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Carrier Contracts: A Minefield of Avoidable Risk

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Carrier agreements are intended to set forth the terms and conditions under which resellers purchase the essential commodity of their business: telecommunications services. Sadly, however, it is a rare instance when the reseller has read or truly understands the essential terms and conditions of its agreements. Even more troubling is the fact that few resellers use their agreements to facilitate their business interests and to protect themselves against undue risk. As a result, rather than being a roadmap to success and a shield against risk, carrier agreements often become minefields through which resellers unwittingly wander until the inevitable misstep is made and damage is done.

While it never is possible to eliminate all risk, it is possible to disarm many of the land mines found in carrier agreements and to identify and map the remaining land mines so they can be avoided where possible. With knowledge and care, it also is possible to anticipate where explosions are most likely to occur and to limit the injury to a reseller's business.

Contract land mines take many forms and are found in all types of telecom agreements. The following is a list of contract land mines where particular caution is required.

Filed Rate Doctrine

Many telecommunications agreements contain an innocent-looking term stating that the agreement is subject to the carrier's tariff. As explained in PHONE+ article, "Unholy Contract: The Legacy and Abuse of the Filed Rate Doctrine" (May 1999), since carriers generally are obligated to provide service pursuant to their tariffs, inconsistent contract terms generally are null and void. Thus, even the most carefully considered and negotiated contract terms are meaningless in the face of inconsistent tariff provisions. Specific legal strategies are required to ensure that the terms of carrier agreements are and remain legally binding on both parties. Put simply, if a reseller fails to properly implement these strategies in its carrier contract, it is at the mercy of its carrier and its ever-changing tariffs.

Take or Pay/Minimum Usage Requirements

These terms generally require a reseller to pay for a predefined number of service units regardless of whether it actually uses those units. Needless to say, these terms are dangerous in any circumstance, as they can require the reseller to pay for service it has not taken and from which it is not deriving revenue. Extreme caution should be exercised before agreeing to such terms. If, however, it is necessary to agree to a take or pay/minimum usage term to obtain an attractive service arrangement or rate, it is critical that the agreement properly addresses a number of issues, including the following:

Quality/Availability of Service. As amazing as it may sound, agreements containing take or pay/minimum usage requirements almost never have corresponding terms obligating the carrier to ensure the ongoing quality and availability of its services. Indeed, quite the contrary, most carrier contracts with take or pay/minimum usage clauses specifically limit or exclude any warranty regarding the quality or availability of carrier services. This means that the purchasing reseller can remain liable for the full take or pay/minimum usage obligation even when the reason that it is unable to purchase the required volume is because the services are of poor quality and/or are insufficient to handle the required purchase volume. Appropriate protective language is required to ensure that take or pay/minimum usage requirements do not apply when the failure to take the minimum amount is the carrier's fault or is due to reasons beyond the reseller's control.

Rate Protection. The issue a reseller usually negotiates most carefully is rates. However, in negotiating rates, it is critical to do so in the context of any take or pay/minimum usage requirements. Most carrier agreements provide the reseller little if any protection against rate increases. Carriers often can increase rates on as short as a week's notice. And there often is no limit on the amount or frequency of rate increases. This creates the troubling possibility that a carrier could, either innocently or otherwise, increase a rate to the point that the reseller no longer is able to meet its minimum commitment. Nonetheless, absent appropriate protective language, the reseller remains liable to pay the charges associated with the full minimum commitment (at the higher rates). Keep in mind that this same take-or-pay problem can arise even if the carrier does not raise its rate. Indeed, today's attractive rate quickly can become unmarketable in tomorrow's competitive market. But, of course, the reseller's purchase commitment remains. Thus, it is critical that a reseller carefully consider rate issues in the context of take or pay/minimum usage requirements and that adequate protections be built into agreements (such as most-favored nations clauses, rate caps and termination clauses) to ensure that the reseller is not required to pay for services that it cannot resell or does not use.

Unclear or Inappropriate Payment Terms

Disputes over terms of payment most often result from poor contract draftsmanship and/or inadequate consideration of relevant issues. At a minimum, carrier contracts should clearly address the following issues: (1) How frequently invoices are rendered; (2) The time period each invoice covers and the form(s) the invoices are in (paper, tape, CD-ROM, bulletin board, etc.), including any charges applicable to any of these forms; (3) The manner of delivery (fax, overnight, etc.); (4) The content of the bill and supporting data (call detail records [CDRs], etc.); (5) The so-called "grace period" before payment is overdue; and (6) The right to and manner of dispute. The last two issues are discussed briefly below.

The "Grace Period." This is the period in which payment is due before any applicable interest, penalty or termination rights apply. In addition to assuring that this term is clearly drafted and provides an adequate time period (normally 30 days), it also is critical that the start date for the grace period be well- defined. Most carrier agreements tie the grace period to a number of days following the invoice date. The problem with this arrangement is that the "invoice date" often is

an arbitrary date generated by the carrier's billing system that bears little or no relationship to the date the bill is actually delivered to the reseller.

Indeed, it is not uncommon for the invoice to arrive weeks after the "invoice date" and at or near the end of the grace period. To address this concern, we strongly urge the grace period and payment date be tied to the date the bill is received by the reseller (which can be established by a fax or overnight delivery record).

Disputes. Most carrier agreements severely limit dispute rights (the time to lodge a dispute) and/or require full payment at the time the dispute is lodged. These terms are very dangerous, particularly in combination. To protect a reseller, dispute provisions should, at a minimum, contain the following terms: (1) An adequate period to lodge the dispute in writing (at least 90 days following receipt of complete billing records in a standard electronic format); (2) No loss of dispute rights when the carrier has committed fraud or withheld data necessary to uncover the billing error; (3) No obligation to pay disputed amounts (escrow arrangements may be acceptable); (4) Carriers must respond in writing within 90 days of a dispute; (5) No right to terminate for nonpayment of disputed amounts; and (6) Near-term arbitration/litigation of all disputes. In addition, resellers should have procedures and staff in place to address disputes as they arise, to document them properly and to issue dispute notices as required by the carrier agreement.

Aggressive/Punitive/ Open-Ended Deposit Requirements

Many carrier agreements contain very aggressive and open-ended deposit requirements. These requirements often give the carrier enormous discretion on the circumstances in which deposits can be required, the amount of required deposits and the notice it must give. As a result, these provisions are very dangerous, even if used in good faith, and especially when used by carriers as a lever to impose other punitive terms on resellers. Careful drafting is necessary here to identify the circumstances under which deposits can be required, the amount of such deposits (such as a multiple of one to three months' bills) and the advance notice required.

Aggressive Limitations of Liability

All carrier agreements contain very comprehensive provisions limiting the carrier's liability for most damages, including lost profits. While these terms often are difficult to negotiate, several issues should be considered.

First, a reseller needs to evaluate the quality of the carrier and the reliability of its services carefully before agreeing to any limitation of liability. In making this evaluation, it is important to understand that courts generally will enforce limitation of liability terms to the letter of the agreement.

Second, if a reseller enters into an agreement containing an aggressive limitation of liability provision, it needs to do so with the understanding that it is likely forgoing most, if not all, rights to damages in the event of a service failure. At the same time, it is critical that reseller agreements with its customers take these limitations into account. For example, a reseller should

not leave itself exposed to liability to its customers caused by the carrier's failure to provide promised services where the reseller cannot recover from that carrier.

Finally, if possible, try to have the carrier's gross negligence and willful misconduct excepted from the limitation of liability. Most carrier tariffs already contain this exception, so it should be possible to negotiate the same exception into carrier agreements. This exception will help protect a reseller against the most egregious misconduct.

Fraud Liability

Fraud exposure is a major concern for carriers and resellers alike, expressly because the potential loss can be so large. To the extent that carrier agreements address the issue, it's not surprising that full liability is normally assigned to the reseller. The concern here not only is the open-ended nature of this exposure, but also the fact that the reseller often is completely blind to fraud and cannot take measures to limit or prevent its exposure. Thus, fraud terms need to be considered carefully and appropriate language included.

Again at a minimum, the agreement should specify the following: (1) The carrier represents that it has systems in place to detect and prevent fraud; (2) The carrier will use those systems for the reseller's traffic; (3) The reseller is not liable for fraud before it is notified of the fraud; (4) The reseller can instruct the carrier to shut down
service to any line or service evidencing fraud; and (5) The reseller is not liable for fraud on any line or service after termination is requested.

Nondisclosure/Noncircumvent Terms

Few, if any, carrier agreements provide adequate protection to the reseller for its customer information. This is particularly critical with 1+ resellers, although it also is an important issue for debit card providers, particularly with respect to their distribution networks.

Resporg Issues

In cases which 800 access is at issue, the reseller should either retain all responsible organization (resporg) rights or assign them to a third-party resporg. When this is impossible, the agreement must clearly specify resporg rights upon termination by either party. When the reseller is the terminating party, the agreement should specify the immediate resporg of all 800 numbers and the transfer of all databases containing customer information.

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