2 The contract

Introduction

It is possible to describe a wheel in terms of its end purpose but a complete understanding is lost without a description of the concept and operation of the axle. Similarly any detailed discussion of the commercial aspects of business without reference to contracts would be misguided. There would be many ways of describing business without such reference. It would be possible to talk about investment as an input and profit as an output, or resources as an input and product as an output. But without discussing contracts, a key part of the story is missing. It is easy enough to say that the manager should contribute to increasing profits by ensuring that contracts are delivered on time, to specification and at minimum cost because failure in these respects eats up money, which erodes profit. But the simple consequence – higher internal cost – of such failures is only a small part of the story. To fully appreciate the picture it is necessary to understand this thing called the contract. In this chapter coverage will be given to underlying legal principles, common contractual phrases and points of practical importance.

Law

Legal framework

Each country has its own system of law and within each system there are many divisions and subdivisions. English law is divided between public law and private law. Public law is concerned with the constitution and functions of governmental organizations, including local authorities, and their legal relationship with the citizen and with each other. Public law is also concerned with crime, which involves the state's relationship with, and power of control over, the individual. Private law is concerned with the legal relationships of ordinary persons in everyday transactions. It is also concerned with the legal position of companies. Private law includes contract and commercial law, the law of tort; law relating to family matters and the law of property.

Applicable law

A contract is subject to law. It is for the parties to the contract to choose the law that is applicable to their contract. If both were domiciled in the same territory, then the law of that territory would normally apply. If the parties are in different territories then they elect the law of one of the territories. Other possibilities are the law of the land in which the contract is physically performed, and the law of the land where one of the parties' parent companies is based. A final option is a 'neutral' jurisdiction. This may be a useful resolution where the parties cannot agree on which of their 'home' jurisdictions should apply. This is much more than an esoteric point for the lawyers. When a company proposes to enter into a contract that is subject to its local law, then the fullest appreciation of the risks in the transaction can be considered as part of the business decision to proceed. This appreciation can be seriously diluted if the transaction is to be subject to a foreign law with which the company is not familiar. To confuse matters further the parties may elect one jurisdiction to govern the legal formation of the contract, another to govern the performance of the contract and another to govern arbitration proceedings. The law in other countries varies dramatically in construction and application compared with English law. Only English law is considered here. Companies doing regular business with overseas customers or suppliers should familiarize themselves with the law which is applicable to their particular contracts. However, once one is familiar with contractual principles under English law, a commercial assessment of the risks and other implications of a foreign law is easier to make.

Appreciation of the law

The law as it affects the formation and performance of contracts, the duties, undertakings and obligations of the parties to each other and to third parties is a splendid mixture of common law, contract law, tort law and statutory law. Even in routine business transactions companies increasingly have lawyers on hand to advise, but legal complexity is no excuse for business people not to possess an appreciation of some basics of the law as it affects contracts. As consumers we all 'know our rights' when we go into a shop, so in business contracts we should know likewise – and it should be noted right away that consumer contracts and business contracts are not the same kettle of fish.

What is a contract?

But what is a contract? In the simplest terms a contract is a mutual exchange of promises. The seller promises to supply goods or services and the buyer promises to pay. If certain criteria are satisfied, this exchange of promises can be enforced in a court of law. As the court has said, 'Contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice'. This ancient statement not only captures the principle of legal enforcement but also illustrates, in its use of the phrase 'freely and voluntarily', a fundamental tenet of English law that contracts are made freely and not 'in terrorem'. This means that neither party may be forced into a contract or forced to perform a contract by threat. Amongst other things, this tells us that penalty terms in contracts are not enforceable, but as the text will show later, one man's penalty is another man's incentive! So contracts may not be made or carried out by force from the parties. However, a court may enforce a contract, meaning that it will require a defaulting party to perform, or failing such performance the court will allow the injured party certain remedies. But this is to jump ahead; to begin with we first need some principles.

Contract types

Although the principle of a contract is easy enough to state, contracts come in many varieties. So as an hors-d'oeuvres to this fascinating subject (sic) a short explanation of the different types of contracts as seen by lawyers is helpful.

Simple and speciality contracts

Contracts can be simple or speciality. Speciality contracts are also known as contracts under seal or deeds. Speciality contracts relate to certain classes of property leases and to contracts in which there is no consideration (see below). This type of contract accounts for a very small proportion of business and is not considered further. Regardless of complexity or volume the majority of business contracts with which this book is concerned are known as 'simple' contracts. Contracts of sale and contracts of purchase are examples of simple contracts.

Written and oral contracts

Simple contracts do not have to be made in writing. Individuals make the majority of contracts as oral arrangements only – whether it be buying a newspaper or purchasing a meal. Examples of contracts that are required to be made in writing are bills of exchange, the sale of land and consumer credit agreements. Although written contracts may be the preferred approach most companies will both place and accept oral contracts where the urgency of the situation demands. The aim will be to reduce these oral contracts to writing as quickly as possible. Nevertheless, to be valid even oral contracts must satisfy the basic legal requirements described in this chapter.

Signed and unsigned contracts

Simple contracts do not have to be signed, although many institutions prefer to require the formality and ceremony of personal signatures. Where a contract is signed then that in itself is strong evidence that the signing party intended a legal relationship.

Bilateral and unilateral contracts

The normal business contract that imposes obligations on both parties that must be discharged is an example of a bilateral contract. Somewhat oddly there can be a unilateral contract in which only one party is bound by his obligations. An example of this is the contract a householder makes with an estate agent to sell his house. If he finds a buyer the seller must pay the estate agent his fee. However, if the estate agent does not find a buyer the agent has no liability to the seller. Indeed the agent has no obligation to take any action at all! The business contracts in question are bilateral contracts.

Express, implied and quasi contracts

Another set of classifications distinguishes between express contracts, implied contracts and quasi contracts. In an express contract the parties commit the terms of their agreement to writing. In an implied contract it is their conduct that brings a contractual relationship into being. A quasi contract is one in which the law would impose an obligation to make a repayment where the beneficiary would otherwise be unjustly enriched.

Executory and executed contracts

Contracts may be termed 'executory' or 'executed'. An executed contract is one where the contract is fully performed. An executory contract is one that is wholly or partly yet to be performed. Somewhat confusingly a 'completed' contract means only that a contract exists in the sense that an offer of contract has been made and the act of accepting the offer creates or 'completes' the contract. So a completed contract will be either executory or executed. However, sometimes, completing the contract (in the foregoing sense) is referred to as 'executing' the contract!

Valid contracts

A valid contract is one that is of full effectiveness. It is not deficient in its construction in any way and is fully enforceable by the law.

Void contracts

A void contract is the antithesis of the valid contract and logically is a contradiction in terms. A void contract is no contract at all. The drawback is that in practice the parties to the contract may proceed to deal with one another as though the contract were valid probably in naïve ignorance of the void nature of their agreement. In such circumstances a court may try to deduce a contract so that the parties may end up where they intended. Indeed it is probably the case that a proportion of business 'contracts' are technically void albeit that no one notices because the parties achieve their intended aims with no difficulty and the effectiveness of the contract is never examined or tested. The essence of a void contract or a void contract term is that a court will not enforce it. The parties are free to continue with their arrangements but in the event of dispute about the arrangement or breach of the void term there is no legal enforcement available, although financial claims may be made if one side has suffered loss or been unfairly enriched at the hands of the other. A contract can be void for a number of reasons of which the following are the main examples:

Non-formation

If the contract is not correctly formed through the absence of one or more fundamental criteria (see below) the contract is void.

Public policy

A court will not enforce a 'contract' the purpose of which is against public policy.

Agreements to oust the jurisdiction of the court

It is fundamental that a party who considers himself aggrieved or injured in some way can appeal to the courts for judgment over a matter concerning his contract. Thus any contract that aims to prevent this will be void. However, it is permissible that the parties may include a contract provision that allows all disputes to be referred to arbitration for settlement with the parties binding themselves in advance to the outcome.

Restraint of trade

The court cannot enforce a contractual arrangement that is constructed in contravention of competition law.

Uncertainty

There can be cases when the agreement that the parties have made is vague or so incomplete that the contract is said to be void for uncertainty. In business contracts, however, the courts are loath to jump to a precipitative conclusion in this regard and will go to some length to find the parties' intentions.

Mistake

A contract may be void for a mistake of fact, which is known as an operative mistake. The nature of the operative mistake is not one of error of judgement where, for example, one side attaches an inaccurate value to some goods that he wishes to buy or sell. It is more of a fundamental failure to understand the nature of the contract or the identity or existence of the subject matter. Where there is a unilateral and fundamental mistake (made by one side only) the contract will be void if the other side knew or ought to have known of the mistake. If the other side is ignorant of the mistake the contract will be valid. If both sides make an identical fundamental mistake (a 'common' mistake) the contract is nevertheless valid. If they both make mistakes that are non-identical (a 'mutual' mistake) then the contract will not necessarily be void if the courts can find the 'sense of the promise'. This means what a reasonable person would have said was the intention of the parties. Thus to the law, mistakes come in a variety of types and a plain 'mistake' made by those drafting the contract (whether commercial or technical aspects) may have consequences quite unforeseen.

Voidable contracts

A voidable contract is one in which the contract appears to be properly formed, but may nevertheless be avoided by one party. An example of this is a contract that is entered into by one party being under duress from the other party. The party under duress has the option to escape the contract if he so wishes.

Unenforceable contracts

If a contract that is required by the law to be in writing is not in writing then it is unenforceable. In normal business contracts of the simple variety this is not going to be a concern.

Illegal contracts

The illegal contract is somewhat similar to the void contract in so far as if the purpose of the contract is criminal in nature or frowned upon by the public interest the contract cannot be effective. The law distinguishes illegal and void contracts because of their different consequences. However, it is presumed that business contracts are not illegal, nor against the public interest and on this presumption the illegal contract is not considered further.

Contract formation

All contracts must be correctly formed so that they will be of legal effect. There are five elements in the proper formation of a contract:

Offer and acceptance

On the face of it, offer and acceptance is simple and straightforward. A offers to supply ten widgets to B for £5 each. B accepts and a contract is created. However, if A advertises widgets at £5 each this is not an offer to sell but an invitation to treat. This would mean that B would have to offer to buy at £5 each and A's acceptance would create the contract. It is thus important to be certain when an offer is actually being made. Acceptance can also have its complications. For the acceptance to create a contract it must be given without qualifications or terms since to do so creates a counter offer which itself must be accepted before a contract can come into being. Quite commonly it is the practice for a company to say to a customer 'we accept the contract subject to the following…'. Strictly speaking this is a counter offer and no contract is made until the counter offer has been accepted without qualification. As a matter of custom and practice the two parties to the 'contract' may each proceed with the business of the contract – one to supply goods, the other to make payments – and a court may decide that a contract did indeed exist. The only question to be decided is whether or not *both* parties intended the qualifications given in the initial response to apply. Again this may depend upon the actions of the parties. For example, if the statement was to the effect that 'we accept the contract but will deliver blue widgets instead of green' and the customer, without having formally confirmed it, accepts deliveries of blue widgets then the qualification was mutually accepted.

A factor to be taken into account in determining the existence of a contract is the point at which correspondence on the matter rested. Where a matter has been debated without full resolution, whichever party had the final say in correspondence may well have the advantage. An example of this is seen in the 'battle of the forms'. In this, a series of forms – request for quotation; quotation; purchase order; order acceptance; delivery instructions; delivery advice note – alternate between buyer and seller and each form carries the buyer or seller's terms on its reverse. The terms are mutually exclusive on many points. What then are the terms of the contract? In such situations a general rule has emerged that the final piece of paper holds sway.

Offer and acceptance must be communicated. As far as the offer is concerned, once it has been communicated it must stand until the offerer revokes it prior to acceptance; the offeree rejects it; the offeree makes a counter offer; the expiry of a specified period (called the validity period); the expiry of a reasonable time having regard to the circumstances.

The act of rejection or counter offer by the offeree has the effect of cancelling the offer. If the offeree were to make a counter offer, for example, and then have a change of mind, finding the original offer acceptable after all, it would be too late for him to accept that first offer. As far as both offer and acceptance are concerned the effective moment is that of receipt. The exceptions are that for acceptance by post where the effective moment is that of posting (properly stamped and addressed), regardless of delay or even non-delivery. In some situations the actions of the offeree may be taken to effect acceptance although there is no formal communication. For example, a buyer taking and accepting deliveries and making use of the goods would have conveyed his acceptance through his actions despite having made no written or oral communication or acceptance.

Intention to create legal relations

As has already been said, a court can enforce a contract if the parties intended their promises to be binding. As a natural consequence of this, the court will provide remedies for the breaking of binding promises – known as breach of contract. In some circumstances it may be that promises made were intended to be kept but no one really expected or wanted a legal remedy for a broken promise – perhaps a cancelled invitation to dinner; in such cases a reasonable person (a standard if somewhat subjective test) would say that there could have been no intention to create legal relations and thus no contract is made. Business people must take care that their actions as individuals may not inadvertently be construed as intentions to create legal relations by the body corporate.

Consideration

Consideration is the legal word for the money that is paid for the supply of the goods or services under the contract. In fact, money is only one example of consideration, which has classically been defined as 'some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other'. An example might be in a contract for software development where, in addition to payment of the contract price, the developer may be granted exclusive commercial exploitation rights in the software.

Consideration must be of value to the recipient; it must pass to the recipient; it must be legal; it must not be in the past – a post-event promise to pay for some service already completed does not satisfy the criterion.

Capacity

All adult citizens have the capacity to contract although there are exceptions. For example, there are circumstances in which contracts made by aliens, persons suffering from mental disorder, or drunkards are void. In business contracts, the question relates to the capacity of the company to be a party to a contract. Companies properly formed under the Companies Act have such capacity.

Legal and possible

The contract must not be illegal. For example, a contract to carry out a crime would not be a contract. The contract must also be capable of performance. For example, there could be no contract to supply a perpetual motion machine.

Types and formation of contracts – why worry?

So what practical advice can be extracted from this morass? For the commercial manager there are probably three points of interest:

Accidental commitments

Firstly, there is the danger of actions or words implying contractual obligations where no such intention was meant. Here then is a first warning to the commercial manager. His conduct may lead to unintended contractual obligations. If the manager appears to be acting on behalf of the company (having the company's 'ostensible authority') then a commitment may accidentally be made. The whole purpose to professional life is the pursuit of business and the creating of contracts. It might be said therefore that there should be no doubt that the intention is to create relations. However, it is frequently just the opposite. Marketing, sales, engineering and project management people will regularly discuss possible transactions with potential customers and suppliers with no intention to create legal relations. It is vital that in such matters the purposes of the discussions are clear to all so that legal relations are not inadvertently established. A letter confirming the discussions, but stating 'the discussions and the letter do not constitute an order or a commitment to place an order with you' is an example of a practical precaution. This belt and braces disclaimer points out that not only is no order created but also that no intention to place an order should be construed from the actions and discussions. Another safeguard in these matters is to use the expression 'subject to contract' which is a recognized expression that should exclude the risk of accidental legal relations.

Uncertainty

Secondly, there is the question of uncertainty. One of Britain's law lords once said, 'It is clear that the parties both intended to make a contract and thought they had done so. Businessmen often record the most important agreements in crude and summary fashion; modes of expression sufficient and clear to them in the course of their business may appear to those unfamiliar with the business far from complete or precise. It is accordingly the duty of the court to construe such documents fairly and broadly, without being too astute or subtle in finding defects… does not mean that a court is to make a contract for the parties, or to go outside the words they have used'. So there is a problem. If the contract (which includes any engineering, construction or manufacturing specifications) is unclear, a court may either decide what the parties thought they meant (which may be different from one or both parties' opinion) or may decide there is no contract at all. Equally dangerous is the habit in business contracts of leaving matters expressly as 'to be agreed'. Such 'agreements to agree' are generally unenforceable unless there is mechanistic process (not just 'good faith negotiations') that a court (or an arbitrator) could apply regardless of the wishes of the parties. So here is the reverse of the first point. A belief that a contract had been made, only for the parties to find it not so (or not so in the manner intended), again, caused through the way in which they conduct themselves.

Custom and practice

A court may take an interest as to whether the contract is a simple transaction or a transaction of a more complex type based upon the prior dealings between the parties. In a once-and-for-all contract the law sees a simple transaction standing by itself, governed by its express terms and within the general framework of contract law. Beyond this, and with great relevance to business contracts, is the idea of relations between parties who regularly do business, particularly if it is of a complicated or long-term nature. A law lord has said that 'in complex relations, obligations, often heavily binding ones, arise simply out of day to day operations, habits, thoughts, customs etc. which occur with precious little thought by anyone about the obligations they might entail or about their possible consequences'. So it can be argued that imputed into the contract are obligations, methods of working, conventions and mutual reasonable expectations that arise through a normal process of trade between contracting parties. However, a law lord has warned that 'an alleged custom can be incorporated into a contract only if there is nothing in the express or necessarily implied terms of the contract to prevent such inclusion and, further, that a custom will only be imported into a contract where it can be so imported consistently with the tenor of the document as a whole'. So there it is, perfectly clear – custom and practice might be implied into a contract or it might not! The lesson, nevertheless, is clear, if somewhat easier said than done – those drafting the contract (commercial and technical aspects) must try to think not only of those immediate points of concern, but whether there are wider matters which, for the clarity of all, should be written into the contract, to the exclusion of all else.

Early lessons

So far, it should be clear that in contractual dealings there are two golden rules. Firstly, be clear when words and actions are not intended to have any contractual effect. Secondly, when it is time to make a contract, write it all down in clear, complete and unambiguous language. But it has already been mentioned that most simple contracts do not have to be in writing at all. However, as a matter of professional necessity companies adopt a practice of committing all contracts to writing. This is for several good reasons. Firstly, the subject matter and rights and obligations of the parties may be extensive in description and definition. This naturally demands commitment to paper. Secondly, it is vital that both parties are clear and share the same understanding of the contract. Thirdly, as individuals move on, it is important that their successors can inherit a clear understanding. Fourthly, a written contract is a sound baseline for changes in requirements, rights and obligations that may arise and become contract amendments. Furthermore, in the event of a dispute during or after the completion of the contract a court will be better able to reach a decision based on written evidence. Finally, where many functions within the company will exchange correspondence with their opposite numbers, it is important to know which bits of paper actually constitute the contract.

The terms of a contract

Terms and conditions

The phrase 'terms and conditions' is commonly used but it is in some ways unhelpful. Some use it as a heading for the list of 'contractual' or 'legalistic' bits of a contract as though they are distinct from the interesting bits (for example, price and specification). This is nonsense. It is a condition of the contract that the specification is met. So, it is wrong to think of the contract as somehow having terms and conditions that are unrelated to the rest. Sometimes 'terms and conditions' are abbreviated to just 'the terms' or just 'the conditions'. Sometimes 'terms' means only those bits that have a time element such as a payment credit period. Contracts also contain 'undertakings'. Are these different from terms and conditions? The text will shortly show that the word 'conditions' does have a particular meaning. What is needed is just one word that will do as a generic heading for that list of the requirements, benefits and obligations of the parties to the contract that constitutes the entire contract. The word 'terms' will be used for this all-embracing purpose. Thus the terms of the contract embrace all the technical bits as well as the commercial aspects. As will be seen shortly, it is convenient from a practical point of view to consider the contract as constructed from these different elements, but this should not detract from the holistic view – there is but the one contract, which should be considered complete and whole in its own right.

Express and implied terms

Terms are either express or implied. Express terms are those that the parties themselves have established and usually put into writing. Implied terms are those terms that either a court will decide may be read into the contract, based on what the parties must have intended, or those that arise from a statute. An example of statutory implied terms is the term of satisfactory quality implied by the Sale of Goods Act. This Act and its implied terms of quality can cause a lot of difficulty in business contracts and will be considered in more detail in later sections.

Conditions and warranties

The terms of the contract are also sub-divided into conditions and warranties. Not all of the obligations created by a contract are of equal importance and this is recognized by the law, which has applied a special terminology to contractual terms to distinguish the vital or fundamental obligations from the less vital. The word 'condition' applies to the former and 'warranty' to the latter. 'Warranty' in this sense should not be confused with the common usage relating to a supplier's warranty (or guarantee) under which he will rectify problems discovered after delivery, which will be discussed in a later chapter. The difference between conditions and warranties has been described thus: 'A condition is a vital term which goes to the root of the contract. It is an obligation that goes directly to the substance of the contract, or is so essential to its very nature that its non-performance may be considered by the other party as a substantial failure to perform the contract at all. A warranty, on the other hand, is subsidiary to the main purpose, and there is no right in the injured party to repudiate the contract; there is only an action for damages. A warranty has been variously defined, but it may be said to be an obligation which, though it must be performed, is not so vital that a failure to perform it goes to the substance of the contract.'

The weakness of this simple distinction between conditions and warranties is that it presupposes that the parties have the desire and ability to make this distinction in their contract terms when the contract is made. In business contracts, this desire and ability may be absent, even if the parties think about the distinction at all. Consequently the law recognizes a third class of term that is called the 'innominate' term. This means that the term will be determined as either a condition or warranty depending upon the severity of the consequences of an actual breach (which may never happen), rather than the possible consequences as may have been contemplated when the contract was made.

As will shortly be seen, it is the injured party's remedies for breach that provides the vital definition of the difference between a condition and a warranty.

Representations

Prior to making their contract the buyer and seller make representations to each other that directly or indirectly lead them to a wish to do business. Such pre-contract representations if they are representations as to fact may be expressly incorporated in the contract and thus they become part and parcel of the contract promises. If they are not so incorporated they may still be of legal effect (unless expressly excluded from the contract). For example, if a buyer enters into a contract relying on a pre-contract representation (which is not incorporated in the contract) he may later be able to rescind the contract (see below) if the representation turns out not to be true.

Penalties

It has already been said that once in contract, performance relies upon the willingness of the two sides, failing which the courts will decide a remedy. The contract itself may provide a remedy but the remedy must not be of the nature of a penalty. A court would not enforce a penalty term. Whether a contract term is or is not a penalty is ultimately for a court to determine by reference to the substance of the term. A penalty cannot be dressed up as something else in the hope that it would not be found void.

Unfair contract terms

The purpose of contract law is to provide a set of rules, which if obeyed will ensure that the contract is enforceable. It is not designed to ensure that the contracting parties have a balanced deal – that is for each of them to decide. If one participant is in a stronger negotiating position, the deal is likely to prove in its outcome more beneficial to him than to the other party. Thus contract law exists to provide a framework of fair rules and not to ensure that the result of each game is more or less a draw. However, there is one major exception to this general principle. It has already been seen that a legally binding obligation can carry an unlimited financial liability for breach. Companies like to conduct their business at minimum risk and the prospect of unlimited liability contracts can make them shudder. So companies look for ways to limit their contractual liabilities. There are two ways of doing so. They can expressly exclude particular liabilities or they can expressly limit the financial exposure connected with liabilities that they cannot avoid altogether. These exclusions and limitations are subject to the Unfair Contract Terms Act (UCTA).

Liabilities excluded or limited

The liabilities that companies seek to exclude or limit are those relating to the following:

- Personal injury or death
- Breach of contract
- Performance as expected
- Complete performance

- Results of negligence
- That goods correspond with description or sample given
- That goods are of satisfactory quality
- That goods are fit for purpose
- That goods are unencumbered.

Liability for personal injury or death can never be excluded or limited in a contractual transaction. In business contracts all the other liabilities listed may be excluded or limited subject to a test of reasonableness and to notice of the exclusion having been given.

Reasonableness

The onus is on the party relying on the exclusion to show that it is reasonable. The reasonableness test is based on:

- The exclusion being fair and reasonable in the circumstances known or contemplated by the parties when the contract was made
- The relative bargaining positions
- The existence of any inducement
- Whether goods were manufactured, processed or adapted to order
- Whether the buyer had reasonable notice of the term.

If the liability were financially limited then also taken into account would be the resources available to meet the liability and the availability of insurance. It would be unfair of a company to exclude or limit a liability that it can easily meet from its resources or for which insurance cover is available.

Notice

For an exclusion to be effective then:

- Notice of the exclusion must have been given at the time the contract was made or the prior course of dealings or trade practice must show that the exclusion is standard practice
- Notice must be in a contractual document
- Reasonable notice must be given
- The exclusion must apply to that which was intended.

The UCTA was largely concerned with the absurd exclusions of liability that appeared in retailers' standard terms used for consumer transactions. The purpose was to set some fair rules that protected the consumer's interests. For example, it is accepted that consumers do not necessarily read or fully understand a standard term contract. It is rightly held that such failures should not harm the consumer's entitlement to a fair deal. In business contracts the parties are much more left to their own devices. However, in 1996 there was a case between St Albans District Council and International Computers Ltd (ICL). The case revolved around a contract term that purported to limit ICL's liability for the loss (of council tax revenue) suffered by the Council as a result of a defect in the computer system supplied by ICL. ICL did not deny the defect but relied upon the limitation to avoid paying the bulk of the Council's losses. ICL believed their position was secure because the Council was not dealing as a consumer and had negotiated the contract in full awareness of the limitation. The court did not agree with ICL and took into account a number of factors including ICL's substantial insurance cover. The result was in favour of the Council. The purpose in remarking upon this one case is that businesses should not assume safety in their exclusion or limitation terms. Since this case, it is important that legal advice is taken when drafting such terms.

Standard and negotiated terms

Where one or more parties regularly do business with one another there is advantage to all concerned in the use of standard terms; that is, a set of terms that buyer and seller will use for most, if not all, of their transactions. This saves considerable time in the drafting of contract documents and indeed in the physical bulk of the documents, as the standard terms can be included by reference. Not only that, but the contracting parties will understand and be confident in the custom and practice that grows up around the use of standard terms.

Standard terms are produced and used by government purchasing departments; by industry bodies (such as the Chartered Institute of Purchasing and Supply); by a sector of industry; and by individual companies, either as standard terms of sale or as standard terms of purchase.

If a trade body produces standard terms, the aim will be to make the terms reasonably well balanced between the interests of buyer and seller. Where one 'side' produces the terms only – whether a government department or a private company – then the terms will be one-sided! This risk must be borne in mind. There is no comfort at all to one side when the other side says 'don't worry, we'll use our standard terms'. The only other form of quasi-standard terms arises where the first one or two contracts between two parties are fully negotiated, but as subsequent contracts of a similar value and type are placed, the parties may agree to adopt the same set of terms that applied previously. This has the convenience of saving time and money, but there is a risk as no two contracts are quite alike and unthinking reliance on what went before may run the risk of changes in circumstances or law not being picked up as necessary in the express terms of the contract.

In the final analysis, contract terms can only be reduced to standards where buyer and/or seller see no advantage to the time-consuming activity of negotiating terms on each and every occasion that a transaction is contemplated. Also, some aspects are actually different every time a transaction is entered into and could thus never be reduced to a standard. For example, payment terms in industries where interim payments are permitted can vary on each contract and most companies will wish to negotiate these on a case-by-case basis. A key commercial skill with regard to negotiating contract terms is the trade-off analysis between genuine risk, practical solutions and legal niceties. For example, a term that permits the customer to cancel the contract for convenience might be perfectly acceptable legally, if the wording is correct, but commercially it might be a disaster unless an adequate period of notice is given. On the other hand a ludicrously brief period of notice might be acceptable if the risk of cancellation is highly remote.

If things go awry

The text has already shown that there are many pitfalls in getting to a binding contract. Nine situations have been given, any one of which can deny the existence of a contract. One of these situations (improper formation) itself has five criteria, failure in any one of which may cause the contract not to be formed. This already reveals a lot about the nature of contractual relationships. More is learned in considering the circumstances in which matters go awry.

Consent

Just as the parties are free to make their contract they are free to unmake it and to decide their own terms for so doing. This may be appropriate where circumstances have changed dramatically and both sides see no merit in continuing with their contract.

Convenience

Some contracts expressly allow the buyer (not usually the seller) to unilaterally and prematurely end the contract under a 'cancellation for convenience' arrangement. Such a right must be included in the express terms of the contract. A buyer who says that 'we can always cancel the contract' to put pressure on the seller is making an empty threat if he has no express right to cancel, provided that the seller is performing the contract properly.

Repudiation and breach

If one party to the contract expressly or impliedly announces to the other that he will not see the contract through, then he is said to be repudiating the contract. A failure to perform a contractual obligation is called breach of contract or contractual default. Breach may be actual, for example, where delivery is not made by the due date, or breach may be anticipated. The defaulting party may anticipate the breach by announcing its inability to perform, for example, by the seller telling the buyer that delivery will be late. The buyer, for example, may anticipate the breach by monitoring the progress of the seller and deducing that the seller will be late. If the seller anticipates his own breach he is repudiating the contract. If the buyer anticipates the seller's breach and takes pre-emptive action for breach before the seller is due to perform, then the seller can treat the contract as having been repudiated by the buyer.

Special circumstances

This book is primarily concerned with the normal course of business where contracts are made and the interest is in the risk and liabilities associated with the performance of the contract. This will be the subject of the next chapter. However, it would be wrong to entirely skip over other situations where the contractual position is not as the parties intended.

No contract

As the text has already remarked, the parties may proceed with their 'contract' only later to find that it is void for reasons of non-formation, public policy, of being an agreement to oust the jurisdiction of the court, restraint of trade, uncertainty, and a mistake. A 'contract' may be unenforceable if it is illegal.

Rescission

One side may undo the contract on the basis of a failed obligation that is outside of the contract. For example, if the purported contract followed a fraudulent pre-contract misrepresentation then the injured party may rescind the contract (unless he knows of the misrepresentation and takes some benefit from it).

Frustration

If a valid contract comes to a stop as a result of an event that arises after the contract was made then the contract may be dissolved for frustration. The event must be so significant and unexpected that it could not reasonably have been within the contemplation of the parties when the contract was made. This is the crucial point. Although both sides always aspire to low risk contracts, there are cases where significant risks must be carried.

Such risks may be allocated to one party or the other under the contract. If one such risk comes home to roost, then the party carrying that risk may not claim that the contract has been frustrated.

Legal remedies

If things do go awry then the law provides remedies. The parties may use the contract to restate, add to, or subcontract from their remedies, although the extent of addition or subtraction may be governed by the law (for example, see unfair terms earlier in this chapter). The terms of contract termination by consent are for the parties to decide. If the contract allows an express right for cancellation for convenience then the terms of cancellation are for the parties to set out in the contract. The main interest is in the remedies for breach, which are as follows:

Specific performance

The buyer's principle default is a failure to pay. For the seller the remedy is quite straightforward. He must sue payment of the contract price. The seller's principle default is to fail to get on with the job (to time or to specification). It would seem that the most obvious legal remedy for the buyer would be to get the court to enforce the contract. This the buyer may do by applying for a decree of specific performance. However, it is a discretionary matter for the courts to grant such a decree but the option is certainly there for the injured side to exercise. If the goods were readily available elsewhere, or if checking compliance with a decree of specific performance was impossible or required constant supervision by the courts, then a decree would not be granted. So where, for example, the goods are available elsewhere no decree would be issued, the contract would be considered terminated and if the goods bought elsewhere were of a higher price, then the buyer would have a right to damages from the defaulting supplier.

Termination

If the breach is a breach of a contract condition the injured party may terminate the contract. No right of termination arises if the breach is of a warranty only. This is the crucial difference between conditions and warranties. The absurdity here is that the consequences of breach of a condition might be trivial but the (lightly) injured party could terminate the contract, possibly to the severe detriment of the other side. Conversely the consequences of breach of a warranty may be very serious but the (badly) injured party has to continue with the contract. Thus the innominate term stands in the middle. However, this is not an automatic escape route for the defaulting party to avoid the risk of termination. If a contract term was clearly intended as a fundamental condition at the outset then a court is not likely to reclassify it after the event. It is in respect of those contract terms where the classification is not obvious in the first place that a court would apply the rules of innominate terms.

Damages

Breach of contract gives the injured party a right to damages, whether the breach is of a condition or of a warranty. Damages must reflect financial loss flowing directly from the breach. The loss may be actual (for example, unrecoverable, expenses) or anticipated (such as loss of expected profits). Such losses must have been within the reasonable contemplation of the parties when the contract was made. Simple contractual exclusions of 'consequential' damages are of little effect in business contracts as the courts find many categories of loss that flow directly from the breach, despite what the defaulting party may think. The losses must be real and not invented by the injured party.

Subject only to the tests of 'directly flowing' and 'within the contemplation of the parties' the scale of the damages that may be awarded for breach is unlimited. Such an unlimited sum is said to be unliquidated damages. It is open to the parties to agree in their contract a fixed, pre-estimate of the damages likely to flow from different categories of breach (delay in delivery being the most common example). Such fixed amounts are referred to as liquidated damages.

Special circumstances

The position regarding damages is somewhat different in the special circumstances mentioned above. If a contract is rescinded the aim of the law is to put matters back to square one, as though there had been no contract at all. If one side has suffered at the hands of the other then he may claim restitutional damages. If the contract is void or is unenforceable or has been dissolved through frustration, and if one side has gained at the expense of the other then the suffering party may claim a reasonable amount from the enriched party.

If a claim in respect of an allegedly void contract or in respect of a breach of contract is prosecuted in law, a case may be formulated under many branches of the law. As well as contract law, a claim may be made in tort, in equity, and in restitution and claims may be made for reliance damages and expectation damages. But such matters do not usually come to the fore where businesses choose to resolve their differences by negotiation. For the purposes of this book it is sufficient for the reader to understand the basic concept of direct damages flowing from breach and that such damages may be liquidated or unliquidated.

Breach and damages – who cares?

So what are the practical issues for the commercial manager? Is this not more esoteric stuff just to keep the commercial people and the lawyers employed? There are four points of interest:

Meeting the specification

Firstly, the commercial manager should remember that the bit (for example, specifications) of the contract in which he is most interested forms an integral part of the legal obligation. In some contracts, the specification may be so voluminous that, in simple terms, it makes up the bulk of the contract anyway. Unless the contract provides otherwise, the obligation is to meet all of the specification. It is most unlikely that a specification will be categorized to make it clear whether each individual requirement is fundamental or secondary. Therefore, assumptions about what is and what is not important are dangerous, as the penalty for failure can be different. Some contracts contain specifications that do categorize between requirements that are, for example, 'mandatory, desirable and non-essential'. In such cases it is still not obvious as to whether the middle category ('desirable' in this example) would be considered fundamental or secondary. It is thus most important to formulate contract specifications very carefully, not only as to their technical integrity, but also from the viewpoint of the legal consequences of failure. Some contracts provide for an allowable degree of variation from the specification (sometimes called 'concessions' or 'permits') perhaps with an automatic right for the buyer to demand a price reduction. Mechanisms such as these are useful tools to avoid the entanglement of a legal debate as to the nature of particular requirements.

Guessing wrong

The second area of concern relates to the extent to which the effect of failure may be foreseen. It has been known for a manager (or a company) to take a view that perhaps the customer will forgo a requirement (which is turning out to be difficult for the company to achieve) because, after all, the selling price to the customer (or the company's originally estimated cost) is low in value. The risk is that if the customer can show that the financial consequences to him are extensive and were known or were reasonably foreseeable by the company at the time the contract was made, then the company may be liable for the consequential costs to the customer.

Letting the 'cat out of the bag'

A third area of concern is the consequence of telling the customer (sometime after the contract was let) that the specification cannot be met or that the programme will be late. There is a laudable tendency for the manager to want to be perfectly open with the customer about such difficulties, but the risk is of contract termination as a result of 'anticipatory breach'. Thus the subject must be handled with judicious care.

Missing the hazard

The fourth point is related to the previous point. Late delivery may expose the supplier to the risk of paying 'liquidated damages'. This is usually a lesser penalty for the supplier than contract termination, but it is nevertheless painful. A non-commercial salesman, manager or supervisor working for the seller may not even be aware of this contractual arrangement and may inadvertently expose the company to this risk. The commercial manager working for the buyer may likewise in ignorance of the arrangement prejudice his company's rights to collect the liquidated damages from the late supplier.

The Sale of Goods Act

The Sale of Goods Act imposes duties on the seller. These duties are to:

- Pass goods title
- Deliver the goods
- Supply the goods at the right time
- Supply goods in the right quantity
- Supply goods of the right quality.

The Sale of Goods Act imposes duties on the buyer. These duties are to:

- Accept delivery of the goods
- Pay the agreed price.

The duty to supply goods of the right quality means that the goods meet the relevant express terms of the contract. Terms are also implied into contracts that goods:

- Correspond with their description
- Correspond with any samples given
- Are satisfactory
- Are fit for a particular purpose.

Business contracts should normally expressly deal with title, delivery, timeliness, quantity, quality and payment. The Sale of Goods Act merely states the position for consumer contracts and gives the fallback position for those business contracts that neglect to deal with these matters. The point of concern here is the implied terms of satisfactory quality and fitness for purpose. According to the Act, ‘goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price and any other relevant circumstances’. Quality takes into account ‘fitness for all purposes for which goods of the kind in question are commonly supplied, appearance and finish, freedom from minor defects, safety and durability’. The implied term does not apply to any defect in quality specifically drawn to the buyer’s attention before the contract is made or where the buyer examines the goods before the contract is made, but fails to notice the defect that the examination ought reasonably to have revealed. It is easy to see the application and merit of these implied terms in consumer transactions, but more difficult in business contracts where the express terms of the contract (for example, the specifications) may be drawn up in great detail, possibly with the buyer taking a proactive role. For this reason, it is open to the parties to a business contract to exclude the implied terms altogether. They must do this with an express exclusion in their contract; otherwise the implied terms are operative, regardless of the detail of the express terms.

Product liability

Product liability is concerned with the safety of goods. Between buyer and seller the seller has a strict liability to supply goods that are of the right quality. This means that if the buyer can show that the goods are defective, then the seller is liable for the damages flowing from such defect. These damages would extend to the cost of correcting the defect, recompense for damage to property caused by the defect and for claims arising from personal injury or death cause by the defective product. A claim for such damages would be a straightforward contractual claim by the buyer against the seller. The buyer could also claim under the tort of negligence if he believed that he could prove negligence. The buyer’s better route is the contractual claim.

Where however the buyer wishes to claim against the manufacturer (where the manufacturer is not the seller) then the buyer has the harder task of showing negligence on the part of the manufacturer, showing that there is a so-called collateral contract between himself and the manufacturer or by instituting third party proceedings against the manufacturer. These common law rights are difficult to pursue and do not cover defects in the goods themselves, only damage, injury or death caused by the defects.

The legal remoteness of the buyer from the manufacturer makes it hard for the business buyer to secure a remedy, but for the consumer the matter is even more difficult. To correct this, Part 1 of the Consumer Protection Act creates a strict liability (meaning the injured party only has to prove that a product was defective and not that there was any negligence) on the producer provided that he supplies in the course of business or for profit. The producer is the actual producer of the product; or anyone holding himself out as the producer (for example, by adding his trademark to the producer's product) and anyone within the EU who imports the product from outside of the EU. The liability is for damages arising from injury or death and damage to property (being property for private use, occupation or consumption), but not for damage in the product itself or for pure economic loss. Whilst this book is not concerned with consumer transactions, the company further down the supply chain from the consumer may find itself caught by this liability.

Contract negotiation

Many business contracts are arrived at through the process of negotiation or at least some discussion between the parties. So it is necessary to look at what the law has to say about the process of negotiation.

Disclosure of information

The first principle is that in ordinary commercial relations (and unless there is a pre-existing contractual obligation to this effect) there is no obligation on the parties to disclose facts to one another. In some special circumstances there may be a duty of care in ensuring that when information is given, it is complete but in business contracts the parties are free to use their best skills and information to negotiate the best deal possible.

Bargaining power

The second principle deals with relative bargaining power. It is a fact of commercial life that the bargaining powers of the two sides to the potential contract will frequently be unequal but commercial pressure of that nature is usually legitimate. After all the weaker of the two sides is free to decide against entering into the contract.

Confidentiality

A third important principle is that the negotiating parties may owe each other the obligation to treat one another's information in confidence. Once a contract is agreed information exchanged must in any event be held in confidence. In the pre-contract stages it is as well to set up a binding confidentiality agreement (see Chapter 4). This may be particularly important where the negotiations fail to reach a conclusion and no contract is ever made.

Misrepresentation

In arriving at a contractual agreement there must be no fraud, coercion, duress, undue influence or misrepresentation. For most businesses it is misrepresentation that can cause practical difficulty. The text has already mentioned pre-contract representations. If these are recognized as mere 'puffery' (obvious exaggerations that simply grab attention) they have no effect at all. If they are of substance and are incorporated into the contract, they simply form part of the contract. If they are of substance but not so incorporated they may still have some legal effect. A representation must be factually correct, if not it is a misrepresentation. There are several forms:

- **Fraudulent**: A false representation made knowingly or without belief in its truth or recklessly careless whether it be true or false.

- **Innocent**: A misrepresentation in which there is no element of fault (that is, fraud or negligence).
- **Negligent**: A false statement made by a person who has no reasonable grounds for believing that statement to be true.

The remedies for misrepresentation may include rescission, termination and damages.

Thus for the commercial manager it can be seen that in participating in contract negotiations, there is no need to volunteer information if it helps the other party, bargaining power can be used to lever the maximum advantage, information must be kept in confidence and both unintended promises (representations) and false promises (misrepresentations) must be avoided.

The content of the contract

Having considered the legal principles on which a contract is formulated and having examined the legal constraints on negotiation (the practical side of negotiation will be covered in Chapter 5) the text will now examine the components of a contract that are essential from a practical perspective.

The 'what' (definition and specification)

It is vital that the goods are defined as absolutely as possible. In the simple case, the 'what' will be the part number, description and quantity, but it is also important to specify other things to be supplied – guides and spares for example. Where the 'goods' are particularly complicated, or where design and development or complex systems are involved then engineering standards, specifications, acceptance and handover arrangements are needed. Definitions of deliverable data must be given. Project control, monitoring and other services required must be specified.

The ‘when’ (timescale and timing of contract performance)

The contract should specify when and at what rate things should be delivered or services performed. The nature of the commitment (or otherwise) to meet timescales is crucial.

The ‘where’ (destination)

The contract should specify the destination to which the goods are to be supplied or the location where the services are to be performed. The contract may be required to be performed in several different locations and possibly in different countries.

The ‘how’ (method of delivery)

The contract must specify how the goods are to be delivered. Packaging, preservation, transport medium and allocation of carriage responsibilities must be specified.

The ‘how much?’ (price and payment)

The price for the job must be struck in the first place or, if not, then a proper mechanism must be recorded for the agreement of price. Careful attention must be given to the timing and triggers for payment. Details must be included for the procedure for invoicing. The contract must also state what rights, if any, the buyer has to recover payments made.

The ‘what else?’ (dependencies)

The contract may need to include certain responsibilities on the buyer, for example to provide facilities, data or goods; to inspect and accept the work of the contract. The contract must specify how contractual acceptance, including any testing, proving and trials are to be achieved.

The ‘what the hell!’ (the allocation of risk)

An absolutely fundamental role of any contract is to allocate risk as between the parties. Specific topics include: the risk of loss or damage to goods (pre and post delivery); the fitness for purpose of the end result; title in the goods; performance of the goods at acceptance and thereafter; liability to third parties; liability for the consequences of delay; liability for product safety; indemnities regarding accidental or knowing infringement of intellectual property rights; risk of damage to property; liabilities in the event of breach; the risk of contract cancellation or termination; the risk of delay through defaulting suppliers; exclusions; terms limiting liability; unlimited liability obligations; bonds and guarantees; cross indemnities; contract warranties. It is only when something goes awry and the contract is examined that the company first realizes (or remembers from when the contract was bid) what it has let itself in for. The reaction is often ‘what the hell!’

Layout of a contract

The physical size of the contract documents almost always varies in proportion to the complexity and value of the job. The purchase of a standard product or service at a standard price may involve nothing more than the buyer’s standard purchase order, comprising a single sheet of paper, the front side describing the item, delivery and price, the reverse side containing pre-printed terms of contract. The supplier may not necessarily agree with all these terms, but if, as a matter of practice, they have never given him a problem he may choose not to make an issue of it and risk losing a customer. However in a major contract it is essential that every word be carefully assembled into a coherent structure. There is no universal, standard layout of a contract, but the following is an outline, somewhat stylized, example.

Schedule of Requirements.

Contract Terms.

Annex 1: Specifications.

Part 1:	Performance specification
Part 2:	Test specification
Part 3:	Acceptance specification

Annex 2: Statement of Work.

Part 1:	Deliverable goods
Part 2:	Deliverable data
Part 3:	Programme plan

Annex 3: Payment schedule

Annex 4: Customer furnished material

A standard contract layout

The Schedule of Requirements is merely a helpful summary that introduces the contract. The contract in its entirety is defined by the contract terms. The contract terms will not only deal with the 'what the hell!' category of issues, but will also, through individual terms, deal with all the other subject matters from 'the what' to the 'what else'. Each such term may for convenience refer to annexes where more detail can be found, but the basic obligation to do whatever happens to be stated in each annex should be established in the contract terms. At the risk of labouring the point, the contract is not an unconnected collection of disparate material, but a single cohesive entity in which the pieces are bound together by the contract terms.

Contract requirements

One function of the contract is to say what the seller must do in performance of the contract. Such requirements, which may be set down in technical specifications or standards, must be incorporated properly into the contract. This may be done by physically including the requirements within the contract document so that they are present within the formal paperwork. Alternatively they may be 'incorporated by reference'. This means that they are simply called up in the contract document by reference. The important points are that the references are unique and precise identifiers and that the contract terms are clear that such requirements do indeed form part of the contract. A habit, which is to be deplored, is that of including at the start of the contract documents, or perhaps within a contract specification, a list of 'referenced documents'. Such habit leaves the list hanging in mid-air with the reader unsure as to whether the material is part of the contract requirement or is just useful background reading. There is no harm in using the contract to draw attention to useful background reading, but it must be clear that this is all that is intended. There must be absolute clarity on what is and what is not a contractual requirement.

Bringing the contract into effect

It has already been mentioned that a contract does not have to be physically signed by the parties. There must be an offer that is met with an acceptance. Offer and acceptance must be communicated, but in simple contracts, signatures as such, are not essential. Telexes, faxes and e-mail, as well as the spoken word can all suffice. It is however important that the parties do have a clear understanding as to what event signals that a contract has been made. Joint signatures of a formal contract document are a good method provided both sides know that prior to such event no contract has been made. However in practice a contract can be formed as a result of a sequence of correspondence in which case the parties should mutually record the correspondence that forms the contract.

Complete agreement

In cases where the formal contract document has resulted from extensive negotiation and much paperwork (for example where the contract document goes thorough many draft stages or where many aspects of the potential contract are clarified or expanded upon – whether orally or in writing – by one or both parties) it is good practice for the parties to include in the contract a 'complete agreement' (sometimes 'entire agreement') term which confirms that the full agreement is now incorporated in the formal contract document to the exclusion of everything that preceded it. This is good practice but requires great care by each of the parties (and especially so in the technical arena). This is because the buyer may have been persuaded to place the contract as a result of various pieces of information (representations) received from the seller and the buyer must ensure that any that are material to him are incorporated. Similarly the seller may have placed qualifications or caveats on some of his promises and he must ensure that these are captured in the contract if he is not to be caught out later. The alternative, which can often seem attractive, is not to have a complete agreement term thus opening the possibility that in a future dispute pre-contract information may be brought into account. This is a sloppy approach, unless one side plans to later rely upon a 'time bomb' ticking away in the earlier material, which is a cynical practice and quite unnecessary if good buyer/seller relationships are valued, and should be avoided.

Conditions precedent

Even where there is a formal contract document that is signed by both parties the contract (as a legally binding set of promises) does not necessarily have to come into effect upon signature. It is not unusual for a contract document to include 'conditions precedent'. These are terms that, if not fulfilled, prevent the contract from coming into force. An example is where the seller is not prepared to have the contract come into effect until he has received a specified amount by way of an advance payment. In such a case the parties will have arrived at their complete agreement and committed it to writing in their formal contract document, but the seller's obligations do not come into force until the advance payment (which may not be available in the buyer's budget by the time the contract has been signed) has been received by the seller.

Intentions to purchase and instructions to proceed

So far it has been supposed that there is time to put a full contract in place before work begins. In business it is not infrequently the case that, because of some urgency, or indeed for other reasons as well (for example the need to signal that other contenders for the contract are too late), the buyer would like the seller to proceed in advance of establishing a full contract. For reasons of his own, the seller may be prepared to go ahead without a full contract agreement where, for example, a later start would give him difficulty with availability of resources. In these circumstances the buyer may issue two different types of notice to the seller:

Intention to purchase

An intention to purchase (also known as a letter of intent) means exactly what it says – the buyer has an intention to purchase. The value of this to the supplier is only that it gives him a clear idea of what the buyer might want and perhaps gives him more confidence that a sale is close. An intention to purchase does not create a contract and the supplier, if he proceeds with work, does so at his own risk. The expression 'working at his own risk' means that the seller risks not recovering the cost of the work done in advance of a contract being placed. In specialist areas this work may be completely nugatory in so far as it may not even be of any use in meeting the requirements of other customers. On top of this the actual doing of the work will have diverted effort from real contracts where there are profits to be made. It cannot be stressed heavily enough that there are real dangers in doing what it is thought the customer wants rather than that for which he has actually contracted.

Instruction to proceed

This instruction is intended to create a binding relationship. Provided that the instruction and its response satisfy all the fundamentals a contract is created. This will be used where time does not permit the buyer to set out his full requirements but nevertheless sufficient of the contract terms can be specified. Wherever possible an instruction to proceed will be given in writing, but, as with oral contracts, the aim will be to formulate the full contract documents as quickly as possible.

It is perhaps a little risky to say that an intention to purchase does not form a contract and that an instruction to proceed is intended to form a contract. No matter how the communication is labelled, the real question is: does the communication amount to an offer of contract that is capable of being met with an unqualified acceptance? If it does, the seller has the option to accept or not. If it does not, then the seller cannot make a contract by purporting to accept the 'offer'.

Changing the contract

Amendments

Once the contract comes into effect it can only be changed under two types of arrangement. Firstly, there is nothing to stop the parties from changing their contract by mutual consent. Functionally, such an 'amendment' to contract has identical status to a contract itself. That is, before it can become a binding agreement there must be offer and acceptance, valuable consideration and intention to create legal relations. All the rules apply but in practice some aspects may be handled differently. For example, the contract amendment, being a contract in its own right, should identify all the terms that are to apply. However, in many cases the parties will wish the terms of the existing contract to apply, and rather than simply repeat them all, the wording of the contract amendment will close with a phrase such as 'all other terms remain unchanged'. As far as consideration is concerned, the wording of the contract may permit amendments to occur with the extra consideration to be arrived at later, but in a prescribed manner. For practical purposes the crucial point regarding amendments is that they must be accepted before they can become binding. It is important to be certain whether an amendment has been accepted or not. Confusion can be caused if either of the parties has the practice of distributing copies of amendments on the day of issue of the amendment (at this stage it is only a proposed amendment) rather than on the day of acceptance.

Changes

In the first arrangement, just described, the parties come together, as it were, outside of the contract to discuss a possible change and if they are then agreed, to cause the contract to be changed as described. The second arrangement is, as it were, within the contract itself. In such an arrangement the contract will provide for certain changes (perhaps the buyer has a right to demand a change to the specification or perhaps the seller has the right to deliver below specification within permitted tolerances) that can be introduced without a full contract amendment. This is a perfectly sound way to proceed provided the contract includes the details of the mechanism and in particular describes how revisions to price are to be handled. Such arrangements are quite common in contracts that have a high engineering content and the engineers control such changes under formal 'configuration control' procedures. But the contractual description of the process must be carefully drawn because such arrangements must satisfy all the rules for proper contract formation, just as with the first arrangement.

Risk

But the contractual aspects of contract changes are not just concerned with ensuring that the legal principles are satisfied. In the case of a contractual mechanism that allows changes to be introduced through a due process, there is the question of the commercial risk that buyer and seller may have to take by following the process. For example, in a contract where the buyer is allowed to direct the seller to meet a different specification it is frequently the case that the seller must change direction immediately (in order to meet the buyer's timeframe) leaving revisions to price, delivery schedule and payment terms until later. Thus the seller may suffer adverse effects on his cash flow while he waits for the commercial aspects of the change to catch up. If the seller will only work to an arrangement whereby he is not obliged to change direction until all the commercial aspects are settled then the buyer may find himself with the choice of settling the commercial aspects too quickly (to the seller's advantage) in order to meet his timeframe needs or delaying the implementation of the change whilst time is taken to deal properly with the commercial aspects. There are tried and trusted methods of dealing with these conflicts. For example, the change process may have different categories of change in which some (for example, those affecting safety) are adopted immediately whilst others are left on ice until the commercial issues have been cleared up. Alternatively the buyer may be given a time period in which he may verify and negotiate the commercial aspects, failing which he must agree the commercial changes proposed by the seller. For the commercial manager it is important that he is aware of the commercial aspects of the process such that he does not accidentally act against his company's best interests.

Authority

Whether a contract is altered by amendment or by change it is important that the parties are clear between them as to which of their respective representatives are authorized to deal with the formal adoption of proposed changes. This is best done within the terms of the contract and communicated to all concerned.

Checklist

- Companies have some freedom to choose and negotiate the applicable law for their contracts.
- A contract is a voluntary, mutual exchange of promises enforceable in law.
- Most business contracts are of the simple type and are best put in writing.
- Simple contracts require no signature.
- Care must be taken to ensure contracts are properly formed.
- Offer and acceptance must be communicated.
- Contracts must include valuable (future) consideration.
- Contracts may be made between companies.
- Contracts must be legal and possible.
- Care must be taken to avoid accidental commitments.
- It is dangerous to rely upon custom and practice.
- Terms may be expressed or implied in a contract.
- Terms are either conditions, which are fundamental, or warranties, which are subsidiary in effect.
- Pre-contract representations have important legal consequences.
- Penalty terms cannot be enforced.
- There are statutory restrictions on terms that exclude or limit liability.
- A contract may end through consent, convenience, repudiation, breach, rescission or frustration.

- A court may award a decree of specific performance but for most purposes the remedies for breach are damages and, if the breach is breach of a condition then the right to terminate also arises.
- The Sale of Goods Act imposes many duties on the seller and some on the buyer.
- Some of the Sale of Goods Act duties may be excluded in business contracts by an express contract term.
- Product liability law allows third party rights of action against producers of defective goods.
- In contract negotiations the parties have no general duty to disclose information to each other; they are reasonably free to make the best of their bargaining power; they should respect the confidentiality of each other's information; they should not make misrepresentations.
- The effective date of a contract may be delayed until conditions precedent have been satisfied.
- The parties may use intentions-to-purchase and instructions-to-proceed to effect an early start, but these are not without risk.
- A contract may be amended by mutual consent or changed by virtue of a mechanism set out in the contract.