

Building business value through strong & enforceable contracts



“Strong and enforceable contractual relationships form the backbone of any valuable business. They provide confidence to business owners, investors, trading partners and prospective suitors. So, here’s some tips to help you negotiate, document and manage successful contractual relationships ”

Negotiating the deal: identify key terms by reference to business objectives & risk

Effective contract negotiation requires careful planning, an understanding of your business goals and an awareness of risk. Identifying the risks unique to your deal will help shape the required negotiated outcomes for key terms. When strategising for risk start by considering risks relating to your offering (e.g. failure of product or service delivery) and your customer (e.g. failure to pay, customer solvency, customer delay). Expand the analysis to include the broader commercial and regulatory environment (e.g. impact of new competition, effect of new laws etc.).

Your risk assessment should then feed into your negotiation plan. Your negotiation plan should, in respect of key terms, detail your preferred position and, recognising that we don’t always get what we want, a satisfactory fall-back position.

Examples of key terms

From a supplier’s perspective, the following key terms are common to many contracts:

- a. Supplier warranties.** The key here is not to over-promise. A failure to deliver a product or service in compliance with customer expectations can have significant consequences – for example, a customer’s right to damages for breach and/or a right to terminate.

Ensure the expectations are clearly stated. Exclude or give only very limited warranties but note that the law often implies a range of non-excludable minimum guarantees.

- b. Payment terms.** Strategies to strengthen certainty of payment include: (i) advance payment (or a deposit to cover your initial supply costs); (ii) bank or parent company guarantee; (iii) if payment is tied to acceptance, limit the customer’s ability to unreasonably withhold acceptance; (iv) retention of title clause ensuring title to goods only passes upon payment¹; and (v) incentives through early payment discount and late payment penalties (e.g. interest).
- c. Capping Liability.** Cap your financial exposure through carefully drafted terms which ensure your potential exposure is in proportion to the contract’s value to your business and consistent with your insurance coverage. If you can’t negotiate an exclusion of all liability then consider capping your liability by reference to a multiple of the contract value.

¹ Note the ability to register your interest in the relevant goods (i.e. the agreement containing the retention of title clause) on the Personal Property Security Register. A recommended strategy to ensure your security interest ranks ahead of other creditors.

- d. **Intellectual Property.** Understand the types of IP that resides in your particular offering and always protect your ownership through carefully drafted terms that preserve your IP value and appropriately limit the rights granted to your customers.
- e. **Granting exclusive rights.** If granting exclusive rights to a customer, e.g. territorial exclusivity, ensure the contract imposes appropriate obligations on your customer to properly exploit and 'do justice' to that exclusivity. For example, express exclusivity as being subject to the achievement of a specified sales target. A failure to achieve required targets might entitle you to agreed compensation (e.g. payment for the shortfall) or to otherwise convert the agreement to one involving the non-exclusive supply of your product.
- f. **Termination.** Think through those events which should trigger a right to terminate and also the consequences of termination – e.g. obligations to return confidential information, cessation of IP licences and payment of fees.
- g. **Liquidated Damages.** Avoid lengthy legal battles relating to damages by including an agreed formula for losses to be paid if the customer breaches a key term – e.g. an obligation to purchase a minimum quantity of product or to otherwise achieve certain agreed outcomes.
- h. **Disputes, governing law and jurisdiction.** Often dismissed as 'boilerplate' clauses, provisions relating to dispute resolution can dramatically impact the cost and enforceability of contracts.



Documenting the deal

Here's a couple of tips designed to help you get to 'yes' and in the best possible shape.

- **Consider an MOU for starters.** For complex or strategically important deals use an MoU or Heads of Agreement to 'step' towards a final binding agreement. The shorter document can be used to establish trust, build momentum, secure 'in-principle agreement' and provide a framework for ensuing negotiations.
- **Keep document control.** Not self serving advice, but ... always offer to have your lawyer draft the agreement and to retain 'version control' (i.e. the process of drafting changes agreed during contract negotiations). The drafting party typically ends up in the stronger legal position.

Managing contract performance

The real fun starts after execution. Personnel responsible for managing contractual relationships must understand each parties' rights and responsibilities to ensure you:

1. Act quickly in response to a breach. Failing to respond quickly, and in accordance with the contract, can result in a waiver of your rights and/or a variation to the terms of the agreement.
2. Meet your contractual obligations. A practical way to achieve good contract management is through a contract 'rules book': an easy to use guide, summarising key terms and practical steps to follow in the day-to-day management of contractual relationships.

Not legal advice. This publication is of a general nature only and is not to be relied upon as legal advice. Always consult your lawyer before making legal decisions.