

Improving Contracting on Campus

Part 1: A Layperson's Guide to Understanding Contract Basics*

Every year colleges and universities, through their administrators, faculty, and staff, enter into thousands of contracts that focus on a diverse array of activities, including outside services and supplies, facilities use, construction, copyright, and research. Yet, despite the prevalence of contracts on campus, many educational institutions have not educated staff about contracts or established a policy to guide employees responsible for contracting. The failure to understand contracts or a campus contracting policy can result in unexpected and sometimes serious liability for educational institutions and their employees who are involved in a contracting process.

Recently, United Educators studied more than 2,000 pending claims to identify the most preventable. Hundreds of these claims involved weak contracting practices by educational institutions, such as:

- Relying on an oral agreement when a written contract would have memorialized and clarified the rights and obligations of each party
- Behaving in a way that implies a contract when none exists
- Using a written agreement that lacks detail or includes ambiguous terms
- Entering into an agreement that cannot be performed as written or is onerous for the institution to perform
- Signing a form contract offered by a vendor that would put the institution at a disadvantage if a problem were to occur

Colleges and universities may avoid problems like these by helping nonlegal staff gain an understanding of contracts and by reviewing their institution's own contracting practices to ensure sound processes are in place.

Understanding Contract "Basics"

What is a contract?

A contract is an exchange of promises that the law will enforce. To create a legally enforceable contract, a promise must be given in exchange for consideration. Consideration is a promise to give something of value, such as a monetary payment, goods, or services. For example:

If the Rock Paper Scissors Company promises to provide XYZ University with 1,000 cases of paper, and in exchange XYZ promises to pay \$20,000 to Rock Paper Scissors, the two parties have created a contract. Each party's promise is given in exchange for consideration or something of value from the other party (\$20,000 in exchange for 1,000 cases of paper).

*Note that "Part 2: Allocating Contracting Risks Between Parties" will appear in the November 2006 Risk Research Bulletin.

The document that reflects a contract can take different forms and be referred to by different terms. For example, a letter, an agreement, a memorandum of understanding, a purchase order, a license, a ticket, and even an email can all be contracts if they reflect the parties' mutual assent to exchange promises.

To be enforceable, does a contract have to be in writing?

Not always. To many people the word *contract* connotes a document with lots of fine print, but that is only one type of contract—a written contract. A written document is not always necessary to create a contractual relationship. A “handshake deal” can also be enforceable. Courts have enforced contracts based on an oral exchange of promises or have recognized implied contracts from the behavior of the parties. The key to determining whether parties have formed an “oral contract” or an “implied contract” depends upon whether they can demonstrate a promise given in exchange for consideration.

Consider the following examples that highlight the problems involved with an oral contract and an implied contract:

An Exchange of Oral Promises:

Bernie Bridges, a representative of ABC College, tells the owner of Tip Top Trim, a local landscaping company, that the college will acquire property on Jan. 1 that will expand its campus by one-third. During this discussion, Bridges promises to pay Tip Top Trim one-third more for its services starting Jan. 1, and in exchange Tip Top Trim promises to perform the landscaping services for the entire campus through the end of the academic year.

On Dec. 22 Bridges is fired, and his replacement, unaware of the oral contract with Tip Top Trim, retains Over the Hedge to provide the landscaping services for the new portion of the campus. Tip Top Trim sues the college for breach of contract. The college refutes the existence of any contract, but Tip Top Trim produces statements from its owner and Bridges that confirm the oral agreement. The college has nothing to contradict Tip Top Trim's evidence.

Tip Top Trim has a good chance of proving it had formed an oral contract with the college based upon the promises exchanged by the owner and Bernie Bridges, the prior representative of the college.

Behavior That Implies a Contract:

For the last 10 years, ABC College has had a handshake deal with Tip Top Trim to provide landscaping services for the entire campus. The college's director of buildings and grounds tells Tip Top Trim's owner that the institution will be expanding its campus by nearly a third in the coming year.

Tip Top Trim hires new employees, purchases additional equipment, and after the campus expansion, provides landscaping services for the new sections of the campus. For nearly a year, the college continues to pay Tip Top Trim its original fee and does not increase its payments. Tip Top Trim sues the college for breach of contract and seeks payment for the additional services provided. The company also seeks recovery of the costs required to hire employees and purchase equipment to service the entire campus in the event the college does not continue to retain Tip Top Trim's services.

Here, a court may determine that the college and Tip Top Trim had an implied contract. In trying to reach a fair result, a court can infer the existence of a contract from the parties' behavior. In doing so, it would consider the college's history of retaining the company without a written contract, the actions the company took in anticipation of the increased campus size, and the college's acceptance of Tip Top Trim's performance of landscaping services for the new portion of campus.

Even though neither arrangement between the college and Tip Top Trim involves a written exchange of promises, the college may still be obligated as if a written contract exists. Also, because neither an oral nor an implied contract involves a written document, the specific terms are vulnerable to the subjective and often faded memories of the representatives who negotiate these contracts. And if the

representative has left the institution, those recollections would be even more tenuous and might be lost forever. Also, because the college has no record of these contractual agreements, it cannot point to a writing that clarifies or refutes another party's claims about the terms of the exchanged promises. Had the college required a written contract, the college's disputes with Tip Top Trim might have been avoided.

Is a written contract preferable?

Almost always. There's wisdom in the adage, "Get it in writing." A written contract has many advantages. It formalizes the promises exchanged between parties and details other terms affecting the performance of each promise, such as start and end dates and payment schedules. A written contract also ensures that each party understands what it is required to do under the contract. A written contract details each party's rights in the event one of them fails to perform, prematurely terminates, or otherwise breaches the contract. Finally, a written contract provides tangible proof of the parties' agreement. Because a well-drafted written contract provides clear guidance on all aspects of the parties' agreement, it can reduce and sometimes eliminate the need for parties to dispute or litigate the contract.

An informal handshake deal may seem less complicated and more trusting than a written contract. However, if a dispute arises between parties, that handshake will not provide any guidance on the exchanged promises or the rights and obligations of each party. A well-worded written contract saves an institution time, energy, and money that will be required to resolve misunderstandings about the terms or even the existence of a contract. When possible, an institution should strive to commit contractual agreements to writing.

Will a written contract guarantee that the parties will avoid contract disputes?

No. A dissatisfied party can always challenge the terms of a written contract. However, a well-drafted contract that accurately reflects the promises, rights, and obligations of each of the contracting parties provides the parties and, if necessary, a court with a road map for resolving these challenges. Yet, not all written contracts are well drafted. When an institution enters into a poorly written contract, problems can also ensue.

Common problems with written contracts are that they lack detail, omit important terms, are ambiguous, or cannot be performed as written. These problems are compounded when the institutional representative does not review the contract before signing it, reviews the contract but does not fully understand its terms, or reviews and ignores questionable terms because of the perceived benefits the contract will bestow upon the institution. For example:

Professor Oscar Optimistic and Learning Adventures, Inc., a well-reputed, national organization focused on outdoor leadership training, have been talking about a joint venture by which the university would establish a leadership program and the company would provide the outdoor training component to enrolled students. Learning Adventures is interested in gaining exposure to a wider audience of trainees who can then promote the training to others. Optimistic and the university believe the program will successfully attract future leaders as students to the university and improve its reputation.

Adventure Learning presents the professor with a contract that requires the university to enroll a minimum of 150 students in the program annually. The contract provides that failing to meet this requirement will result in a \$15,000 penalty and the contract's termination. While initially concerned about the penalty, Optimistic quickly concludes that the positive appeal of the leadership program is likely to attract a large number of students and signs the contract. In the first year of the program, only 75 students enroll.

Learning Adventures terminates the contract and demands the \$15,000 penalty. The professor is shocked that the company would take this action. Optimistic claims, on behalf of the university, that he employed all reasonable efforts to meet the contract's enrollment minimum and refuses to pay the penalty.

In this case, Optimistic did not seriously consider how to best protect the university if the contract could not be performed. Rather, he placed undue emphasis on the likelihood that Learning Adventures' good reputation and services would attract students and the opportunity that the joint venture would benefit and improve the reputation of the university. To avoid entering into a contract that contains unfavorable terms, the institution's representative must ensure that the contract's language conforms with prior discussions, ask about the terms that disadvantage the institution, and seek the assistance of legal counsel when the contract is difficult to understand or appears unfair.

Who should sign a contract on behalf of the institution?

Generally, a written contract is not effective until the parties sign it. A signature indicates that the signing party agrees to and is bound by the contract's terms. When confronted with a contract dispute, courts routinely examine a contract for signatures and generally regard a party's signature as proof that the party understands and agrees to its terms even if the party did not actually read, understand, or fully agree with it.

As an entity, an educational institution cannot itself sign the contract. Rather, institutions are bound to written contracts when they are signed by an individual who has been authorized to act on its behalf. Typically, high-level administrators have that authorization. To increase the ease of doing business with outside contractors, top decision makers can also delegate that authority to other staff throughout the institution. Given the importance of this responsibility, colleges and universities must balance the need to ensure that contracts receive the appropriate level of review before they are signed against the need to increase the institution's ability to transact business in a timely and flexible manner. After carefully balancing these interests, each institution then needs to clearly identify those positions on campus that it authorizes to sign contracts.

What happens if an employee signs a contract without authority?

The results of an unauthorized signature on an agreement can have unfavorable consequences for both the institution and the signer.

Only those employees "with authority" should sign an institution's contracts. However, if an employee signs a contract without authority, in many instances the institution still will be bound to perform the agreement. If the other contracting party reasonably believes that the employee has authority to sign or enter into the contract, then the employee's "apparent authority" will bind the institution. Consider the following:

After serving as an outside computer consultant to the local university, the institution hired Charlie Cheatum to coordinate the updating of the university's computer system. Cheatum's position did not have authority to sign contracts. Nonetheless, he signed a contract that obligated the institution to purchase computer equipment from Farmer and the Dell Computers for a total cost of \$75,000. Cheatum regularly made similar purchases from Farmer and the Dell when he was an outside consultant for the university. Also, the university has not issued a policy or any other communication informing vendors, suppliers, and service providers such as the computer company that he was not authorized to sign the contract.

The college could be required to accept and pay for the computers if it was reasonable for Farmer and the Dell Computers to believe that Cheatum had authority to sign the agreement. A contracting policy that is well publicized and clearly identifies those positions on campus authorized to sign contracts is one way to provide important information to potential contractors.

Even though a court may require the university to perform the contract, unauthorized signers act at their own peril. For example:

The university first became aware that Charlie had signed the contract without authority when Farmer and the Dell sued it for breach of contract. The university terminated Charlie's employment for acting outside the scope of his employment and for the misuse of university funds, and then filed suit to hold him personally liable for the contract.

Institutions can view employees' unauthorized actions as taken outside the scope of their job responsibilities and may even be able to hold employees personally liable. To provide clear guidance, an institution's contracting policy can address both who has authority to sign agreements and the consequences to employees for signing contracts without authority.

Improving Contracting Practices on Campus

Colleges and universities can undertake the following strategies to improve their campus contracting practices and reduce the likelihood that they will encounter contract-related problems.

1. Establish a Campus Contracting Policy

A policy that requires written contracts is of paramount importance to improving campus contracting processes. The policy should also include a consistent practice of contract review and signing by authorized employees only.

- *Perform Contract Reviews*

Campus policies typically require that every contract to which the institution is a party receive an appropriate level of review before it is signed. The employee who negotiates the contract may be the best person to perform the review because he or she can evaluate the accuracy of the promises contained in the contract. A contract review may also be reserved for higher level officials depending on the value of the contract or the type of business relationship that is contemplated. At the same time, it is important to understand that many contracts that do not involve large amounts of money can still present a large liability exposure for the institution. An institution may want to establish other criteria to trigger a heightened review of a contract. For example, an institution may require legal counsel to review all contracts that are nonroutine, extend over one year, or involve substantial complexity or liability exposure.

Many institutions find it helpful to use a checklist with a step-by-step guide for reviewing contracts. A checklist can be particularly useful when two or more employees are responsible for reviewing and signing a contract. The completed checklist details the steps that the contract reviewer undertook before it goes to the authorized people for signing. The guidance provided by a campus contracting policy or a contract review checklist or both can ensure that all institutional agreements are reviewed by the most appropriate persons before the institution agrees to them.

- *Establish Who Has Authority to Sign Contracts*

Colleges and universities take different approaches when conferring contract signing authority upon employees. Institutions that want to promote a centralized contracting process will limit signature authority to a few people on campus, such as trustees, officers, or deans. However, that limitation can delay the signing process until after the small circle of signers completes other work priorities. To increase the speed of the contracting process and ease of doing business, institutions can expand the signing authority to a broader range of employees, including department heads and other lower level administrators, such as managers, directors, and supervisors. Institutions that employ the less-centralized approach may want to establish a tier of signers based on the contract's monetary value. For example, a policy could provide that supervisors

can sign contracts involving an amount less than \$2,000, department heads can sign contracts up to \$5,000, and a trustee or officer must sign contracts involving amounts over \$5,000.

2. Develop Model Forms for Routine Contracts

Consider working with local or in-house counsel to develop form or model agreements for those types of contracts that are most common on your campus and then require the use of those forms. Examples of contracts for which educational institutions often develop forms include purchase orders, facilities use agreements, professional services or consulting contracts, and simple copyright licenses.

3. Create a Central Repository for Contracts

Institutions can manage their contractual commitments by developing a central repository for all pending agreements. Depending upon its size and the number of contracts, an institution could establish a single, central repository or a system of repositories broken down by college or department. Also, many institutions use contract management software to create and maintain a repository so that the institution can effectively track and monitor the performance, expiration, and renewal terms of its contracts. These software programs can also house the contract document as well as related items, such as documents referenced in the contract, side agreements, and information about the employees who are responsible for a particular contract.

Depending on the number of pending contracts, some institutions find it useful to appoint a contract manager to oversee the repository and take responsibility for monitoring the implementation of contracts. The manager can keep a watchful eye on both the institution's and the outside vendor's compliance with their respective obligations under the contract.

4. Educate Representatives About Contracts and Campus Policy

Educating institutional representatives involved in the contracting process about basic contract principles and the institution's policy is key to reducing contract-related claims. Many employees are intimidated by contracts and think, "I'm not a lawyer so I can't be expected to read or understand the language in a contract." Yet, these employees often are the most knowledgeable about the contract's subject matter and core promises. Moreover, contracts are interpreted based on the plain meaning of the language used to describe the exchanged promises, rights, and obligations of each party. If institutions can demystify basic contracts for employees who negotiate, review, and sign contracts, and inform them about the guidance and other resources contained in the campus contracting policy, the quality of the institution's contracting process is likely to improve.

Ideally, institutional representatives who are closer to and better understand a contract's subject matter can supplement any specialized review performed by legal counsel or other experts. To educate employees on campus contracting, institutions can use training seminars conducted by local or in-house legal counsel, create a contracts section on the institution's website, or write and distribute articles outlining critical information for employees to understand about contracts and the campus policy.

A Final Word

Many claims and unexpected liabilities are avoidable through clear campus contracting policies and procedures. An institution that takes the time to implement good contracting practices is more likely to be bound to written contracts that have been reviewed for favorable language and the less likely to face contractual problems.

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Resources

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www.nacua.org/fileStreamer/default.asp?file=/outline/docs/viii_contracts/viii-06-06-2.doc.)

Contracting Policies

Arizona State University

www.asu.edu/counsel/manual/index.html

George Washington University

<http://my.gwu.edu/files/policies/SigningofContractsandAgreements1.pdf>

Hofstra University

www.hofstra.edu/pdf/ORSP_ContractExecutionPolicy.pdf

Maricopa Community Colleges

www.maricopa.edu/legal/bc/index.htm

Seton Hall University

<http://admin.shu.edu/complianceprogram/ContractDocs/ContractsPolicy.htm>

University of North Carolina at Charlotte

www.legal.uncc.edu/contract.html

University of Texas

www.utsystem.edu/ogc/smallcontracts/contractreview.cfm

University of Tulsa

www.utulsa.edu/research/PPG/contractreviewpolicy.html

Yale University

www.yale.edu/ppdev/GuideBusinessAgreementContracts.pdf

Contract Review Checklists

Contracting Basics, Arizona State University

www.asu.edu/counsel/brief/contractbasics.html

Contract Checklist, University of North Carolina at Charlotte

www.legal.uncc.edu/contract.html

Contract Review Checklist, Seton Hall University

<http://admin.shu.edu/complianceprogram/ContractDocs/ContractsPolicy.htm>

(Go to listing in left-hand margin and click on "Contract Review Checklist")

Guidelines for Written Contracts, Maricopa Community Colleges

www.maricopa.edu/legal/blc/guidelines.htm

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