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CONTRACT NEGOTIATION PITFALLS

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Everyone wants a degree of flexibility in their commercial position during contract negotiations; to give a little here and hopefully gain something there.

However, sometimes preserving a position can result in there being no binding contract between the parties. This can be problematic and expensive for parties when a dispute arises.

It is important to keep in mind that there are two practical effects of a contract. One is to bind the parties so that the deal can be done; and two to ensure that if issues arise you have effectively managed any risk that may be attributed to you so you limit your liability.

Most contracts proceed smoothly and each party walks away with that they bargained for. But sometimes, this does not occur and having considered a transaction in its entirety, where do you stand in the event of a dispute, it can save you time, money and your business reputation.

PITFALLS

Often we see clients who have their own standard terms and conditions for supply and send this to the other side. Issues then arise when both parties have standard terms which are exchanged. So the critical question is whose contract prevails?

Even experienced parties can get caught out. In 2012, SDR Australia ("**SDR**") and Leighton Contractors ("**Leighton**") argued in Court about this very point as they could not agree whether SDR was entitled to be paid by Leighton for work it had performed in fabricating steel silos.

SDR claimed it was entitled to be paid a reasonable price as the parties had not executed a formal contract.

Leighton claimed SDR was entitled to be paid according to its Standard Contract, even though it was not signed, because of representations made by SDR it was acceptable. The parties had referred to the Standard Contract during their negotiations and had sometimes acted in accordance with it. The Court decided that in the absence of a signed contract, there was not sufficient conduct by the parties to give rise to a binding contract.

The Judge considered the language used in various letters of intent, as well as the approach of SDR to the negotiations with respect to the Standard Contract terms. The letters between the parties showed Leighton intended to award the contract to SDR on the basis that the offer was subject to agreement on further terms. The letters supported SDR's argument that the parties did not intend to be bound until they signed a written contract.

BUT, HOW DOES THE OUTCOME OF THIS CASE AFFECT YOU?

You should ensure that the following elements of a binding contract are present prior to work commencing on any project:

. **Offer and Acceptance**

There must be a "meeting of the minds" or consensus as to what has been agreed, including the important terms and conditions.

If there are two sets of terms and conditions exchanged, then make sure both parties explicitly agree about which document is going to govern the relationship.

Remember that an offer is not sufficient to make a binding contract. There must be an acceptance of the offer communicated to the other party either verbally or in writing. Sometimes acceptance can be deduced from the conduct of the parties, but if you are trying to avoid disputes, then relying on conduct will not be as good as an unequivocal email or letter.

. **Intention to create legal relations**

The parties must also show that they intended to create a legal relationship. Sometimes issues arise if one of the parties reserves their rights to bring up additional issues or indicates any negotiations are subject to a formal contract or board approval. In such cases, a court might find that the negotiations were not finalised and there was no intention to be bound.

. **Consideration**

If one party has provided consideration under the contract (that is, the value passing between the parties such as the price asked for the exchange of goods or services), then that is usually sufficient to show that the parties intended to create legal relations.

However, consideration itself is a tricky concept. While it is often described as the price of the transaction, the price might not be a monetary value and the benefit received by the entity may not even be tangible.

. **Certainty of Terms**

If the contract terms are vague, incomplete or are an "agreement to agree", then it will not be binding on the parties.

The terms agreed upon should be clear, unambiguous, complete and certain. The contract should not require a party to give a commentary of what each term means.

Certainty of terms will be an issue where, as in the case above, two sets of standard terms and conditions are exchanged. In such cases, we suggest comparing the common terms of each contract and agreeing to those first. Then, discuss and negotiate the remaining contradicting terms to come to an agreement so that there is one coherent contract governing the transaction.

You must be certain as to which contract you are going to rely upon in the event of a dispute.

GENERAL RULES

Contracts can be partly written, partly oral and partly by conduct. You are less likely to get into a dispute with the other party if you have a clearly worded contract that has been signed by both parties.

If you are a party to a contract, then you should be retaining all written communications between the parties, records of telephone conversations and records of conduct. These documents may be important if there is a dispute.

It is important to remember that contracts are risk management tools. While it is difficult to foresee disputes at the beginning of a potentially prosperous business relationship, parties need to be pragmatic.

The time taken and money spent to properly draft a clear contract could potentially save you a lot of time and money if there is a dispute.

IN OUR NEXT ALERT, WE DISCUSS CONTRACT TERMS THAT CAN MINIMISE AND MANAGE RISK LIABILITY WHEN A DISPUTE ARISES.

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