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Contract Corner: Term (Part 1)

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What is the term of your contract? It is one of the most basic questions with regard to any agreement, but drafting provisions regarding the “Term” raises multiple issues, both legal and practical.

In Part 1 of our two-part post on this subject, we review some important considerations to keep in mind when drafting this common contract provision.

Effective Date. Defining the date a contract begins is the first step in establishing the term. However, frequently, determining the start date of a signed contract is not straightforward. Contracts can be “dated” on a date, “effective” or “commence” on a date, and/or contain blanks for dates to be completed under signature lines. Many times, a signed contract will contain blanks to be completed for each of these possibilities, and such blanks will be filled in with different dates, or some/all of the blanks will never be completed.

The first issue in establishing the start date is determining the actual date that the parties agree that the terms of the contract will become applicable. Typically, this date should be specifically set forth as the “Effective Date” of the contract, and all other potentially applicable dates/blanks should be removed, including the common blanks for dates under signature lines. Please note that establishing a defined Effective Date does not eliminate legal issues that may be raised by predating or postdating a contract (such as fraud or securities law requirements), and those considerations must be addressed in establishing the Effective Date.

End Date. Determining the date a contract ends may be the most common question regarding any signed contract, but again, determining that date is not always straightforward. The best practice is to determine the actual date the parties desire the contract to end and specifically set out that date in the contract so the term begins on the defined Effective Date and terminates on the defined End Date. However, frequently, the term is defined to last for a number of years, months, quarters, weeks, days, etc. This formulation can raise issues for determining the actual end date (e.g., whether a “year” spans calendar years vs. a contract year vs. a fiscal year). In addition, the date when such time period ends may raise issues that are overlooked by the parties (such as an end date on a weekend or in the middle of a fiscal quarter).

Length. Establishing the length of the term of a contract also raises multiple issues. From a buyer/client perspective, if there are many potential vendors and the goods or services are not critical, a shorter term may be preferable so that flexibility is preserved and pricing remains competitive. On the other hand, if the provisions of the contract are particularly favorable, the goods/services are unique, or transitioning to another vendor will be costly or difficult, a buyer/client may push for a longer-term contract. From the other side of the table, a vendor may not be willing to commit to pricing/service levels for a longer term to limit the length of an unprofitable venture. Alternatively, a vendor may want to extend the term to recover any upfront startup costs the vendor incurs and may be willing to offer better rates/terms to its customer/client if it can guarantee a longer term.

Other factors to consider include contracts related to specific projects where the length of the contract is tied to the term of the projects (alternatively, particularly for “master” agreements, survival provisions can provide that the contract’s provisions apply to any uncompleted project after termination of the contract). In addition, the duration of any IP license rights, such as the term of any applicable patents, factors into the determination of the term (or any survival provisions). Finally, multiple terms for the contract—such as an initial term with additional terms based on the attainment of milestones—may be added so the term provision more closely matches the

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goals of both parties to the contract.

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