052_FD Apr 05 Brief 3 dm 18/3/05 5:52 pm Page 50

BINDING CONTRACTS DO NOT HAVE TO BE WRITTEN DOWN

When suppliers or contractors fail to provide the goods and services they have promised, companies can always fall back on the contract between them, stipulating the terms and conditions – if the contract is well written.

Too often, contracts fail to adequately protect those parties who might be receiving the services as agreed, but have doubts over the quality and speed with which they are delivered. Lawyers often say that contracts are less useful in the 'grey areas', where the relationship is not going well but, on the other hand, the business is not suffering any major loss as a result.

Best practice

According to Neil Wallis, assistant solicitor in commercial law and intellectual property at law firm Macfarlanes, "given that the main way of enforcing a contract is to sue for damages, and that is time-consuming and costly, businesses will not wish to use a sledgehammer to crack a nut for minor non-compliance issues".

As such, companies need to write strong yet flexible contracts that allow them to put in place other controls and risk management strategies to ensure their business does not suffer because of loose adherence to a contract.

One approach, says Wallis, is to have a service credit regime. This is, in essence, a box-ticking compliance method, where the company notes every incidence of dissatisfaction, such as late delivery, wrong packaging, poor quality, overcharging, incorrect invoicing, etc. For every instance of non-compliance, the customer can then propose to deduct money from the outstanding amount.

Another approach is to have a 'no service, no fee' regime, whereby the customer withholds funds for the time that the services, goods or facilities provided under contract are not available. Another possibility is to deduct the supplier's profit element from the contract for poor service, paying solely for the cost-price and delivery of the goods and excluding all other extras.

Find alternatives

Wallis says that if a company is not bound by an exclusivity contract, whereby it can only be supplied the agreed goods, services and facilities from its contracted supplier, then it should consider using other firms. "Unless exclusivity has been signed away, companies are free to look around for alternative suppliers. This has the advantage of establishing good business relations with companies that you might want to sign contracts with in the future, but it also lets your existing supplier know they could lose your business to a rival firm unless they honour the spirit of the contract you have both signed," says Wallis.

Late payment is another issue that can cause business relationships to become fractious. Fortunately, companies are protected under UK law, even if they have neglected to include punitive measures in their contracts. In 1998, the Late Payments of Commercial Debts (Interest) Act came into force, which allows those companies awaiting payment the right to charge interest on the amount due. However, the right is rarely used in practice, says Wallis, particularly if the company delaying payment is a large customer.

In fact, says Wallis, there are some circumstances where it is better for companies not to sign contracts. "If the relationship is obviously going to be short-term, or if the goods/services being commissioned is a relatively simple transaction, then there is obviously no need to sign any form of contract," he says.

Paperless contracts

Companies that purchase non-critical goods or services usually do not feel the need to agree contracts because "put simply, they pay on receipt", says Wallis. If the goods do not turn up, there is no payment to make, and so no money is lost and little harm done.

However, even if no contract has been signed, companies can still be obligated to supply goods and services – as well as receive them – if it can be established that there is a "contract by customer practice". In essence, this means that if a business has been regularly supplying a certain amount of goods to a customer over a long period of time, then there could be grounds to say that a kind of contract has been in place and so both parties are bound by it unless they mutually decide to end the relationship.

For example, if a baker has been supplying 1,000 loaves of bread daily to a local store for one year, it may be fair to assume that the baker has been commissioned by the customer to provide such an amount on a regular basis, despite the fact that no written contract may exist between them. Should the store decide not to use that particular baker any longer, it would need to give sufficient notice so that the baker does not lose money manufacturing products that are not needed, as well as try to find a replacement customer.

However, a "contract by customer practice" is not as cast-iron as a written contract. "The success of such a case would depend on what one means by regular supply, long term and sufficient notice," explains Wallis.

According to Wallis, while the law can help companies take recourse against suppliers or customers for poor service and loss of business, there is no substitute for having a well-drafted and well thought-out contract. "Many companies still opt for standard, boilerplate contracts and are inflexible when the business relationship turns sour and are stuck with a supplier that can't deliver, or a customer who won't pay. Companies need to think ahead and include clauses that will offer them greater protection."

Neil Hodge

A wide range of Briefings can be found at www.financialdirector.co.uk/briefing

Useful links

- **For more information, contact Neil Wallis at neil.wallis@macfarlanes.co.uk or call 0207 849 2323**