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BACKDATING THE CONTRACT EFFECTIVE DATE; PITFALLS AND PRACTICES

In many jurisdictions it is permissible to have an earlier contract effective date than the date of signing, but is it advisable? This paper will outline some of the potential pitfalls of a contract effective date that is substantially earlier than the date of signing and describe various methods used to provide for an earlier contract effective date.

As an example, under New York law the parties to an agreement may agree to an effective date earlier than the date of signing (referred to in this paper as backdating). New York courts have stated the principal as follows: "It is fundamental that where parties to an agreement expressly provide that a written contract be entered into 'as of' an earlier date than that on which it was executed, the agreement is effective retroactively 'as of' the earlier date and the parties are bound thereby accordingly"¹.

However, just because it is within the parties power to backdate a contract does not mean that it is without adverse consequence or advisable. The following are some factors to consider before making a contract effective before the signing date.

A. **Pitfalls of Backdating.**

1. **Liability Due To Misrepresentations Between Effective Date and Signing.** An effective date earlier than the signing date creates the possibility that a party to the contract, an affiliate of a party or another entity will make an inaccurate statement, representation or certification during the period between the effective date and the signing date. That misrepresentation could, depending upon the context, result in civil or criminal liability. The misrepresentation might, for example, be in another contract or document; in a governmental filing; or in a response to a discovery request. One statutory provision, among others, that provides for criminal liability is 18 USCS 1001² which creates criminal liability for certain false statements, including false statements in connection with certain applications for credit.

¹ Colello v. Colello, 9 A.D.3d 855, 857-858 (N.Y. App. Div. 4th Dep't 2004)

² 26 U.S.C. § 7206

2. Breach Upon Signing. When the contract has an earlier effective date than the signing date particular care must be taken to insure that all of the obligations have either been performed prior to signing or are possible to perform after the signing date. If there are obligations that are impossible to perform on or after the signing date then that party will be in breach immediately upon signing. For instance if a contract was signed June 1, 2013 and was effective as of January 1, 2013, an obligation to provide quarterly financial statements within 30 days after the end of the quarter would be impossible to perform for the first quarter of 2013. For clarity, the obligations that only apply after signing should be distinguished from those that are intended to be retroactive to the effective date.
3. Confidentiality Obligations. Confidentiality obligations can be particularly troublesome in a backdated contract. It is important in a backdated contract for the confidentiality provision to specify the date when the obligations begin. Generally that would be the signing date because an earlier date such as the effective date would mean the company would be subject to the confidentiality obligation before it had the opportunity to advise its representatives that it is subject to the obligation.
4. Conspiracy; Tax Matters. Backdating documents for the purpose of creating tax deductions or manipulating income will violate U.S. tax law³, if applicable. The law of other jurisdictions is undoubtedly similar. Also, even if provisions of the tax code are not violated, backdating documents can result in criminal liability under conspiracy statutes. In a 1988 Second Circuit decision⁴ the court considered backdating tax shelter documents to be part of a conspiracy in violation of the general U.S. federal conspiracy statute⁵. The court considered the backdating to be part of a conspiracy to frustrate or obstruct the IRS's function of ascertaining and collecting income taxes even though the scheme was never consummated. In that case the actions of the conspirators were particularly egregious, but consider whether backdating in general might inadvertently create or contribute to the appearance of a conspiracy.
5. Assumption Of Unanticipated Obligations. Backdating may result in a party assuming unanticipated indemnity or other obligations. A 1999 U.S. District Court decision⁶ illustrates how, particularly in large organizations, backdating can create indemnification issues. There, the issue was whether or not a backdated master service agreement (MSA) applied to a loss that occurred between the contract effective date of March 1, 1996 and

³ United States v. Vallone, 698 F.3d 416 (7th Cir. Ill. 2012)

⁴ United States v. Rosengarten, 857 F.2d 76 (2d Cir. N.Y. 1988)

⁵ 18 U.S.C. § 371

⁶ Gulf States Airgas, Inc. v. American Marine Constr., Inc., 1999 U.S. Dist. LEXIS 1628 (E.D. La. Feb. 11, 1999)

the contract execution date in June 1997. Although it was overturned on appeal⁷ due to the specific terms of the contract unrelated to backdating, the case illustrates the problem. Braun and AOD did business under a MSA dated April 17, 1995. GSA acquired the assets of Braun on March 1, 1996. GSA then leased equipment (acquired from Braun) to AOD with invoices containing terms placing risk of loss on AOD. The equipment was lost on April 27, 1997. After the loss, on June 12, 1997, AOD, sent a letter to GSA proposing that GSA and AOD enter into a MSA in the same form as used between Braun and AOD and that it be dated effective as of March 1, 1996, the date (before the loss) when GSA acquired the Braun assets. GSA agreed and signed the MSA, which obligated GSA to indemnify AOD against loss of the equipment. The district court held that notwithstanding the MSA being signed after the loss the MSA still applied since it was effective prior to the loss. It is not difficult to imagine this sort of situation arising in a large organization where one department may not be aware of matters being handled by another department.

6. Possible Badge of Fraud. The reported cases include many examples where documents have been backdated with criminal intent or otherwise for the purpose of committing a crime or perpetuating a fraud⁸. It should go without saying that a party should never backdate a contract or document for those purposes. Even when a contract is backdated in good faith and without misrepresentation there is a possibility that the backdating could create a stigma or represent a badge of fraud⁹. Consider whether the particular circumstances surrounding the backdated contract are such that it would be advisable to avoid even a remote possibility that the contract could be construed later as having been backdated with criminal intent or to perpetuate a fraud.
7. Compliance Issues. When the effective date and the signing date are different issues can be created regarding which date applies for purposes of the applicability of, and compliance with, laws and regulations¹⁰.
8. Prohibited In Certain Jurisdictions and Circumstances. If an agreement or other document must be executed before a notary or other governmental official then it will be necessary

⁷ Gulf States Airgas, Inc. v. American Marine Constr., Inc., 1999 U.S. Dist. LEXIS 3389 (E.D. La. Mar. 18, 1999)

⁸ For example, see United States v. Hames, 185 Fed. Appx. 318 (5th Cir. Tex. 2006) where the court considered evidence of backdated contracts as sufficient for a jury finding of an intent to defraud; and see CA, Inc. v. Wang, 2011 U.S. Dist. LEXIS 127850 (E.D.N.Y. Nov. 4, 2011) where documents that were backdated for the purpose of early recognition of income violated GAAP and consequently SEC rules and regulations.

⁹ See Graham v. Comm'r, T.C. Memo 2005-68 (T.C. 2005) for a discussion of backdating as a badge of fraud.

¹⁰ See Dyncorp Info. Sys., L.L.C. v. United States, 58 Fed. Cl. 446 (Fed. Cl. 2003).

to show the execution date, and in some circumstances it may not be possible to make the contract effective on an earlier date. Also, in some jurisdictions providing for an effective date earlier than signing may be prohibited and illegal. Consequently care should be taken when contracting in or under the laws of an unfamiliar jurisdiction.

B. Methods of Backdating.

1. "[Agreement] entered into on January 1, 2013" – This formulation is not advisable because of the affirmative misrepresentation as to the date of execution if the contract was actually executed on a different date.
2. "[Agreement] entered into as of January 1, 2013" – Courts such as the New York court in *Colello v. Colello* cited above sanction the use of "as of" as shorthand for an effective date different than the signing date, and the use of this formulation is common, as is use of "effective as of". However, it creates potential for confusing the effective date and the signing date and it would be better practice to use one of the formulations below. This formulation or "effective as of" can be useful where the contract is executed in counterparts.
3. "[Agreement] entered into June 1, 2013 to be effective as of January 1, 2013" – This formulation fully describes what has happened and is a preferable formulation to those described above. An alternative where the contract is executed by the parties on different dates would be to provide the date of execution under each signature with the contract being described using the formulation in 2 above.
4. "[Agreement] entered into June 1, 2013 (the "Execution Date") to be effective as of January 1, 2013 (the "Effective Date") [or (the "Beginning Date")]" – Using defined terms such as described here would be the most preferable approach of the four described in this paper. This formulation allows for describing each obligation in the contract in terms of either the Execution Date or the Effective Date [or Beginning Date] when it is appropriate to distinguish which date applies to a particular obligation. The reason for Beginning Date rather than Effective Date is that the contract is effective only upon execution and use of "Effective Date" could create the potential for confusion. When the parties execute the contract on different dates an alternative would be to provide the date of execution below each party's signature with "Execution Date" defined as the last date on which a party signed the contract.

In summary, using an effective date earlier than the execution date can be appropriate but the factors above, among others, should be considered before backdating a contract. For instance when a contract is signed in counterparts the parties may execute it on different dates. In that circumstance, use of the "as of" formulation could be appropriate. Also, when there has been contract performance prior to the execution of the contract that may be a reason to use an earlier effective date. However, it should be possible to describe that situation in the recitals and/or the body of the contract without backdating, and that would usually be a preferable approach.