



902 Shifting Risk

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Faculty Biographies

Douglas J. Cole

Douglas J. Cole is the vice president and general counsel for ECS headquartered in Chantilly, Virginia. ECS is a privately-held group of companies providing geotechnical engineering, construction materials testing, and environmental, specialty, and facilities engineering and consulting around the country. As the head of a two-person law department, his varied responsibilities usually focus on matters of risk management and insurance, commercial and public contracting, litigation and dispute management, intellectual property rights, corporate compliance, and labor and employment matters.

Prior to joining ECS, Mr. Cole was a partner in a small Northern Virginia firm as well as working in-house for a large computer services provider and the Department of Defense. Mr. Cole has provided contract and risk management training for the Department of the Army, the Department of the Air Force, as well as various legal and insurance organizations.

He is currently active in ACC's Small Law Department Committee and is also a member of the ABA and the National Contracts Management Association.

Mr. Cole received his B.S. from Middle Tennessee State University and is a graduate of the American University, Washington College of Law.

Jack O'Neil

Jack O'Neil is the general counsel and secretary for Western Construction Group, Inc. The company is headquartered in St. Louis, Missouri and operates a specialty contracting businesses nationwide through subsidiaries with branch offices in 35 cities. Mr. O'Neil currently works from Breckenridge, Colorado.

Prior to joining Western, Mr. O'Neil was affiliated with the law firm of Armstrong Teasdale Schlafly & Davis in St. Louis. He has served as an instructor and adjunct assistant professor at the Saint Louis University School of Law.

Mr. O'Neil is a member of ACC and served as president of the St. Louis Chapter in 2000. He is also a member of the Missouri State Bar and the construction law forum of the ABA.

He has a B.A. from DePauw University, and a J.D. cum laude from Saint Louis University School of Law.

Bruce Pincus

Bruce Pincus is general counsel of Minitab, Inc., located in State College, Pennsylvania. Minitab, Inc., a privately held company with over 250 employees and wholly owned subsidiaries in England and France, is the developer of Minitab Statistical Software, Quality Companion and Quality Trainer – applications widely used in statistical education and process control initiatives such as Six Sigma. Mr. Pincus is responsible for identifying, directing, and responding to all legal matters relating to the company. He works closely with Minitab's executive and management team on general corporate operational concerns, with a focus on trademark and copyright issues, software licensing, sales contracts and agreements, and employment and labor law matters.

Prior to joining Minitab, Mr. Pincus was in private practice in the San Francisco Bay Area where he advised corporate clientele in the technology sector and related industries, ranging from start-ups to firmly established businesses.

In State College, he serves on the board of directors of the Jewish Community Center and the committee for redevelopment of the State Theatre, a small-screen cinema being converted to an all-purpose venue for the performing arts. Mr. Pincus is a subcommittee chair on ACC's Employment and Labor Law Committee.

Mr. Pincus received a B.A. from the University of California, Berkeley and is a graduate of John F. Kennedy University School of Law, where he served on the *Law Review* editorial board.

SHIFTING RISK – Why, How, and When

Jack O'Neil, General Counsel, Western Construction Group, Inc.
Bruce Pincus, General Counsel, Minitab, Inc.

Your business people have identified a certain risk that is associated with your company's day to day business. They come to you and inquire about using the Contracts they have vendors or customers sign to shift some or all of that risk to the other party to the Contract. The panel members have discussed these issues as they relate to the industries with which we are most familiar. Software, and Construction. Some thoughts are included in the outline, and reflect our day to day point of view and experience. It is hoped that this will help you translate these ideas to your particular company, and industry.

Why Shift Risk?**NEED. You need to if the transaction is to be commercially viable.**

There are some transactions and industries, where you can't charge enough to make it worth taking on certain risks.

CONTROL. You are allocating the risks to the party with the most, or better ability to control the risk. A reasonable transaction that is negotiated by knowledgeable people should end up here.

MARKET POWER. You have enough market clout to demand what ever terms you want. You should question whether you really have this much market power, or if some of your people just think you do.

UNSOPHISTICATED COMPETITION. You can because the people you are shifting it to don't have a clue what you are doing. This may be very unlikely in many markets, but in some, you will hear, "the others guys will sign this without any changes, why won't you?"

Check Your Bargaining Power.

Is the world really beating a path to your door? In some service industries, the competition may be viewed as the same as you. In which case competition may be all about price. If people don't care whether it is you or the competition, they aren't likely to negotiate on risk shifting.

Do you customers get annoyed when you try to negotiate terms and conditions? If the legal department is not directly involved in negotiation, do the business folks really understand the risk shifting provisions? Do they just say no

to any changes in the contract because they don't want to have to send it up the line?

Practice Tip: Don't use .pdf format when sending terms that you know will be negotiated or that contain terms that you know the other party will not accept as written

Approach to Shifting Risk

Get as much as you can. Is this really a long range relationship or a one time deal that you do not expect to recur? Try to be reasonable.

Take enough of an even handed approach that your sales folks can sell what you write. It also helps if the sales people who will be presenting these terms understand something of why they are in there. Does it really do your people any good to have to say, "I don't know what that is for, the Legal Department says we have to have it." A good training program on these points may be beneficial in the long run.

Is the legal department the final say in what the contract contains? If you think you have it, are you sure?

Try to soften the wholesale dumping of risk that people present to your business folks. Look for ways to qualify the risk shifting without just crossing things out.

Do you give as good as you get? Again, reasonable treatment should be the goal.

Some Steps in the Analysis**1. Identify the Risk.**

Price Risk – The risk that costs will go beyond established pricing.

- Raw Material costs
- Labor costs
- Bad estimates
- Changes in work

Credit (Collection) Risk – What is the risk that the money won't be there when the bill is sent?

- Potential Bankruptcy
- Contingent Financing

Subcontract where money is coming from two levels up

Product Risk – What is the risk of a problem with the end product?

- Doesn't work
- Is incompatible
- Is not the right product for the application
- Is defective
- Wears out too soon

Warranty Risk -- Similar to product risk, except from the other side. When it is you product or service. What warranties can you make, which do you want to disclaim?

- Who is responsible for product selection?
- What about misuse?
- How long should the product last?
- Should the warranty be the same as the useful life?

Representation Risk – Truth of present or past facts that are key to the success of the deal. What kind of representations do you want, or need?

- Investigation. Have done what you need to understand and assume risks.
- No past or pending litigation or claims that will hinder the deal
- No past customer complaints
- No regulatory violations

Shipping/Storage Risk – Who bears the risk of loss or damage in shipping products, or in storing materials before incorporated into final work product?

Property Damage Risk – Which party, or which insurance policy covers risk of damage to property.

- Your property – When located on the premises of the other party.
- Customer property – When your people are on their premises.

Injury Risk – Who is responsible for injury to persons connected to, and in the area of work or product. Liability and defense costs, can be handled separately

- Your own employees, particularly when on the other parties premises.
- Other people's employees e.g. contractors, business invitees.
- Third parties, general public.

Competition Risk – Risk of losing business or information to competitors.

IP Risk

- Lost information/data
- Corrupted information/data
- Infringement Claims from others.

Employment Risk

Risk of business interruption

Transfer Methods

Price Risks

- Cost plus pricing
- Unit pricing
- Guaranteed maximum price
- Lump sum price
- Long term supply agreements
- Cancellation triggers

Competition Risk

- Non- compete, non-solicitation agreements.
- "Most favored nation" provisions.
- Long term requirements or supply agreements

Insurance. Many of the risks are transferred to Insurance, but whose policy covers?

- Your insurance
- Other people's Insurance.
- Being named as an "additional insured" on another's policy.
- Fidelity and Surety Bonds -- Contrast to insurance.

Contract provisions -- I can write whatever you want, but if you can't sell it, it does no good.

Remember the law school Contracts class maxim: no one is ever going to read the contract until something goes wrong. And the other maxim of: everything is negotiable. So there should be something written in the agreement. But be reasonable.

Indemnification

Bodily Injury
Property Damage
Defense Costs

Indemnification from all manner of other claims

Shipping and Storage Risk

FOB and the like.
Bonded Storage
Who pays for the insurance?
Right to inspect

Waivers and Releases.

Up front agreement to waive claims
Releases automatic on happening of some event.

Exculpatory Legislation

Many of these are meant to counter what is perceived as unfair risk shifting, by stating that such provisions are not enforceable.

Automatic Claim Waivers

Waiver of Claims if notice not given within a certain period of time.

Placement. Should it be in **BOLD, ALL CAPS, ETC?** Or can you just slip something in. Check local case law for enforceability issues.

IP Risk Considerations. Here are some thoughts on some of the issues in the IP Industry.

General Considerations

The basic desire of any software purchaser and licensee is to have a software application that works and does what it says it will do.

This begs the question of what will the software actually do? Rely on: First: the published documentation and specifications; Second: current users – do some due diligence; ask for references and call them, speak to the users, ask about problems, strong points, weak points, etc.; Third: the salesperson and the website (except to the extent it can provide the documentation and specifications.)

Then, and this is critical, there has to be an analyses and determination if the software application, and what it will actually do, is what you actually want! Why, because every agreement contains (or should contain!) a statement that disclaims any warranty that the software application your purchasing will actually meet your requirements – rather, only that it will function as described and defined.

Specific Warranty Considerations

What to think about in a software transaction (not in any order of importance and not exhaustive):

Media - replace it

Services – trained personnel

Virus – clean vs. scanned using common industry tools

On-site personnel – confidentiality, background checks, etc

Disabling Devices – consider “annual” and “timed” licenses

Non-Infringement re: Valid Title – including 3P components (assignment of 3P warranties)

Non-Infringement re: Authority - to grant the license or sell it

Performance – in accordance with documentation, specifications

Error free – is this really possible?

Compatibility – upgrades and enhancements will work, legacy issues

Obsolescence – no plans to discontinue maintenance, development, support

Regulatory Compliance – application meets standards if in regulated industry.

Practice Tip: Consider how long a warranty is given re: time / statute of limitations. Negotiate the warranty period.

Indemnification and Disclaimers of Warranties

Indemnification is the most common way to allocate risk between parties. Expect it to be included in every software transaction. But remember, it is used to cover 3P claims, not the indemnified party's own damages.

Assuming the worst case scenario, do you want to "risk the company" on a warranty you have given? Size the indemnification for the transaction if you can.

Practice Tip: Be sure to disclaim liability for all 3P claims which are not covered by a specific indemnification.

Practice Tip: Watch for a licensor limiting or disclaiming liability for its own conduct, e.g., negligence or gross negligence. That's not reasonable. And the corollary is true, too: watch for a licensee seeking indemnity for its own negligence or gross negligence.

Samples – for presentation purposes only:

Warranty of Title: We warrant that We have the right to grant this License to use the Software.

Is this good enough? Does it need more? What is your comfort level? What about 3P components?

Compare this: We warrant that We have the right to grant this License to use the Software. We further warrant that no part of the licensed software infringes upon or violates the copyrights, patents, patent rights, trade secrets or other intellectual property or other rights of any third party and that We have all of the rights necessary to perform Our obligations in accordance with this Agreement without infringement on any third party rights.

Looking at the following, ask these questions: What do you like about them? What don't you like about them? What would you add? What would you delete? Are they fair?

Indemnification: We agree to defend or settle at Our expense any claim, suit or proceeding arising from or alleging infringement of any copyright, patent or intellectual property right of any third party; provided that You immediately notify Us of such claim, allows us to control the litigation or settlement of such claim, and cooperate with

Us in the investigation, defense, and/or settlement of such claim. This indemnification does not extend to any claim of infringement resulting from Your unauthorized modification of Our Software or from use or incorporation of Our Software in any manner for which it is not designed or permitted.

Limited Warranty: We warrant that the functions contained in this Software will operate without substantial program errors, but We do not warrant that the functions contained in the Software will meet Your requirements or will operate without interruption or error, or that all defects will be corrected. Except for Our obligations regarding Indemnification, Our entire liability, and Your exclusive remedy for the breach of the foregoing limited warranty, shall at Our option either be replacement of the Software with a product You accept as a reasonable alternative, or the refund of the license fees paid by You for Your use of the Software during the then-current license term.

Warranty Disclaimers: The warranties contained in this Agreement are in lieu of all other warranties. The Software is provided "as is," without warranty of any kind to You or any third party, except as set forth herein, including, but not limited to, any express, statutory or implied warranties of merchantability or fitness for a particular purpose.

Limitation on Liability: You agree that We shall not be liable to You or any third party for any loss of profits, interruption of business, or any indirect, incidental or consequential damages of any kind whether under this Agreement or otherwise, even if You have advised Us of the possibility of such damages.

Warranty Nullification: Any and all warranties, express or implied, shall be void and We shall have no liability or obligation to You for any claim resulting from Your unauthorized modification of Our Software or from use or incorporation of Our Software in any manner for which it is not designed or permitted.

Cost – Benefit

Consider the dollars in the transaction. Does the size of the deal affect the risk? Are there risks that are about the same no matter how many dollars are involved?

Direct Cost of Risk Transfer – Insurance premiums.

Cost of claims in loss sensitive insurance program.

Indirect Cost – Customer/Supplier backlash.

Will customers and suppliers take their business elsewhere if the risk transfer costs are too high?

Benefit:

Not having to reserve for such claims, or at least reducing the reserve.
Reduced Defense Costs

NEGOTIATING POINTS

Understand the Risk.

Look at alternative shifting devices, and be in a position to discuss them.

Have a good rational reason for why you want to shift, or resist the shifting, of that particular risk.

Try to get an understanding of the other parties concerns. The language it self may give you a clue.

Look for compromises that meet those concerns. There is almost always some room, as many risk shifting provisions are written extremely broadly.

Be willing to let the other side have some input on the language.

Get the next draft back ASAP.

Be reasonable.

PRACTICE HINTS.

If you are not the gatekeeper on every contract your company signs:

1. Get the word out on these issues to the people who are.

2. As counsel, stay focused on the “legal” issues and make sure that the appropriate people are focusing on the “business” issues. An accept/reject decision should be able to be made by either the legal department or the business unit. Whose risk is it, and who is responsible for protecting the interest involved.

3. Train your people on the risks and what they can do about them. Give them reasonable forms, and the information to understand what is in them.

How to get a start on training.

Try to get on the agenda of the next sales meeting, to talk about the risk transfer provisions in your contracts.

Try an on-line Newsletter. Monthly Tips from the Legal Department. If you keep it to one page, many will read it.

Create Contracts training programs for your sales and operations people.

Spice those programs up with war stories, of your own, or anonymously borrowed ones.

If you can put a dollar savings on a particular contract provision. You can do the same thing in reverse, if you missed an opportunity to save dollars by not negotiating that risk transfer provision.