

## Vendor management & contract negotiations (Part 3)

By Daniel A. Cotter | August 29, 2016

You have now reviewed the governing documents and have a good understanding of the company's mission and how it is organized. You understand the staffing issues for your start-up. You can now turn to vendor management and contract negotiations.

### GETTING A BASELINE INVENTORY

You have organized and collected all governing documents. You should make sure that you have a full inventory of contracts. Find out where executed contracts are kept. You will need to interview almost everyone at the start-up to make sure the inventory is complete. As part of the interview process, ask the interviewees to:

1. Provide all hard copy contracts the interviewee has in her possession – whether or not executed by one or all parties;
2. Advise you of any “understandings” or informal agreements; and,
3. List all vendors and third parties with whom the interviewee has interacted.

You likely will discover that some third-party engagements have no formal contracts in place. You will want to remedy these situations by reaching out to the third party and opening a dialogue to memorialize the understanding of the parties.

Reducing all contracts and agreements to writing will help you and your start-up down the road to make sure the parties' expectations are met, as well as allowing enforcement and interpretation should a dispute arise.



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(You will recall the statute of frauds requirement that some contracts must be in writing, including contracts that take more than one year to complete.)

### ESTABLISH AN INVENTORYING AND STORAGE SYSTEM

After compiling an initial inventory of existing contracts, you should develop a system for storing all contracts in a repository to be maintained in the Office of General Counsel. You might consider purchasing a management software solution, but for most start-ups and even very large organizations, a “homegrown” system consisting of an Excel spreadsheet and scanned copies of all contracts stored in a segregated file on your system should be sufficient.

Your objective in developing the repository is to help ensure future access to the agreements should you need to review an agreement for any reason. If you build your own inventory system, you should consider capturing and indexing relevant information with respect to each contract, such as:

- Parties to the contract;
- Renewal or termination dates of the contract;
- The annual and total spend of the contract;
- Other pertinent terms of the contract; and,
- Dispute language and dispute mechanisms.

Having a well-developed inventory system will allow you to have a full understanding of your start-up's agreements and relationships and will also help you as you move to the next step; developing parameters and a framework for the contract management policy.

### ESTABLISH A CONTRACT MANAGEMENT POLICY

Once you have an inventory of existing contracts and a system for tracking them in place, you can now develop a contract management policy. The purpose of the contract management policy is to provide guidance on managing contracts and vendor relationships. You want to make sure the contract management policy you develop permits your start-up's management to appropriately authorize, assess, measure and monitor the contracts established with vendors.

An effective contract management policy consists of a number of elements, including the following:

1. A contract authority matrix;

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2. A contract review protocol;
3. A process for conducting due diligence in selecting a new vendor and contract structuring (standard provisions);
4. Review and oversight procedures; and,
5. Storing contracts in a central repository.

### **ESTABLISH A CONTRACT AUTHORITY MATRIX**

Your contract authority matrix will identify those persons authorized to enter into contracts, and will also set forth authority levels for the personnel identified. For example, your CEO may have unlimited approval authority, while other top executives may have lesser authority.

The designated approval authority can be measured in terms of “annual spend” or “life of the contract.” You will have to determine what thresholds are appropriate.

### **ESTABLISH A CONTRACT REVIEW PROTOCOL**

Depending on your start-up, many contracts may be de minimis. For example, you may rent a copy machine for a few hundred dollars per month. If you and your legal team are small and faced with a significant number of contracts as well as with time-consuming work such as IPO registrations or capital raising, you may want to establish minimum thresholds for what contracts you must review.

Based on the inventory you have conducted and the system you have in place to track contracts, you should be able to determine an appropriate review threshold for your start-up.

### **DUE DILIGENCE IN SELECTING A NEW VENDOR AND CONTRACT STRUCTURING**

You should develop a due diligence checklist or process to assist your start-up in vendor selection. You should include requests for information about the new vendor’s financial condition, its specific relevant experience, its reputation and the scope and effectiveness of its operations and controls. (For example, you should find out whether the vendor has obtained an SOC1 report from an acceptable auditor and request a copy.)

The amount of due diligence you require will be dependent in part on the length of the contract, the significance of the services the vendor will provide, and the financial size of the contract. You should develop a protocol for assessing a vendor’s ability to fulfill any indemnification obligations it may have

under the contract with your start-up.

You should also develop guidelines for specific provisions you will require in the contract. Common areas might include renewal terms (automatic, or advance notice of expiration), indemnifications, intellectual property rights, and dispute resolution. Your guidelines can be very specific about the language you require or it can more generally identify what you are looking for in each provision (you should strongly consider establishing specific language in the guidelines to help you in negotiating contracts).

If you have an area where the volume of contracts is significant, you might consider template agreements (for example, independent contractor/consultant agreements or software licensing agreements). The templates might not be accepted by the vendor, but you will have a document that you can use to compare with the vendor contract and to make edits to conform to your requirements. Having strong processes in place will improve your efficiency in contract negotiation.

### **REVIEW AND OVERSIGHT**

Entering into the contract is not the end of the vendor management process. You will want to establish a review process to monitor the vendor’s quality of service, financial condition, and applicable controls and reports. In addition, you will want to review the performance by the vendor to ensure that each vendor is performing consistently with the terms and obligations of the agreement it has in place with your start-up.

### **STORING CONTRACTS IN A CENTRAL REPOSITORY**

This step has already been addressed in this article. You will have to determine whether to build a system internally or utilize an outside vendor solution.

After following these steps, you will have an effective vendor management process and policy in place. Once you have developed the inventory and system and established review protocols and provision requirements, you will be able to effectively oversee the myriad relationships your start-up has with third parties, as well as advise your management team on financial and performance issues relating to the vendor relationships.

You should stress the importance of effectively implementing and maintaining a strong vendor management program to your management team.

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<http://www.insidecounsel.com/2016/08/29/nuts-and-bolts-for-in-house-counsel-vendor-managem>



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