ANSONS
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CLIENT GUIDE

FOCUS ON CONTRACTS

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Introduction

All businesses enter into contracts on a regular basis, whether with customers or suppliers, banks, employees or others. Sometimes there is a written contract, sometimes a set of trading terms of one or other of the parties, sometimes an exchange of correspondence or perhaps no documents at all. Each contract brings with it anticipated benefits and risks, but for various reasons, some businesses often enter into the contracts without sufficient consideration of the terms. The purpose of this article therefore is twofold:

'Businesses often enter into contracts without sufficient consideration of the terms.'

- first, to consider briefly some of the common reasons why contracts do not tend to be overly scrutinised and to offer some thoughts for consideration in relation to those reasons; and

- second, to give a few useful pointers to clients who rely on their own review of contracts in order to increase their knowledge and awareness of some of the issues that can arise in various practical scenarios.

Implied terms

In some cases it is not entirely clear which terms actually govern a contract. This situation might arise because the contract is an oral contract; because the parties have agreed to proceed without having concluded the terms of a written agreement; or because it is uncertain which of the party's terms apply.

Another reason why terms may not be apparent is because they are implied into the contract by operation of law. With regard to contracts with consumers, for example, the Consumer Rights Act implies numerous terms into a contract, such as an implied warranty that goods sold are fit for purpose.

Where one party acts as an agent of another, the law imports a duty of good faith into the relationship that binds both parties. Another very important example concerns partnership arrangements. If the parties fail to agree terms, the law imports into their arrangements terms set out in the Partnership Act 1890. Aside from assumptions regarding the sharing of profits and losses, which may or may not be appropriate, these provisions include a right for any partner to terminate the partnership and require immediate sale of its assets to realise his or her share.

'Where one party acts as an agent of another, the law imports a duty of good faith into the relationship, which binds both parties.'

Importance of incorporation

Another situation where it can be unclear which terms apply to a contract is where there are two sets of contract terms; for example, a supplier's standard terms of sale and the customer's standard terms of purchase. The two sets of terms will be diametrically opposed to each other.

'It can be unclear which terms apply to a contract when there are two sets of contract terms.'

Each party believes or hopes that its set of terms will apply and each set of terms will include provisions to say that it should apply and that the terms of the other party are not accepted. If it gets to court, the court will need to choose and it is likely that one or the other of the sets of terms will be applied. It is then something of a winner-takes-all situation.

There may be a number of factors that are relevant as to how the courts will determine which set of terms should be applied, but to maximise the likelihood of a business's own terms being incorporated in such a situation, it is very important that they are drafted to reflect the order, documentation and practices actually used in the business rather than off-the-peg terms or terms 'borrowed' from another organisation.

Unenforceable terms

The law imports into contracts a number of terms to protect consumers. Terms which try to deny these rights are likely to be unenforceable and quite probably criminal. In the case of business-to-business contracts, the law assumes that businesses are generally more capable than consumers of looking after themselves but that does not mean that all terms agreed between parties will be enforceable. In particular, it should be noted that the Unfair Contract Terms Act provides, generally speaking and at least in relation to standard terms of sale, that exclusions or limitations of liability clauses are only effective to the extent that they are 'reasonable'.

'Terms which try to deny consumer rights are unenforceable and quite probably criminal.'

Limitations of liability clauses are perhaps some of the most important provisions a supplier can include in its terms of business. Therefore, it is important to be aware of the risk that they are unenforceable. A provision that says that the business's liability is limited to the cost of goods supplied may seem to be reassuring, but if the clause is not drafted with care and is not appropriate for the business, the protection it appears to offer may be illusory.

Missing terms

One point to bear in mind when reviewing a contract, and which is also a challenge to a lawyer engaged to do this on your behalf, is that it is always important to consider not only what is set out in the words in front of you but also what is *not* included in the terms. In all probability, it is the points that are of most importance to you that the draftsman for the other side is most likely to have left out.

'Remember to consider not only what is set out in front of you, but also what is not included in the terms.'

Aside from deliberate omissions, some contracts may simply fail, for whatever reasons, to address some of the important issues which arise, for example, intellectual property rights or data protection implications.

Even when terms are included, it can sometimes be tempting to look at these with a mindset of considering only whether or not superficially they are something 'we can live with'. This is an understandable and sometimes necessary approach. When reviewing a contract in this way, however, it can sometimes be difficult to appreciate how different a particular contractual provision might look if it had been drafted from your perspective.

Very often, it will only be when alternative drafting is produced and the wording is compared that the significance of who accepts what risk, and which provision is really more appropriate to the facts, can properly be understood and considered. Sometimes the real risk underlying a particular provision may be disguised or not readily apparent and a provision may be less beneficial than it appears. Does it say when a particular action must be taken or at whose cost?

Legalese

Even today with the drive towards plain English, the need to avoid ambiguity or uncertainty means that contract drafting, at least in business-to-business contracts, is still likely to adopt a particular style, which may differ from that which may be appropriate for other written communications. Those who review contracts need also to be aware that certain terms commonly used in drafting have acquired a particular meaning or significance under the law that may not always be readily apparent. I would caution any client who is not already aware of the risk to take particular note of the word 'indemnify', or any variant to the same, and to beware of agreeing to give contractual indemnities that may entitle the other party to claim an amount significantly in excess of what would be a normal entitlement to contractual damages. Whether relying upon or resisting them, contractual indemnities should always be drafted and negotiated with great care.

'Agreeing to give a representation can have a similar effect to giving an indemnity.'

Another word to watch out for is 'represents'. Agreeing to give a representation may have a similar effect to giving an indemnity, by potentially exposing a party to a claim to the remedies available under the tort of misrepresentation, in addition to those available under contract law. Phrases such as 'time is of the essence' and obligations to use 'best' or 'reasonable' endeavours have also acquired particular judicial meaning. A reference to International Commercial Terms such as 'FOB UK Port' can import shipping terms relating to the sharing of risks and obligations into the contract, but even where the use of these terms is properly understood by the parties and they are correctly applied and expressed, the effect could be unintentionally compromised if contradicted by another inconsistent provision in the contract.

We will sort problems out as they arise

It is common for us all to hope that a problematic situation will not arise, and to take a calculated risk on dealing with it if and when it does arise. Nevertheless, a party who does this can be very much at the mercy of the other party, as well as of events and circumstances, and is at the very least likely to be in a weak negotiating position if something does go wrong. It may not always be easy, but it is far less difficult to negotiate contract terms in a position where nothing has yet gone wrong and the stakes and the atmosphere between the parties are less charged.

'Determining the scope of what a client agrees to buy or sell is critical to avoiding later disputes.'

Often the most contentious commercial issue to be agreed may be the price, where lawyers do not tend to get involved in the negotiations, although we do look to secure changes which may go directly or indirectly towards increasing profits or reducing costs.

Another important area where lawyers may be more directly involved is in determining the scope of precisely what it is that a client agrees to sell or purchase. This is critical to avoiding later disputes but can often be dealt with inadequately in contracts. A particular risk to be aware of is where the description of what is to be supplied is set out in a document attached as a schedule. This document may have been prepared for another purpose or be otherwise unclear, unsuitable or unfavourable. Another risk is where a description of what is understood to be supplied is set out in other documents or correspondence but these documents are excluded from forming part of the contract terms. Most contracts include some form of 'entire agreement' clause which could have this effect.

Commercial pressures

This is possibly one of the main reasons that contracts are sometimes entered into without sufficient review of the terms. In part, it reflects commercial imperatives to secure work in what remains a highly competitive commercial environment. Salespeople can work very hard to win new business and, when there is the prospect of a good new order or a good new customer, the last thing they want to do is to see that new business jeopardised with contractual wrangling. However, if liability is not effectively limited or sufficiently secured against, if there is a problem, a contractual claim may wipe out any anticipated profit from the customer and, in the worst case, could be enough to send a business under. Ultimately, any business receiving an order must take into account all relevant factors and make a decision as to whether or not to accept it accordingly. What is important for those who are responsible for managing risks is, at the very least, to have sufficient knowledge or advice in order to understand the nature and extent of the risks involved in accepting any proposed contractual terms. Only then are the individual and the business in a position to weigh up the associated benefits and risks and to consider the appropriate steps to mitigate any risks.

'The highly competitive commercial environment means contracts are sometimes entered into without sufficient review of the terms.'

They are bigger than us!

Large companies may seek to give the impression that their terms are non-negotiable. They clearly have a strong interest in doing so. The reality is that generally within industry and commerce, even with the largest companies, there is usually some scope for negotiation, provided that the proposed changes to terms are reasonable, appropriately targeted and justifiable. One party may be larger but there is generally some reason, interest or concern that has led it to the other party's door, which may make that party's negotiating position a little stronger than might initially be apparent. Moreover, standard terms for a party are usually very heavily weighted in favour of the party for whom they have been prepared. Often the terms will include provisions which are wholly unreasonable and drafted on the basis that they might never be read by the other side, let alone challenged. Usually, the lawyer will be aware of the unreasonableness and will readily agree to it being modified, when challenged on the point by another lawyer.

'When negotiating, focus on the concerns that are most important for your business.'

The decision as to exactly which points should be negotiated and how far these negotiations should be pushed will depend on which concerns are the most important ones for a business, and understanding and focusing on these issues. It is unlikely that you will succeed in agreeing every change, which would be desirable, but usually the contractual position can be significantly improved.

Cost

Understandably, another reason why businesses may choose not to have contracts reviewed by a lawyer is the cost of the advice. The cost has to be weighed against the potential value and risk attached to a particular contract.

'It can be less costly to get advice at the start than after an issue has arisen.'

In essence, the cost of the advice can be justified on two grounds. First, it can prove considerably less costly for a business in the long run to take legal advice at the point of putting in place contractual arrangements, rather than after an issue has arisen and it is too late to do anything about the terms. The range of situations where the cost of failing to take advice can far exceed the cost of such advice is extensive. Aside from costs and claims arising where there is a dispute or something goes wrong, costly errors may potentially arise from failing to identify and meet the compliance requirements. These vary according to the nature of the business; businesses that sell to consumers or trade online are two obvious examples of businesses which are subject to extensive, complex and constantly changing legislation.

More positively, in most contractual arrangements, there is usually scope for lawyers to be able to put forward suggested changes to a contract which have the potential to make a positive direct impact on the client's bottom line, whether by securing savings or otherwise leading to an increase in profits. Some commonplace general examples include achieving savings for a supplier by improving prospects or rights for ensuring payment from the customer; putting in place security; or effectively retaining title to goods supplied until payment. Identifying obligations to be performed by the other party and shifting the burden of responsibility or cost in relation to other obligations, as well as identifying other opportunities to add value, for example, in relation to the exploitation of intellectual property, are other means by which advantages may be gained.

'There is usually scope for lawyers to suggest changes to contracts which can secure savings or tend to the increase of profits.'

However, where costs remain an issue we recognise that it is important to deliver value in terms of said costs. Therefore, Ansons are prepared to be flexible in relation to arrangements in respect of these costs where necessary, by making proposals for how the scope of our advice could be focused in order to get maximum value within a specified budget.

This briefing is intended only as a general summary of the points discussed rather than as specific legal advice.

If legal advice is required or if you wish for further information regarding any of the points considered here, please contact us and we will be happy to assist.

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