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A Practical Guide to Legal Risk Management: Contracts

This publication is the second in series of guides to legal risk management. The last topic was [governance](#), and future topics include programmatic risks, personnel, general operational, and financial risks. Lawyers Alliance staff attorneys are available for a more focused assessment of your nonprofit organization's specific legal risk management activities, and our network of pro bono attorneys are ready to assist with legal projects that will reduce your organization's unnecessary exposure to legal risk.

Why it Matters:

- An afterschool program contracts with a consultant to create a new urban farming educational curriculum, but the contract didn't specify that the materials created belong to the afterschool program. The contractor begins marketing the materials to other programs without the consent of the original afterschool program, causing participation in the afterschool program to decrease.
- Seeking to diversify its revenue stream, a nonprofit organization providing peer counseling considers contracting with a managed care company to provide those services to Medicaid clients. Upon reviewing the contract, the nonprofit realizes it would technically be obligated to comply with many obligations and regulations more suitable to a traditional medical practice, such as the requirement to have 24 hour emergency coverage for services, and must weigh the projected compliance costs against any expected income.
- A nonprofit organization providing home delivered meals to seniors is awarded City funding, but is unable to serve all of the neighborhoods required under the contract. The subcontract that the organization develops with another provider to provide those services doesn't specify which organization can retain any contributions collected from the clients served, and a disagreement arises between the parties regarding allocation of those contributions.

Contractual agreements are the tools at the core of any business, including mission-driven nonprofit businesses. They govern funding arrangements, facilities and office operations, employee benefits, and collaborations. Failure to understand all the terms of an agreement or to seek legal counsel when entering into a contract can result in unnecessary confusion, inefficiency, or financial loss. While a well-drafted contract will not eliminate risk entirely, it allows all parties to allocate the risk that something will go wrong. A thoughtful attorney can provide guidance that will enable an organization to make informed decisions regarding its contractual obligations and risks, even about contracts with terms that are not negotiable.

While the specific contractual risks that matter vary from one organization to the next, a thoughtful review of contractual relationships and obligations will contribute to reducing risk overall for any organization. For example, nonprofits entering into contractual agreements can manage contract risks if they consider:

- *Even the “boilerplate” of a contract can contain material terms.* A careful reading of a standard telecommunication services contract, for example, may specify that the organization will be obligated to pay for services whether or not there is a service disruption.
- Contracts represent an area of risk management in which legal risk and *compliance obligations* overlap, particularly for contracts pursuant to which a nonprofit agrees to provide program services. It should be clear to all staff involved in the delivery of services what the organization’s obligations are, including timing, staffing, record keeping, documentation of services, and audit obligations. Failure to perform under a contract or properly comply with reporting and documentation requirements exposes the nonprofit to financial and reputational risks that have significant implications for the long-term health of an organization.
- The contract or agreement in question should *clearly and appropriately allocate risk between the parties*, particularly when contracting with another entity in connection with a collaboration or joint venture. For example, an agreement in which a nonprofit will collaborate with another organization to provide onsite health screenings should specify fundraising or financial contribution obligations, employee supervision obligations, indemnification provisions, data management and privacy compliance, and reporting obligations, among other things. A well-drafted contract allows collaborators to manage the programmatic risks involved in a proactive manner as well as protect an organization from the risks involved in challenges encountered. A collaboration that shortcuts the due diligence and contract negotiation process exposes an organization to unnecessary risk.

Risk Identification Guideline: Contract Risk

The following list of issues highlights some of the most common contract risks, but the specific issues your organization should address will be different. This is especially true for contract compliance concerns for organizations providing services under government contracts or with complex contractual relationships with collaborators.

1. **General Contracting Authority and Process:** Do you have appropriate policies for which contracts must be approved by management or board?
2. **General Contract Negotiation and Terms:** Do you have appropriate review mechanisms, including legal counsel, to ensure understanding and compliance with

key contract terms, including:

- a. Proper allocation of the risk that something will not go as planned
 - b. A clear scope of services to be provided, including organizational capacity for providing those services, adequately and accurately described
 - c. Term of contract, including whether contract is renewable
 - d. How contract can be modified or amended
 - e. Termination provisions, including any financial consequences of terminating the contract
 - f. Subcontracting or assignments requirements
 - g. Identification of the regulatory obligations you will be subject to as a result of the contract
3. **Consultant Contracts:** In addition to general contract terms described above, have you accurately classified the consultant as an independent contractor, and if so, does your contract reflect all of terms that are consistent with that status?
- a. Are you certain the consultant is not better classified as a part-time employee?
 - b. Is your intellectual property (materials, software, mailing lists, etc.) protected?
 - c. Is ownership of all materials to be created by the consultant under the agreement clearly assigned?
 - d. Are there other areas of concern (private client information, etc.) that should be addressed in the contract?
4. **Leases:** In addition to general contract terms, does your lease address the following issues:
- a. Do you intend to use the space in ways that are permissible under the lease?
 - b. Are utilities and taxes and repair and maintenance obligations clearly allocated?
 - c. If your landlord is asking for a guarantor, is the guarantor comfortable with the financial risk that will be assumed?
 - d. Do you have the right to terminate the lease in the event you lose funding?
 - e. Do you have the right to sublet or assign the lease?
 - f. Are you in compliance with insurance requirements in your lease?
5. **Government Contracts:** In addition to general contract terms:
- a. Have you planned realistically for cash flow scenarios under the contract?
 - b. Are your organizational documents and policies up-to-date and compliant with obligations under HHS Accelerator (NYC) or Grants Gateway (NYS)?
 - c. Do you understand procurement regulations, and how to avoid violations?
 - d. If you hold multiple government contracts, do you understand the cost allocation limitations on each (to avoid “double dipping” between government contracts) and appropriately report those allocations?
 - e. Are you adequately prepared for auditing obligations?

Next Steps:

To follow up on any issue involved in contract and other legal risk management challenges, please contact Elizabeth Perez at eperez@lawyersalliance.org or 212-219-1800 ext. 232.

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