ThoughtTrace™

THE IMPORTANCE OF CONTRACT INTELLIGENCE IN M&A, REGULATORY COMPLIANCE, AND CONTRACT LITIGATION:

How AI is changing the game and saving millions

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Introduction

Businesses experience drastic change from one year to the next. Their employees, their projects, and their regulatory environment are in constant motion. Organizations do their best to adapt, but the challenge to keep pace can be obstructed by lack of contract intelligence. This is especially true when each department – from sales and marketing to finance, IT and HR – generates hundreds or even thousands of contracts per year with vendors and business partners, siloing critical information.

Business activities that involve any one of these departments, or any combination of them, will require efficient and effective contract review. However, many companies are at a disadvantage in situations that require contract review – like litigation or acquisitions – because they don't have access to high quality contract intelligence. Knowing what information, obligations, and risks are held in those contracts is essential, but difficult to achieve.

The challenges that businesses encounter

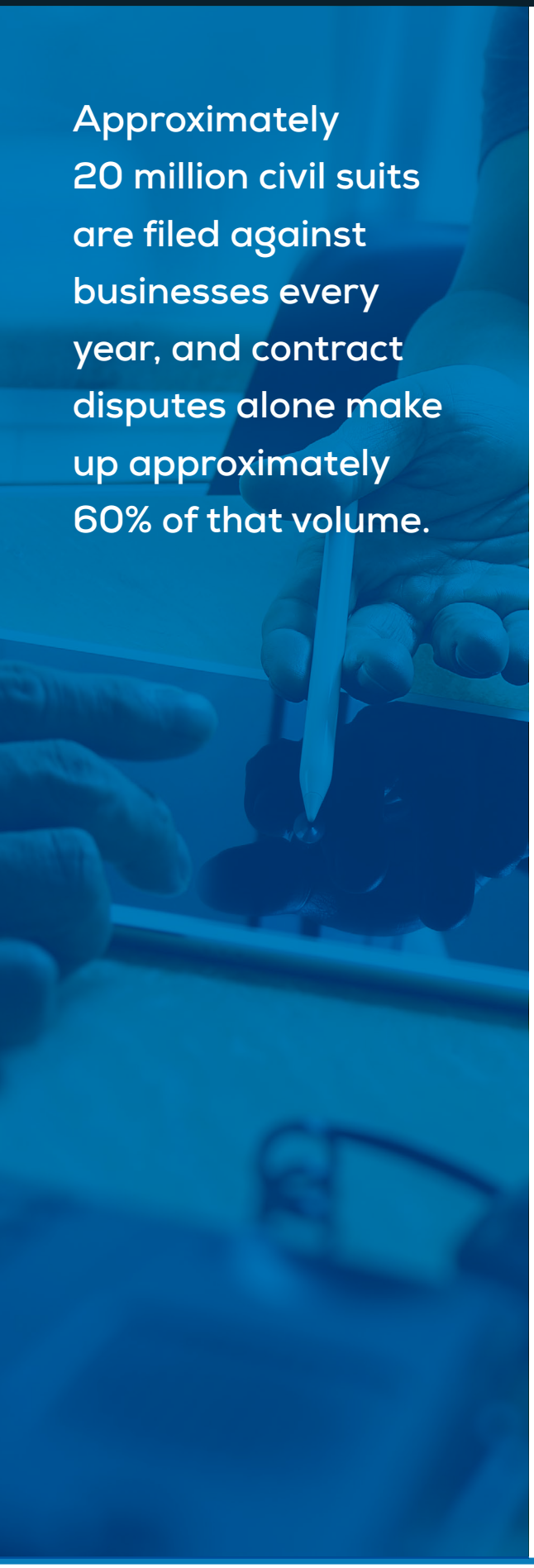
As a result, one of the most common issues that businesses face today is a lack of insight into exactly what information those contracts contain. This is largely the result of two primary factors: First, the sheer volume of contracts creates a backlog of information that has existed longer than the tenure of many employees. Second, many companies do not have the resources to handle both day-to-day business needs as well as the review of standing agreements to find inherent risks.

If a business is fortunate enough, it will have a legal team, a contract management team, or a combination of both. However, not all companies will have in-house legal or contract management resources. And the businesses that do possess such personnel will usually focus those teams on current contract negotiations and organizational risk management, where they can provide the most value.

The reality is that even the most well-staffed businesses will not have the resources needed to address day-to-day operations while also properly managing risk across existing contracts. According to a 2017 Thomson Reuters Legal Tracker LDO Index, corporate legal departments are busier than ever with a rapid increase in work. Most are inundated with current negotiations and ever-changing regulatory demands. Further, because these teams are not revenue-generating business units, they often do not have the largest budgets within the company.

Thus, businesses face the following questions, which many struggle to answer:

Many companies do not have the resources to handle both day-to-day business needs as well as the review of standing agreements to find inherent risks.



Approximately 20 million civil suits are filed against businesses every year, and contract disputes alone make up approximately 60% of that volume.

- If there are more contracts to negotiate per week than the contract or legal teams can handle, are unapproved contract terms making it to execution?
- How does an already busy team tackle an outdated contract template in the system?
- How can the team stay in front of expired contracts?
- If the company is sued under an older contract, how can it be sure that risks are properly transferred between parties?
- How is the current team aligning contract management/templates/negotiation with the work of prior legal or contract team employees?
- Are contract amendments properly aligning with the relevant contract language?

The ultimate question that businesses must answer is, "Is it really that important to know what risky provisions are contained in historic agreements?" The answer is, "It depends." If a company is one of the lucky few to operate without a problem during its existence, then the risks bubbling below may never surface. However, the chances of that are incredibly slim. Approximately 20 million civil suits are filed against businesses every year, and contract disputes alone make up approximately 60% of that volume. If a company is sued – whether for a contract dispute or any type of claim wherein a party consults contract-held obligations to determine which party must defend said suit (e.g. third-party claims for bodily injury and indemnification provisions) – then these organizations very quickly realize it's in their best interests to manage risk across the contract backlog.

Such questions must be asked in the following three situations, when contract intelligence is of the utmost importance to companies:

1. Litigation that involves contractual language

To understand the real-world impact of contract intelligence, consider recent litigation developments between IBM and United Microelectronics Corp. (UMC):

> The United States Court of Appeals for the Second Circuit found the details of contract language to be highly relevant in the parties' legal dispute when it remanded the case back to the District Court for the Southern District of New York in an early 2019 ruling. IBM initially brought the breach of contract claim, claiming that UMC failed to to pay a $10 million licensing fee for intellectual property. The district judge agreed that UMC failed to do so and in 2017 ordered it to pay the $10 million intellectual property licensing fee. UMC's appeal raised the issue of whether the damages should have been capped at $2 million due to a liability cap in an amendment to the original contract. IBM argued the limit did not apply because the amended contract language did not specifically apply to the original agreement's provision. The panel disagreed, noting it found reason for the parties to have agreed on a $2 million cap, but also determined that the language was ambiguous enough to require extrinsic evidence to resolve, sending it back to the district court. The matter was ultimately resolved between the two parties.

This is just one of many examples that make it clear that a company's visibility into its contract language is invaluable – particularly if a dispute arises during the course of a business relationship or if a company faces a regulatory compliance mandate.

The GDPR not only applies to companies in the European Union, but also to organizations outside the EU if they offer goods or services to EU citizen data subjects.

2. New regulations that require contract updates

Managing risk in business relationships is daunting enough, and the pressure can be compounded by regulations that require revisions to existing contracts with partners or vendors. Take the General Data Protection Regulation (GDPR) for example. GDPR was adopted by the European Parliament in 2016 and finally became effective on May 25, 2018.

It represented a substantial change in data privacy regulation from current policy. The GDPR not only applies to companies in the European Union, but also to organizations outside the EU if they offer goods or services to EU citizen data subjects. The regulation also applies for companies that monitor the behavior of EU data subjects, as well as those that process and hold the personal data of EU citizens. The condition is enforced regardless of the company's location, which means cloud storage and hosting companies are affected wherever they are located. The GDPR requires that "controllers" of data update contractual language with "processors" of their data. This contractual language must contain specific organizational and technical security measures agreed to by the parties for the protection and data privacy rights of the EU data subjects. Global businesses that deal with EU data subjects must comb through all of their contracts to determine:

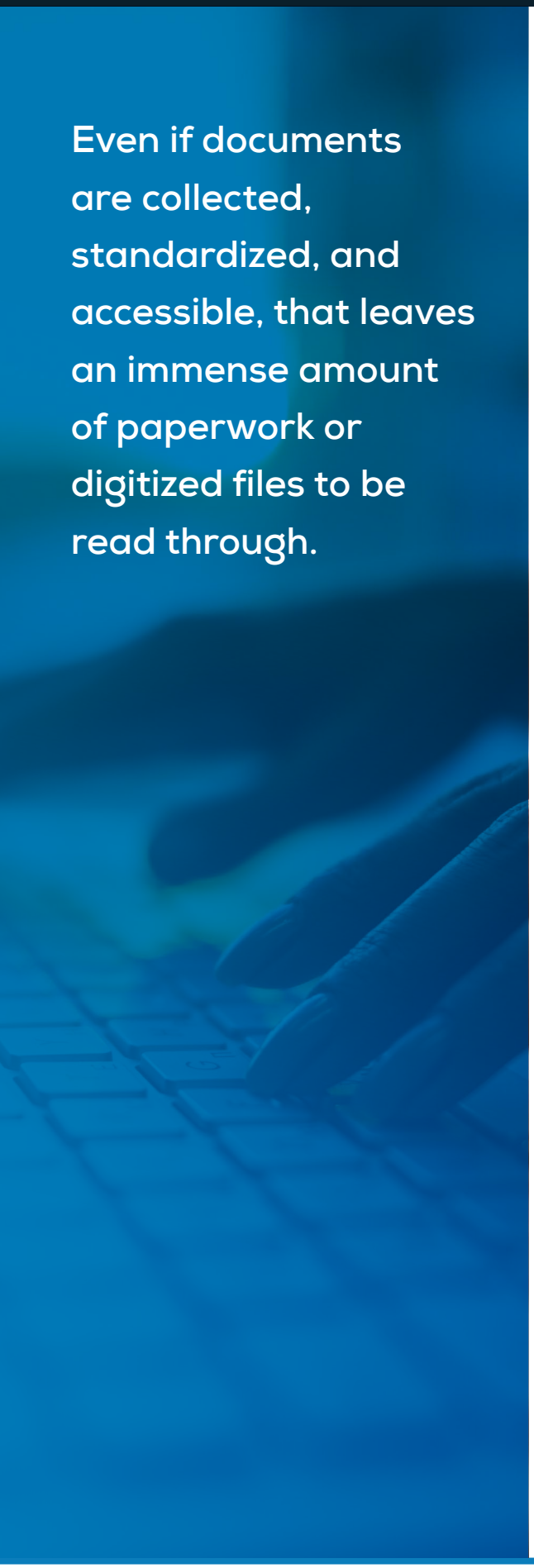
1. Whether they or their business partners qualify as either a "controller" or "processor."
2. In what way they relate to each other in terms of the "controller/processor" relationship.

These answers will inform the type of language that will be placed in an amended or renegotiated agreement between the parties.

As the GDPR compliance date neared, companies scrambled to organize and gain contract insights. Those with knowledge of their contractual obligations could devote time and labor resources to the heavy task of amending that language in light of GDPR. On the other hand, organizations without insight into their contracts had to first gather the appropriate information needed from standing contracts before they could start the compliance negotiations. This set many companies back in terms of employee resources, and costs poured into reviewing contracts as the implementation drew near.

3. Mergers and acquisitions that necessitate due diligence

Mergers and Acquisitions are the third scenario in which the value of contract intelligence becomes apparent. Companies involved in M&A activity are responsible for due diligence reporting in their existing contract populations. And as markets continue to show a large appetite for M&A's, companies may increasingly come under pressure to quickly mine immense historic contract holdings for accurate insights.



Even if documents are collected, standardized, and accessible, that leaves an immense amount of paperwork or digitized files to be read through.

However, companies face obvious barriers to the efficient analysis of contracts – especially in the scope of due diligence required by M&A's. One of the first hurdles is the organization of documents. In the absence of a central repository, contracts are often stored separately among their respective business units in disparate locations such as email, folders, and spreadsheets. Siloed departments result in a low level of information sharing, which severely hinders efforts.

Even if documents are collected, standardized, and accessible, that leaves an immense amount of paperwork or digitized files to be read through. In such cases, many young businesses that are being acquired may turn to experienced law firms for outsourced due diligence. Similarly, companies with sufficient resources may outsource to preserve productivity of their own internal teams. But the costs of such arrangements quickly come to bear.

Depending on the size of the project and its unique needs, the team size and project length will vary, but on the low end a project can cost approximately $80,000. M&A projects can easily run five to 10 times that. There is also potential for additional, unplanned costs. If new documents need to be added to the review because of regulatory oversight, or if a timeline is extended, the original SOW will need to be updated with each change and additional costs may accrue.

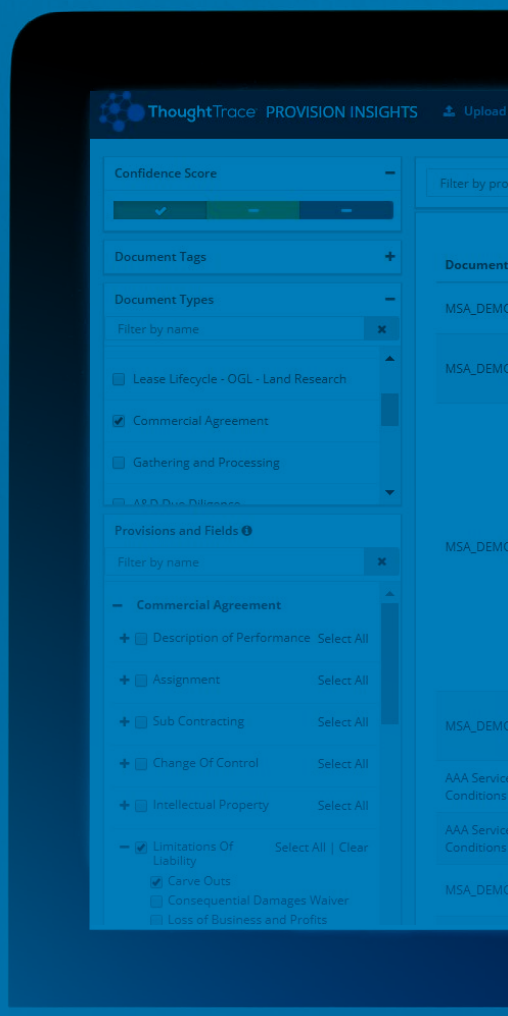
A solution for improving insight into contracts

Despite all the headwinds businesses may face in such situations, there is still a way for them to regain control of the contract review process, removing the uncertainty of manual methods or the expenses of outsourcing.

That solution is artificial intelligence-powered software. An AI-powered solution will significantly reduce the resources needed to efficiently and accurately analyze contract holdings. What would take months can take days, and what would take weeks may take only hours. And this is without sacrificing quality of insights; rather, AI increases that quality. Solutions that can read down to the intent of the word return the exact provisions or language elements you're looking for in a fraction of the time.

With these advantages at their disposal, companies can direct recovered time and manpower toward tasks where teams are most valuable, rather than basic information-gathering efforts that sap resources.

ThoughtTrace is an AI software that separates itself from the pack, putting the intelligence in your company's hands, and leaving the training of the software to us. With ThoughtTrace, contract review isn't the expensive and heavy lift companies know it as, but instead a stage of uncovering and understanding risks or obligations. For more information on how ThoughtTrace can start working for your company today, visit thoughttrace.com and request a demonstration.



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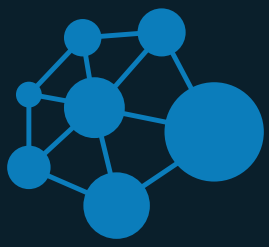

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