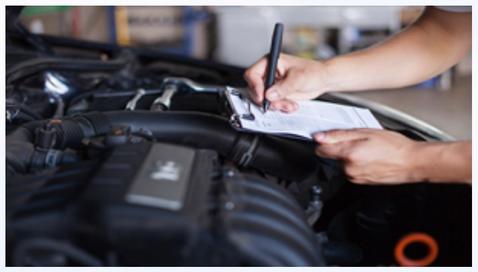
You Signed The Contract: But Do You Know What It Said?

You know contracts are important. In fact you know they are VERY important. You also sign contracts with all of the people you do business with, from your bank and insurance carrier to lenders and providers of warranty, gap and other programs. Because a contract is a necessary part of any business transaction, it is important to understand basic contract terms and their implications. You really should read contracts carefully and completely enabling you to understand what you are agreeing to before signing on the dotted line. Unfortunately, many people don't understand what they are signing and, even worse, some are signing without reading them at all.

As with many of the legal and business issues that arise in the motor vehicle industry, reviewing contracts can seem like an overwhelming task. Granted, they often can be long and complex documents written in legalese, which means they tend to put the average reader to sleep. They can, however, be quite simple to review if you understand a few basic principles. By the time you receive the contract, you have hopefully already spoken to others who have a relationship with the company, evaluated the financial aspects of the relationship and conducted other steps in a proper due diligence examination. At this point, you may even be sold on the opportunity. Keep in mind, however, that it's the written contract that governs the relationship. So, let's get started. Go ahead and pull out one of your contracts and I will walk you through it.



Most standard contracts begin with the "preamble". The preamble identifies the parties, their respective addresses and principal places of business, and usually defines how they will be referenced in the main body of the document. The preamble may also briefly state the desired objectives for both parties. Once the basic objectives of the parties are defined, most contracts will move into the sections that define the parties' relationship and their responsibilities and obligations to one another, including any applicable representations and warranties being made. Payment terms may also be included.

It is important to define whether the relationship with the other party is that of a product or service provider, agent, independent contractor or employee because this usually determines the scope of liability and responsibility for the relationship between the parties. Make sure that your responsibilities and the other side's obligations, as well as the products and services to be provided, are clearly and accurately described. Ambiguous language in a contract can lead to misunderstandings, delays, frustration and even litigation.If you are relying on something important when entering into a contract, such as a promise or guarantee, take the time to verify that this information is actually written in the contract. If the verbal promises aren't reduced to writing, you shouldn't count on them. The payment terms should also describe in detail the amount to be paid, when and how it will be paid and whether offsets against other amounts owed will be permitted. If offsets are permitted, you should request that notice of the amount and reason for the offset be provided.

Consistency between the terms of the contract and any terms set forth in attachments and the other documents provided to you, including any brochures and/or documents that will be provided to your customers, is a must. Usually this isn't a problem, but sometimes you'll find inconsistencies between the terms in the contract and these documents. For instance, I have on occasion found discrepancies between a service contract document that indicates a warranty program is "dealer obligor" and a dealer agreement that indicates the program is "administrator obligor".

With the parties' expectations and obligations defined, the next set of provisions often address the duration of the relationship and what will happen if and when it ends. Duration and renewal provisions define whether the contract will remain in effect for a fixed period, until otherwise terminated by one of the parties, or until a specified event occurs. The parties may also agree on a method of renewing the contract. For instance, the contract may automatically renew unless otherwise terminated upon prior notice, or it may expire unless renewed within a set time period. Keep in mind that automatic renewal or termination provisions will require some type of action on your part, usually on an annual or semi-annual basis, in order to continue the relationship. That means calendaring and staying on top of providing notices within the appropriate time frames.

Speaking of termination, most of us know from the beginning of any business relationship that it will probably end some day; yet we often sign contracts that do not clearly state what will happen upon termination. Ownership interests in data and customer lists, responsibility for returning or destroying documents provided by one party to another and which, if any, obligations and responsibilities continue to exist even after termination, are just a few of the issues that must be addressed. You should also make sure that you have the same right to terminate as the other party. Too often we see clauses that permit only one of the parties to terminate the contract, with or without cause or notice, and one-sided default provisions. Both parties should have the right to end the relationship under similar conditions and terms. If termination is permitted based upon a breach, you should also request a reasonable notification of the alleged breach and an opportunity to cure it prior to the termination becoming effective.

Indemnification, limits of liability and damages clauses often go hand-in-hand with termination provisions. They are also typically one-sided in favor of the drafting party. There is an old saying, "when it comes to contracts, you don't get what's fair, you get what you negotiate." So, negotiate! Indemnity provisions should provide that if something goes wrong due to an error on the part of one of the parties, that party will hold harmless and indemnify the other party from all damages, costs and expenses, including attorney's fees, it incurs as a result of that error. If the other party retains the ability to assess damages, make sure you do too. Damages can be limited to actual damages (lost revenue and expenses actually incurred) or may include consequential damages (such as loss of potential revenue) and liquidated and punitive damages that are assessed primarily as a punishment or penalty.

Virtually every contract includes "boilerplate" or "standard" provisions at the end of the contract. This language may seem trivial, but it is often not "standard" at all and can end up being tremendously important in the event of a dispute. For example, attorney fee provisions often state that the non-prevailing party will pay the legal fees and costs of the prevailing party. You may wish to suggest that both parties be responsible for their own costs and fees unless a court of law rules otherwise. Choice of law and forum (location) selection clauses identify the laws that govern the contract and the state, county and even courts where lawsuits or arbitration proceedings must be commenced. Again, the drafter of the contract often seeks to apply the law in its home state, which may be disadvantageous and costly for you. Finally, pay attention to the provisions governing modification of the contract. Revisions may be necessary for routine things, such as a change of address, as well as to materially alter the terms of the contract. Too frequently the proposed modifications become effective by a party continuing business as usual. Changes to material terms should always be in writing and signed by both parties.

One last piece of advice: Never sign a contract you don't understand. A well-drafted contract spells out the rights, responsibilities and obligations of each party. Clarify the issues you don't understand, try to negotiate those that don't fit your needs and, when necessary, get help from a knowledgeable and experienced advisor to assist you in making your decision. Remember, no contract can save a bad business relationship, but a bad contract can harm a good one!

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