

## **Five Key Steps To Successfully Negotiating A Commercial Contract**

Ensuring your commercial contracts work for you is a key part of business success. To get the terms you desire requires three essential elements:

- a) a precise knowledge of the terms required to ensure you meet your commercial objectives
- b) expert drafting of those terms, and;
- c) the confidence to negotiate

It is the third requirement which often catches even the most confident business people out. However, every human being is a born negotiator, and you negotiate in every area of your life. From a child promising to clean their room in exchange for the latest X-box game to asking for a more flexible deadline, chances are that few of us have days where we are not subtly working to get our own way.

Therefore, the only reason that negotiating a commercial contract may seem intimidating is that; a) there is money involved, and b) you probably believe the person on the other side of the negotiating table is smarter/richer/more able to walk away from the deal than you. Thankfully, none of these factors are usually true. But there are ways you can strengthen your position and improve your chances of creating a win-win situation.

Whether you are dealing with a commercial lease, cross-jurisdictional joint venture agreement, or a distribution agreement, here are our five key tips for successfully negotiating any commercial contract:

### **One – Draft a comprehensive Head of Terms**

A head of terms (also referred to as a term sheet, letter of intent, or memorandum of understanding) is a document which sets out the core terms a party sees as forming the main part of the contract. For a low-value, simple contract, the heads of terms may be contained in an email chain and never formulated into a document. But for larger deals, such as joint ventures or the acquisition of a business, your solicitor should draft a formal head of terms.

A head of terms will usually be marked 'subject to contract'. However, certain elements can be made legally binding such as confidentiality and exclusivity clauses and provisions stating a party must pay the other's costs should they choose to leave negotiations early.

The advantage of creating a head of terms is it allows parties to a contract to set out the key clauses on which to focus their negotiations in advance. In addition, a head of terms document provides clarity for negotiations and avoids any miscommunication or misunderstanding that can otherwise occur through verbal and informal email or online discussions.

### **Two – Make sure all the legal details are included in the initial drafting**

Some people can be so eager to close the deal they forget to ensure to include all the legal elements of a contract. It may sound dull to have to stipulate which jurisdiction will apply in a cross-border agreement, however, if a disagreement develops, this little detail can save a small fortune in legal costs to establish which country should hear the dispute. Other

elements to include in the initial agreement are what currencies will apply to the deal, what warranties and indemnities will be included and, a dispute resolution clause which sets out not only the steps for resolving disputes outside of court, but the preferred names of any mediators or adjudicators to be appointed.

### **Three – remember the basic principle – losses loom larger than gains**

In a ground-breaking paper published in 1979, Daniel Kahneman and Amos Tversky coined the term ‘prospect theory’<sup>1</sup>. Prospect theory assumes people value losses and gains differently. Also known as the ‘loss-aversion’ theory, the general concept is, if two equal choices are put before someone, one presented in terms of potential gains and the other in terms of potential losses, the former will usually be chosen. This is because, as Kahneman and Tversky discovered, losses have a greater *emotional* impact than gains.

In their paper, *Psychological Influence in Negotiation: An Introduction Long Overdue*<sup>2</sup>, Deepak Malhotra and Max Bazerman set out the following proposition:

“Negotiators are more likely to gain support for their proposals if they state in terms of what the other side stands to lose if the proposal is rejected than if they state in terms of what the other side stands to gain by accepting.”

### **Four – Remember the WIFM of your proposal**

WIFM stands for What’s In It For Me? Most people forget how self-centered a majority of human beings are. American entrepreneur and master negotiator, Robert Ringer, stated in his classic book, *Million Dollar Habits*, that the most poorly received words in the English language are “I, me, and mine”. If you want to persuade someone to do something for you, you must couch it in terms of the benefit taking such action will provide to them, and completely ignore your own gains when presenting the benefits of the terms.

### **Five – Resist the urge to sound too clever unless you have a weak argument**

You may think you will gain more respect at the negotiating table by using complex language and demonstrating your in-depth knowledge of the deal. However, research shows whether such a strategy will gain you an advantage depends on how strong your argument or justifications for your position are.

The Elaboration Likelihood Model (ELM)<sup>3</sup> suggests that the way in which a message is communicated can impact the degree to which central vs peripheral information processing will dominate. Central cues include factors such as the quality or strength of the argument; peripheral cues comprise of factors such as the credibility of the source or the number of arguments presented.

Malhotra and Bazerman put it this way:

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<sup>1</sup> Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under risk. *Econometrica*, 47, 263-291

<sup>2</sup> [http://www.hbs.edu/faculty/Publication%20Files/08-058\\_17eca3fb-6891-4572-a8f0-7f25a4b92729.pdf](http://www.hbs.edu/faculty/Publication%20Files/08-058_17eca3fb-6891-4572-a8f0-7f25a4b92729.pdf)

<sup>3</sup> Petty & Cacioppo, 1986; Petty, Heesacker, & Hughes, 1997; Petty & Wegner, 1999)

“ A negotiator who has strong justifications and arguments will be more likely to have their demands accepted if they:

- speak slowly,
- avoids being overly technical,
- provides a written explanation of the core demands and justifications, and
- avoid negotiating at a time when the other party is distracted.

A negotiator who has weak justifications and arguments will be more likely to have their demands accepted if she

- speak quickly,
- uses technical language,
- evades requests to put the offer in writing, and
- negotiates when the other party is busy or otherwise distracted”.

### **Concluding comments**

Much of the art of negotiation comes from having the confidence that you are worth what you are asking for. By taking the time to study what you have to offer and how this will benefit the other party, you will find yourself in a much stronger position to negotiate commercial contracts that work for your business.

**Bennett Griffin are award-winning solicitors based in West Sussex with offices in central Worthing and Ferring. Our experienced and specialist solicitors offer a comprehensive service and will work with you in an honest, considered, and practical manner. Our specialist solicitors can provide expert advice on drafting and negotiating commercial contracts. Please contact us on 01903 229 999 or by email at [info@bennett-griffin.co.uk](mailto:info@bennett-griffin.co.uk) for more information.**

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