

# CONTRACT TERMS: A PRACTICAL GUIDE

This list briefly explains the meaning and purpose of many commonly used contract terms. It is intended to help you better understand common contract terms and how they may affect your rights. This guide is *not* a substitute for legal review. For specific questions about your contracts, please contact our office at (206) 682-5600.

**ARBITRATION:** When parties enter into a contract, they can elect to have disagreements about the contract decided by an independent third party instead of in court. This independent third party is an arbitrator. The arbitrator normally hears evidence from both sides and then issues an “award” that tells the parties who gets what. Decisions by arbitrators are usually binding and cannot be appealed or reviewed by a court. By agreeing to an arbitration clause, you give up the right to go to court. You should consider carefully whether to agree to an arbitration clause and consult counsel if you are unsure. **Note:** Arbitration is not the same as mediation.

**ASSIGNMENT:** An assignment is the transfer of rights or responsibilities held by one party (the “assignor”) to another party (the “assignee”). Contracts often limit or prohibit assignments.

**ATTORNEY’S FEES:** Parties to a contract may agree that if there is a dispute between them regarding the contract that the losing party will have to pay the attorney’s fees of the winning party. Generally, in Washington, a party can only recover their attorney’s fees if there is an attorney’s fees clause in the contract. Such clauses can be a double-edged sword, so the decision on whether to include such a clause must be considered carefully in each situation.

**BREACH:** When one party doesn’t perform an obligation required of them in the contract, that party is in breach of the contract. A breach may result in an action or claim for damages, an order requiring performance, and/or termination of the contract.

**CHOICE OF LAW/FORUM/JURISDICTION:** A contract may include a clause that specifies that laws of a particular state (*i.e.* Washington) will apply to the contract and/or where a claim made under the contract will be heard (*i.e.* King County courts). These clauses can require that any claim relating to the contract must be brought in the location stated. Watch for contracts that have clauses calling for disputes to be resolved in places other than where your business is located.

**CONFIDENTIALITY/NON-DISCLOSURE:** These provisions ensure that specific information is available only to those authorized to have access to it. These clauses are used to keep sensitive, proprietary information secret and prevent its use for anything but the performance of the contract. The obligations of these provisions often extend past the term of the contract. Many times parties will enter into separate non-disclosure agreements prior to beginning negotiations.

**CONSIDERATION:** Consideration is the legal term for something of value that a party exchanges with another party. Consideration does not have to be money or goods, but can be a benefit or promise given by one party to the other. For example, in a lease agreement, the tenant’s consideration is the payment rent and the landlord’s consideration is providing the tenant with the leased premises. While an exchange of consideration is required to form a contract, the exchange does not need to be equal.

**DAMAGES:** Damages are what a party who breaches a contract must pay to the other party to compensate that party for their loss. Generally, damages for a breach of contract should be enough to restore the non-breaching party to the position that party would have been in if the contract was not been breached. Many contracts contain provisions limiting damages or calling for specific amounts of damages (“liquidated damages”). These provisions should be reviewed carefully because they can have a major impact on your rights and remedies.

**GUARANTY:** A guaranty is where a third-party (the “guarantor”) agrees to be responsible for performing one of the contracting party’s obligations in the event of a breach. For example, landlords often require the owners of a company to personally guaranty the payment of rent by the company. What the landlord is asking is that each owner be personally responsible for payment of the rent in the event the company fails to make payment. Guaranties create direct personal liability and can vary quite widely in their terms. While they are often a fact of life for the owners of growing businesses, it is strongly recommended that you consult a lawyer before agreeing to any personal guarantees.

**INDEMNIFICATION/INDEMNITY:** When two parties enter into a contract, one party can agree to reimburse or pay another party for loss or damages they experience as a result of the contract. These provisions can dramatically increase the risk associated with a contract and should be examined carefully. *See also* Warranty.

**INJUNCTION:** An injunction is a court order requiring a party to stop engaging in a certain action.

**INTELLECTUAL PROPERTY (“IP”):** Intellectual property is original creative thought that has commercial value. It includes copyrights, trademarks and patents as well as trade secrets, business methods, and industrial processes. Often parties will use confidentiality and non-disclosure agreements to protect the secrecy and use of their intellectual property.

**MEDIATION:** Mediation is a voluntary process in which a neutral third party tries to help the disputing parties to reach a mutually agreeable solution. In contrast to Arbitration, the independent third party does not make a binding decision. If the disputing parties cannot come to an agreement on how to settle their dispute, they may pursue other forms of legal relief such as arbitration or a lawsuit.

**NON-COMPETITION/NON-SOLICITATION:** A non-competition clause is where a party agrees to not pursue a similar profession or trade that competes with another party’s business. A non-solicitation clause is where a party agrees not to sell to customers and/or recruit employees of the other party’s business. In order to be valid, such agreements must be supported by consideration, protect a legitimate business interest, and be reasonable in place and time. Such clauses can severely limit your rights; consult counsel before agreeing to such clauses.

**TERMINATION:** The cancellation or end of an agreement. Termination occurs most often in the natural course of events when the entire contract has been performed and all payment completed. However, a contract may also be terminated under other circumstances, such as breach or when performance becomes impossible.

**WARRANTY:** A warranty is a promise of affirmation of quality. For example, in a sales contract, the seller may provide a warranty that the product or services is of a specified quality or will meet a specified purpose. Failure to perform to the standard warranted can result in a claim for breach of warranty. Warranties may be implied into contracts by law or industry standard. Often, contracts limit or completely disclaim all but those warranties specifically spelled out.