



BRIEFING NOTE

MANAGING BUSINESS RISK WITH CONTRACTS

Introduction

The risks associated with supplying goods and services are many. For example:

- The product or services supplied may not conform to the customer's expectations.
- Poorly performed services or a fault in the product may cause injury to the customer.
- Poorly performed services or a fault in the product may cause damage to the customer's business.
- The supply of goods or services may fall foul of certain legislative provisions (often inadvertently).
- You may not get paid!

Written contracts cannot exclude all business risk. They can however be used to good effect to minimise and manage these risks.

Back to Basics

The most common method of contract formation is where one business supplies its standard terms and conditions of business to another and these are then accepted – either in writing or simply as a result of the acting's of the other business. At the most basic level, an offer has been made and a contract is then concluded by the acceptance of that offer.

Many businesses fall into the trap of proceeding on the basis either that a contract has been concluded (when in fact it has not), or by assuming wrongly that their terms and conditions of business apply (when in fact a different set do). This often arises because the "acceptance" of standard terms and conditions contains qualifications based on the buyer's standard terms and conditions. Such a qualified acceptance is treated by the law as a counter-offer which must then itself be accepted. This process of a business trying to incorporate its own standard terms and conditions rather than accepting those of another is commonly referred to as the "Battle of the Forms".

Rather than risk losing this "Battle", many businesses instead prefer to issue a draft contract to the other business stating that it is their "standard" contract and that, subject to minor changes being made by the other, the contract must then be signed by both parties. Until this is done there is no formal contract.

Whatever contracting procedure you use, you need to take great care to ensure that you have a concluded contract and that this contract is wherever possible based on your own terms and conditions of business.

Implied Contractual Terms

Businesses should be aware that the law implies certain terms into contracts for the supply of goods and services. The Sale of Goods Act 1979, for example, provides that in all contracts for the sale of goods the following terms are implied:

- That the seller has title to sell the goods.
- That the goods will comply with any description.
- That the goods are of satisfactory quality.
- That, if sold by sample, the goods will conform with the sample.

Although not possible with business to consumer contracts, if it is fair and reasonable to do so, parties in business to business transactions can contract out of most of these implied terms by using express contractual terms to the contrary.

Express Contractual Terms

Clauses in contracts are rarely “standard” because they are often tailored to suit particular business requirements. “Standard” clauses or terms are often one-sided as a result of a business being unprepared to negotiate or perhaps simply in the hope that they will be overlooked or signed without detailed enquiry by the other party. Businesses therefore need to take care to understand the implications of the clauses in any contracts that they accept. Businesses also need to consider what is missing from the contract!

The following clauses are commonly contained in commercial contracts:

Exclusion Clause

Within certain limitations, it is possible to exclude liability to your customer for damages caused by your breach of contract. For example, it may be possible to exclude liability for consequential loss. However, the following restrictions apply to Exclusion Clauses:

- The exclusion must be clear and unambiguous.

- You cannot exclude liability for personal injury or death.
- You cannot exclude the implied term that the seller has title to sell the goods.
- In consumer contracts, or “standard” term business contracts, any exclusion of liability for breach of contract must be fair and reasonable.
- In consumer contracts, or standard term business contracts, any conditions that allow a party to provide no performance, or to provide performance substantially different to that which the customer might reasonably expect, must be fair and reasonable.
- In consumer contracts any condition (not just exclusion clauses) must be “fair” i.e. it must not cause a “significant imbalance in the parties rights and obligations to the detriment of the consumer”.

Payment Clause

The contract must contain clear and unambiguous provisions on payment. They should specify:

- How much?
- What is included in the price, and what is not?
- If there is a separate price list, reference to it and a provision that it can change without notice (note this might be unfair in consumer contracts).
- If necessary, provide a mechanism for price increases.
- Specify time for payment.
- Specify interest if payment is late.

If your bargaining position allows, consider providing for payment in advance. Also consider obtaining guarantees, or whether to obtain credit insurance for the customer. If the goods supplied are non-perishable, consider a “retention of title” clause.

Specification Clause

In many contracts a detailed specification of the product or service is necessary. The contract should either incorporate it

or refer to it expressly. If the specification is prepared separately it is important to ensure that its terms do not contradict the terms of the contract.

Insurance

It is crucial to make careful enquiries into the financial position of any parties that you deal with. In addition to obtaining financial covenants and 3rd party guarantees, you should consider requiring the other party to insure against the risk of breaching the contract with you. If this cannot be negotiated then you should consider obtaining insurance against the risk yourself. Business should not forget that the financial position of even well known businesses can change for the worse.

Intellectual Property Rights Clause

Some supply contracts deal with questions of intellectual property rights. For example, contracts for the supply of services that may produce copyright material (e.g. contracts with third parties for the supply of design services). Here it is crucial to agree who owns copyright in the resulting design. Unless there is a written agreement to the contrary, the designer will own the copyright and the client will only have an implied non exclusive licence to use the design. Many businesses do not properly understand what intellectual property rights they have received or for that matter given away.

Delivery and Acceptance Clauses

Contracts for the supply of goods or services should contain detailed provisions on delivery and acceptance of the goods or services. For example

- Where are they to be delivered?
- When are they to be delivered?
- Have they been delivered?
- Who bears the delivery costs?
- Who bears the risk of damage in transit?
- Provide for time limits on rejecting the goods/services.
- Is re-delivery possible?

- If delivery is by instalment, does a defect in one instalment entitle the customer to reject everything?

Termination Clause

You should consider how long you want a contract to run and also the events where you would want to be able to terminate the contract (eg liquidation of customer). Do not forget to consider 3rd party contracts and return of property in the event of termination.

Export Clause

If you are exporting the goods consider:

- Advice on local law in the country of destination.
- Do you wish to incorporate a set of international rules on the supply of goods?
- Are export licenses necessary, if so who obtains them?
- Whether you want to provide for letter of credit or other international payment terms?
- Which law applies?
- Currency of payment.
- Currency of payment, and if so who bears risk of currency fluctuations?

Data Protection Clause

If your business deals with the personal details of individuals then you need to comply with Data Protection legislation. In particular you should consider:

- Notifying the Information Commissioner with details of how your business deals with personal data.
- Getting a written contract signed where processing of personal data is carried out on your behalf by a third party.
- Obtaining the consent of individuals for "non-standard" business uses of personal details (including exporting outside the EU and use of "sensitive" personal data) unless an exemption applies.
- Ensuring personal data is kept safe and secure by using appropriate technical measures.

Distance Selling Regulations Clause

If your business supplies products or services to consumers then you need to check to see if you comply with the Distance Selling Regulations. These regulations provide consumers with a number of statutory rights, including a right of cancellation and also a right to receive certain information about the goods or services either prior to conclusion of the contract or thereafter but in good time prior to performance of the contract. It may be appropriate to make provision in your contracts for these rights if you have not done so elsewhere.

Other Clauses

The clauses listed above are by no means exhaustive. It may be appropriate for your business to include other clauses to address particular issues. These might include:

- Product liability & safety.
- Non solicitation of staff.
- Third party rights.
- Confidentiality.
- Waivers.
- Severability & illegality.
- Force Majeure.
- Arbitration.
- Exclusion of pre-contract representations & agreements.

Conclusion

Written contracts cannot remove the risk from supplying goods or services. They can however minimise some risks and manage others including compliance with relevant legislative provisions. Every business must consider all the possible risks involved in supplying or receiving goods or services in **their** industry and consider those contractual terms and conditions that are most relevant to managing **those** particular risks.

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March 2008