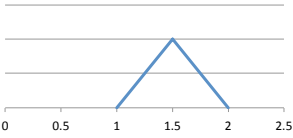
- Examples of other distributions include:



Power Law



Beta



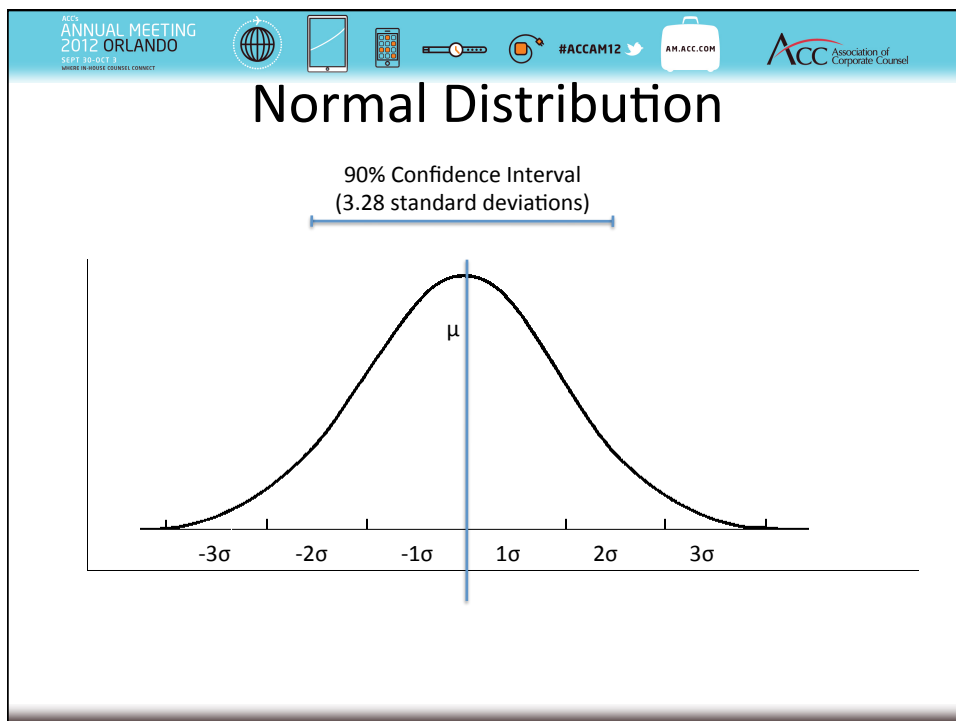
Triangular

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## Other Terminology

- $\mu$  = Mean (or Midrange)
  - The upper bound of the confidence interval less the lower bound of the confidence interval divided by 2
    - $(\text{upper bound} - \text{lower bound}) / 2$
- $\sigma$  = Standard Deviation
  - Indicates how wide-spread data points are. A smaller standard deviation indicates that a high number of data points lie near the mean value. A high standard deviation indicates a high number of data points lie far away from the mean value.
    - $(\text{upper bound of CI} - \text{lower bound of CI}) / \text{standard deviations corresponding to the CI}$
    - Z-score



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## Input Ranges

Ranges				
Ranges	Legal Maintenance Costs (\$ per unit produced)	Defensive Legal Costs (\$ per unit produced)	Legal Enforcement Costs (\$ per unit produced)	
<b>Upper Bound</b>	\$0.009	\$0.006	\$0.009	\$0.009
<b>Midrange</b>	\$0.008	\$0.003	\$0.008	\$0.008
<b>Lower Bound</b>	\$0.007	\$0.000	\$0.007	\$0.007

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## Function

- Random number generation function for normal distribution in Excel:
  - =NORMINV(RAND(), Mean, (Upper Bound – Lower Bound)/(Standard Deviation Range Corresponding to Desired Confidence Interval))
- Some software packages may have analytical packs built-in that will have random number generators for various distributions

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## Perform Monte Carlo

Simulation Runs				
Run #	Legal Maintenance Costs (\$ per unit produced)	Defensive Legal Costs (\$ per unit produced)	Legal Enforcement Costs (\$ per unit produced)	Savings (\$ per year)
1	\$0.009	\$0.004	\$0.008	\$0.022
2	\$0.008	\$0.004	\$0.008	\$0.020
3	\$0.008	\$0.005	\$0.007	\$0.020
4	\$0.008	\$0.002	\$0.008	\$0.018
5	\$0.008	\$0.003	\$0.008	\$0.019
↓				
95	\$0.010	\$0.004	\$0.008	\$0.022
96	\$0.007	\$0.003	\$0.009	\$0.019
97	\$0.008	\$0.006	\$0.007	\$0.021
98	\$0.008	\$0.001	\$0.008	\$0.017
99	\$0.008	\$0.005	\$0.007	\$0.020
100	\$0.009	\$0.003	\$0.009	\$0.020

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## Histogram

Cost per unit (\$)	Number of runs in increment
0.011-0.012	2
0.012-0.013	2
0.013-0.014	6
0.014-0.015	11
0.015-0.016	16
0.016-0.017	18
0.017-0.018	16
0.018-0.019	17
0.019-0.020	6
0.020-0.021	5
0.021-0.022	1

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## Monte Carlo Example 2

Ranges							
Ranges	Cost Savings (\$ per unit produced)	Legal Cost (\$ per unit produced)	Quality Costs (\$ per unit produced)	Work Stoppage	Probability of Stoppage	Length of Stoppage in Months	Production Level (units per year)
<b>Upper Bound</b>	11.00	\$0.050	\$9			12.0	140,000,000
<b>Midrange</b>	7.50	\$0.025	\$6	5%		6.0	134,000,000
<b>Lower Bound</b>	2.00	\$0.000	\$3			-	128,000,000

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## Monte Carlo 2

Simulation Runs									
Run #	Cost Savings (\$ per unit produced)	Legal Cost (\$ per unit produced)	Quality Costs (\$ per unit produced)	Work Stoppage	Length of Stoppage in Months	Production Level (units per year)	Savings (\$ per year)	Breakeven met?	
1	\$ 9.24	\$ 0.01	\$ 6.00	1	5.1	79,193,472	\$ 256,204,036.95	1	
2	\$ 10.88	\$ 0.01	\$ 4.44	0	10.8	130,678,982	\$ 840,011,855.23	1	
3	\$ 11.86	\$ 0.04	\$ 6.17	0	7.6	132,688,254	\$ 748,969,924.67	1	
4	\$ 5.93	\$ 0.03	\$ 9.10	0	11.5	132,143,525	\$ (421,759,797.69)	-	
5	\$ 9.64	\$ 0.02	\$ 5.32	0	10.2	131,182,254	\$ 564,874,073.28	1	

95	\$ 8.43	\$ 0.02	\$ 5.07	0	7.4	136,437,026	\$ 456,424,126.36	1	
96	\$ 9.43	\$ 0.03	\$ 2.61	0	2.1	127,343,770	\$ 864,553,771.24	1	
97	\$ 4.72	\$ 0.05	\$ 6.85	0	11.4	134,728,445	\$ (294,551,548.24)	-	
98	\$ 6.96	\$ 0.02	\$ 8.11	0	6.0	132,509,803	\$ (154,728,343.29)	-	
99	\$ 7.14	\$ 0.02	\$ 5.83	0	0.1	132,612,820	\$ 170,827,742.25	1	
100	\$ 4.18	\$ 0.03	\$ 5.55	0	4.9	131,899,924	\$ (183,909,052.56)	-	

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## Analysis

- In this scenario, chance that some cost savings is realised ( $>0$ ) is 72% (based on 1 set of 100 runs)
- Chance that cost savings are not realised is 28%.
- Does not take into account certain other factors, e.g., cost associated with migrating vendors
- Monte Carlo and other statistical tools should be used for approximation and estimation. They do not provide definitive outcomes, but help eliminate uncertainty regarding events.