Contract negotiation handbook

Getting the **most** out of commercial deals

DAMIAN WARD

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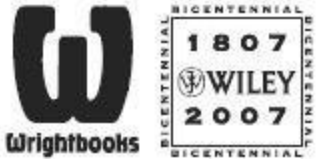

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Disclaimer

For Caroline, Miles and Toby

About the author

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Throughout his career, Damian has assisted countless clients to resolve disputes arising from contracts.

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Introduction

This book will help you get the most out of your commercial deals and contracts.

The commercial world can be a cold, hard place. There are hundreds of thousands of intelligent, hungry and astute people doing deals every day in Australia. Very few of them are suckers. Most know their business and what they want to get out of it on every level — profit, growth and expansion.

When you are in such a competitive environment it is critical that you are prepared. This book will help you prepare for contract negotiations and to do the best possible deal you can.

As a lawyer who has been involved in negotiating many commercial contracts over the years, I have seen a kaleidoscope of behaviour from the incredibly astute to the widely speculative.

Some of those who have negotiated best are those without any 'formal' education. Their insight, intuition and ability to manage the other parties has been educative to watch. At the other end of the spectrum have been those who have MBA or doctoral qualifications but proceeded through the deal with clumsiness and a lack of smarts. This reinforced a maxim I was given by a client when I was a junior lawyer: *What you know is important, but whether you win or lose today depends on how you use it.*

I have also assisted clients with my fair share of disputes over the years. What has ultimately compelled me to write this book is seeing too many people fall into traps that are easily avoided — concentrating on the sexier or more cosmetically important parts of the deal to the detriment of the 'stuff drafted by the lawyers for the lawyers', as one client once told me.

If some of the lessons in this book had been employed at the outset, millions of dollars could have been saved and been better spent on business expansion and improving the bottom line rather than on lawyers in disputes neither party wanted to have.

In a slightly melancholy way, I suppose the other theme of this book is never to openly trust in the negotiation and performance of contracts. My view of contracts is that they are essentially a competition where both parties are seeking to obtain the maximum advantage for themselves. While there may not be winners and losers as there are in a sporting contest, often

one party comes off second best. A contract negotiation is not a place for a group hug or to blindly rely on the word of your counterparties.

In my experience trust is directly related to leverage — he or she with most leverage can be the most trusting. However, there are not that many contracts that I've seen where the leverage is so one-sided as to give the more powerful or stronger party the right to be complacent.

Bearing in mind the general parallel of competition will help. Just as the person marking you in football or on the other side of the tennis court net is a competitor, so is your counterparty in a negotiation.

It is important not to mistake or merge competition with enmity. The best contractual negotiations, and ironically the best contracts as far as performance are concerned, tend to be between parties who negotiate hard for the strongest deal for themselves and both sides mutually recognise this. It develops a sense of respect. That respect in turn is the basis for performance of the contract.

This book is targeted at all people who negotiate contracts, from a junior procurement officer or small businessperson to a senior corporate executive.

From my observation, people at all levels in the commercial hierarchy can fall into similar types of traps and create problems for themselves and their businesses that could be avoided by more focus and preparation.

It is critical that what they want and need out of the deal is clearly known.

This book is in essentially three parts. They are:

- *The contractual environment* — a user-friendly précis of the law and the legal elements of a contract. I have placed an emphasis here on removing the jargon and unnecessary verbosity lawyers speak with in the hope of making what seem complex and strange ideas easily graspable concepts.
- *Doing the deal* — from the first stage or baby steps to the final negotiation of the contract. I provide practical tips and assistance in this process.
- *The end of the relationship* — the third part of the book addresses termination. In particular I deal with the situation where things end badly and a dispute arises.

The key word is preparation. I have often been surprised in the past by the confidence contract negotiators have had in doing a deal that meets all their needs and wants when in fact they are unprepared. They have not fully articulated those needs and wants to themselves — let alone been in a position to negotiate the contract in a dynamic environment with a counterparty who wants as much as they can get in their own best interests.

If there is one message I would like contract negotiators to take away from this book, it is that there is no limit to the amount of preparation you can do at every level for the negotiation. A badly negotiated contract is like a two-storey brick house built on a foundation of sand. It may look good for a period of time but the sand shifts and the walls collapse. A negotiation that has been properly and completely prepared will generally see a house that lasts for as long as the owners want it to.

Given the competitive context of contractual negotiations, I cannot guarantee that after reading this book that you will necessarily have the upper hand in every negotiation and do deals that every time meet your heart's desire. Sometimes the bitter truth is that you will need to do deals with people who have more power, money and leverage. You are not in the position to get the deal you necessarily want.

However, if you still use the tips set out you will be on much stronger ground and are likely to have negotiated a better position than might otherwise have been the case.

What this book is not

You will be unsurprised to know that, like any lawyer, I like to get my disclaimer in early!

This book is a general guide to negotiating contracts and the law of contract. It is not a textbook. It contains a summary of often complex and arcane legal principles.

There is no substitute for getting specific legal advice. If you have an issue in relation to entering into a contract or, alternatively, a dispute arising from the performance of one, talk to a lawyer who is experienced in the field.

Like people, each contract is different. The nature of the issues you have in relation to the contract will depend on factors such as:

- the subject matter of the contract
- the amount of money under the contract
- who your counterparty is
- the respective resources the parties under the contract have
- the importance of the contract to the parties in their business
- the access either party has to legal advice
- the personalities involved.

As a matter of law, your lawyer has specific duties to you as a client. These duties are important and taken seriously by lawyers.

While I hope you can use this book as a general reference and as a guide to understanding the concepts and issues in relation to negotiation of contracts, it cannot replace tailored and precise legal advice!

Part I

The contractual environment

Chapter 1

Springboard and safety net

A good commercial contract has the characteristic of being both a springboard and a safety net. It is both a sword and a shield. It provides an opportunity to expand and grow your business yet must have within it protections so as to ensure that if things go wrong, your position is guarded and preserved to the fullest extent possible.

Optimism is a good thing in a negotiation

There is a natural tendency in negotiating and then entering into a contract to believe that because of your personal experience, skills and attributes, you will be able to negotiate a contract that is watertight.

Rarely does the entrepreneurial businessperson believe there will be any problems under the contract. They think if there are, they will be able to fix them. While commercial braggadocio of this kind has probably got them where they are, I would also bet it's bought them more than a few problems in their commercial lives. This is because in all likelihood they have seen the contract as a springboard and ignored the safety net that should be incorporated in it.

Bear in mind both dimensions of the terms of a contract. Give them equal importance in both your preparation and negotiation of the deal. If you make sure of this you will do your absolute best to guarantee that all possible problems at both the front and back ends have been dealt with prior to signing on the dotted line.

How the contract will give your business bounce

Obviously any person in the commercial world entering into a contract wants to obtain the best possible financial and commercial position for themselves. For a provider of a good or service they want to be able to

charge the highest price the market will bear giving them the highest positive profile and a platform to developing a longstanding and loyal relationship with their customer. The purchaser in all likelihood would like to pay the lowest possible rate for a good or service of the highest calibre with an honourable counterparty who will work with them to ensure the contract gives them all the benefits they hope and desire from it.

In this context, both parties are looking to the best deal in their own interests. They want to enhance themselves in a commercial sense. The springboard component of a contract negotiation is the easy part. If you have undertaken proper preparation and you know your business environment, knowing what you want is relatively unchallenging.

It is the pessimistic and caution-driven safety net that provides more of a problem.

Sometimes even the most skilled of highwire artists slip!

Generally, the safety net is the part of the contract that allows you to address what will happen if there are problems in the relationship with your counterparty. If one party or the other does not perform the contract, you will want to know what the implications will be.

As mentioned in the introduction, one of the big themes in this book is preparation. There is almost no limit to the amount of thinking and consideration you can give to:

- where you want to be during the course of the contract on a macro level
- precisely what you want to get out of the contract on a micro level
- what it will take for you to perform the contract
- what it will take for your counterparty to perform their parts of the contract
- the danger areas (or identifying what are) the potential issues that may arise during the course of the contract
- assessing the possible permutations and combinations of problems and whether at any stage or time a particular type of breach can be

remedied by a patch or a fix
- what happens if your counterparty falls over and can’t perform the contract at all — how important is this contract to the continuation of your business?

The vices of not properly considering the safety net are illustrated by the example overleaf.

Example

Persuasive Advertising Agency is a medium-sized agency that prepares print media advertisements for clients. Virtually all its work is by computer. Advertisements are prepared on tailored software programs and almost all written communication with clients is by way of email or other electronic means.

Given its size, and for other commercial reasons, Persuasive enters into a maintenance agreement over both software and hardware with Total Computer Maintenance Solutions. Total is a small enterprise that has five technicians. Three of those technicians are owners of the business and the other two are employees. The significant appeal for Persuasive was that each of the Total representatives they met came across as professional and personable and that they guarantee high levels of responsiveness. On this basis and just before entering into the maintenance agreement Persuasive retrenches its two internal IT staff.

Soon after the contract with Persuasive, Total enters into a separate agreement with Mega Merchant Bank. It is for further computer maintenance. It was an attractive offer and one they couldn’t refuse.

In the interests of maximising profitability and with the hope of not sacrificing service, Total do not employ any further technicians and retain the five staff in the business to provide client-related services. They think they can deal with both clients with current resources.

On a deadline for a major blitz of pre-Christmas advertising for another client, a large department store chain, the Persuasive computer system crashes. Contact is made with the representatives from Total. Each of the five technicians is working at the bank. No-one can be spared to assist Persuasive. This means that deadlines are missed for

publishing print advertisements for the department store. This means Persuasive is in breach of its contract and loses the client on the basis that it could not deliver what it said it could.

Persuasive's desire to enter into a contract based on price (the springboard) and optimistically believing that nothing will go wrong (and therefore the absence of a safety net) has led to a catastrophic problem. There is no clear and easy solution for it. It may have rights for damages against Total for breach of the agreement; however, depending on how precise the performance measures are in the agreement, this claim may be speculative and therefore problematic to assert. Either way, it will mean time-consuming and potentially expensive court proceedings.

Working out the difference between springboard and safety net terms

The distinction between springboard and safety net terms is quite clear.

It is almost as simple as discerning the front end of the contract from the back end; that is, the entrepreneurial attractive part from the insulation against things going wrong.

The springboard terms will tend to be those that everyone wants to focus on. They will be the terms like:

- What is the good or service to be delivered under the contract?
- When is the good or service to be delivered?
- How much is the provider of the good or service going to be paid?
- By what means are the goods or services to be delivered?
- When will the provider invoice for the goods or services?
- What are the terms of payment (such as 30 days after invoice)?
- Is there any exclusivity in the contract for providing the goods or services?
- Is the contract of limited or unlimited scope?

These are the interesting parts of the contract for both parties.

On the one hand for the provider of the good or service, these parts deal with the big issues like:

- What have I got to deliver?
- When do I have to deliver it?
- How much am I going to be paid?
- When am I going to be paid?

On the flip side, the issues for the purchaser will be:

- What am I going to get?
- When am I going to get it?
- What will it cost?
- When do I have to pay?
- How much of the product do I currently need?
- Is there scope for an uplift?

The safety net clauses will look immediately less interesting. That is because they tend to be more in standard form and do not deal with the sexy parts of the contract — what you are getting or what you are paying for it.

They will tend to deal with matters like:

- indemnities
- whether the agreement is an entire agreement or is a mix of different types of terms
- whether there are any warranties
- the variation provisions
- how the respective parties can terminate the contract and on what basis
- any agreed damages liability for one party to the other if the contract is breached
- what happens in the event the contract is rendered impossible to be performed by one party or the other
- how GST is to be dealt with.

These provisions look generally unappetising to read. They appear to have been drafted by a lawyer who thinks the sky is about to fall on his or her head! They are, for want of a better term, the boring parts of the contract.

However, the importance of the relatively less glamorous part of the agreement should not be underestimated. These clauses are critical. They are as enforceable as any of the more immediately business focussed 'front-end' clauses in the contract. A failure to properly consider where your best interests lie and how the contract should pan out in practice may cause untold difficulties if there are problems in the contractual relationship.

So what does this mean?

A successfully negotiated contract should have attention paid to both the springboard and the safety net. It should not sacrifice one at the expense of the other.

As previously suggested, a key theme in this book is planning before you start talking. The more you think about these issues, and in particular anticipating what might go wrong and what the implications of this will be for you, the better armed you will be in the negotiation to deal deftly, quickly and efficiently with all issues.

Another advantage will be that, as often as not, your counterparty will not be focussed on these apparently more mundane and less interesting aspects of the contract. By having a greater awareness and understanding of all aspects of contracts you may be able to get the jump on the other party to your advantage.

As suggested above, there is a natural tendency to focus on the front-end issues. This is at the entire expense of looking at the back end. This means a person who has given holistic consideration to the contract will be forearmed with views as to what is likely to happen to the contract and what their position will be if things go badly.

The two levels of the safety net

There are two broad levels of thought you should work on when considering your position and negotiating the contract with regard to the safety net. They are:

1 What clauses do I need to include in the contract to ensure that my position is protected if my counterparty breaches or does not perform their obligations under it?

2 What will be the implications for my business if this contracting party either is not willing to, or is unable to, perform their obligations under the contract?

The first of these has a more direct relationship to the precise terms and clauses of the agreement. The types of safety net clauses set out above are internal mechanisms in the contract that can assist you to maximise your position under it. In particular, warranties, indemnities and liquidated damages clauses can be really important aspects in maximising your position.

The second level goes to the viability of the contract. If the contracting party with whom you have entered into an agreement does not perform their obligations, do you have another supplier of the relevant good or service to step into their shoes at short notice so as to ensure minimum business disruption?

This is more a general commercial risk management issue and is often difficult to cater for. Again, liquidated damages clauses and termination clauses drafted in the appropriate and precise ways may be important.

Clauses like this will allow you firstly to exit the contract on the default and claim back any damage you have suffered that is agreed under the contract. Of course you have no legal necessity to agree what the damage will be and you have your rights at general law if there is a breach of the contract irrespective as to whether there is a damages clause in the contract or otherwise.

Later in the book there is a more precise outline of contractual terms and their effect.

Two sides of the coin

Two parties negotiating a contract tend to have different perspectives on what they will and will not do and what they want to get out of the deal.

At various times in this book the perspectives of a seller or a purchaser are adopted.

It is not intended as a manual for either sellers or purchasers. The premise is to set out general principles and guidelines in relation to negotiating contracts for both sides of the deal.

Who can enter into a contract?

Generally speaking individuals, companies or other entities have absolute freedom to enter into contracts. Individuals, companies or other entities can enter into contracts that are good, bad or indifferent. They may agree rights and obligations in those contracts that are commercially sensible or self-evidently unwise.

There are certain categories of people who do not have freedom to enter into contracts. In broad terms they are:

- children
- people with a mental illness
- intoxicated or drunken people
- bankrupts or companies in liquidation.

The right to freely enter into a contract for these people or entities is impaired by virtue of their special difficulties derived from immaturity, compromised circumstances or practical hurdles.

Being a party to a contract — what does this mean?

Entering into a contract is serious business. It means earning certain legal rights on the one hand and committing to obligations on the other.

Example

> You are a procurement manager for a public company that owns a coal mine. You acquire an expensive new dragline mechanism for the mine. You negotiate the terms and conditions of the contract over a significant period of time and satisfy all the requirements of who can enter into a contract. The contract is signed by both parties.

Your company now has a legal obligation to do for the other party what it said it would do. That would generally mean providing information to them as necessary so as to perform their obligations. It will most certainly mean making a payment or delivering goods or services to them at a milestone or a date that is agreed. It may mean making a sequence of acts at different times during the course of the contract. Subject to all of the above elements being satisfied, you have an obligation that you cannot simply abandon or avoid. The company cannot elect that it is no longer bound by the contract. The only rights you will have to terminate the contract will be for breach by the other party or on some other basis that you have negotiated.

The old cliché that a contract is ‘not worth the paper it is written on’ is a brave and possibly unwise comment for a party to it to make. A well-drafted contract that can be enforced is invaluable. You ignore it at your peril and cost. If your counterparty is sufficiently aggrieved by your conduct in not satisfying your obligations to the letter and within the spirit of the agreement, it may be able to terminate the contract and sue you for breach of it. This may have significant financial consequences.

Entering into a contract is a commitment that, subject to various conditions being satisfied, is very hard to break or ignore.

To do so will be to risk serious and decidedly undesirable consequences!

Chapter 2

Contracts — what are they?

Doing deals — the stuff of life

Contracts are the essential heart of any commercial relationship. We all enter literally hundreds of thousands of contracts over our lives, many of which are verbal. They are as important a part of modern business life as walking, talking and breathing.

This book is primarily focused on negotiating commercial contracts. It does not deal with a ‘retail’ contract where you seek to buy food from the supermarket or a movie ticket. In those types of contracts there is little room for negotiation and there is a beautiful simplicity to the relationship between you and the other party — you want what they have and are willing to pay for it (or vice versa). That’s it!

While these essential dynamics are present in larger commercial contracts, the rights and obligations of the parties and the context in which the contract is negotiated is much more sophisticated, subtle, and at times, treacherous.

This section will help you:

- understand what a contract is
- understand the consequences of breaching a contract
- negotiate a contract
- avoid pitfalls in negotiations
- better manage your contractual relationships.

Lawyers can be terrifically presumptuous in seeking to advise clients how to negotiate commercial deals at the business level. This is wrong. No-one knows your industry, and in particular your business, as well as you. You are the one selling or buying the product, good or service. You are the one directly dealing with the representative of a company on the other side. You

are in the middle of the fascinating, compelling and sometimes frustrating dynamic of trying to do a deal. You are best positioned to know what is a good deal and what is bad.

I have no ambition to try to tell you how to do that.

This is not least because negotiation styles are as varied as the individuals in the business community. What works for one person does not work for another.

The negotiation soup

A successful negotiation is a mix of:

- leverage
- strategy and tactics
- personal relationships
- concessions — giving in what does not matter to you but does to them
- judgement and reading the play
- timing
- restraint
- presentation
- decisiveness
- theatrics — the spectrum of leaving a negotiation in a huff to poker-faced silent contemplation
- the ‘bottom line’ — the point at which an impasse may be reached and the parties do the deal or not.

Reading your counterparty, understanding their agendas, knowing their strengths and weaknesses and seeking to position them to your advantage is a subtle synthesis of all of these elements.

No matter what anyone says, there are no hard-and-fast rules of the game to apply.

Successful negotiators exist on intuition and wit as much as wisdom and intellect.

I have tried to provide you with some background information from a lawyer’s perspective that, when combined with your intuition, wisdom and

intellect, will hopefully enhance your position in any commercial negotiation.

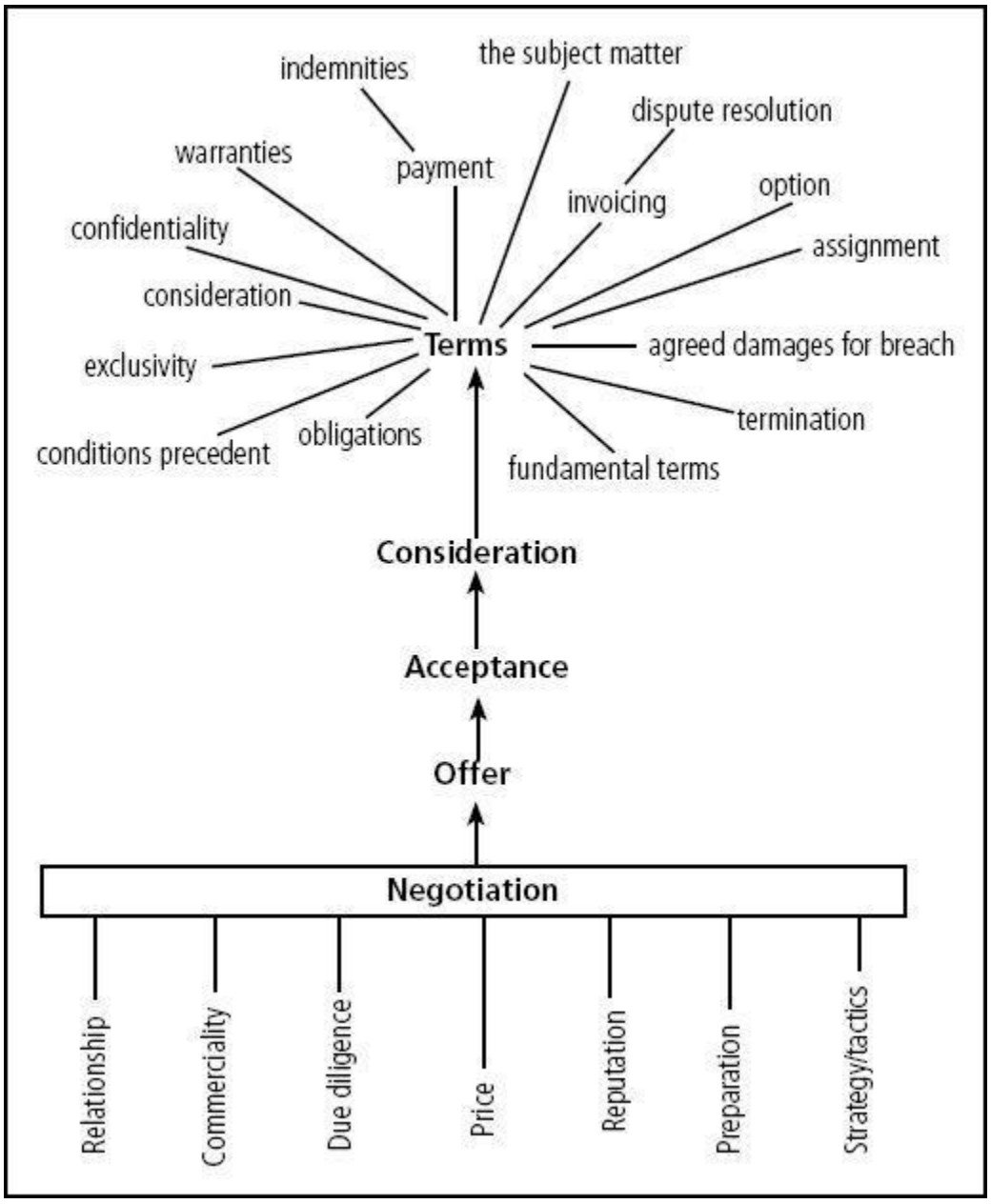
The contract tree

There are three broad stages in entering into a contract:

1 preparation and negotiation
2 agreement of core or ‘trunk’ terms
3 agreement of further terms — the ‘safety net’.

The contract tree pictured in figure 2.1 (overleaf) figuratively represents the three stages.

Figure 2.1: the contract tree



There will be no contract without some type of negotiation. The negotiation synthesises elements of:

- the relationship between the parties
- commerciality
- due diligence and analysing your counterparty
- price — what makes this a good deal or otherwise

- reputation — what is the reputation of your counterparty? Will this have an adverse or positive impact on your reputation in the market?
- strategy and tactics — how to get the best out of a negotiation.

The next stages of contractual formation are the trunk represented by:

- offer and acceptance
- consideration
- terms.

It is necessary for each of these elements to be present for a contract to be entered into.

On the formulation of the springboard and the safety net, the audacious and entrepreneurial (although possibly unwise!) contractual counterparty will stop here. They have their eyes on the prize being the good or service or the income they will earn from providing a good or service. They do not anticipate the need for more.

On the other hand the judicious contractual negotiator will move to the third stage of contractual formation which is the negotiation and discussion of precise terms of the agreement. While these terms incorporate a dimension of the springboard, this is where the safety net comes into play.

It is important to give equal attention to each stage before fully and finally entering into the agreement.

What is a contract?

When it is all broken down, a contract is essentially:

> *an agreement or understanding between two or more parties over an issue or subject matter in which they are to have rights and undertake obligations to the other party.*

Types of contracts

There are, in broad terms, two types of contracts: oral contracts and written contracts.

Written contracts

From a lawyer’s perspective, a written contract is the best form of agreement a commercial party can enter into. This is because all the terms and conditions of the contract are clearly set out within it. It makes proving the contract much easier. It is less likely for there to be a dispute as to what the terms and conditions are.

Where a contract is in writing, the courts generally take the view that the contract itself contains all of the rights and obligations of the parties. However, as you will see below, contracts can be a mix of oral, written and implied terms.

Importantly, when a contract is in writing it is generally not relevant how one or both of the parties understood the contract or what they intended it to be. Courts are very literal. They look at the language and construe or interpret the words used; the words ‘speak for themselves’. The court considers it its job alone to understand what those words mean in their plain and ordinary use. This is because courts generally place faith in parties to express contracts to reflect the bargain or the deal they have negotiated.

However, courts are filled with cases in which contracts for the sale of expensive goods and services are by words only.

Oral contracts

An oral contract is when an agreement is made only in spoken words between two parties. It is as enforceable as a written contract. However, there is a significant practical problem. Often the parties have different views of what the contractual terms, rights and obligations are. This is particularly so when Smith is alleging against Jones that Jones’s breach of the contract has caused Smith significant financial damage. Smith wants Jones to pay for the loss caused by Jones’s conduct. In many instances, whether driven by opportunism or a genuinely different understanding of what Jones was to do under the contract, a dispute develops as to what obligations Jones had.

As you will appreciate, oral deals are uncertain. If there is disagreement as to what the deal was, it is necessary for a court to determine on the basis of the evidence presented which party's version of events is more persuasive or objectively likely. This is a complex and difficult exercise when Jones is saying black and Smith is saying white. The presence of contemporaneous documents reflecting one version of events or evidence of other witnesses may be extremely useful.

Example — part 1

Prosperous Mining Company has a problem with underground water pipes that are necessary for the efficient conduct of part of its mining operations. It urgently needs a blockage fixed. Industrial Plumbers is a business that Prosperous Mining has regularly contracted for all of its plumbing services on the mine site.

There has always been a good relationship between the two businesses and Industrial Plumbing have always provided good service. Prosperous Mining has been happy with the company.

Industrial Plumbing is contacted urgently to visit the mine to fix the pipe problem. The scope of work identified by Prosperous Mining is a blocked pipe. Industrial Plumbing, when commencing the work, sees that the pipe is partially damaged. It has two options. It could patch the pipe as a stop-gap or completely replace it. It elects, given the urgency, to completely replace the pipe. This is the best fix.

Industrial Plumbing sends an invoice to Prosperous Mining. Prosperous Mining alleges the price is too high, saying it did not agree to replace the pipe, only to repair it. Secondly, Industrial Plumbing has incorporated a premium in the price given that it responded urgently, time effectively and efficiently. It essentially kept the mine open by what it did. It meant they had to abandon other jobs and had to manage other unhappy customers. It always charged a premium for urgent work. It has charged Prosperous in this way before.

Prosperous Mining alleges that replacing the pipe and charging the premium were not part of the contract.

Bear in mind it was an oral contract where a representative of Prosperous Mining contacted Industrial Plumbing and simply requested that they attend to fix the problem. There was no discussion of the precise terms of the contract.

Industrial Plumbing feels entitled to the complete amount in its invoice given it did the best thing by Prosperous Mining by replacing the pipe to avoid further problems. And, given prior practice, it considers the premium charge as reasonable.

Neither party here is morally in the wrong. Industrial Plumbing's view is formed by prior conduct and a general sense of what is commercially right. On the other hand Prosperous alleges that the contract was a narrow one and did not involve replacement of the pipe or the charging of a premium. Prosperous Mining may contend that if it had known that this was how the job was going to be undertaken and costed by Industrial Plumbing, it may not have engaged it.

It is a dispute about the terms of the contract. Uncertainty prevails. Assumptions and expectations have clouded views about what the contract is and what the parties had to do under it.

Let's tweak the facts in that example slightly.

Example — part 2

> Say the representative of Prosperous Mining, when first speaking with the principal of Industrial Plumbing, said that attendance on the site is conditional upon the 'okay' from the site foreman. That authority was never received. The principal of Industrial Plumbing took that as being only a formal matter and one that would be taken care of by the Prosperous Mining representative. He did not see that as a necessary step to occur prior to getting the work done. There was a breakdown of communication. What was said was not properly understood. On the other hand the Prosperous representative thought they said something that was not actually reflected in the words they used. The work is done and the costs incurred.

Here we have two parties who are likely to have vastly different stories as to the effect of terms of the conversation. The crucial part of the negotiation was when the work was to be done and whether there was a step prior to the

work starting. One party says it was made clear. The other party says it was not an issue.

Again, neither party is necessarily lying. There are two views about the implications or meaning of the conversation. Of course there is no sound-recording of the conversation. It is not possible to objectively prove what was said. It is necessary for a court to decide which of the two versions of events is more probable.

Complicating this is the presence of past practice.

Example — part 3

> Assume that in the past Industrial Plumbing has been called on short notice and has attended the site without need for further authorisation. This has happened on numerous occasions. It has never been delayed in doing emergency work on the mine site once a call has been received from a representative of Prosperous Mining seeking its help. There is nothing in writing.

It is likely a dispute will develop as to what the terms of the contract were, what was asked for, what was delivered and what it should cost. They have two different views of the same event. The consequences of those views are dramatically different.

Oral contracts are generally to be avoided for this reason. Courts are littered with cases involving alleged breaches of oral contracts. The party against whom the allegation of breach is levied says, ‘I never agreed to that’. There is a significant fight about what the rights and obligations were, let alone whether they were breached. These disputes can be costly and are inherently risky for both sides.

Judges do their best to determine a case on the evidence before them. However, judges are also in a difficult position. They undertake no independent enquiry of their own as to the credibility or honesty of the two parties. They have before them, for all intents and purposes, two honest people with vastly different views of the facts and contract. Often it is difficult for a judge to discern if one is lying or whether the parties merely have different views of events.

Oral contracts are dangerous.

In a commercial context if you are dealing with a counterparty that insists on an oral contract only, your antennae should be raised.

In my experience parties who want to maintain only oral contracts are looking to self-interestedly preserve flexibility in their commercial arrangements. Rarely is a party that wants to maintain this flexibility thinking of you. They are looking to keep their ability to perform the contract flexible and in a way that best suits them, practically or financially. Again, what suits them may not suit you. Beware of the oral contractor!

Are all contracts equal?

There is no legal difference between an oral and written contract. They are equally as binding. However, as you will have seen from the Prosperous Mining example, there is a vastly different level of proof in establishing the terms of the contract between oral, written and implied contracts.

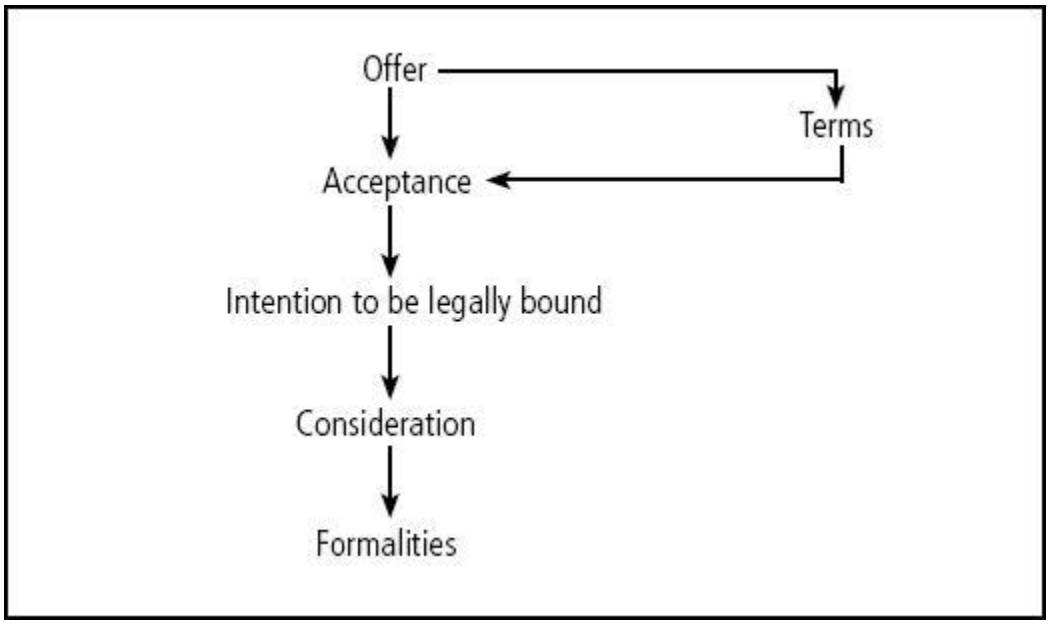
While speaking simplistically, a contract is a contract is a contract — proving it is a vastly different endeavour.

It is on this basis that I display my prejudice for written contracts in every situation where the transaction is of significant size and scope or has any moderate level of complexity to it.

What are the elements of a contract?

The elements of a contract are illustrated in figure 2.2.

Figure 2.2: the elements of a contract



Offer

Without an offer there is simply no basis for there to be a contract or agreement. It is the first stage in the process of entering into a contract. However, as silly as it seems, discerning whether an offer is made is not as simple as you may think. The key element is whether the person making the offer will be bound if it is accepted. An offer can be made to one person or a class of persons. An offer can be revoked or withdrawn at any time prior to it being accepted.

Example

An events company is invited to provide a credentials document to organise the Prosperous Mining Christmas party. Prosperous Mining, after reviewing the credentials document, sends a letter to the events company requesting only some of its services as set out in the credentials document and precisely identifies them. It offers to purchase those services for $20000.

Again, using the example of Prosperous Mining and the event company, the event company says in correspondence back to Prosperous Mining, ‘We are happy with the scope of the work but it will cost $30 000’. This is not acceptance of the offer. The acceptee (the event company) has sought to vary the deal.

Say the counter offer by the event company for the same scope of work for $30 000 did not have a closing date. The Christmas party is scheduled for 15 December and Prosperous Mining accepts the offer on 10 December. The contract is not performable given the short time frame given. It is likely that a court would find the counter offer was open for acceptance for a reasonable time after it was made, being a period that would allow the parties to prepare and perform their obligations under the contract. Given the nature of the contract, it calls for sourcing a room or venue and other steps under the scope of work. As we all know, organising functions at Christmas time is an extremely complex and sophisticated commercial undertaking! It requires military-type planning and surgical precision. Also it requires the wisdom of a seer in that arrangements need to be made months ahead of the actual date.

This is an offer that can be accepted on its terms. It is simple and complete. Further negotiation is possible, but the deal done will not mean accepting Prosperous Mining's offer.

Responding to an offer — reject or accept? Do I want a contract?

Acceptance is the second stage of establishing a contract. If there is no acceptance, there can be no contract. There are a number of simple rules in relation to deciding whether an offer has been accepted or not. They are:

1 The acceptance must be absolute and unqualified — that is, it must not have any conditions on it. A conditional acceptance will not constitute acceptance of the offer made. Those conditions are being imposed alone by the accepter. It is not an acceptance of the offer made but a different deal.

2 If the offerer has indicated any conditions that must be satisfied before the offer can be accepted, those conditions have been complied with.

3 An acceptance is in reliance on the offer made and not on some other basis or misunderstanding.

4 Acceptance must be communicated to the offerer. It is possible for the offerer to indicate that it is not communication of

acceptance although this will be an irregular and commercially infrequent situation.

Is it an acceptance or a counter offer?

Sometimes the lines can be blurred between what is an acceptance and what is a counter offer. A party may look like it is accepting an offer by adopting 90 per cent of what is offered. However 100 per cent is the mark that needs to be reached. An ‘acceptance’ that adopts part of what is offered and changes a component of it is a counter offer. That reverses the roles. It is up to the original offerer to decide whether to accept the counter offer or not. A counter offer is a rejection of the initial offer.

In the Prosperous Mining–event company example, the offer to do the work by the events company for $30 000 is a counter offer. It may be accepted as a counter offer, however that would shift the positions of offerer and accepter. The event company would become the offerer and Prosperous Mining the potential accepter.

How long does an offer hang out there?

An offer lasts until one or more of the following occurs:

- it is revoked by the offerer
- it lapses on its terms (such as being open for seven days)
- the offering company is wound up or a person making an offer dies
- the accepter does not fulfil all the conditions in relation to the offer
- the party receiving the offer makes a counter offer
- a reasonable time passes from the time of the offer being made.

The most uncertain position in the above scenario is the passing of reasonable time from the offer being made. There is no neat or clear formula of law that allows a party to decide whether an offer is still available on the basis reasonable time has not passed. It very much depends on assessing the nature of the offer, the nature of the acts required for acceptance, the subject matter of the contract, the general commercial circumstances of the parties and any prior dealings between them. It is an

issue that is considered in all the circumstances of the commercial relationship.
It is likely in this context that the court would find a reasonable time for accepting the counter offer was not five days before the appointed time for the function. Therefore, the offer had lapsed at a prior time to the purported acceptance by Prosperous Mining.

Intention to be legally bound

It is not enough to have offer and acceptance. It is necessary for the parties to the contract to agree to be legally bound. That means that implicitly one party understands the other may sue it if it breaches the contract.

It is extremely rare for a contract to expressly state that the parties agree to be legally bound. In this context, courts have developed rules of thumb as to interpreting offer and acceptance and whether there is a contract or otherwise.

Parties to agreements in relation to social or domestic matters are assumed not to intend legal enforceability (such as a son telling his mother that he will meet the midnight curfew. There is generally a serious question of integrity in a promise of this kind!).

Parties to agreements concerning commercial matters do infer legal enforceability (such as when an accountant performs services for a client and is not paid, there is an avenue to sue and recover the fees).

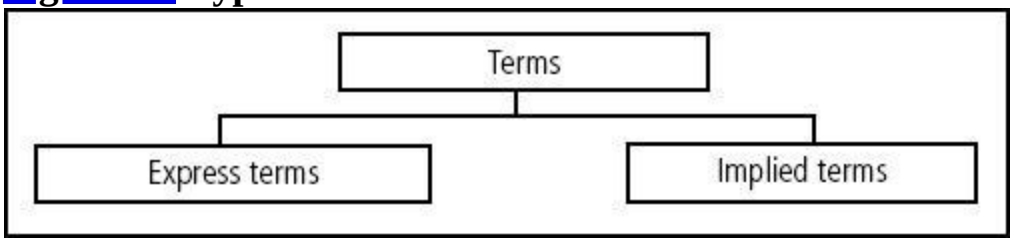
Consideration

Another essential element of contracts is consideration. Consideration is an elusive concept. It essentially is an act involving legal detriment or giving something of value in exchange for a promise for a good, service or act. For example, consideration for the purchase of a pair of shoes is the price of the shoes themselves. Without consideration there can be no agreement or contract.

The terms of the contract

The terms of the contract are its contents. Like contracts themselves, there are two types: express terms and implied terms, as illustrated in figure 2.3.

Figure 2.3: types of contracts



Express terms

Express terms are terms that are overtly agreed between the parties. In a written contract, express terms are the parts of the contract that are openly in writing and to be clearly understood by the parties.

On the other hand, with oral contracts, identifying express terms can be more difficult. They still exist, but because words are ephemeral, so often are the express terms. There will regularly be a difference of opinion as to what was said, and therefore what the express terms of that contract will be. Again, written contracts are vastly preferable.

An express term, as the name suggests, is an express agreement of the two parties as to the terms of their deal.

Example

Carbon Refining undertakes to provide 10 tonnes of carbon by no later than 5.00 pm on the Thursday of each week to Inky's Printing, a business that makes printing materials. The contract sets out the quality and nature of the carbon required. It sets out that the delivery time is an essential term. It clearly mandates that it is the responsibility of Carbon Refining to deliver the carbon to an appointed address within the time frame agreed. These are all terms that are expressly agreed between the parties. Failure to comply with these terms will constitute a breach of the agreement.

Carbon Refining conducts its business 24 hours a day. On a number of occasions it attempts to make its weekly delivery of carbon to Inky's Printing at 11.00 pm on a Wednesday night. Inky's premises are shut and therefore no-one is there to receive the delivery. The carbon company alleges breach of the contract by the print stock company. It says there is nothing in the agreement mandating when the delivery must be made other than before the benchmark time and on a weekday. It wants to work the

contract to its best advantage and for it that means delivery late on Wednesday night. It is how it best manages its clients' demands across all of its contracts on a weekly basis. A dispute develops in relation to whether the delivery of carbon at 11.00 pm on a Wednesday night is properly in performance of contractual obligations.

Put the boot on the other foot. Say Inky's sought to terminate the contract on the basis of three purported deliveries at 11.00 pm on a Wednesday night. Because Inky's was closed Carbon could not get the goods to them until 5.45 pm on the next Thursday. On each occasion the deliveries were 45 minutes after the 5.00 pm deadline. It did not cause any great commercial prejudice to Inky's. It inconvenienced the inventory manager and no one else. However, Inky's purports to terminate the contract on the basis of these breaches by Carbon.

Implied terms

A contract may also comprise implied terms. An implied term is necessarily ancillary, or secondary, to the express terms.

It is not possible to have a contract without express terms but with all implied terms. There are broadly two types of implied terms. The first is a term implied as a matter of fact. The second is a term implied as a matter of law.

A term implied as a matter of fact is to assist the parties in facilitating their commercial agreement.

Courts will imply terms to contracts so as to allow the parties to honour their obligations and enforce their rights. In this context the court looks at the contract and sees what terms need to be implied to it to make it commercially effective.

There are three main circumstances where courts will imply terms as a matter of fact. They are as follows:

1 where there have been past dealings between the parties and a certain assumption or understanding has developed between them

2 where there is an industry-wide custom or trade usage in relation to the matter of the subject of the contract

3 where it is necessary to give business efficacy to the contract, that is, make it commercially executable.

There are certain terms implied by law.

Terms implied by law are, for example, that corporations providing goods and services must provide those goods and services in a way that is fit for the purpose for which they are required. Goods must be of merchantable quality and services must fulfil their requirements.

Similarly, there is a term implied in all commercial contracts of good faith and reasonableness. That is, all parties to the contract must behave reasonably and good faith in relation to their counterparties.

These are legal principles that are implied in every contract. In some circumstances they can be contracted out, but this is quite rare. It is generally considered as a matter of law that implying terms of this type is a good thing in contracts because it assists parties in honouring their obligations and exercising their rights fairly, justly and appropriately.

If a court was invited to determine this dispute, it is possible it would imply a term to the contract that delivery must be within business hours. This is to give business efficacy or effect to the contract. While the parties do not expressly contemplate in their agreement times of a day when a delivery may be made, a court may consider the delivery time being at Carbon Refining's discretion to be uncommercial. Bear in mind here, the general rule is to give practical business effect to the contract.

It is possible a court may find that alleged termination of the contract by Inky's, given the technical and inconsequential nature of the breaches fails to meet this obligation of good faith and reasonableness. Inky's is neither showing good faith or reasonableness in relying on these minor breaches as a basis to attempt to terminate the contract. Again, the court has implied a term to give the contract business efficacy and to give effect the bargain between the parties.

It is the general tenor of the law not to let parties avoid contractual obligations and commitments on the basis of minor and trifling breaches by another party. The purpose of a contract and the impact of the breach on the party are matters that the court may closely consider.

Formalities

Some contracts must be formalised in writing as a matter of law. These contracts tend to be important contracts dealing with significant commercial

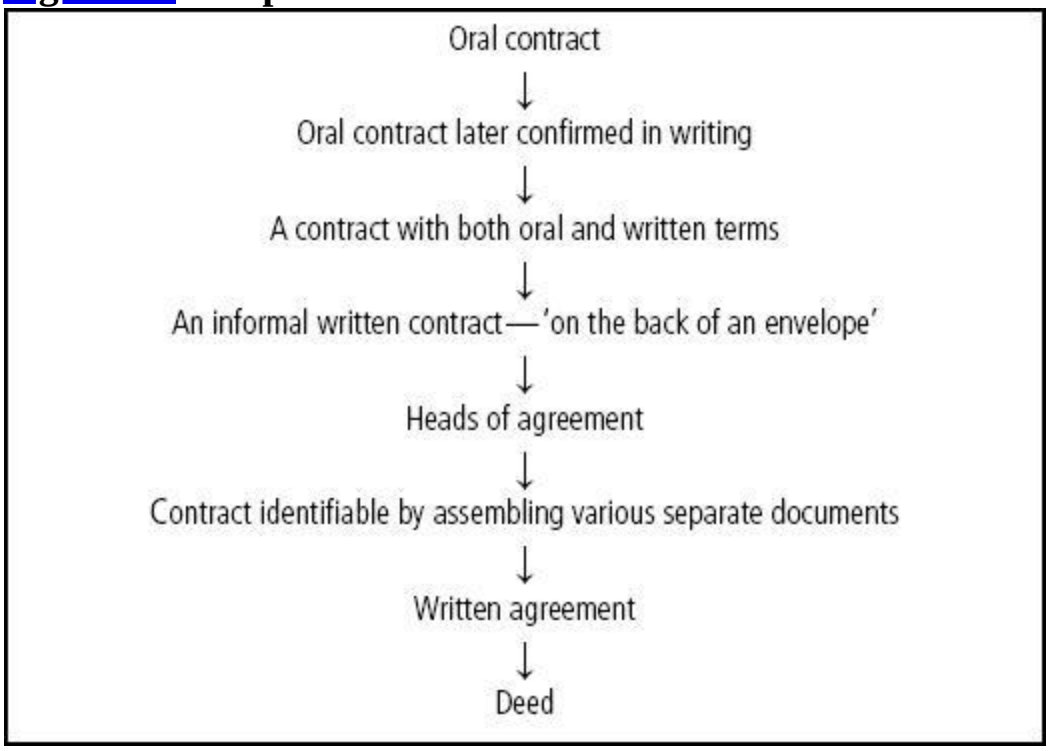
issues like the sale or purchase of land, agency agreements or certain significant commercial promises.

From blurry to precise — the evolution of contracts

As stated above, a written contract is vastly preferable to an oral contract in almost every regard. In this sense I have broadly identified eight stages of a contract going from uncertainty to certainty. Each of these types of contract is enforceable. Each of them is binding. The emphasis here is on being able to clearly, precisely and categorically identify relevant contractual terms. In general terms the greater clarity the better your position is.

Figure 2.4 represents the evolution of contracts as I see them in the evolution of certainty. Each of these forms of contracts are dealt with throughout this book in greater detail.

Figure 2.4: the phases of a contract



The essential message here is that detail is important and valuable.

Using examples to illustrate the movement from uncertainty to clarity, each of these stages is set out in the following pages.

Oral contract

An oral contract is one reached by a conversation and no more.

Example

> John goes into an electronic store to buy a television. He asks a lot of questions of the salesperson as to the quality and attributes of the televisions he is looking at. Many representations are made to him. Based on strong praise given by the salesperson for a particular television, he buys it, spending $5000. He is given a receipt although it contains no terms and conditions and even omits to indicate a returns or refunds policy.
>
> This contract is essentially an oral contract. While the invoice may be a partial record of it, its terms are oral. The written record is merely a receipt. It does not assist in determining the terms and conditions of the deal. It may be that John complains about the television's lack of performance in due course and wishes to sue the retailer for breach of contract. He may allege that the television either did not have the attributes the salesperson spruiked it as having or alternatively it did not perform to the level as had been represented.

John will be mired in a puddle of uncertainty. It is likely there will be two substantially different versions of events as to the oral contract. It is possible there will be different views as to what the contract was. John has a significant problem in establishing the terms of the contract, let alone their breach.

Oral contract confirmed in writing

This is when an oral contract is reached and later confirmed in writing.

Example

> Jane wishes to have spotlights installed around her house to illuminate her outdoor areas. An electrician provides a quote for the work. After speaking to the electrician and

reviewing the quote Jane decides she will need only half the number of lights she requested the electrician install. She telephones the electrician and asks him to come back and install lights in specified places around the home and expressly tells him she will only need half of what she had originally thought. Jane, in a fit of contractual exuberance, sends an email to the electrician confirming the terms of the agreement. The email records the terms of the conversation and the basis upon which the electrician will do the work. It also requests that the electrician complete the work by a certain date.

Jane has wisely sought to record in writing the agreement between the parties. While the contract is oral, and the later email is merely a record of it, it substantially improves her position in the event there is a dispute about the subject matter or the performance of the contract. This is because the electrician conducted the work after he received the email and read it.

A contract with a mix of oral and written terms

This is when some of the terms are in writing whereas others are oral and not recorded anywhere.

Example

Safety First Insurance Company enters into an agreement with Renovation Management Consultants to undertake an analysis of its management structure and provide recommendations as to reforming this part of the business.

After negotiations an in-principle decision to proceed is made. Renovation send a general form letter of retainer to the insurers. The letter sets out in very general terms what they are to do and their rates.

Halfway through the job there is an update or status meeting. The insurers are very happy with the speed and progress the management consultants are making. They expand the range of the works to include analysis of their mid-tier management also. This deal is done in a meeting in the boardroom of the insurer. The management company do not send an amended retainer.

The work is continued.

This is a situation where there is a mix of oral and written terms of the contract. The initial retainer only sets out or represents part of the ultimate deal done between the parties. There was a variation and expansion of the contract halfway through, which was oral. Again, this is as enforceable as a written variation subject to it being proved by the party seeking to enforce it.

Again, the party seeking to enforce this part of the contract will suffer the same potential difficulties as a party seeking to enforce an oral contract.

Informal contract in writing

Example

A landowner, Sweet Developments, and an excavation company, Happy Digging, meet to discuss a potential contract for excavation works on a development site. Happy and Sweet talk about the work involved. Sweet is erecting a large block of flats on the land and given the nature of the contract and the urgency Sweet has, they sketch out what Happy is to do on a tattered piece of paper.

Given the urgency Sweets impresses upon Happy, the work starts the next day.

The sweat-stained, dirt-smudged paper broadly outlined the scope of the work, the price per tonne of the excavation and a 10 per cent premium if the work were to be completed within a week. A dispute arises in relation to the premium. Sweet disputes its obligation to pay it and Happy seeks to rely on the informal contract.

Happy’s position is substantially improved by there being terms in writing that were initialled by representatives of both parties even though not in the terms of a formal and fully considered agreement. Hopefully the document will be sufficiently clear to state what the parties are to do even though it may be eccentric in form.

Heads of agreement

An agreement of this kind is a stepping stone to something more complete and generally formal.

Example

> Big Bank wishes to acquire Little Bank. There are high-level negotiations between the senior management of the respective banks and an in-principle decision to proceed is needed. The decision is contingent upon due diligence or investigations by Big Bank as to the representations made by Little Bank's management. Big Bank wants to tie Little Bank into exclusivity of dealing with it for a period of time. It also wants to bind Little Bank to merge when and if the due diligence process is successful. It proffers a heads of agreement that sets out various high-level terms and conditions of the merger/acquisition and binds Little Bank to a confidentiality undertaking. The undertaking stipulates that Little Bank will not deal with any other party as to a sale of its business (or part of it) for a set period of time, nor will it disclose the nature of its negotiations with Big Bank.

In essence, the agreement keeps Big Bank's options open. It is not obliged to report back to Little Bank at any stage as to the terms of the due diligence or whether it has been successful. The deal is a platform to allow a bigger deal to be done. Within itself, the deal is not for the transfer of any substantial asset but rather to allow further exclusive negotiations to continue.

Exchange of letters or assembling documents to compile a contract

In this instance a number of documents are assembled to reflect the contract as a whole.

Example

> Lemon Dry Cleaners and a customer, Richard, have been in dispute in relation to an allegation Richard made that the dry cleaners lost a very good suit he had left with

them. There were no written terms of the dry cleaning contract.

After a flurry of letters making allegation and counter allegation, Richard and Lemon resolved their differences. He was to get $400 in dry cleaning free of charge for no more than six months' duration. The offer came in a letter from Lemon to Richard. He replied accepting the offer.

This is a binding and enforceable contract when the two letters are assembled constituting the offer and acceptance. There were no other terms and conditions to be agreed or unresolved. It was a simple contract in brief terms setting out the deal.

Richard and Lemon had resolved all of their differences on an enforceable and fully concluded agreement.

Written agreement

As the name suggests, the deal is set out in full detail in a document signed or assented to by the all parties.

Example

Fast Buses sought to buy Toot. Both were bus companies operating services within the metropolitan area. Fast Buses's lawyers draft a detailed agreement setting out precisely all of the terms and conditions. After some discussion on its wording, it is signed by both parties and the contract performed.

Deed

This is a different form of written agreement. It will generally look similar to a properly drafted written agreement, however it contains some additional formality. Without going into great detail, its primary difference is that it requires no consideration for it to be enforceable.

Now I am in the contract, when do I have to start performing it?

This will depend very much on the terms of the contract itself. Sensible negotiators will pay close attention to when their obligations under the contract start. This is an issue that can be of huge importance. This is dealt with more fully below.

There are generally three timing sequences as to when your obligations under the contract start:

1 You have reached the final stage of negotiation and the terms are settled. The express terms have been agreed. The parties intend to be immediately bound to the performance of those terms.

Example

Super Mining wants to purchase three heavy tipper trucks from Tough Trucks. A representative from Super Mining attends the Tough Trucks yard and pays an order deposit. An order is made by Tough Trucks and the parties intend to be immediately bound to this contract. Tough Trucks is obliged to deliver and Super Mining is obliged to pay.

Say the deposit is still paid by Super Mining but before it proceeds with fully completing the contract a maintenance agreement will need to be entered into where Tough Trucks send representatives to the mine site to maintain and service the trucks. The payment of the final amount and delivery of the trucks is contingent upon this service and the maintenance agreement being resolved.

An in-principle deal is done between Tough Trucks and Super Mining for the purchase of three trucks. However, there is still negotiation on price and a possible discount for buying three trucks at once. Further, the maintenance agreement needs to be resolved in full and final terms and a written agreement dealing with both the purchase price and related issues and a service and maintenance contract need to be agreed before either party intends to be bound at all by the contract.

2 Alternately, the parties have agreed the full terms of the contract, but make the performance of some of the obligations in it subject to a further written agreement or an event occurring.

3 The parties have, in principle, agreed the terms of their commercial relationship but they do not wish for there to be any obligation by either party until a formal contract is executed or a particular condition or event occurs that triggers their rights and obligations.

In the first two categories the parties are immediately bound. In the third category the parties are not bound unless an agreement is entered into or a trigger event occurs.

Your commercial circumstances will dictate which of the three contracts you wish to enter into.

But we didn’t have a deal — I didn’t agree to that!

The boundaries between oral and written contracts can be fluid. A contract can exist that has a mix of written, oral and implied terms. This rarely arises when there is a formal document. Here the parties turn their minds to what all the rights and obligations of the parties are to be. Terms may also be implied, but rarely will oral terms be imported to such an agreement.

Where an agreement is by an exchange of letters or an ‘order and quote’ there is much greater scope for there being ambiguity in what is to be said and done.

You need to decide at the outset whether you wish to have a looser oral arrangement or something more formal. On the other hand you may not want an agreement and therefore no rights or obligations until a document is drawn up clearly, precisely and definitively setting out those rights and obligations. If this is the case, it is fundamentally important that you communicate this to your counterparty at the outset. This should preferably be done in writing. A short letter, fax or email to your negotiating counterparty telling them they should consider no agreement to be entered into until a deed, agreement or other identified form of document is

negotiated, resolved and executed. This will avoid any uncertainty as to whether you have entered into a contract during the course of negotiations.

Of course there are two sides to every story. You may enter a negotiation on the assumption that you have no obligation to be bound until a formal deed is signed, sealed and delivered. Your counterparty may not share this assumption. On this basis they may take steps immediately after the negotiation on the assumption an oral contract has been entered into. This can be a cause of great heartache and dispute.

This potential unpleasantness can be avoided by a simple statement at the start advising that at no stage should any contract be considered to be entered into by the parties unless it is set out in writing or the trigger event has occurred.

An oral statement to this effect is as valid as if it is in writing. However, you come across the same problem in relation to oral contracts. It is much easier to prove your position if it is in writing. A conversation can be the subject of dispute and your counterparty may deny you ever said what you did.

There is a risk in any context when talking about contracts where your intention, desire or position is not set out in clear and unambiguous written terms.

That document doesn’t reflect what we agreed — how do I fix it?

There is a basis for having an agreement that does not reflect the bargain struck between the parties fixed. However, it is extremely difficult. This circumstance often arises where there are different levels of sophistication with the contracting parties. If there is a party who regularly enters into detailed written contracts and who understands the ways of contracting in sophisticated terms, and a party on the other side who is less knowledgeable, it may be that the sophisticate is able to get the honest but naïve party to sign an agreement that may not reflect those terms and be more beneficial to the sophisticate.

Example

Big Dump Waste Management enters a deal with a two-person haulage business. The subject matter of the contract is the disposal of certain types of liquid waste held by Big Dump, which it does not have facilities to deal with. A deal is done where a rate is agreed per delivery. That flat rate is agreed whether the truck is full or has only one barrel on it. The haulage company can only make money out of the contract if it is paid the full amount on each pickup. It cannot make sufficient profit if it is paid on a per-barrel basis.

A contract is quickly drawn up by the waste company. It is a sophisticated contracting party. It has entered into numerous contracts over the years and its in house counsel and procurement team are extremely savvy. It gives a written agreement to the small haulage company which provides that it will be paid per barrel of deliveries. The document is provided on the basis it reflects the deal and is a fait accompli. Statements of comfort are made that the quicker it is signed the quicker the relationship can start. Unwisely, but possibly understandably, the haulage company signs the agreement in good faith.

It sends invoices for its services.

An objection is raised by the waste management company that it is overcharging.

It responds by saying it charges per delivery, not on barrel volume. A full truck costs the same as a relatively empty truck. The waste management company points to the agreement on a per-barrel basis.

Take again the example of Big Dump and the small haulage company. If three separate orders were placed by Big Dump to collect barrels of waste and on three separate occasions there is no appearance by anyone on behalf of the haulage company and the waste remains on the waste management company site, this may constitute a breach of an essential term of the contract. The heart of the contract is for the waste to be hauled and disposed of appropriately by the haulage company. It is simply not honouring its obligations. Breaches in these terms are likely to justify termination of the contract for non-performance.

Given that Big Dump is the more sophisticated negotiating party, it may incorporate a stipulation that only it has the right to terminate on 30 days' notice. The agreement may be silent as to the rights of the small haulage company. This does not mean the haulage

> company has no rights at all. It simply means their rights are at general law — on the basis for the breach of an essential term of the contract by the waste management company. Big Dump has, using its commercial sophistication, given itself maximum commercial flexibility by allowing itself to terminate without cause or reason on 30 days' written notice.

It may be necessary for the small haulage company to seek rectification of the agreement so the written agreement reflects the deal done between the parties. The deal in the document does not reflect the commercial terms agreed. Either by deceptiveness or a unilateral renegotiation of the contract, the infinitely more experienced waste management company did not incorporate the deal agreed in the document.

Putting aside issues of commercial honesty and ethics, it may be possible for the party in the weaker position to seek to rewrite the terms of the contract so that it reflects the agreement struck.

It is necessary in this context for the party who complains the agreement does not reflect the deal to set out in clear terms what the contract should have said. It will then need to prove that the agreement was in the terms it alleges. This, yet again, is easier said than done. Often the more sophisticated party will simply rely on the contract and say with a shrug of the shoulders, 'The contract is the contract! It is what we agreed. There is no basis for it to be rectified.'

It is hard to show that a written agreement does not reflect the true bargain struck between the parties. The precise circumstances of the negotiation and, often more importantly, the execution of the agreement will be critical. You will need to gather all the information you can explaining the circumstances under which the contract was negotiated and executed. That explanation will need to be sufficiently credible.

A court will not rectify the contract merely because you do not like the way it is expressed or because it seems to be favouring one party more than the other. If the agreement reflects the deal struck between the parties in general terms, the court will not rectify the agreement.

It is extremely important that you closely scrutinise the terms of the contract prior to entering into it. There is no part of a contract that is unnecessary to closely read. There is no aspect of the agreement that is immaterial or unimportant.

There is no easy way to fix a bad contract that you believe does not represent the deal you struck with the counterparty. Bear this in mind at the front end of the negotiation and, more particularly, when the deal is being documented. This will save you significant heartache, anguish and potentially significant sums of money during the course of the contract (not to mention the benefit of avoiding court proceedings!).

I am not happy — how do I get out?

There are broadly two ways to terminate the contract.

They are for breach by the other party or under a right of termination in the agreement itself.

The law provides that if there is a significantly serious breach by the other party to the contract you have a right to terminate it and sue them for damages you have suffered as a result of their breach. It is important that this right is only conferred in relation to serious breaches. Minor or trifling breaches do not allow you to terminate the contract. You may still have a right to claim damages for those breaches but you cannot terminate your rights and obligations under the agreement.

This applies equally to all parties under a contract.

The alternate course is where there is a right under the agreement for parties to terminate. These rights are generally in one of two circumstances. The first is a right to terminate for no cause at all on a reasonable period of notice (generally identified in the agreement as being 30, 60 or 90 days). There is no magic to this time frame. It is a matter to be agreed between the parties.

The other type of a termination clause is termination for material or substantial breach. This largely conforms to the right conferred at law generally to allow a party to terminate a contract for breach of its terms.

The contract is terminated — what does this mean?

The termination of a contract is effectively the death of it. It means your rights and obligations under it dissolve.

There are some contracts with terms that have a survivorship after the contract is terminated. However, these terms are generally in the nature of preservation of business records or passive obligations. It is extremely rare for a contract to be terminated and there to remain active obligations after it has ended.

However, it is important that any legal rights for damages or other claims that have accrued by one party against the other survive termination.

Often parties see it as commercially necessary to terminate the agreement and then sue for breach. It is an unsatisfactory position to be caught in litigation with your counterparty yet the parties still have subsisting contractual rights and obligations. Human nature seems to stop people on one hand remaining amicable and friendly in a contract while on the other hand being locked in mortal combat in court proceedings.

I know it’s not a fair contract but they agreed to it!

Generally speaking parties can agree any terms of the contract they like. This is subject to the contract being ‘legal’ as set out below.

It is a fact of capitalist commercial life that there is often a disparity of leverage or negotiating power when entering into a contract.

Example

> Heavy Hand Pty Ltd virtually owns the market for the manufacturing of conveyor belts. The manufacture of that product requires high quantities of rubber. Heavy Hand enters into contracts with rubber farmers on imbalanced terms. They impose onerous obligations on the farmers, pay them little per tonne and the contract grants significant and potentially punitive rights to Heavy.

There is nothing wrong at law with a contract of this kind.

There is nothing legally obliging you to be nice to your counterparty in the negotiations.

A key factor the court looks to when assessing contracts like this is whether they are at ‘arm’s length’. This means there is no duress or

unconscionable conduct in entering into the contract. If the weaker party elects, on the basis of all relevant information, to not enter into the contract the court will be generally loath to set it aside.

This is because it is an exercise of free will. It may not be a desirable contract in terms, but it was open to the weaker contracting party to reject it.

In various statutes in the states of Australia there are laws that moderate the operation of this general principle. They give the court power to set aside or actually rewrite ‘unfair’ contracts.

However, this aspect of the law is rarely used successfully in relation to commercial contracts.

Take the rubber farmer example. The fact that the rubber farmer could have refused the contract (albeit subject to substantial commercial pain) would be a significant factor weighing against a court rewriting a contract between it and the manufacturing company.

On the other hand if a mortgage was entered into by a lender with two elderly people who spoke English as a second language and who did not obtain any legal advice, a court may set aside or rewrite the mortgage on the basis that there was unfair bargaining power and therefore, in broad terms, the contract is unfair.

While there is no law compelling a party to be nice to their other party in negotiating a contract, this is not quite as clear when the contract is entered into.

As a matter of law there is an obligation of good faith and reasonableness implied in all contracts. While not expressly stated as a ‘be nice’ clause, it may have this effect. It imposes a general obligation on a party to show good faith and be reasonable in performing the contract. That could mean letting go minor or technical breaches. Importantly this clause will effect a party’s right to terminate this contract for breach. Also it may limit rights to damages a party may have for relatively minor breaches by the counterparties.

Example

Smith Mining is in a 10-year rolling contract with ELO Telecommunications Services. ELO provides access to telecommunications bandwidth to operate internet and other services. When the contract was entered into Smith Mining was 20 per cent of its

current size. By way of natural commercial growth and acquisition, it is now a much larger company and its contract with ELO does not have a termination clause. There are six years left and it wants to get rid of ELO. It has spoken to ELO about this but ELO has been militant and threatened to sue for breach of contract if the contract is terminated without reasonable cause. Smith Mining retains a consultant to construct scenarios where the telecommunications services to be provided by ELO fail. It is attempting to engineer a situation where ELO is in repeated breach of the contract and therefore justifying a right of termination of it by Smith Mining.

Its Machiavellian scheme is successful. ELO, on a strict analysis of performance, looks terrible. The consultant has worked wonders in torpedoing ELO's performance under the contract.

Smith Mining seeks to terminate the contract.

ELO realises its performance has been hampered not by fair and reasonable means, but by sabotage. It contests the termination, saying the conduct of Smith Mining has been underhanded and an attempt to orchestrate breaches. It has not arisen from the natural ordinary course of the contract. Smith Mining has tried to put ELO in a position where it must breach the contract that, in turn, has caused the breaches. On this basis it is in breach of the implied term of good faith and reasonableness. It has not acted within the spirit of the contract. In fact to the contrary, it has tried to generate phoney grounds for the termination of the agreement on the basis that it no longer wants to be in the contract.

A court will most likely find the implied term has been breached.

This legal principle moderates the otherwise harsh cold commercial world of contracts where there is no obligation to help counterparties. This principle of law is in line with a broader and more contemporary theory of contracts. That is, both parties are working to a common end. A more traditional theory was that contracts were adversarial and that everyone was out to benefit themselves. You still have no obligation at law at all to assist your counterparty. While, as stated above, the law is not clearly stated in these terms, it may be considered the practical effect of good faith and reasonableness.

However, it is important to note that courts are unlikely to compel you to waive large breaches of a contract or failures by the other party to perform their obligations properly. The compulsion to be ‘reasonable’ will arise in instances of relatively minor breaches or issues under the contract. It means a party cannot opportunistically seize upon minor breaches or infringements for its own advantage.

What are illegal contracts?

An illegal contract is an agreement that obliges one or both of the parties to breach the law. On the other hand, the contract itself may infringe. The illegality of a contract does not necessarily refer to its precise terms and conditions. It generally goes to the subject matter of the contract. A contract to commit a crime is an illegal contract and not enforceable. It is important to analyse the subject matter of your contract and consider whether it is in breach of any statutes or law. If it is, there is real risk the contract will be unenforceable.

Example

> There are three competitors in the waste management industry. The first one is Big Garbage. The second is We Dump. The third is Big Bins.
>
> They each have a roughly one-third share of the market and all have generally good reputations.
>
> Big Garbage and We Dump meet at midnight in a parking lot to construct a plan to undercut Big Bins. The idea is to inflict commercial pain for a period of time with a view to removing Big Bins from the market. They set a price Big Bins cannot afford. They will then remove half of their competition respectively. They agree to compete openly and fairly once Big Bins is out of the market. However, their common purpose in the short term is to remove Big Bins as a player. They agree a per-tonne ceiling price for dumping garbage — a price they believe they can commercially carry, although with an extremely limited profit.
>
> They are both of the view that Big Bins will be insolvent if it has to compete at these prices. Four months into the arrangement Big Garbage decides that Big Bins is more

resilient than it had thought it might be, and now, it is the one that is having commercial trouble. It moves its price to a more profitable level.

We Dump complains to it about its conduct in breaching their agreement.

This conduct is anti-competitive under the Trade Practices Act. It would not be possible for We Dump to go to court to seek to enforce this agreement because the agreement itself is illegal. It is not legal or proper at law to use market power to exclude a competitor in this way by ganging up on them.

While We Dump may be extremely unhappy their plan has been foiled, they have no legal remedy. A court will not enforce a contract that is illegal.

In fact, it may be much worse than this. If they were sufficiently unwise and badly advised to commence proceedings, it is likely the case would be summarily thrown out and that they would be referred to the Australian Competition and Consumer Commission (ACCC) for prosecution for breach of the Trade Practices Act.

This can have serious consequences for you and your organisation if you unwittingly enter into an illegal contract and lose under it. It may be that you have no rights under that contract and no right of redress or remedy against the breaching party. This is because the court will consider the agreement itself to have been illegal and either void from the outset (in effect not existing at any time at all) or, secondly, to be unenforceable.

This is made all the more disadvantageous if you entered the agreement without knowledge that the subject matter of the contract was illegal and lost a lot of money as a result of its breach.

Horses for courses — types of contracts

There are a vast number of commercial contracts that parties enter into. These include:

- *Lease* — a lease is an agreement where a landowner confers on another person or entity a right to sole and exclusive possession of land. While the landowner remains the owner of the land, it does not have a right to possession of that land during the course of the lease.

The lease generally sets out the terms and conditions upon which the tenant can occupy the land. Depending on the nature of the land and the general circumstances, these terms and conditions may be more or less onerous.

- *Licences* — a licence is a right to use a particular piece of property, including land. It may be a license to use intellectual property such as a trademark or a work that is copyrighted. A licence sets out the terms and conditions upon which the right is conferred. Obviously the key elements are the fee for the licence, the duration of it, and the uses that the licensee (or the person getting the licence) will be restricted to using the property for. Licences can be granted in general terms in relation to any form of property.
- *Guarantees* — a guarantee is an agreement by a person to stand behind or support another person or entity.

Example

Lots of Land Pty Ltd owns a commercial building in the city. Soft Hands Physiotherapy Pty Ltd wants to lease space from Lots of Land. Lots of Land looks at the accounts of Soft Hands Physiotherapy and it forms doubts about the solvency of that company going ahead. It seems as though it does not have any substantial assets and is incurring debts in the conduct of its business. Lots of Land is concerned that Soft Hands will not be able to pay the rent at some stage during the course of the lease. Lots of Land requires that the directors, shareholders or related people of Soft Hands give personal guarantees that, if Soft Hands cannot pay the rent, they will do so. That will mean they will be putting their personal assets at risk so as to ensure Lots of Land suffers no loss if Soft Hands cannot meet its obligations to pay rent under the lease.

- *Indemnity* — an indemnity is like a guarantee in that it provides a safety net. If a party indemnifies another it means that the indemnifying party will cover any losses or damage that the indemnified party suffers.

Example

Happy Insurance Pty Ltd confers a policy on John Smith in relation to motor accident damage. John Smith has a car crash. It was his fault and he claims on his insurance policy. The policy is an indemnity to cover him for any loss he suffers as a result of his conduct in driving his car. The insurance company pays out on the indemnity. That means it makes good all damage he has suffered and the damage to the other car. The policy has indemnified him or covered him for the loss.

- *Mortgages* — a mortgage is a document that protects a lender of money by giving them a potential right over land owned by the borrower. A mortgage means that the lender has an interest in the land. It generally gives the lender a right to sell if the borrower does not repay part or all of the loan funds.

Example

Jim wants to borrow $100 000 from Big Bank and offers his house as collateral. Jim owns the house with no money owed on it and Big Bank accepts the house as security for the loan. Jim signs a mortgage that is relevantly registered against his ownership of the land. The mortgage provides that if Jim does not repay part or all of the money loaned, the bank may take possession of the house and sell it to recover the loan amount, any interest and its costs associated with the sale process. This is a mortgage document. Jim is called the mortgager and the bank is called the mortgagee.

Using the same Big Bank example, if Jim had an expensive car or a valuable piece of plant or equipment, he may confer a charge on Big Bank as security for the loan in similar terms. While there are significant legal differences between mortgages and charges, given that the security in either instance is different (land as against some other property), the general concept is the same.

- *Charges* — charges are similar to mortgages but are in relation to property more generally. While charges can be over land, they are generally over other items of property like plant and equipment, companies or intellectual property rights.

- *Agreements for services* — these are agreements for providing professional and other services by a company, person or entity. They have common elements such as identifying the nature of the services to be provided, the price of those services, when the service is to be provided, who is to provide it and a termination date of the agreement if that is appropriate.
- *Agreements for goods* — like an agreement for service, an agreement for goods generally stipulates what the goods are (the subject matter of the agreement), when they are to be provided, the price, the quality or nature of the goods and any warranties or indemnities in relation to providing the goods.
- *Shareholders' agreements* — a shareholders' agreement is an agreement between shareholders and a company. A company is a separate legal entity from its shareholders. A shareholder owns part of the company (in the form of shares). Sometimes shareholders enter into agreements with companies setting out the terms and conditions of their relationship. It is not absolutely necessary for shareholders' agreements to be entered into. However, in a range of commercial circumstances, and with larger companies, shareholders' agreements can be an extremely valuable and a clear way in which the company can obtain certainty as to the conduct of its shareholders and the shareholders obtain express and clear benefits.
- *Directors' and officers' agreements* — again, these agreements generally relate to the conduct of a company's business affairs. Directors and officers are the controlling mind of the company. They often enter into agreements with companies in express and clear terms setting out such matters as their remuneration and their duties. An important part of directors' and officers' agreements can also be indemnities from the company covering those directors or officers for any loss caused by their conduct in the absence of fraud or reckless disregard of their duties.
- *Joint venture agreements* — a joint venture agreement is a deal done between two or more parties that consigns them to the undertaking of a commercial endeavour with a common purpose. It is not a company, partnership or other legal entity. It is a statement of a number of parties coming together to undertake some commercial deal. Regularly, joint ventures are undertaken in relation to land development. The

agreement sets out the rights, liabilities and entitlements of the parties and generally sets out their respective contributions. Joint venture agreements should contain more rather than less detail. The more clearly the rights, liabilities and entitlements of the joint ventures are set out, the less the chance for a dispute and the more efficient their ability to resolve any disputes that arise.

- *Partnerships* — a partnership is a form of legal entity where a number of people come together to conduct a business or undertaking. It is a particular term at law and partnerships have large body of law that regulates the way in which they can conduct business.
- *Contracts for sale of land* — this is a contract that deals solely with the transfer of ownership in land from one person or entity to another. Again, there is a complex and detailed body of law regulating the manner in which contracts for sale of land take place.
- *Contracts for sale of business* — these are contracts by which ownership of businesses changes hands. While there are legal requirements in relation to the sales of business, they are less mandatory than in the context of land. There is much more commercial flexibility in negotiating contracts for sales of businesses between the parties to the transaction.
- *Contracts for sale of personal property* — again, there is much greater flexibility in parties negotiating a contract for the sale of a piece of personal property. By personal property I mean anything that is not land or a business. It may be the sale of a large piece of plant or equipment or a valuable gem. The subject matter of contracts in these terms is limited solely by the range and nature of property people can own.
- *Employment contracts* — this is a contract setting out a relationship between an employer and an employee. Again, there is a long, detailed and complex body of law in relation to contracts in employment. They closely regulate the relationship between the employer and the employee. There are a number of legal terms implied in a contract of employment. On this basis, contracts of employment can be in fairly short form and look informal in that they are by way of letter. However, a contract of employment is like an iceberg. What is not in the contract but implied in it is a matter of law is as important as what the words say themselves.

- *Management agreements* — these agreements regulate the management of a company, business or thing. There has been a growth in management agreements in the past 20 years, by the growth in outsourcing. Companies and businesses are now seeking to have administrative parts of their business conducted by other specialist companies or entities and a management agreement sets out the terms and conditions of that work being undertaken.
- *Restraints* — a restraint is a contractual obligation imposed on a person not to do a certain thing. Restraints must set out with absolute clarity what the restraint is, that is, what the person will not do, the duration for which they are restrained from any conduct and whether they are to be compensated for the restraint. Restraints may be standalone documents or incorporated in other agreements.

Example

Richard enters into an employment agreement with New Era Electronics to develop LCD televisions. In the contract of employment Richard agrees that upon termination of the contract by him or the employer he will not work in the LCD television industry for six months from the date of termination. As a result of this, New Era Electronics agrees to pay him six months' salary at the rate of pay he is receiving at the time of termination so as to cover his exclusion from the market. The restraint only restricts Richard from working in the LCD development industry. He could work as an IT professional or in any other capacity other than in research and development with LCD televisions. The benefit for the employer is to take Richard out of the market so his skills and attributes are not immediately accessible by a competitor. The employer is willing to pay for this benefit. This is a restraint. It is seeking to restrain Richard from competing with it.

There is a significant body of law in relation to restraints and enforceability of them. There is no 'perfect' restraint. The circumstances in which the party entered into the agreement, the relative bargaining positions they had, the subject matter of the restraint, whether compensation has been paid and the intended

conduct of the party bound by the restraint are all material matters relevant to whether the restraint will be enforced or not.

- *Share sale agreements* — this is an agreement whereby shares in a company are sold from one person or entity to another. This corresponds to a sale of business agreement, however shares in a company are property that can be bought and sold. They are equity or part ownership in that company. Share sale agreements bear many of the hallmarks and contents of other agreements for the sale of goods and services.

This is a mere sample of the vast range of commercial agreements and instruments parties can enter. There is an almost endless range of contracts in the commercial world that parties can do deals in. It is important to bear in mind that labels given to contracts are often merely descriptive. They implicitly set out the subject matter of the contract and its terms. For example, a guarantee will have certain standard terms and conditions. This is different from a mortgage that will in turn will be different to a partnership agreement that will be yet in turn different from restraint.

There is no set limit of categories of contracts at law. These labels have grown by evolution as descriptions merely of the nature and type of contract a party or parties enter into.

The majesty of master agreements

An agreement that is regularly used — and can be of great assistance in business — is a master agreement. A master agreement is a set of terms and conditions setting out the rules of the game as to the commercial relationship between two parties. It does not oblige one party to buy a good or service from another. It merely says that if an order is placed, this is the way the commercial relationship will be regulated.

Master agreements are of great value when you regularly use the good or service of a supplier or service provider and the good or service is sought at short notice.

It means you do not need to negotiate a new agreement on each occasion. A master agreement will usually set out:

- the standard of quality of the good or service to be provided
- how long after an order the good or service is to be provided
- how the good or service is to be delivered
- terms of invoicing and bulk discounts
- what happens in the event of a dispute.

This will enable you to make a quick, prompt and efficient order for the good or service without there being a residual fear that any of these issues have not been resolved.

Example

> Prosperous Mining regularly requires the assistance of electrical contractors in maintenance and repairs at its mine. It does not directly employ electricians. It has an agreement with Flash Electrical who are experts in the mining industry and in working with the equipment used by Prosperous Mining. Prosperous Mining decides, so that the contractual terms between the parties are clear, to proffer a master agreement to Flash Electrical. This sets out all the rights and obligations of the parties if an order is made by Prosperous Mining for Flash Electrical's services. It does not require either party to do anything. It merely sets up the rules of the game if an order is made.

It has been traditionally thought that a master agreement is more favourable for the provider of a good or service. This is because master agreements are not usually issued by purchasers of goods and services and have often not been given great scrutiny by purchasers.

A master agreement can work as effectively for a purchaser of goods or services on the basis that they negotiate it properly at the outset of the relationship.

Master agreements are usually prepared by providers of goods or services and presented to purchasers as a done deal. Against their personal interest, the user of the good or service merely accepts the terms of the master agreement on the basis they are 'standard' terms and conditions. There is no such thing as standard terms and conditions.

With contracts, subject to statutory or legal obligations, everything is at play. All terms and conditions can be negotiated. It is important as a user of

goods or services that you closely consider the terms of the master agreement and assess its commercial implications. You are always able to negotiate these terms and conditions with the provider of the good or service. The extent to which they are willing to negotiate should regulate your eagerness to contract with them!

This is a bad deal — how do I save myself?

Sometimes the best of intentions just aren't enough.

Regrettably there are instances where a party simply cannot perform their obligations under the contract. Try as they might and using absolute goodwill, circumstances are beyond their control. This is a lamentable situation for both parties to the contract. Neither obtain the benefit of it. There are certain legal avenues available to a party in order to alter or transfer rights and obligations so as to minimise the pain, inconvenience and commercial damage they suffer.

Variation of the contract

The parties to a contract have absolute power and ability to vary the terms of their bargain. It is a matter addressed in further negotiations.

Variation of contracts is a regular feature in the commercial world. With changing circumstances for both buyers and sellers of goods and services, the respective demands change and with that, their contractual needs.

The key element is goodwill on both sides. It takes a degree of maturity and a good relationship in the contract to understand that your counterparty is experiencing difficulties and agree to a variation.

This is an excellent way to avoid a potential breach. The steps in resolving a dispute by variation of a contract are as follows:

1 Identify why — it may be caused by a difficulty in performance of the contract raised by one party to the other or any other reason.

2 The parties negotiate and discuss potential ways that the contract can be changed to their mutual satisfaction.

3 Subject to these negotiations, the parties reach agreement.

4 As a result of the negotiations, the variation to the agreement is finalised.

Variations to agreements can be oral or in writing. However, I again expose my prejudice for written agreements. An oral agreement is no less enforceable. There are similar problems to proving oral variations as apply to establishing the primary agreement. Parties may have two different opinions about what was said and as a consequence what impact that had on the parties' rights and obligations. In order to avoid any uncertainty in these terms it is always better to have the agreement put into writing so the terms and conditions are clear. Both parties get a chance to consider what is put down on the page as being the variation.

Oral variations are difficult to prove. Generally speaking a party seeking a variation of a contract is the one benefited by it. Their version of events always helps them. That arouses suspicions in a court's mind as to whether the party is being truly frank and honest on the variation of the contract. Regularly courts seem to ask themselves if this is so important to that person, why did they not put it in writing so that it was beyond doubt? The absence of writing on an important variation of contract may work strongly against the party who is seeking to rely on the variation in the context of a subsequent dispute.

Transfer and novation

The law allows contractual rights and obligations to be transferred. This is a novation. However, a novation of contract requires agreement of everyone. All parties to the contract agree for one party to step in the shoes of another.

Example

Silky Computer Services provides software, hardware and maintenance services to John Smith Accounting. It has had three consecutive five-year contracts. It is three years into the third of these contracts and it has two years to go. John Smith Accounting did a great deal with Silky in the last contract when it was in some business difficulties. It acquired maintenance services at a low price at a time when Silky needed the work. Silky, in better times, wants to move out of providing services to small to medium enterprises and has its sights on much bigger corporations. Secondly, the contract is not a good one for it. It cannot make any profit given the deal it did means its margins were

low. As previously set out, it cannot terminate the contract without cause. It does not have any contractual or legal rights to do this. However, it wants to put the contract at an end for its own purposes. It seeks and secures the assistance of a much smaller enterprise called Three Men and a Modem who are willing to take over the contract. They are happy to step into the shoes of Silky in all regards, including accepting the price structure of the deal. Given their more modest overhead structure, they can make the contract work for them.

Silky contacts John Smith Accounting and proposes a transfer and novation of the contract. On the basis that assurances are given that no drop in service will be suffered by John Smith, he agrees to the transfer. This is done by way of a deed of novation.

A novation can be in favour of a buyer or seller of goods or services. That is the buyer may want to novate or transfer their rights to a related party in their companies or to some other entities. Subject to the seller of the goods or services being satisfied as to the commercial circumstances of the incoming party, it may agree to the novation. It is generally done by way of a deed or detailed written agreement.

A novation can be an excellent way to avoid the consequences of a breach of a contract that cannot be honoured by one party when there is another who can step into their shoes to make sure no-one suffers any loss. It can be an excellent technique to be used by a party who, for good reason or bad, no longer wishes to be bound by the contract. However, the circumstances in which a novation is sought are important. A party novating a contract (or removing obligations and rights under it) must be sure that all of their obligations pass, any rights they still want are preserved and they get an indemnity and a release. The indemnity is from the incoming party agreeing to cover you for any liability you suffer as a result of the novation. The release is from the other contracting party (your former counterparty) from any claims or other allegations they assert against you in relation to prior breaches of the contract.

As a term of the novation, John Smith may seek an indemnity from Silky that any loss he suffers arising from the unsatisfactory or defective performance of the contract by Three Men and a Modem will be covered by it. If Silky is confident that Three Men and a Modem can do the job and therefore there will be no sustainable or credible claim by John Smith

Accounting, it may give this indemnity. It is confident it will never have to pay out under it. This indemnity may oil the wheels of the deal on the novation by giving John Smith the safety net he wants so as to ensure that he is no worse off.

Part of the point of a novation of contract is to obtain a clean break. You are removed from the contractual relationship. To the best extent possible you need to take every step you can to ensure there are no lingering obligations or rights that sit with you or your counterparty.

This may not always be possible to secure. There is no entitlement either commercially or at law to do it.

If you are seeking a novation of the contract on the basis you cannot perform your obligations and it is a ‘get out of jail’, you may have relatively little leverage to require an indemnity and release and waiver. This will mean the incoming party will not indemnify you for any loss that it suffers. On the other hand, the old counterparty to the contractual relationship you are leaving may say it will not give you a release and waiver. This heightens your commercial risk. However, on balance and in circumstances where a ‘get out of jail’ is necessary, this is risk a party may have to take.

This is not a hard-and-fast rule. It is necessary for you to consider closely what prospective liabilities exist against you as at the time of the novation. The more sizeable the liability the less emphasis you should place on novation and the more you should look at other solutions to your commercial difficulties.

But they are just standard terms!

There are no standard terms in an agreement. There is nothing the other side can say to you that is ‘an industry standard’ and is therefore legally required.

Terms that are legally required in contracts are generally implied as a matter of law. That means they do not need to be stated in the contract. They are in there no matter what. The law says so.

All contractual terms are open to negotiation. If your counterparty is telling you that the law requires terms that are favourable to them and onerous to you, this is generally a negotiating tactic. It will require a close analysis of the term itself and the relevant legal principles. However, as a

general rule, they are seeking to coerce you into a position where you do a deal that is better for them and worse for you by alleging that the way the clause has been drafted is out of their hands — it is a legal requirement.

More often than not this is a bluff. Closely review these clauses. Seek legal advice if you have to.

The hot tips

- *A contract has many elements* — they are all part of both the springboard and the safety net and you need all parts combining in the right balance in the commercial circumstances to make a successful whole.
- *Beware of oral contracts* — they have a danger within them. Do you want to be in an I say/you say fight where you can't control the outcome?
- *All contracts are equal* — don't treat an oral contract as being any less important.
- *Offer and acceptance* — you need a perfect match.
- *Keep it in writing with as much detail as possible* — 'less is more' is not a theory of contract writing or negotiation!
- *Pay attention to the terms* — does the written contract match the deal you've done? Fixing up a contract that is wrong is easier said than done. You need to convince a court of what the deal was and how it should be expressed — these are two big hurdles to jump.
- *Terminating a contract is not like your first boyfriend or girlfriend* — the 'it's not you, it's me' line does not work. You can't exit when you want to. You've done a deal and are bound subject to how well you've negotiated the termination provisions.
- *Maximise your flexibility to get out* — do your best to ensure termination provisions are as flexible as possible for you yet as inflexible as possible for your counterparty.
- *Think closely about termination* — a rocky period does not necessarily mean the contract is all bad. Does terminating suit your grand plan?
- *Make sure you have a replacement to fulfil the job being done by your soon-to-be-severed counterparty* — a contract can be varied but

requires the agreement of all parties. You can't unilaterally change the terms to suit your new commercial circumstances or improve your deal.

- *Beware of terms implied by law* — what is implied at law depends on the nature of the contract. Get advice on this issue. There are unseen dangers in terms implied by law that non-lawyers understandably do not know. Don't fall victim to this trap.
- *You can transfer or novate the contract but you need agreement of everyone* — this may be a fix for a bad deal or unpleasant circumstances but only when everyone agrees.
- *There are no 'standard' terms that are mandatory* — except terms implied by law, everything is up for negotiation. Whether you can shake someone from the 'standard terms' mantra depends on your leverage and commercial position. Think about this in detail if you are met with the 'these are our standard terms' line.

Part II

Doing the deal

Chapter 3

Preparing to do the deal

Making a deal

Negotiating a contract is the synthesis of skill, bluff, artistry and theatrics always with an eye on what the law allows you to do.

Great contract negotiators combine all these elements in a perfect balance. Because of this ability they can often do remarkable deals.

The gift of being able to portray oneself selectively as the dominant, compassionate, powerful, yet reasonable party during the course of a negotiation is a rare skill.

As I mentioned, it is not the purpose of this book to teach those skills. The purpose is, however, to flag a number of legal issues that negotiating parties should consider prior to commencing discussion of any proposed commercial arrangements.

Addressed below are various matters that should be given close and detailed consideration when preparing for the negotiation. At no stage is it necessary to disclose any of these matters to the other side. In fact, on 99 occasions out of 100 it would be to your commercial disadvantage to do so. Often negotiations move very quickly and decisions need to be made as to commercial terms without the opportunity for much contemplation or consideration.

Like almost anything in life, preparation is key. The steps you take in preparation for a negotiation are instrumental. Having an advanced, and if possible, concluded position on each of the matters set out below will allow you to enter the negotiation on an extremely solid foundation.

Further, if your counterparty has not given consideration to these issues in the same way, you are at a significant strategic and tactical advantage. You are in a position to decisively address the matters discussed during the negotiation without the need for further thought or contemplation. You can, depending on the personal dynamics and all the circumstances of the negotiation, tend to develop a ‘hothouse’ atmosphere on the other side

where you can keep them under pressure to do a deal that may be to your commercial advantage and, as a corollary, less than perfect for them.

Know what you want

This sounds trite. You may understandably ask yourself — who goes into a negotiation not having a clue about what they want? The short answer to that is, a bad negotiator.

However, otherwise good negotiators may go in knowing in general or conceptual terms what they want out of the deal. This does not arm them with the necessary information they must have so as to properly and fully advance their commercial interests.

To tell a sophisticated commercial negotiator going into a contract to ‘know what you want’ sounds offensive. It is not intended this way. There are different levels of knowing what you want in a commercial contract. The more precision you have the better you will be positioned to negotiate a contract that is commercially advantageous and meets all your requirements.

Knowing what you want involves the following three broad elements:

1 What are you looking to obtain out of the contract? What do you need on a business level?

2 What can your counterparty realistically deliver?

3 What are the benchmarks for delivery as to time or financial considerations in the contract?

There are distinct and separate matters parties need to decide upon prior to going into contract negotiations. These are not simply to ‘do the best commercial deal’. You should make sure the elements have been identified, considered and later, fully negotiated so they can be articulated in a written agreement. The more that can be included in the agreement, the better the position you are generally in.

A negotiator should be properly suspicious of a party on the other side who thinks the ‘less is more’ theory of contractual expression is the way to go. They may present themselves as wanting an economy of fuss and to keep things simple. The probable reality is that they may also be seeking to increase their flexibility under the contract so they can deliver goods or services in different terms from those you think you are buying. This allows

them to ensure they maximise their profitability, prospectively at your expense.

As we all know, there is an army of deceptive negotiators in business out to advantage themselves at the expense of counterparties.

Beware of a negotiator who tries to create a situation where their obligations under the agreement are set out in very general and unspecific terms. This will allow them to perform their obligations to the lowest letter of the agreement. This may be contrary to your assumption or understanding of how the agreement is to be performed.

Returning to the dragline example and looking at it from the mining company's position, the following are the sorts of matters that it would be appropriate to give detailed and close consideration prior to the negotiation:

- What are the precise applications the dragline is to be used for?
- What is the reasonable period of time the company expects to have the dragline in operation?
- Over what period of time should the dragline operate without the necessity for overhaul or substantial maintenance?
- What is the dragline's production capacity?
- When must the dragline be delivered?
- If the dragline is delivered late, does it give rise to a right of termination? Are there damages clauses where the manufacturer must pay the company a specified sum identified as being its damage. In this context the damages estimate must be reasonable and neither extravagant nor unconscionable
- Who will install the dragline?
- What warranties or performance guarantees will the company require for the dragline?
- What is the dragline worth (based on market value and how much moveability there is in price)?
- What service is the manufacturer obliged to undertake, if any?
- If the manufacturer is not obliged to service the dragline, must it give a warranty and undertaking to cooperate to the fullest extent possible with the entity or company with whom service and maintenance contracts are entered into?

- What is the policy and pricing structure of the manufacturer on spare parts?
- Will licences and intellectual property rights be given to the company? They may be important for emergency repairs. Intellectual property in relation to the design of the dragline may need to be given to the company so it knows the internal workings of the dragline so as to fix it promptly in an emergency. If this is the case, is this at an additional cost?

This is only a shortlist of commercial considerations in relation to the contract. In reality there will be many more matters at play.

These issues should all come up sooner or later; however, the more concluded the position of the coal mining company is at the start in relation to what it wants and needs, the better the position it is in to stipulate these requirements in the negotiation on its own terms. Once these requirements have been clearly identified and set out, it is a short hop to incorporating them in the written agreement. It is hoped that during the course of the negotiation both parties can reach a point where they are at agreement on these and other material issues.

It would be regrettable if questions were unasked and issues not raised at the outset. The negotiations are the time to clearly and unambiguously address these matters and the result of the negotiations should be fully explained and incorporated in the agreement.

Many a party has rued a lack of preparation in negotiating an agreement. Lack of preparation means things are missed. It is a regular refrain of a contracting party that ‘I thought it was in there’ or ‘I wish we had thought of this at the time’.

Often there is no great mystery, magic or novelty in these points. It only requires a party sitting down at the outset and considering closely what it needs out of the deal on a macro level (such as delivery time and price) and a micro level (such as warranties and intellectual property rights).

The negotiating position for the dragline manufacturer would be necessarily different. It would need to consider issues such as:

- Do they have any products that are currently fit for purpose? In the light of the requirements of the coal mining company, can they sell a

product currently in their range? Does it need customising in any way? If so, how? What will this cost?
- What is the delivery time to be?
- Can the products be manufactured profitably without cutting corners or skimping during the course of manufacturing that ultimately impairs the dragline's ability to operate?
- Does there need to be a set price agreed for the core elements of the dragline and the other components be agreed on a variations or additions basis?
- Can the dragline manufacturer meet the service requirements we want? Can the dragline manufacturer provide spare parts at a commercially satisfactory price as sought by the coal mine company?
- Is there to be a penalty clause in the agreement if we build the dragline and the contract is terminated by the coal mine company for any reason at all?
- To what extent will we need to make an investment in people or plant and equipment in order to honour the contract? If this is significant, a term should be incorporated in the liquidated damages clause that if the coal company terminates the agreement prior to it being performed fully and completely by both parties, damage is expressly admitted by the coal company.

As you will note from a comparison of the above, many of the issues are common to both parties.

They will have different perspectives on them but they will need to reach positions of agreement.

It has been my experience in participating in negotiations of this type that the more prepared a party is, the better the commercial deal they can do.

Often a matter is cleverly and strategically raised by a party that is well prepared and has given full consideration to the issues. Preparation means you will be more able to assess the timing of hitting the other side with a big point for maximum effect in your interest.

Take for instance the warranties that the coal mining company would seek from the dragline manufacturer in our example. If it had completely and fully considered what it wanted from the manufacturer, and the manufacturer had not given the same level of consideration to the warranties it may offer, it may be that the coal mining company can extract

a better suite of warranties than the manufacturer should give. This is because in their eagerness to do the deal and with their core level of confidence in the nature of the product they provide, they will make warranties that are excessive or beyond what the equipment can reasonably deliver. This will arm the coal mining company with a significant commercial advantage. A breach of a warranty in this sense gives rise to a right to damages. If the manufacturer has been excessively confident in the warranties it has given, and the machine does not live up to them, it may be that there is a damages claim by the coal mining company in relation to the breach of the warranty.

This could be a significant sum of money.

This is an example of how a more prepared party can obtain a commercial advantage without being deceptive, dishonest or unethical. It is merely preparation and a more detailed and comprehensive consideration of all the commercial issues in relation to the negotiation considered earlier that has given them the upper hand.

Allied to this may be a sense of time pressure that the coal mining company seeks to place on the dragline manufacturer. Subject to the dragline manufacturer's susceptibility to this tactic, it may cause it to concede on matters that appear innocuous (like general warranties) but actually have an important and legal contractual context and consequence.

Example

A mining company negotiates a deal with Fixin' Management Consultants to provide advice and recommendations in relation to restructuring the management of the business.

That would, on its face, seem to be the start and the finish of the request; however, the ambit of the work to be done by Fixin' is not set. They have a very broad scope of services they could provide. The more they do, the higher the price. This may work to the management consultant's benefit but not to that of the mining company.

Say a dispute develops as to the management consultants not addressing one of the issues that was of highest commercial importance to the mining company. In the absence of a clear contractual stipulation as to what Fixin' was to do, it may be it has a credible and ultimately successful argument that the work the mining contractually

> required was done. It thought the contract was different and less than what the miners thought they had agreed. This illustrates that knowing what you want under the contract in precise terms is extremely important. Without it you can't adequately express it in the contract.

As a general rule, no amount of detail is too much in this context. The greater the detail you add in, the more obligations you impose on your counterparty to do what you want them to do. Leave them as little discretion as possible as to these issues.

A regular feature of disputes is the assumptions that develop in the respective parties. The contract sets out the terms and conditions. It may be general or specific. The more general the contract is, the more likelihood there is for unhappiness to develop by one party or the other as to the way they 'assumed' the contract would be performed.

The Fixin' Management Consultants example is relevant here. The mining company may have formed a view with its own management team as to the role the management consultants will play, what they would deliver and when they would deliver it. On the other hand, Fixin' may form a view that they were to do the minimum possible (and therefore charge a relatively modest amount) given the scope of the job was not definitive.

Neither party is being dishonourable. On one hand the mining company's assumption is that it will get a comprehensive review of the structures and the form of its business. On the other hand Fixin' are keen not to be seen as overchargers and opportunistically doing work that has not been requested. They want to keep their bill as modest as possible in an attempt to maintain the goodwill of the mining company and perform their professional obligations within ethical bounds.

The absence of a clear explanation as to the contractual terms has lead to a potential dispute. Both parties are unhappy. Litigation is threatened. Possibly even more importantly, a budding commercial relationship that could have been to the mutual benefit of both parties into the future has been, to all intents, destroyed.

It is all about knowing what you want.

Setting out what you want from the contracting party precisely and deliberately is a fundamental first step in contractual negotiations. This should be done before the talks start. It has three main benefits:

1 *It focuses your mind on what you want out of the contract.* Implicitly you know how this contract is going to fit into your business. In most businesses, entering into contracts is like putting together a jigsaw puzzle. In your business providing a good or service, you generally need the assistance of other providers of goods or services in order to get you into the market. Knowing what you want out of a contract allows you to integrate the subject matter of the contract into the jigsaw of your business.

2 *At the outset it tells the contracting party what you want from them.* It allows them to form a view about whether further negotiations are worthwhile. Alternatively, it allows them to come back and talk to you about your requirements and for you to prioritise them.

3 *It makes for infinitely more efficient negotiations.* At the start of a negotiation you and your contracting party should speak in generalities about the nature of the work, its scope, delivery times and other general information. Negotiations may be commenced on ancillary issues without the heart of the contract being addressed. This is to be avoided. You and your staff may waste a significant amount of time in talking about detail issues when in fact, it may not be possible for a contract to be entered into at all on the big performance items. This is something you need to be particularly wary of with deceptive, yet skilled negotiators. They may be seeking to provide services that are actually not a perfect fit for the task or they do not have the expertise to do the job. They ‘soft sell’ the detail and persuade you of their skill and competence in other areas on other aspects of the contract. It is human nature to assume that if they were not skilled and competent on other aspects of the job, they wouldn’t be tendering for the work that is at the heart of the job if they didn’t have the same level of skill and competence there! However, this is not necessarily the case.

Example

Suburban Partners Accountants bids for the work of a public company that runs a property development operation, Deep Land. Deep Land advises Suburban that the

contracted work will be to assist in due diligence with acquisitions and sales of assets, general bookkeeping support to the internal accounts division and audits.

Suburban is strong with general bookkeeping, has some experience in audits of public companies but does not have the resources, skills or experience in assisting a public company in a short-term due diligence exercise. With public companies, due diligence projects are generally immediate, confidential and urgent. They require the devotion of significant resources on very short notice for an intense period of time. At no stage did Deep Land descend into any detail as to the precise requirements it would be likely to have in each of these disciplines of accounting.

A great rapport develops between the CEO of Deep and the principal of Suburban. They become friends. On the basis of the general amity between the parties a contract is entered into. The contract is a general letter of retainer and it specifies that the accountants are to provide audit bookkeeping and due diligence assistance as required in very broad terms.

An urgent acquisition becomes available to the Deep company. It is a small company that would fit beautifully in the Deep group. It requires devoting significant accounting resources to analyse the financial records of the business it is seeking to acquire. The accounting firm has neither the resources nor the competence to assist; however, they commences the due diligence exercise on a wing and a prayer. They see it as a great opportunity to develop skills in a new line of work. It quickly becomes clear to Deep that the accountants are not capable of fulfilling their obligations.

Suburban is replaced on the due diligence exercise. They send a bill for their work but Deep objects to paying it on the basis that the work is valueless. On the other hand the accountants say, ‘We did the work, we deserve to be paid’.

Here a dispute developed solely due to the lack of clear scope. The property development company knew what it wanted; however, it didn’t go to the second stage of identifying precisely what it wanted, when it would want it and the general circumstances of its demands.

The more precise the scope of work under a contract, the better position the company buying the goods or services will be in if it is breached by the counterparty.

A contract that clearly sets out what the other party is to do allows for easy reference as to whether it is breached or not. It is sometimes hard to discern whether a breach has occurred in a contract. It allows for performance in possibly many and varied ways. You need to know the terms before you can work out if it is breached. General and ambiguous terms mean it can be hard to work out which terms, if any, have been breached.

Know what you don’t want

This is the flipside of knowing what you want. It is sometimes useful in contracts to have negative stipulation. That is, to tell the other side the goods and services you will not need from them. This is more important in service contracts than for goods or products.

Expressly carving out what you don’t want helps in that it:

- stops you wasting time negotiating on a service they want to provide but you don’t want from them
- narrows the scope of the work
- assists you in disproving dishonest claims for payment for goods or services you did not buy.

Take the example above of Deep Land and the accountants. If they purported to provide tax advice gratuitously and outside the scope of the agreement, and more importantly it was never requested from them, the recipient may not have to pay for any advice received. This is because the company did not enter into a contract for a service of that kind. No-one had asked the accountants to do this work. They had made an assumption that it would be necessary. However, that assumption does not give rise to a contractually enforceable right.

As you will appreciate, there may be an uncertainty about whether the work was in the scope of a broad contract. If you expressly include a negative stipulation in the contract telling them not to do this work, you have put yourself in the strongest possible position to comprehensively and quickly deal with the dispute by pointing to that clause and telling them that they did that work at their own risk and cost.

Knowing what you will do

A key aspect of negotiating contracts is not overpromising. What you say in the negotiations may be relied upon by your counterparty even though a half promise or overly enthusiastic comment you made does not end up in the written agreement.

Example

> Super Sand Mining has a piece of equipment acquired from a United States manufacturer, Fine Sand Sifters Inc. Fine Sand contracts with Aussie Engineering as its Australian agent and distributor. The distributor agrees to take care of all repairs and maintenance. The piece of equipment fails and they encounter a problem: Aussie Engineering is based in Sydney and Super Sand's piece of equipment is located in Far North Queensland. Super Sand contacts Aussie who says it has the skills and resources to immediately fix the machine. A broad short-form contract is entered into setting out the scope of the work, being the on-site repair of the machine and rates of charge. The contract expressly provides that any further work will need to be agreed between the parties either on a quoted rate or a further do-and-charge hourly rate.
>
> But there's another problem: Aussie's expert on that particular machine is out of the country on holidays. The distributor sends, in good faith, their second-best option in trying to perform the contract. The person sent does not have skills or expertise in that machine. They attend the mining site but are unable to fix it so send the machine to Sydney for repair. The action causes the machine to be out of action for a month at a substantial financial loss.

In this sequence of events the representation made by the distributor was that it could do the work and had the skills in-house to meet the urgent demand. This was in fact not the case. The relevant person who would have done the work was not available. It was not best equipped to perform and overpromised. This meant that there was a much greater risk to the mining company in having the work done.

In entering the contract the mining company relied on a representation that the work would be done by the right people. There might have been other companies that were capable of doing the work and that were better

suited to it with the key person available. This is a matter the mining company did not explore because Aussie, being the body approved by the manufacturer, told them that it could do the job.

The essential problem was a representation about what the distributor could do that was contrary to its real position. If the distributor had been frank about this, it would have been much better. The mining company would have been on notice as to what the distributor could and could not do, and therefore could not have complained about being oversold.

This issue is dealt with in far more detail in chapter 6, ‘Traps for the seller — pitfalls in negotiations’.

What you won’t do

As discussed above, a general negotiation in a short form of contract may lead to misapprehension about what you are willing to do and not do under the contract. A negative stipulation again in this context can be very helpful. Even if it is not in the contract, it can be made shortly after. It is useful to put the other side on notice of what you cannot or will not do. This is important in general contracts because the scope of work is often broad and interpreting the obligations you have under it can be difficult given the scope.

Example

> Wally & Wong Tax Lawyers agree in a contract to provide taxation advice to Trusty Advertising. The services provided by Wally & Wong will be an analysis of the structure of the Trusty corporate group and advice on a more tax-effective restructure. The lawyers do not provide services in relation to the finalisation and lodgement of tax returns. Trusty also has accountants.
>
> The lawyers retainer agreement expressly excludes any work in relation to preparing or finalising tax returns. It stipulates the services the firm does not offer under that contract.
>
> Trusty tells its accountants that, because the lawyers are involved, they will not have to take care of lodging tax returns. This is because of Trusty’s misapprehension as to the

broad circumstances of the contract with these lawyers. It has not been properly read by Trusty and on that basis no tax returns are filed.

There is a default and penalties are levied by the taxation office.

The problem here is caused solely by Trusty Advertising. The lawyers beneficially set out what they will not do under the contract meaning there was no dispute as to the ambit and nature of the taxation service the lawyers were to provide. Not only were the services to be provided comprehensively set out, what they would not do was also made clear. It made the position of Trusty Advertising in making a claim for the lawyers' failure to perform the contract simply untenable. The contract made it clear what work the lawyers would do.

What do I need to do to perform the contract?

As a party that provides a good or service, it is critical that you form a view about your ability to deliver under the contract early on.

While the suggestion above that the scope of the work be set out precisely and rigorously was from the perspective of a buyer, it is equally important for seller.

You cannot simply elect to no longer be bound by the contract and write it off as bad experience.

Once you enter the contract, you are obliged. Subject to the contract being frustrated or terminated, your obligations will last as long as the duration of the contract. Your obligations will remain as set out in the contract. They may not be particularly favourable in hindsight. It doesn't mean you can abandon them.

It is not possible to merely allege the contract has been frustrated at law on the basis that you emotionally or commercially want out. As you will have seen from the treatment of the principle of frustration, it requires there to be an event outside the walls of the contract for that principle to apply.

Poor commercial planning or an overenthusiasm to do a deal without properly understanding the elements necessary to get that deal done will

generally not be a frustrating event for the purposes of the law.

Example

You operate a haulage company that has had contracts with various manufacturers in and around the Black Valley. Your haulage company provides services transporting products from factories to customers and other freight-forwarding entities. As a result of changes to the industrial relations legislation you decide to try to put all of your employees on negotiated contracts. You have 50 truck drivers who work on a 24-hour roster basis. As a result of your attempt to renegotiate their contractual terms their union becomes involved and they call a strike. For 72 hours you are unable to provide haulage services. In this period the customers are unable to secure alternative haulage contractors. On the 60th hour your clients terminate your contracts.

They sue you for damages.

You allege the contract was frustrated as a result of your employees' conduct; that is, you can't perform and it is not your fault.

There is a real risk in a case like that you would not be able to allege the contract was frustrated as a matter of law. This is because there was no third event occurring that was outside your control. The trigger for the industrial action was your desire to put the employees on different contractual terms. If you had not done this and maintained the status quo, there probably would have been no disruption to the services and the employees would have continued executing their obligations of their employment.

Example

Your company provides IT services on a contract basis. Your area of specialisation is in software. You have a long and close relationship with a sub-contractor who has written software for a number of applications for your clients. They have done, and continue to do, an excellent job in providing software services. However, owing to bad practices in their business, the company goes into administration. That means an external administrator is appointed to trade the company out of its difficulties. Administration takes the power away from the directors and the shareholders and puts the company in

the hands of the administrator. The administrator will generally trade the company more cautiously. You are told informally by your personal contact at the company that things are not looking good and there is a real prospect the company will become insolvent. You do not seek to enter a contract with any other party to provide software services.

Two days after the company goes into liquidation (a death sentence for a company) you enter into a new 12-month contract with a TV company for IT services. An important component of that contract is your reliance on the services of the company now in administration.

Shortly after you enter into your new contract the IT company in administration becomes insolvent. That means it ceases trading and a liquidator is appointed to sell all of its assets to pay its creditors. It no longer conducts any business.

You have no ability to service part of your contract because you relied upon the IT company now in liquidation. The TV company becomes extremely unhappy and terminates your contract for breach of a fundamental term being the provision of that software service.

Again you allege the contract has been frustrated. However, it is probably not frustrated at law; this case is another example of the risks in overpromising.

At the time the contract was entered into, the contracting party had an agreement with the company in administration. You knew things were looking grim. A prudent businessperson would have entered into a new relationship with another entity who could satisfy their obligations. While this may have made life harder and the contract would have needed a lot more supervision because you would need to make sure the new people were up to scratch, it would have ensured that in the event of disaster a safety net was there.

This is another situation where a failure to ensure you can deliver what you said you could may cause an huge and insoluble commercial problem for you.

Can they do what they say they can?

Sometimes in a negotiation the deal you are about to do looks too good to be true. This is because it sometimes is.

It is remarkable the number of people who do deals in a entrepreneurial way thinking ‘it is a risk but it will be all right’. They win the contract and then decide how to perform it. This is world’s worst practice.

It is bad for the provider. However, it may quickly become bad for the buyer if it relies on the performance of that contract in its business. It is a cold comfort to have a lawyer tell you that you have a fantastic damages claim against a company with no assets when you are suffering daily commercial loss. The fact that a court might uphold you as being legally in the right in due course is meaningless in a crisis.

There is nothing in the law that prohibits you from asking for more information from your contracting counterparty. It is up to them as to whether they are willing to deliver this detail.

A party that is willing to do a fair deal will generally give you the information you want. If they have nothing to hide and are commercially and professionally ready, in the spirit of salesmanship they probably want to display to you how good their business practices are and otherwise how they are ready to perform the contract.

The most skilfully drafted contract in the world will not save you if the other party is simply not in a position to do what it has to under the agreement. Rights of action against them may be meaningless and will ultimately be very time consuming and costly to enforce.

This heartache can be prevented by a comprehensive due diligence at the outset.

It is always useful to remember that you have the whip hand if you are buying the good or service. You have significant leverage given that they are selling to you. A giver will generally take all steps possible to satisfy a purchaser that they are ready to do the deal.

The more documents you can see in support of their assertions about their readiness, willingness and ability to proceed, the greater the chance you will stop the problem from happening.

What ‘form of life’ is your counterparty?

There are various types of legal personality in which business can be conducted. In very broad terms, the two types of legal entities with whom you will be negotiating a commercial contract will be a person or a company.

A person is of course an individual. They run and conduct a business in their own name. They are therefore the contracting party. They will be the person named on the agreement. All of the rights and obligations in the agreement conferred on their side will be held by them. They have to personally perform them. If they breach the agreement the consequences are for them personally. Any breach will either need to be made good by them or, alternatively, any damages awarded will be paid from their assets. If they cannot meet their obligations under the contract it may be a consequence that they are ultimately bankrupted.

A company is a far more difficult beast to contract with. A company must have directors and shareholders. Directors are the controlling mind of the company. They make the decisions for the company as to what business it will do and how it will conduct itself commercially. It must also have shareholders. They own the company. The shares in the company are the equity or value it has. Shareholders may or may not be directors. They generally have power to elect the directors or nominate them.

A company is a useful tool for a party that wishes to enter into a contract but avoid personal liability. If you enter into a contract with a company, your contract is not with the directors or shareholders. It is with the company itself. Although the directors and shareholders look like the company, they are not. It is a separate legal entity. Any breach of the contract will be by the company. Any claim you have arising from the breach will be against the company. If you need to sue and seek damages, the viability of that claim will be regulated entirely by the assets the company has.

Example

> XYZ Computers enters into a contract with John Smith Accounting to provide 15 computers and relevant software in the conduct of John Smith’s business. Those computers are provided on 1 August. On 15 August they cease working. John Smith Accounting complains to XYZ Computers who are uncooperative. John Smith needs to replace the computers and it does so with another supplier. It makes a damages claim

> against XYZ Computers for breach of the contract. XYZ Computers is a company owned by two individuals who are its directors and has no assets; it is a hollow shell that trades as a company and it owes money. The viability of John Smith's damages action is entirely regulated by what he will ultimately get out of it. There is no point having a wonderful victory in litigation on the merits of the case and finding when the door is pulled open the cupboard is bare. The whole point is the recovery of damages. If there is no available money at the end of the process, while it is not meaningless, it has a powerfully hollow ring about it.

It is of fundamental importance that you identify who the contracting party is to be.

This sounds like an obvious point. However, your negotiations will always be with individuals. A company is 'incorporeal'. By that, I mean it exists as a legal notion but does not exist in reality. You cannot shake hands with a company or have it take you to lunch. You can only shake the hands of or dine with its shareholders and officers.

You will therefore be negotiating with these people in the process of entering into a contract. It is easy to be lulled into thinking that the real person you are contracting with is a director or shareholder. You know, like and trust them. They have presented well during the negotiations. They seem credible, honest and forthright. This may all be true. However at the end of the negotiations you find that a company name pops up as the contracting party. This should have been a matter to which you paid close attention right at the start.

At the outset, you will need to seek, to the best of your ability, information about:

- the financial position of the company
- the latest accounts of the company
- the company's assets and liabilities
- the current balance sheet and management accounts of the company.

It would be brave (and unwise) to enter into a contract with a company without knowing its financial position. This is because, if the contract goes badly, you need to protect your commercial position to make a claim

against that company. It is unsatisfactory to be put into the position set out above where you have a fantastic legal claim but it has no consequence. Your damage cannot be made good. If a company is to be the contracting party you will need to obtain information about that company during the process of negotiating. To proceed without this information would be at significant commercial risk and may cause you both heartache and heartburn if the contract goes badly and you are left without legal remedy.

Beware of dealing with companies. They are a way in which deceptive commercial parties can obtain the benefits of the contract yet preserve their rights to get out of it at no personal liability or suffering themselves. However, your liability and level of suffering may be acute as a result of entering into a contract with a company that has no assets and is effectively a hollow shell. The fact that it is trading — for all intents and purposes — as a viable and prosperous entity does not tell the full story.

Chapter 4

Negotiating — doing the deal

A four-act play?

Every negotiation of a contract is different. This is because the subject matter, the personalities, the price and the commercial pressures are idiosyncratic. A contract negotiated for a good or service in May 2007 may proceed entirely differently when renegotiated in May 2009. If nothing else, broad market shifts in a globalised economy mean circumstances change with startling and often disorienting regularity.

The nature of the negotiation will be ordained by the size and nature of the contract. A contract to provide a fairly regular or commoditised good or service will tend to be simple. It is the price, delivery time and quality of that good or service that are the main issues.

However, larger contracts involving more money, more sophisticated assets or services and more complex rights and obligations will ordinarily have a longer negotiation period and be more detailed in nature.

Different transactions have different negotiation profiles. An acquisition of a competing business is a different negotiation from the deal you may do with your financiers to fund that acquisition. This is in turn a different negotiation from that which you do with the management employees of the business you are acquiring. This is again different from the negotiation you do with the landlord of the old premises occupied by the business you have bought in order to opt out of the lease.

Below I have set out the four regular steps that are undertaken in negotiations. They are:

1 can I do a deal?

2 the recap

3 locking them in before we are signed, sealed and delivered — do I need to?

4 negotiating the words.

The following tips assist in each stage of the negotiation. This is not intended to be prescriptive. There is no necessary reason a negotiation will follow this path. You may not need all four stages. You may go straight from stage 1 to stage 4. It is largely up to you, your counterparty and the commercial circumstances.

Can I do a deal? Drawing the big picture

The preparatory considerations to be given are generally at this stage of negotiations. This is when you are working out whether you can do the deal or not. As the negotiation progresses, more and more information is obtained and you form a view about the viability of the contract. The key messages here are precision and particularity. The more detail you can extract from the other side in every sense, the better position you are in to form a view about whether the contract is worth pursuing or not. This can take a relatively long or short time depending on the negotiating style of your opponent, how forthcoming they are and whether they are being deceptive or full and frank.

The glorious uncertainty of negotiation may mean they seem as though they are all of these things during phase 1.

The recap

At various milestone stages in the negotiation it is useful to have a recap with your counterparties. This does not need to be formalised. It can be a relatively casual summary of where the negotiations are up to. This is of assistance on three levels:

1 *It forces you to be vigilant in keeping track of where the negotiations are at* — an issue that does not appear important early on may become fundamentally important later. A recap regularly through the negotiation expressly causes you to think about where you are up to and what has been resolved and what hasn't.

2 *It provides a useful point to revisit matters that have been previously negotiated and tentatively resolved or left open* — subsequent negotiations and other terms or conditions may cause

you to rethink how you structure the deal early on. A recap allows the parties to discuss where the deal as it is at this stage and whether that sits comfortably with what was initially negotiated.

3 *It allows you to make an efficient decision as to whether the negotiation is worth continuing with* — if the recap means you have much less resolved than you would have hoped, the negotiation is not meeting your requirements and the vista is bleak, it may be time to assess whether the negotiation is worth it. It is a trigger point for you to assess where you are up to and can work against a general optimism that a deal can be done when that optimism is misplaced. It is particularly useful in this context in big negotiating teams.

Often stronger personalities in a negotiating team will be more influential and in my experience they are also generally more optimistic. They may pressure others into continuing a negotiation when they are trying to do a deal that can never be done. Their optimism, drive and verve can be infectious and overpowering. These attributes are generally appealing but can sometimes be misplaced. An objective assessment may make it clear that a deal cannot be done and that is best resolved sooner rather than later. A recap is a formal means by which the understandable but unwise enthusiasm of charismatic colleagues can be addressed.

Locking them in before we are signed, sealed and delivered — do I need to?

This assumes you have got to a stage where the big issues are tied off and you are ready to enter into a contract.

A heads of agreement may be a useful document at this stage. It does not purport to be the full and final contract, however it sets out what the parties intend to do subject to final documentation.

Example

> Two large privately held companies talk about a merger. They skirt around and flirt with each other over a period of time about whether the merger discussions are worth pursuing. They sketch out the general terms of the merger.

A heads of agreement may be useful to set out what the agreement to that point is. The heads of agreement may bind the parties subject to subsequent conditions or events arising. It is a powerful statement of goodwill that they want to do a deal. It commercially justifies expensive consultants and professionals being brought in to finalise the agreement. It means, in general terms, the parties want to do a deal. It also may have binding legal consequences if all of the conditions precedent or subsequent necessary events fall in line.

A big question is working out whether you want the heads of agreement to be enforceable or not. It is sometimes hard to have a fully enforceable heads of agreement because, commercially speaking, both parties want to keep their options open and the final deal is still in play.

However, in important commercial negotiations you want to maintain confidentiality and exclusivity. Confidentiality is an issue you should deal with at the outset, particularly if you are buying and selling businesses. It is generally in both parties' interest that all individuals enter into confidentiality deeds, ensuring they do not tell anyone about the negotiation taking place.

When you get to an advanced stage in seriously exploring the deal, and on a provisional basis agreeing to it, you may wish to tie in the counterparty to exclusively dealing with you and no-one else.

If you are the more eager party in doing the deal, you may want to tie in your counterparty on a limited but enforceable contract through the heads of agreement. This is also risky. By entering a heads of agreement you expressly acknowledge that you haven't resolved all aspects of the deal. There is a practical consideration here about what a court would be asked to enforce if there was a dispute. This would depend very much on the terms of the heads of agreement and what it said.

There are also strategic issues. Often it is good not to be seen to be too eager to do the deal because it hints at loss of commercial objectivity. When a party has lost its commercial objectivity and seems to be taking an

emotional or overly enthusiastic approach, it leaves it open to be manipulated by the other side.

A heads of agreement can be a useful document, although only on a restricted basis. Again, the precise subject matter of the contract, who your counterparty is and the broad commercial circumstances, will be important in you determining whether a heads of agreement will hurt or help you. If it helps, what terms need to be incorporated and is it to be binding? These are the consequential questions when and if you decide on a heads of agreement.

The heads of agreement needs to be closely considered. How will it help? What does it give us? What does it oblige us to do? Does it help or hurt when objectively assessed? What happens if things turn nasty — can we be sued and if so what are the risk profiles? All these considerations are important and different in each case.

Example

A small software supplier, Softly Softly, is negotiating a multimillion-dollar contract with a bank. It suspects the bank is talking to bigger market players. The bank has never stated that Softly Softly is their only courtier. A deal is negotiated where price, development milestones and installation dates are resolved. The outstanding issues are intellectual property ownership, maintenance, resourcing and guarantees and indemnities among less negotiable matters. Softly is happy and wants to exclude competitors. It closely considers a heads of agreement. The great benefit will be that the bank will need to commit to it exclusively. On the other side, the bank will want to add a clause that says if Softly does not go ahead, it agrees to pay any damages the bank suffers.

The software that is the subject of the agreement is necessary for the rollout of a new finance product. If there are undue delays in finalising the contract or Softly causes it not to go ahead, the bank will rely on this clause. If Softly does not cause it to go ahead for any reason, liability may arise. The relative sizes of the bank and Softly may mean that a claim by the bank causes Softly to go under. Softly is potentially writing the bank a blank cheque on a damages claim.

After sleepless nights and soul searching, Softly opts for the heads of agreement on the basis of exclusivity. They form a view that this exclusivity is of greater value to them

than the potential risk for the damages claim. However, they know the bank will rely on the clause and it is probably enforceable. What they don't know is how much it may cost. However, the heads of agreement may pave the way for Softly to go from a small market player to a serious operator at warp speed. Here self-belief and optimism have won out although importantly not at the expense of rational judgement and risk management.

The key element is the balancing act Softly makes between tying the bank into an exclusive deal and the risk of time pressure. Any extended negotiation of the agreement will be a problem for the bank, and as a consequence, possibly also Softly. Softly must place a commercial emphasis on quickly negotiating the agreement. However, given the disparity in the commercial sizes of the respective entities and the fact that the bank will always have more leverage, this may be easier than it sounds.

Take for instance intellectual property rights. If Softly's work is successful, it may wish to retain intellectual property rights in the software so that it can be marketed to other banks in Australia and around the world. However, it is fairly and squarely in the bank's interest to take those intellectual property rights and utilise them itself. It is in the bank's interests to either use that product to sell to other financial institutions or quarantine a great software product so it is used only by itself. This may give it a market edge.

It may be that a deal is not done because of no agreement on who is to own the intellectual property rights. This would be extremely problematic.

The deal falling over may give rise to a damages claim given the bank tied itself to exclusively negotiating with Softly and a deal was not done. The bank preserved its right to sue Softly for damages if it suffered any commercial loss as a result of any delay, under the heads of agreement, including protracted negotiations.

Again, Softly formed the view it could manage the commercial risk and that the potential opportunity outweighed the possibility of it being sued and having to pay out a lot of money to the bank.

Of course the simple way out would be if there was a sticking point in the negotiations for Softly to simply concede intellectual property rights. However, this is easier than it sounds. Softly is obviously confident of the

product it is developing and, commercially speaking, its eyes light up with the prospect of selling it to other financial institutions.

This situation again illustrates the delicate and gut-wrenching matters a commercial party must consider when considering whether or not to enter a heads of agreement as a stage in doing the deal.

More than joining the dots — final wording

When preparing the full and final written agreement, leave nothing to chance or assumption. Consider every aspect of the deal and make sure the words reflected in the agreement are consistent with the deal you have done.

It is extremely dangerous to place too much faith in your counterparty or assume that because both parties are showing goodwill at the outset they will honour their representations and the deal they have done.

The value and importance of the precise words to be used in the agreement cannot be emphasised enough. Their gravity is profound. Time and incredible care must be taken to ensure you are happy with the way every clause of the agreement is expressed.

Even apparently innocuous clauses can be loaded so profoundly on one party's side that it makes the agreement very risky to enter into.

It is also important, at the risk of being pessimistic, to consider what happens if the relationship breaks down. Termination clauses in particular are given very little heed in commercial negotiations because the understandable assumption is that 'nothing will go wrong' or 'if it does, we will be able to fix it'.

Sadly, this is not always the case.

Courts are full of disputes involving breaches of contract where one of the parties could have advantaged themselves by giving close consideration to the clauses that looked to be formal or standard.

It is also important to consider whether any of the clauses in the agreement are illegal. As set out above, courts will not enforce or will render void contracts or parts of contracts that contain obligations that are illegal. A particular area of trap is the Trade Practices Act. In general terms

parties cannot contract out of the Trade Practices Act. That means that they cannot engage in any anti-competitive practices by agreeing to squeeze out other market players. You also cannot agree to remove warranties that your service is fit for purpose or your good is of merchantable quality. These are implied by law. Any attempt to do so will not be accepted by the court.

It is important to acknowledge these kinds of legal principles because they may be important to you in the contract. You need to know whether there is a risk it will be unenforceable. That may materially change the commercial considerations you have in entering into the contract. In this context it is important to obtain legal advice or closely consider the relevant legal issues so as to ensure you are given maximum protection and do not have an important clause that is illegal in a contract.

Chapter 5

Terms of contracts to keep an eye on

If it is in there, it is important

There are no unimportant terms of contracts. Every term has its use and place. If the contract goes well, some of the terms may never be relied upon by either party. An example of this is a clause terminating the agreement.

However, when negotiating and entering into an agreement, it is important to scrutinise all of the terms of the contract. Your vigilance should be heightened when you are provided with a contract already drafted by your counterparty.

In particular, closely review the clauses that are generally towards the end of a written agreement and look like ‘standard terms’. As already stated, there are no standard terms in contracts. There is no term that cannot be negotiated. On this basis there is no term that does not require your full and complete attention as to what it says, does and implies.

Set out below are some terms that look merely technical and logistic, but may in fact be Trojan horses.

Conditions precedent clause

This clause provides that some or all of the terms of the agreement will only become operational if an event or act occurs.

Example

> A management company provides ‘integration services’. It assists two separate businesses that have merged or when one has acquired the other to integrate their systems, people and operations time and cost effectively. It may be that the services of this company are sought after. One of the parties may seek to enter into an agreement with the management consultant that if the merger or acquisition takes place, they will provide a precise set of professional services to facilitate it. However, the agreement

contains a condition precedent. That condition precedent, or necessary event, is that the merger or acquisition actually takes place. If the merger or acquisition does not take place there will be nothing that the management company is obliged to do and nothing that the requesting party needs to pay for. In this context it would be unwise for the management company to spend too much time and money in preparing to meet contractual obligations that may never come to pass.

Variation clause

Contracts will usually include the basis on which they may be varied. Generally speaking, the only means by which a written contract can be varied is by agreement of the parties recorded in writing. This is because the contract sets out the way a variation must take place. Often the agreement is recorded in a formal document entitled something like 'Variation to contract between X and Y dated 1 January 2007'. However, an exchange of letters may be sufficient to satisfy a variation clause that needs to be in writing. It depends very much on the words used in the clause. If the contract is well prepared it will generally not allow for any variation other than in writing. This is sensible. The primary agreement is in writing. So should the variation be. Also, it promotes certainty and allows the parties to clearly see what they have to do under it.

It is important to acknowledge a clause of this kind as you may not be able to vary the contract other than by written terms.

Example

Say you have a discussion with a representative of your counterparty. You believe you have agreed a variation of the contract. It is never put in writing. You rely on that variation in performing your obligations. It is alleged you have breached the contract even though you did what you thought was agreed.

The variation is unenforceable because it is not in writing. Here the opportunism of your counterparty may cause you to suffer genuine financial damage. While they in principle agreed to the variation, this is not recorded

as required by the contract. This leaves it open to them to assert that no variation of the contract occurred given all the rules have not been complied with.

Variations can also be oral depending on what the contract says. But again, my prejudice for written contracts comes to the surface. The problem of uncertainty prevails in oral variations. A fight about the variation is generally the last thing you want.

Entire agreement clause

You may need to make a decision whether the written agreement records the entire agreement between the parties. If you have taken the time and energy to put the agreement in writing, it generally should. This will ordinarily mean that an entire agreement clause should be added to the agreement.

The effect of an entire agreement clause is to ensure the parties acknowledge the agreement records all the rights and obligations that exist between them under the contract and that there is nothing outside the contract or any oral terms not set out in the agreement itself.

Entire agreement clauses can be extremely important if you are the stronger party to the contract or a buyer of a good or service. If you have done a good job in setting out in the contract what you want from the vendor and their obligations under it are clear, an entire agreement clause is a further strong protection for you. If the document has all you want, you are ordinarily best served by this type of clause.

It means it cannot be alleged that there are other terms and conditions that regulate the way the parties deal with each other under the contract. You have certainty. A clause in these terms will generally say there are no express or implied conditions, warranties, promises, representations or obligations in relation to the agreement other than those implied by law.

Example

> A company enters into an agreement with a waste services organisation to dispose of its industrial waste. A short-form agreement is entered into. It has an entire agreement clause. The agreement provides for payment by the disposer on a per-tonne removal of waste basis. However during the negotiations a rebate system was discussed: after every

1000 tonnes of waste disposed it was agreed that the waste management company would pay a bonus of a further 10 per cent of the fees earned from that 1000 tonnes of waste. It is not in the agreement. Remember, it was in short form!

The customer makes a claim against the waste management company for the bonus. The waste management company says it was not agreed in the contract and they rely on the entire agreement clause saying the agreement sets out all the rights and obligations of the parties. It has put the provider in an extremely difficult position in seeking to enforce what it considered to be a contractual right. They probably cannot. The entire agreement clause works against them.

While one can never say ‘never’ in this situation, the court will generally say the entire agreed clause is there for a reason and therefore will uphold it. The provider would in all likelihood have to show deceptive practice by the customer. This is hard.

Governing law clauses

The parties in an agreement will usually decide which legal jurisdiction will govern the contract. If it is a contract between two interstate Australian entities, they may decide on a particular State or Territory. If it is a contract between international parties, it is necessary to decide which country’s jurisdiction will be the relevant one for the determination of disputes. This is a clause that may be critically important in the event of a dispute under the contract. It seems immaterial at the time of entering into it, but legally speaking will be of profound impact if a dispute develops.

Example

An Australian company enters into a contract with a Dutch software company. The Australian company manufactures telecommunications hardware. The Dutch company makes software that is an application on the hardware made by the Australians. They enter into an agreement where the Dutch company is to provide the Australian company with software for a set fee. The Dutch company provides the software. The Australian company then forms the view that the product is not fit for its purpose and the Dutch company has not complied with its contractual obligations. However, the contract has a

clause that Holland is the proper jurisdiction of the contract. The Dutch company had delivered to the Australian company its standard terms and conditions which, without a lot of thought and consideration, the Australian company had signed.

The Australian company seeks to assert a dispute in Australia. The Dutch company relies on the governing law clause.

It is necessary for a court to determine whether the governing law clause prevails and whether Holland or Australia is the proper jurisdiction. The court will look closely at the negotiation and the term of the clause itself to decide what the parties had intended. Importantly, the court will seek to give effect to what the parties intended. It will not decide on a parochial or nationalistic basis for the convenience of one party or the other.

Joint and several liability clauses

Often an agreement will have a term that says if there is an obligation that binds one or more people or entities they will be liable for the performance of that obligation jointly and severally. If there is an obligation binding two or more entities under a contract, it is possible that the counterparty can hold one of those people alone liable for the performance of that obligation. They do not have a proportional liability. This means that because there are five people all with ‘one’ liability it does not mean they have a responsibility for 20 per cent each. They may be obliged to perform all of that contractual obligation irrespective of the others.

Example

A retailer contracts with a business owned by three individuals (not a company) for updated sales training for its staff nationwide. The training will be expensive. It will involve the trainers travelling to various stores and retail centres around the country to train staff. As a term of the contract, if there is any breach by the trainers, an agreed amount by way of damage is to be paid by them. Certain types of breaches are set out and the amounts they need to compensate the company for those breaches are express in the agreement. There is a joint and several liability clause. This means that if there is any breach and these damages clauses are aroused, the company can pursue any one of

the owners to the exclusion of the others, or all three together. Their liability may be separately or together. It enhances and increases the flexibility of the company in enforcing its rights to specific performance and the damages clause.

Again this is very important when you have a joint venture type of agreement or agreement with counterparties whom you do not control. Breaches of the agreement by them may cause you to assume a much greater obligation and liability than you had intended at the outset.

If you are uncertain about your commercial partners or those on ‘your side’ of the contract and have doubts about their viability and willingness to see the contract through, you should avoid a clause like this.

On the other hand if you are contracting with a number of entities, you should incorporate as far as possible joint and several liability clauses. It means each of the entities will be liable for the entire breach.

Indemnities

Indemnities are safety blankets given by one party to another under a contract. One party says to another that it will ensure the other party suffers no actual loss under the contract arising from its conduct. Generally indemnities set out particular circumstances in which the indemnity applies.

Example

Fast Taxi operates a taxi network in a major metropolitan city. It enters into arrangements with various vendors of goods and services around the city that a 10 per cent reduction will be given on their goods and services for customers of the taxi service. This is regarded as an attractive value-add to encourage more passengers to travel on the service. The vendors of goods and services see it as an important marketing ploy to increases sales. One of the vendors of goods and services is a museum. A passenger of the taxi service relies on their discount to enter the museum. As they enter the museum the passenger slips on a spilled drink and their head collides with the marble floor. They suffer a serious brain injury. They sue the museum and the taxi service for negligence.

> However, happily for the taxi company there was an indemnity in the agreement. The vendor agreed to indemnify the taxi company against demands against it arising out of its performance of its obligations under the agreement that are suffered by a third party or another person. It relies on this indemnity. It succeeds and has no actual liability in relation to the claim.

In this example the indemnity serves as an insurance policy for the taxi company. Any damages and liability it suffers shall be met by the museum on the basis of the indemnity.

Indemnities can be extremely useful when there is a risk of a third party liability arising. That is, a liability to someone who is not in the contract. That liability can be by breach of contract, infringement of the Trade Practices Act, personal injury, defamation or any other type of liability that may arise. The key here is to draft the indemnity clause in the broadest possible terms so as to offer the widest protection.

Guarantees

Regularly in contracts involving companies, a party will seek a guarantee from the shareholders, directors or officers of the company entering into the contract. It is possible to trade with companies that have very limited assets and that offer those controlling the company great protection from personal liability.

Example

> A large commercial landlord enters into a lease over office premises. The company lessee is without assets. It is not insolvent, however, in the event it is sued and a judgement made, no money could be obtained in satisfaction of the judgement because the company has no assets to be realised. The landlord seeks a guarantee from the directors of that company that if there is any default under the lease they will stand in the shoes of the corporate tenant and make good personally any loss that the company has caused. It places the company’s liabilities in their hands. It protects the landlord if the company does not perform its obligations.

In order to protect their position, a counterparty to a contract with a company may seek guarantees from the individuals standing behind the company so as to make sure they assume liabilities for the company under the contract if they arise. This should focus their minds more on performing the contract to the letter and not breaching it. It will mean they are personally liable for any breaches.

As a matter of law, the company and its officers and directors have separate legal identities. They are not one and the same. A liability against a company is not a liability against its directors and shareholders.

An important part of a clause in these terms is that the counterparty may be in a position to compel the directing officers of the company to give a guarantee where they effectively stand in the shoes of the company in the event of a liability. Because of the fragile commercial situation the company has, they may not be willing to do this. However, if they sign a contract undertaking this obligation, their counterparty may be able to get specific performance of it. That means a court may compel them to execute a simple-form guarantee.

By a failure to closely scrutinise the contract and understand the guarantee clause they may unwittingly enter into an obligation that they do not want to have but cannot get out of. On the other hand no guarantee means great risk for the other party if the company goes under.

Confidentiality

One or the other party may seek that the agreement be confidential. Often it is not necessarily in both parties' interests to maintain that the agreement be confidential. It is important to consider whether confidentiality is something that is in your best interest. Equally, if you would like to shout from the rooftops that you have a contract with a particular entity, do you renege on the deal if they insist that the agreement be confidential?

It is important to look at why you are entering into the contract. If it is a 'flagship' contract it may assist you in marketing. If the other party wants to keep the existence of the contract confidential, this may make it less appealing.

Example

Big News PR firm does a deal with a major merchant bank to handle its public information management and corporate reputation. The bank is very image conscious. As a matter of policy it does not like its counterparties publicly stating they have it as a client. The bank insists that the existence of the contract be confidential. That means no disclosure about it. This goes against what Big News wants to do. It sees this contract as marquee business and it wants to provide this relationship as a means of getting bigger and better work. It wants the radiated glory of the success of the bank. The bank makes lots of money and Big News wants to be able to tell people it acts for an entity that makes lots of money. It considers the fact that the bank has chosen it to be a great vote of confidence that others will also give. This was a major part of the benefit Big News thought it would get when entering into the contract. Now it won't get it. Is the contract still worthwhile? This is the question for Big News. The rates are bad and the bank wants the world for a song.

The other type of confidentiality relates to the terms of the contract only. This may mean a party wants to keep certain confidential terms undisclosed. This may be for a kaleidoscope of good commercial reasons.

Example

Reliable Car Rentals does a deal with Clear Air, a domestic airline. It offers rebates to Clear Air for referrals and enters a marketing joint venture. Reliable wants people to know about the relationship generally. It does not want other businesses to know about the rebates. It has preferred-user deals with a number of large hotel chains without the rebate. It knows they will ask for the same deal if they know about it. Reliable does not want to offer it, so it incorporates a term of the contract that the rebate is confidential and not to be disclosed by Clear Air. The agreement in its other terms must be promoted publicly for its success.

Warranties

Warranties are an important part of commercial contracts. They generally involve a party giving clear representations as to facts. Generally speaking,

those warranties relate to the commercial state of affairs a contracting party has as at the time of entering into the contract.

Example

> Big Storage Pty Ltd seeks to buy Little Storage Pty Ltd. In the contract Little Storage warrants that the accounts as at 30 June 2007 are accurate and valid. Further, it warrants there are no liabilities to any director or shareholder of Little Storage.
>
> The sale of the company is completed on 1 August 2007. After getting the books and records, the people behind Big Storage realise there is a great deal more money in the bank accounts as at 30 June 2007 that was not recorded in the accounts. In addition, significant slabs of money have been paid as loans to the shareholders of Little Storage after 30 June 2007. The warranties have been breached. Big Storage makes a claim against Little Storage for breach of those warranties.

It is critical that you ensure that warranties are absolutely factually accurate. It is a high-stakes game to give warranties that are not absolutely and clearly true at the time of entering into the contract. Your counterparty will rely on those warranties on entering into the agreement. Those warranties not being absolutely correct may cause you a significant liability if you are anything but full and frank.

If you cannot give a warranty in the terms requested that is satisfactory, do not give one at all.

There are various ways in which warranties can be crafted so as to ensure they are accurate.

The wording of warranties is often an area of prolonged discussion. This is because the party giving the warranty needs to make sure what it says is precisely and absolutely true and as narrow as possible.

The court will strictly construe the warranties. That is, it will look at what the warranty precisely says and means. On this basis the more precise the warranty, the more limited the fact you are asserting. As a consequence, you are in much better shape in proving that warranty was not false and was at all material times true.

Dispute resolution clauses

Sometimes in contracts parties will regulate the way in which disputes are to be dealt with. Again, these clauses seem innocuous when negotiating into a contract but may become extremely important when a dispute arises. There are generally three ways disputes are resolved:

1 *mediation* — a formalised negotiation at which neither party is ordered to do anything but it is hoped that a settlement can be reached

2 *arbitration* — court-like proceedings where a decision is imposed but not by a judge

3 *court proceedings* — a judge hears the dispute and determines who is in the right or wrong.

Each of these dispute resolution mechanisms has important benefits and disadvantages. It is important that you closely consider these benefits and disadvantages in deciding which of the dispute resolution mechanisms potentially fits your needs best. I deal with some mechanisms below.

This decision is generally best made with your lawyer who is probably more familiar with these strategic considerations.

Waiver

A party may waive all or part of its rights under a contract. Waiver of rights means the party does not insist on the strict performance of an obligation in the terms of the contract or it gives up its right to enforcement of that term at all.

Waiver of contractual terms occurs extremely regularly in modern contracts. This is because the party to the contract at the outset cannot contemplate all of the swings and roundabouts that they may be subject to during the contract. Waiver is a flexible way in a good contractual relationship of ensuring the needs of the supply of the good or service can match the wants of the buyer.

Contracts regularly have clauses that either:

- set out that there will be no waiver of any rights under the contract except made in writing — this means that if there is any oral waiver or otherwise it is a matter that needs to be confirmed by a document ordinarily signed by the party waiting
- stipulate that any indulgence granted by one party to the other during the course of the contract does not constitute a waiver of a right or constitute a variation of the contract
- specify that no partial exercise of any power or right stops the party insisting upon the strict terms of the contract in future.

In these contexts the waiver clause has two purposes. They are to ensure:

1 no waiver occurs without writing for the purposes of clarity of communication

2 any indulgence granted by one party to another is not an implied waiver of contractual rights. It may be a one-off instance but not create a new mode of conduct.

Severability

While this sounds like a medical term, it can be an important aspect of contracts. The law changes from time to time. What may constitute a valid enforceable contractual term today may not be so tomorrow depending on the decisions of a court or any legislation enacted by Parliament.

On this basis it is important to corral, or sequester, terms of the contract that become unenforceable from the document as a whole. This means any term of the contract that cannot be put into action as a result of changes to the law does not infect the other contractual terms or the whole agreement itself. In this sense, the term that is in breach of the law becomes severed or excluded from the contract.

It can be useful in certain contracts to expressly state that if a term is unenforceable all other provisions that remain valid at law remain of full force and effect. It is only the term of the contract that falls foul of the law that is severed or excluded from its operations.

This can be a useful device to ensure that the rights and obligations you have under the contract remain binding even if one part of it becomes unenforceable.

Fundamental terms clause

Fundamental terms are the most important terms in the contract, as the name suggests.

The breach of a fundamental term gives rise to a right to terminate the contract in the hands of the other party. A breach of an ‘inessential’ or non-fundamental term only gives rise to a right to sue for monetary damages.

There is a general guide at law as to what are fundamental terms and what are not; however, the dividing line is never clear. Whether a term is a fundamental term or not depends more broadly on the subject matter of the contract, the contracting parties, their intentions at the time of entering into the contract, what terms are necessary to make the contract work as a commercial instrument and what the term itself does.

In certain circumstances it may be useful to identify the fundamental terms of the agreement to avoid uncertainty. A clause of this type would identify the parts of the agreement that would give rise to a right to terminate the contract if breached. A clause like this would work in tandem with a termination clause.

However, you need to closely consider whether a fundamental terms clause is to be to your benefit or otherwise. It will generally not be to the benefit of the supplier of the goods or services. They will want to maintain some flexibility.

On the other hand, for the purchaser of a good or service predictability as to delivery is essential. In the event of delay or some other quirk in the delivery of the good or service, the purchaser may wish to keep its options open to terminate and the clause should contain broad rights in this service.

This is an example of an innocuous-looking clause in the agreement that may have fairly severe consequences for one or other party depending on whether it is incorporated in the contract and the precise clauses identified as being fundamental terms of the contract.

Successors and assigns

This clause binds future parties to the contract.

Successors at law are those who buy your company business or take control of it in the future. It also applies to individuals.

Assigns are entities or people to whom you have given your rights and obligations under a contract.

A clause in these terms states the parties agree that the benefit and obligations in the contract bind successors and assigns of both parties.

Example

> Speedy Couriers runs a delivery service for parcels and packages. It has developed a reputation for fearless speed and accuracy. It is taken over by National Couriers. National Couriers is the leading courier company across the country.
>
> Speedy has a contract with Grafix — a graphic design company. It delivers plans, diagrams and other work done by Grafix to its clients in the city on a daily basis.
>
> Speedy is to be sold to National Couriers.
>
> There is a general master agreement between Speedy and Grafix. It contains a successors and assigns clause. That means that all of the contractual benefits Grafix gets from Speedy will transfer to National, the new owners of the business.

Variation clause

Variations to agreements are part of commercial life. They need to be agreed by both parties. It is generally not possible for one party to unilaterally vary an agreement — that is, without the agreement of the counterparty.

It is possible to set up in your contract the way in which a variation of the contract may take place. Generally speaking, if the contract has been properly negotiated and is fully set out in writing, the agreement records that any variation to it must also be in writing. The clause may also set out the manner in which the variation is to take place. This can be by a further agreement or deed. Alternatively, it may be merely by exchange of letters. This is an important matter to turn your mind to at the outset. You do not

need to mandate or forecast what the variation may be. All you have to do is to make sure there is provision in the agreement for a variation to take place and how you think this should happen.

Notices

While it seems a boring and mundane issue, it may also be important for a regime to be constructed where one party is to give the other notices under the contract. This is particularly important when notices of breach are in play. Otherwise, notices as to variation of the contract or for any other purpose are often better delivered by an agreed and structured method. It avoids any dispute down the track based on ‘I told you about that’ by an informal means. It also regulates the flow of information under the contract so that anything important becomes notified in a structured and proper manner.

Generally notice provisions regulate:

- the manner in which notices can be provided (hand-delivered, sent by mail, fax or email)
- that a notice is given if it is delivered in a certain way (by one of the means set out above that can be proved by evidence that dispatch actually sets out the identity of the person to whom the notice should be sent and relevant contact details).

If the contract is one in which there are likely to be notices, it can be really important that the information is delivered strictly within the terms of the contract. On this basis you may have an extra clause saying that a notice not delivered in the approved manner is of itself invalid as a notice to give rise to rights under the contract.

Example

> Sure Logistics has a contract with Fresh Food Supermarkets. The contract has an exclusivity term. That is, Sure must only provide logistic services to Fresh Food. Sure wishes to enter into an arrangement with a larger supermarket chain. To do so, it is necessary for it to terminate its contract with Fresh Food. The managing director of

Sure sends an informal email from his Blackberry after a meeting with the new contracting party telling Fresh Food that it has ended its relationship.

However, the contract provides that a formal notice of termination must be delivered providing 30 days' notice of any termination to Fresh Food CEO on Sure letterhead and signed by the MD.

Fresh Food, in its desire to find a replacement logistic service provider in the interim, contests the termination. It says that the termination was not properly executed because a notice was not validly sent. Sure had not honoured the terms of the agreement in the manner in which it sent the notice.

Assignment clause

Broadly defined, an assignment is the transfer of rights or interests in a contract to another party.

There is a significant body of law on rights and entitlements that transfer under an assignment.

There are two ways assignment clauses are used in general commercial contracts:

1 a prohibition on the contract being assigned, attempting to stop this taking place

2 assignment generally being permitted by the party not being able to reasonably refuse consent to the assignment.

Some contracts are not susceptible to being assigned. This is particularly so if there is a service of a quality or character being provided by one entity to another. It may simply not be possible in the market to get someone to replace your service provider at the same level of skill, quality and experience. In this context it may be appropriate to enter into an agreement expressly precluding assignment by either party of the contract. It is, and was always intended to be, a contract between the two parties only. There is no intention for any replacement of either party. If one or the other cannot buy or deliver the service, the contract will be deemed at an end or some other arrangement reached. This is important in the context of drafting your termination clause.

Notwithstanding the above, a halfway house can be reached. It may be that assignment can take place with the written consent of the other party. While this generally conforms to the position at law, it still may be useful so as to be absolutely clear to indicate in the agreement that an assignment of a right cannot take place without the prior written consent of the counterparty. This is the type of clause you would add when you have a good relationship with your counterparty and do not think they will be difficult if you wish to try to assign your rights and obligations under the contract to someone else in due course.

If you anticipate that the relationship may not be eternally harmonious you may wish to have a clause that allows you to assign the rights and obligations on notice. The counterparty will be bound to consent to the assignment acting reasonably. This basically means if a contracting party of a similar size, quality and nature to you can be sourced by you as your replacement, it will ordinarily be difficult for your counterparty to reasonably not consent. The general rule here is, all things being equal, a clause like this facilitates the assignment taking place.

Force majeure

A force majeure clause can be more colloquially referred to as ‘an act of God’.

It generally means that circumstances beyond the reasonable control of a party occur that prevent them from performing their obligations. However, if they have any fault or any negligence in the event occurring, they cannot generally seek the protection of the force majeure clause.

Example

> Swift Sneakers are a sneaker manufacturing company. They are riding the crest of a fashion wave and their products are in high and insatiable demand. While their design and marketing takes place in Australia, the manufacturing of the sneakers occurs in a large purpose-built factory in Bangkok.
>
> They have undertaken joint marketing with a number of substantial retail stores and promised a new range for the upcoming spring fashion season. This requires them to have shoes manufactured and delivered by August.

The manufacturing process is well under way in mid May. However, overnight there is an explosion at the factory and it burns down. The factory and everything in it is destroyed. This means that Swift will not be able to honour their contract with retailers. This will be a source of concern for retailers because they have marketed Swift as being one of the up and coming brands and have considered them to be a big attraction for shoppers. Retailers indicate they will lose sales and foreshadow a damages claim.

Swift, very wisely given its business circumstances, incorporated a force majeure clause in its standard terms and conditions with the retailers. It invokes this clause to explain its breach of contract and as a consequence relies on the term that allows for the suspension of its obligations until the circumstances giving rise to the unfortunate event can be resolved.

The elements of a force majeure clause are generally as follows:

1 *A definition of what a force majeure event is* — generally it is defined in the inclusive way. That is, it can be any event that stops business but includes things like strikes or industrial action, war, governmental legislation or orders, quarantine or customs, a natural disaster or similar calamity outside the control of the parties.

2 *Sets out what are the consequences of a force majeure event occurring* — this is usually suspension of the contractual obligations or immediate termination of the contract and would depend largely on the parties and subject matter of the contract and the commercial circumstances in which the contract takes place.

3 *The procedure a party seeking to invoke a force majeure must employ immediately the event arises* — this generally means an agreed form of notification and can also contain an obligation that it must promptly and efficiently and as soon as possible restore itself to a position where it can perform its contractual obligations in the event they are suspended and the contract is not terminated.

Exclusivity

Sometimes it may be appropriate to try to tie in a contracting party exclusively. This is particularly so if you think you are given a competitive edge by the sole ability to exploit their resources and skills. While the Trade Practices Act has a lot to say about matters of this kind, there are ways in which this can be done without infringing that statute.

This however is a matter that requires precise legal advice and a detailed consideration of all the facts and circumstances in relation to the proposed deal.

Given the powers of the ACCC a badly worded or ill-devised exclusivity clause may see a dawn raid on your offices seeking to extract information that the ACCC alleges constitutes anticompetitive conduct. This is obviously an event to be avoided. Exclusivity, while it can be extremely useful, needs to be looked at in the context of the relevant law at the time the contract is entered into.

Restraint of trade or competition

As with exclusivity, restraints of trade or competition can be a valuable tool to protect your business and confidential information within it.

It is important to bear in mind there are two levels of restraints in the ordinary course of business. They are:

1 a restraint on the employee or competitor from competing in the same field of business

2 a restraint on the use of confidential information obtained by the employee or counterparty in the course of the contract.

The first of these restraints is very difficult to uphold without compensation. That is, if you wish to take out your counterparty from the market for a period of time, the law generally considers this unfair if you have not paid them for this period of time. You are seeking to deny them their income-earning capacity without making good their loss.

The second form of restraint of confidential information is more readily enforced but relies generally on a precise and appropriate definition of what constitutes the confidential information in the commercial context. This is a matter in relation to which you should pay a huge amount of attention on entering into a contract. Where you think your counterparty will have

information in their hands that, if used against you, removes your competitive edge or diminishes your ability to keep your market lead you need to identify it clearly.

I can’t emphasise enough that precision is crucial. The more detail in which you can identify the categories of information and, if possible, the pieces of information themselves, the better position you are in to identify clearly in the contract what the other party cannot use.

Again, restraints require delicate drafting. It is a matter that you should closely consider.

As a rule of thumb, the key is not to be greedy. Seek a restraint that you honestly and genuinely believe you need to protect your business. Do not ask for anything more. If push comes to shove and you are forced to test the restraint in court proceedings it will be necessary for you to, generally on oath, indicate why the restraint is needed. In my experience, courts form an adverse impression of a party if a restraint is drafted high, widely and handsomely where something far more limited and, in all the circumstances, fair is adequate.

Exclusion of warranties

Just as it may be important to include warranties in the agreement, you can expressly exclude them.

It is generally not possible to exclude the implied warranties incorporated by law. These are imported into every contract as a matter of law. The Parliaments of the Commonwealth and of all states have decided that contracts should have these terms. It is not possible for you to decide that you don’t like the look or taste of those terms and therefore to exclude them. You may set out in the agreement that nothing in it seeks to restrict, modify or vary any condition, warranty or liability that may be implied by certain acts. However, you don’t have to as the law operates in this case anyway.

Putting aside these legally imposed warranties, it is possible to exclude any warranties to the agreement if they are not given within it. A clause of this kind would say clearly that there are no implied conditions, statements or warranties about the quality or nature of the goods or services supplied. They are intentionally and overtly excluded. As a corollary, it may also be

important to say that the party excluding the warranty will not be liable for any claim for a breach of the warranty when in fact it has not been provided. Even better, it has been expressly and deliberately excluded.

Statement of no infringement of third party rights

Sometimes, and depending on the nature of the business conducted by your counterparty, you may want them to expressly state in the agreement, in the nature of a warranty, that they do not infringe any third party rights, be those rights in the nature of intellectual or personal property.

Clauses of this kind are regularly used where your counterparty employs intellectual property or software licence rights in the course of the contract. You may want an express warranty from them that there is no breach of the rights of any third party and that all relevant licences are issued and held by the contracting party so as to ensure:

- they can perform the contract and will not be the subject of any litigation for claims for breach of any rights that will in turn cause them to be unable to perform their obligations under the contract
- avoidance of any allegation that you have been complicit in a breach of intellectual property or other rights with them and therefore yourself open to a claim.

While this clause is not absolutely necessary, it is a failsafe and classic safety net type of provision. It serves as a statement by one party to another of the state of affairs.

Termination/default

This is a highly important clause.

As we discussed in the springboard–safety net distinction, no party enters a contract hoping for the worst. People in business have a degree of confidence about their ability to cut through the stormy waters and make

sure the relationship stays strong. However, there are instances where this does not occur. You cannot unscramble an egg.

In this context a termination clause becomes often the focus of great scrutiny for and on behalf of a party seeking to get out of the contractual relationship.

A lot of time and energy needs to be devoted to the terms of this clause prior to entry into the agreement. The ‘get out of jail’ is as important as the steps through the gates of heaven.

There are many ways to draft a termination clause.

The key matters to bear in mind in the process of considering such a clause are:

- What do I need as a matter of commerce in order to get out of the contract?
- What do I need to do to exit this contract?
- What are the business implications for me?

Depending on the answers to each of these questions you will be in a position to decide whether you want a ready ability to terminate the contract or are happier for there to be a longer exit period.

Never assume that the right to terminate in a termination clause is the same for both parties. It is a regular device used by providers of goods or services proffering ‘standard terms and conditions’ that they have a ready and easy right to terminate the contract often on a very short period of notice whereas the purchaser can only terminate for breach of a fundamental term and only after giving the supplier 30 days or more to remedy the breach.

Here is clearly a substantial inequity of termination. On the one hand the supplier can go when it wants. The purchaser, however, must identify a fundamental breach, give the supplier an opportunity to remedy it and if it can’t, only then terminate. This is often in the context of there being a fairly poisonous relationship with the supplier for the period between when the breach is notified and the time when its remedy expired. If the supplier scrapes in and fixes the problem at the last minute, a tense tone in the relationship may prevail.

Looking from a distant and broadly moral perspective, clauses in these terms are unfair. They confer a greater flexibility and dexterity to one party over the other.

There is no necessary reason for this. In most contracts there is no such an apartheid of rights. It is all about the negotiation and bearing in mind the safety net.

Example

> EDU is an online education course provider. Wide is an internet bandwidth provider. EDU and Wide enter into a contract for Wide to facilitate EDU in providing online educational services to its customers.
>
> They enter a contract that provides Wide can terminate the contract on 30 days' notice. EDU must continue to use the services for those 30 days and Wide can invoice up to and including the last day on which the contract is in force. On the other hand EDU can only terminate the contract if there has been a fundamental breach of it by Wide (which specifically arises only through circumstances in the contract itself) and must provide Wide with 60 days to remedy any breach before the termination is triggered. That means from the date of the notice until the period ends there may be conceivably 61 days in which the breach prevails and an inadequate service by Wide is maintained. There are no clear set-off rights in the agreement for EDU not to pay or to pay a lesser amount to Wide.

This contract is all about being one-sided. It is somehow worse that the one-sidedness was supervised and, implicitly, endorsed by EDU! It did not even try to negotiate a better deal. It probably skimmed the termination clause and assumed the same rules applied for either party. It wishes to get out of its contract and has a serious problem.

The court will generally uphold a termination clause like this. It will consider that, if the parties turn their minds to an issue of this kind, what they have said in the agreement reflects the way in which the deal is to be done.

Liquidated damages clause

It may be possible for the parties to agree the consequences of the breach or termination. However, legally speaking, you are swimming in possibly troubled waters in this context. It is very important that you precisely identify what the likely or anticipated consequences of the breach will be for you. You should avoid imposing a penalty in the agreement on the other side for breach giving rise to termination. This will not be upheld by the court. A penalty is a failure to pre-estimate the damage you will suffer and merely an attempt to extract a windfall from the other party.

Example

> The Sydney Scallops football team hire a pontoon boat for an end-of-season trip. They agree in the hire agreement to a damages clause. If it is necessary for the pontoon owner to fix any damages after the cruise, it can charge the club no less than $15 000 for those repairs, no matter what they are. During the course of the cruise, and notwithstanding the impeccable behaviour by the footballers, a rail is broken.
>
> The pontoon owner sends an invoice to the club for $15 000. The club raises a query about the invoice. The pontoon owner relies on the contract clause. In actual fact the railing cost only $250 to replace.
>
> The pontoon owner in a moment of contractual bravery sues the club for the balance of the money ($14 750).

The general test the courts apply in relation to deciding whether a contractual term is a penalty or otherwise is to:

- consider the damage that the party actually suffered
- look at what the clause says
- decide as to whether the clause, in the context of the damage, is extravagant and unconscionable.

The key in liquidated damages clauses is to do as much research and due diligence as you can to ascertain what your likely damage is to be if there is a breach of the contract. In many forms of contract this is just simply not

possible. On that basis it is often unwise to include a liquidated damages clause if you have no reasonable grounds for forecasting either:

- the range of the likely breaches
- what the commercial consequences of those breaches are to be.

Further assurance

Sometimes parties need to do further things and execute further documents in performance of their contractual obligations. The contract should contain a term which is a general undertaking from one party to another saying they will do whatever else is reasonably necessary to put the terms of the contract into place.

Example

> John sells a hot dog shop to Jim. As a term of the Council Development Consent, John needs to assign to Jim his rights to run the hot dog shop and his hot dog vendor's licence. This is not referred to in the sale agreement. Jim realises this one month after he buys the hot dog shop and gets a visit from the council inspector who threatens to close him down.
>
> Jim contacts John and requests he execute an assignment form. He relies on the further assurance clause in the contract in which John agreed to do all things further in order to put the contract into place. Honestly and subject to his contractual obligations John executes the document.

GST

The goods and services tax has been in place since July 2000. Clauses of this kind in contracts appear extremely dry and uninteresting. However, they can have very serious implications. This is a matter you should address with your accountant in detail. It is extremely important that the GST clause reflects the position you wish it to have. The key is ascertaining who has the

liability to pay the GST. Secondly, if GST is levied does one party have to account to the other? If so, how? These are all important questions that need to be negotiated and reflected in the agreement clearly and unambiguously.

Other clauses

The above list is not intended to be comprehensive. There is a vast range of contractual clauses that parties may seek to insist upon that are ancillary to or seek to flesh out the rights and obligations of the parties under the contract. The terms of those clauses are highly important.

They have the capacity to be Trojan horses. Look at them closely. Decide whether you are happy with their terms. If you are not, do your best to renegotiate them. On the other hand, can you do a better deal on those clauses even though they are acceptable in principle?

Again, all terms in a contract are up for negotiation. Depending on the goodwill of your counterparty, the possibility for drafting a deal is endless!

What you need to add largely depends on the subject matter of the contract.

You may need to obtain government approvals in order to do the deal. You may need to insert condition precedent clauses. These will need a separate contractual term dealing with the steps the parties undertake.

I have set out the regular and ordinary clauses that a commercial contract may have. However, the more complex the contract, sometimes the more detailed and complex the clauses need to be. In this context you should work closely with your lawyer in order to make sure the contract addresses all relevant matters to keep the equilibrium between the springboard and the safety net!

Chapter 6

Traps for the seller — pitfalls in negotiations

Commercial negotiations can be a risky business. Your natural impulse to enthusiastically market the products and services you deliver can have the potential to lead you into legal trouble.

Misleading and deceptive conduct — what is it?

The law says you cannot engage in misleading and deceptive conduct or conduct that is likely to mislead or deceive.

Section 52 of the *Trade Practices Act 1974* provides the following:

> *A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.*

This section applies nationwide. There are respective provisions in state legislation on dealing with ‘persons’ so that both companies and almost all other entities are covered as far as misleading and deceptive conduct is concerned.

The range of activity that may be misleading and deceptive is extremely broad. An example of some of the conduct that can be misleading and deceptive is as follows:

- spoken words
- written words
- gestures
- silence or failing to respond to a question or proposition
- advertising or marketing
- doing things on the basis of an assumption that had developed between two people

- predictions or opinions
- the direct comparison of products or services.

Misleading and deceptive conduct can be anything that creates an impression in another person about a state of affairs or certain facts that is misleading and deceptive. It is not necessary for you to intend to be misleading and deceptive to infringe this area of the law. Innocent statements made with the best of intentions with an honest belief in the truth of the comment can still be misleading and deceptive.

Example

XYZ Computers Pty Ltd is a company that sources and sells computer hardware. Freedom Finance Ltd is a medium-sized financial institution. Freedom Finance seeks to open a new branch. A procurement officer from Freedom Finance undertakes a negotiation with a representative from XYZ Computers for the purchase of 300 computers (being terminals and PCs). During the course of negotiations the procurement manager from Freedom Finance says, ‘You guys have the best price, things are looking good. It all looks great! We would love to do business with you. What are your delivery times like? We will need the computers in three weeks. Can you deliver?’ The sales team member from XYZ Computers says, ‘That’s no problem. We will place orders with our suppliers today to make sure we can meet your three-week deadline.’

The Freedom Finance representative makes no comment in reply. The true position is that Freedom Finance is negotiating with three hardware suppliers and is seeking to extract the best price. While the XYZ Computers price was the most competitive in the negotiations to this point, Freedom Finance does not want to commit to a service provider until it finally explores all options to extract the best deal.

As a result of the conversation XYZ Computers places an order incurring a liability of $700 000 with its respective suppliers of terminals and PCs. A week later the procurement manager from Freedom Finance sends a letter to XYZ Computers thanking them for their time but indicating they will be sourcing the computers with another business. XYZ Computers has committed to orders from its suppliers. Those commitments are irrevocable. It will need to pay for the terminals and PCs irrespective of whether there is a final contract with Freedom Finance.

> Now assume the Freedom Finance procurement manager had not made a comment to the effect that, ‘This all looks great! We would love to do business with you’, but had merely not responded to the assertion by the XYZ Computers representative XYZ would be ordering product. Its silence may still be considered by a court to be misleading and deceptive. This is because the court may consider their conduct predatory. It may be seen that a reasonable and proper response was for the Freedom Finance manager to say, ‘Don’t do anything yet. We are still negotiating with other parties. We will contact you and have a written contract drawn up when and if we agree to go with you.’

XYZ Computers may allege it was misled and deceived by the procurement manager from Freedom Finance in that he did not clearly indicate that negotiations with other suppliers were continuing and that there was no contract. It interpreted that conversation with the Freedom Finance manager as meaning that it was to order product. The Freedom Finance representative let the response hang without telling XYZ this would be unwise given there was no commitment in the eyes of Freedom Finance.

Depending on the final terms of the evidence given by the witnesses on either side, context being everything, it may be that a court finds Freedom Finance liable. This liability would arise even though there was no intention by Freedom Finance representatives to mislead and deceive.

Written and spoken words are the most common ways in which misleading and deceptive conduct occurs.

Misled by silence?

Silence or failure to respond to a question or proposition may constitute misleading and deceptive conduct. It requires the person engaging in the misleading and deceptive conduct to intentionally withhold information.
Knowingly allowing someone to rely on mistaken understanding as to a state of affairs may be misleading and deceptive conduct in this context.

The good news is that making a misleading and deceptive representation is not enough for a claim to be made against you. It is necessary for the person to whom the representation has been made to *rely* on that

representation. If they have not relied on a representation, no claim can be made.

Example

A representative of a professional services partnership attends a meeting with a prospective major new client in the mining industry. During the course of the meeting the prospective client is advised that the professional services firm acts for three corporations with international mining interests. The purpose of this representation is to add a lustre to the firm and show that it has industry experience with some of the top players in the field. The marketing manager fails to advise that the firm has not done any work for these clients for five years and the relevant principals at the firm with contacts with those businesses have since left.

On the basis of its price competitiveness the prospective client enters into a contract for services with the firm. It later comes to light that the representation was misleading and deceptive in that the firm did not have the three international mining businesses as clients as at the date of the representation and that the principals of the firm who had contacts in that area had long since left.

The new client complains to the firm about misleading and deceptive conduct. It foreshadows a damages claim against the professional services firm.

As set out above, an essential aspect in establishing you have suffered damage arising from misleading and deceptive conduct is that the representation has been relied upon. The mining industry client admits to price being the most important. It may be difficult to persuasively establish to a court that it relied solely upon the assertions of industry know-how in its retention of the professional services firm. Many other factors such as availability, reputation and primarily price inform its choice. In this sense it will be difficult for it to persuade a court that if the representations of industry know-how had not been made, the client firm would not have been retained.

Example

A representation is made by a manufacturer of parts for car assembly plants that it can source a part necessary to repair a broken-down piece of assembly equipment from the US within 48 hours. It quotes a premium price to the car manufacturer given the speed of sourcing the part and that it is only one of two Australian businesses that can get it and have the machine working again. Later a written quote is provided indicating it will take no less than five days for the part to be sourced from the US after the quote was received. The customer instructs the distributor to source the part from the US. On the third day after the quote has been sent the car manufacturer complains about the absence of the part. The distributor refers to its written quote and says that its ultimate representation, and a contractual term, was that the part could not be sourced earlier than five business days. The car manufacturer complains that it could have obtained the part within a shorter time frame from the distributor's primary competitor. It alleges that it was misled and deceived into entering the contract with the distributor on the basis of the representation that the part could be sourced within 48 hours. However, the car manufacturer ignores the later quote.

A court may find it did not reasonably rely on the initial oral quote given that it was countermanded by a later written quote. It did not rely on the representation. Reliance is key. It is not merely a formal requirement.

Example

A large property trust represents to a property management company that, 'The Board has decided that all of our commercial property management will be placed with you guys from the start of the new financial year. We have seven buildings in the city with 250 000 square metres of lettable commercial space, 98 per cent of which is currently tenanted. You can expect management fees in excess of $1 million a year on the rates we are currently being charged by our property managers at the moment.' Apart from feeling a warm glow of prosperity, the principals of the property management company do not employ any further staff, acquire any further plant or equipment or take any deliberate step to address this influx of new work. They have sufficient capacity in their business to absorb this new work without the need for further acquisition of plant, equipment or staff.

The representation is false. There has been no decision by the Board of the property trust to this effect. In fact, there is an intention to keep the property management

services with the current service provider. The representation is made to dishonestly secure a personal favour by the employee of the property trust making the representation.

The property manager complains of misleading and deceptive conduct by the trust. However, it has taken no steps in reliance on the representation. While it has been misled and deceived as to the position of that property trust with its property management services going ahead, it has suffered no damage as a result of the misrepresentation. It has not altered its position. The claim for misleading and deceptive conduct would be without a consequence, that is, damage, even if there were a later contract.

A misleading and deceptive representation may prevail even though a later contract is entered into. If the subject of the representation is not covered by the later contract then the contract does not dissolve any misleading and deceptive conduct.

Example

A retailer of large-scale audiovisual equipment represents to a public company that all of the AV equipment it sells has a 10-year warranty from the date of purchase — ‘that is why we stand by it so strongly’. On the basis of the quality of the AV equipment and warranty, the company decides to purchase the equipment. The contract reveals no warranty. Four years later the sparingly used AV equipment fails during a major client presentation. It causes major embarrassment. As a result of the appearance of incompetence, a major customer decides to place its further business with another entity. The AV breakdown showed the presenter as a chump. It costs a lot to lose the client.

The company complains to the seller of the equipment that it had failed. It claims repairs on the warranty and alleges damages being the loss of the client solely attributed to the failure of the equipment. The seller responds that there is no contractual warranty for repair as the company did not buy one.

As in the case above, it is a question both of reliance and of a later contract being entered into. It may be contended by the retailer that no matter what representations were made to induce a sale, the contract clearly sets out the terms and conditions of the purchase. If representations were made to the contrary during the course of negotiations, these representations were overtaken by the contract documents. It would assert that a party cannot rely on pre-contract representations to enter a contract that itself is in different terms from the representations. The contract prevails.

On the other hand, the purchaser of the equipment would say that the contract was silent on the terms of the warranty and the representation that a 10-year warranty prevailed over the equipment was very important to it in making its purchase.

Again, depending on the circumstances, there is a risk that a court would find the retailer has engaged in misleading and deceptive conduct. The damage suffered by the company may be the cost of repairing the equipment that the manufacturer would otherwise have undertaken under a warranty. There is doubt, however, that the court would award damages for loss of the client given that it may consider it too remote from the actual damage suffered as a result of the misleading and deceptive conduct (that is, the misrepresentation that a warranty was implied in the contract).

Talking the talk — the art of selling

The law allows a degree of latitude in sales presentations or initial negotiations. Some exaggeration is allowed. Negotiations in very general terms not dealing with specific products or services and the attributes of those products and services have generally do not constitute misleading and deceptive conduct. Examples include:

- ‘Happy Partners Lawyers provides the best legal services in the market.’
- ‘Happy Partners Lawyers is the premier provider of legal services in the Australian market.’
- ‘We deliver a service and product that is second to none.’

Competitors

A significant pitfall for negotiators has been making comments directly about industry or market competitors. There is a natural impulse in promoting and marketing your product or service to address the qualities, attributes and deficiencies of products manufactured by competitors. In this process there may be a tendency to exaggerate or highlight deficiencies in a competitor's product. The law places a great deal of responsibility on you as to the making of the representation. This is called 'comparative' marketing or advertising.

In comparative advertising or marketing you need to ensure all comments about your competitor are absolutely correct. Examples include:

- Things that are generally safe to say if they are provably correct are:
    - 'Barry's Bearings do not make products to the same level of workmanship or materials that we do.'
    - 'Our after-sales service is the best in the market. You will not find better.'
    - 'Barry's Bearings make bearings at a cheaper price. They do not have the same levels of attention to detail in the manufacturing process as we do.'
- Things that are ordinarily unsafe to say unless they are absolutely correct are:
    - 'Barry's Bearings use inferior products and they lie about the materials used in the production of their bearings.'
    - 'Barry's Bearings provide absolutely no after-sales service at all. They advertise this as being one of their great value-ads but you will find if you use them that it just doesn't exist. They are liars.'

- ‘Barry’s Bearings’ products are cheaper than ours because they are not made to proper industry tolerances. The bearings will work for a short period of time and then fail. This can be both unsafe to your workforce and cause huge damage in downtime when your machines aren’t working. Their product is rubbish.’

It is not illegal to disparage or criticise a competitor. However, if what you say is not absolutely true you are in real danger of a claim of misleading and deceptive conduct being made against you. It is a very high risk. In undertaking this form of advertising, marketing or selling you are running a very fine line.

Identification advertising

Often businesses in marketing their products like to identify their customers or clients. If a particular manufacturer of products provides its product to industry leaders, there is an associated glow of quality and pedigree for your product. However, if you seek to use this strategy, precision in what you say is crucial. If they still use the product then it will not be misleading and deceptive to indicate this. However, if they were ex-customers, generally the use of words like *‘the types of businesses who’ve used our fishhooks are ... ’* is appropriate. This contains no suggestion that they are still using your fishhooks if they are no longer customers.

You have more latitude when talking about the pedigree of your customers. It is much less likely that a customer or former customer will take offence at these references and complain. However, if you are going to refer to them in writing, it would be prudent to obtain the written consent of the client.

The hangman’s noose?

What are the consequences for me if it is found I have been misleading and deceptive? Generally, an award of monetary damages is made against a

misleading and deceptive party. The dangers for misleading and deceptive conduct are different from those for breach of contract.

However, it is necessary to establish that actual damage has occurred — that means the misleading and deceptive conduct has actually caused damage. Misleading and deceptive conduct without provable financial damage does not generally justify court proceedings.

Example

Fabulous Software Services Pty Ltd has a high market share and a peerless reputation for business accounting software. Sam the Software Man is a software distributor. Happy Mortgage Brokers is a medium-sized mortgage broking business with 10 branches. Happy Mortgage Brokers wants to buy a new software accounting system. It approaches Sam the Software Man and asks specifically for a tailored software program by Fabulous Software Services. Sam realises the wholesale price of Fabulous Software products of this kind leaves him little margin for profit. Given his long-standing relationship with Fabulous Software he has packaging for Fabulous Software products. In a desire to maximise his profit, he packages Super Soft products (a premium market competitor with Fabulous Software) as a Fabulous Software program and provides it to Happy Mortgages.

Happy Mortgages subsequently realises it has been sold a product inferior to that which it thought it bought. It advises Fabulous Software. Fabulous Software complains to Sam who admits to packaging the inferior product as their own. However, Sam tells Fabulous Software that he provided the Super Soft product.

While Fabulous Software may have a claim for the loss of the sale, it is a small amount of money. It does not commercially justify a claim. Although Fabulous Software feels its reputation has been horribly misused through the misleading and deceptive conduct of Sam, it has suffered no significant damage as a result of the misleading and deceptive conduct.

The question the court generally asks itself in determining whether any damage has been suffered by a party who alleges it has been the victim of misleading and deceptive conduct is: What position would that person have been in if the misleading and deceptive conduct had not occurred? Has the

person making the claim sustained disadvantage as a result of altering their position, as a consequence of the misleading and deceptive conduct?

Example

> An automotive company provides written assurances to a public relations firm that it will place no less than $1 million business with it per annum for three years. The document containing the representation is not sufficient to be a clearly enforceable contract.
>
> However, the public relations company opens a new office closer to the head office of the automotive company, employs further staff and buys plant and office equipment so as to conduct the business. The automotive company then places its business with a competitor of the public relations company. The public relations company would not have opened the new office, employed further staff or purchased further equipment if not for the strength of the representations made by the automotive company. The court finds the automotive company has engaged in misleading and deceptive conduct. It is liable to the public relations company for damages. Those damages are to put the PR company in a position it would have been in if the misleading and deceptive conduct had not occurred. That is, the automotive company may be obliged to meet all further costs of the lease of the new premises, pay staff redundancies and compensate the PR company for all costs ‘thrown away’ in relation to the plant and equipment.
>
> That may mean reimbursing it for all the equipment purchased that is unnecessary for the ordinary conduct of its business and that cannot be redeployed elsewhere. This could be a significant amount of money.

The court examines how much worse off the person who has been the victim of misleading and deceptive conduct is. It does not look at how much better off he or she could have been had the misleading and deceptive statements been true.

The company and its people can be liable

Individuals who are employees or representatives of a corporation can be sued personally for any misleading and deceptive conduct as people who

are ‘knowingly concerned’ in the misleading and conduct. This means the company or employer can be sued jointly with the person making the representations. The company is considered the primary representor. The person who has conveyed the representation may also be sued as having been knowingly concerned in the conduct. Both parties have a potential personal liability.

Example

Sturdy Constructions and Acreage Development Company enter into a joint venture proposal. Acreage Development will commit land it owns and Sturdy Constructions will construct commercial warehouse premises on them. The contract provides a sunset clause for Sturdy Constructions to complete its work. If it does not do it by a set date then it must pay an amount of money in damages to Acreage Development. Halfway through the construction of the warehouse premises a director of Sturdy Constructions advises the director of Acreage Development that the construction will take two months extra given that steel roof trusses from Europe have been delayed. The director of Acreage Development says, ‘That won’t be a problem. We won’t rely on the damages clause. We understand that’s out of your control.’

Three days after the sunset date passes, Acreage Development sends a letter of demand to Sturdy Constructions. It makes the damages claim on the failure to meet the sunset date.

Acreage Development sues.

As a counter claim, Sturdy Constructions alleges that Acreage Development engaged in misleading and deceptive conduct and that the director who made the representation was a person knowingly concerned in that misleading and deceptive conduct and therefore should be liable to the same extent or equally with Acreage Development.

The liability is mutual.

There is a risk the court would find that because the representation was made by a director of Acreage Development in the course of its business, that company is liable. Further, the director, because of personal involvement in the process, has aided, abetted, counselled or procured the misleading and deceptive conduct. Alternatively the

company was knowingly concerned in the misleading and deceptive conduct. Both the company and the director are liable for misleading and deceptive conduct.

The good news! Not all cases of misleading and deceptive conduct mean that damages flow from them. Just because misleading and deceptive conduct may have been engaged in, it does not mean there is a proper foundation or basis for court proceedings as a result of this conduct.

Example

A large accounting firm is fitting out its newly leased premises. The design staff of the company retained to source desks and boardroom tables source Oregon redwood tables. The accounting firm is attracted to the style and shape of these tables but it turns out that the tables manufactured and delivered are made in Thai teak.

The accounting firm is not happy; however, the Thai teak and the Oregon redwood are of similar colour and texture. The Thai teak is in fact significantly more expensive than the Oregon redwood. The design company does not propose to charge the accounting firm any uplift in price and provides a superior product (Thai teak) at the same price as the inferior product (Oregon redwood). The accounting firm nevertheless asserts misleading and deceptive conduct in that it wanted the Oregon redwood. The tables are otherwise fit for purpose and within all the relevant design parameters set by the accounting firm.

The accounting firm has, in all likelihood, suffered no financially compensatable damage. In fact it has obtained a benefit from the misleading and deceptive conduct in that it has got tables of a higher quality of timber notwithstanding that it may not be happy about it. While there has been misleading and deceptive conduct in that it has not been given what it thought it had bought, this conduct has not caused any damage.

The dos and don’ts in relation to misleading and deceptive conduct are summarised in table 6.1.

Table 6.1: dos and don’ts

Dos	Don’ts
Make sure every statement you make is	Don’t exaggerate elements of the deal that will

supportable by fact and is ‘doable’.	be considered beneficial for your customer. Precisely, accurately and factually identify what the purchaser will get, when they will get it and what the products’ general applications are.
Promise and deliver — make sure you can.	Don’t withhold information that is material to your customer’s consideration in buying the product.
Set out in precise detail the qualities and attributes of the products you are selling and your service ability. Tell it like it is.	Don’t attribute qualities or applications to the product it does not have.
Provide customers with the entire picture. If the product was not precisely designed for the application the client seeks to put it to, advise the client of this.	Don’t make promises or predictions about the product that cannot be fulfilled or that you have no reasonable grounds for making. General statements of comfort are okay. Precise assertions of the attributes of the product are dangerous. Do not undertake a direct comparison of your product to a competitor’s products or misrepresent or criticise the competitor or its products unfairly.
Clear up any uncertainties that have arisen. Be clear about any difficulties you will have in either the manufacture or delivery of the product in the time frame sought by the customer — it is counter productive and often dangerous legally to pay lip service to the customer’s demands. The implications may be more than a cranky customer — it may arouse a legal liability against your business.	Don’t say anything you cannot factually support or prove.
Always qualify any representation or sales pitch you make if you can. Do not imply your competitor’s products are inferior if this is not actually true. Do not identify your customers as people who have used the products unless you either know or believe they are agreeable to you using their corporate reputation and branding in this way.	

Chapter 7

The telltale signs of the overseller — buyer beware

Assume for a moment that a buyer does their preparation. They know exactly what they want, when they want it and how they are going to apply the good or service. They have initially taken care of the springboard aspects of the contract. They will deal with the safety net during the course of the discussions.

There is not much more a buyer could do to prepare themselves for the negotiations.

The negotiations start and things are very friendly. How does the buyer know they are dealing with an overseller or someone who is only worried about signing on the dotted line, and that working out how they will perform in the deal is an issue they will postpone for the future?

It is realistic to assume that in almost all contracts there is dimension of bluff and bluster. Both parties at various stages may overstate positions they have or their commercial needs to enhance where they think their strengths in the negotiation are.

Along with this there will generally also be a degree of overselling by the person providing the good or service.

In a contractual relationship, slight overselling is not necessarily a problem. However, if it appears at all, it should happen right at the outset. Often it is necessary to pitch the qualities and attributes your product or service has very highly in the initial phases so as to attract the interest of the buyer. If you do this sufficiently skilfully and speak in very general terms about what your product and service can do for your counterparty and how it can help them in their business, as a seller you will generally be safe.

On the other hand, as a buyer, if you take the general statements on faith and they are the basis for entering into a contract, you are not doing your job properly on the level of either the springboard or the safety net.

While it has now become a cliché, the doctrine of caveat emptor still largely prevails. Buyer beware! There is still a dimension of responsibility

on a purchaser to look after their own interests during the course of the negotiations. Statements that are at a high level of generality are like the preview before the movie. After seeing the trailer you can't say you've seen the film (although with modern Hollywood, there is an argument to say you may have already seen the best bits). You need to descend to the contractual depths.

Example

> James Smooth is a high-profile real estate agent. He has a select piece of waterfront property as one of his listings. He has an affluent single Korean investor interested in purchasing the property. At an initial meeting at Mr Smooth's offices, he tells the investor: 'This is the best waterfront property in Sydney. You won't find better.'
>
> He then takes the investor to look at the house. It is a grand house with fabulous views. The vendor is seeking a top-of-the-market price for the purchase. Given the qualities of the property and importantly what has been represented to him by Mr Smooth, the investor buys the property without dealing with any other agents or assessing the market more generally.
>
> He soon realises he has bought the property at approximately 15 per cent above its real market value and that there are properties with better prospects and nicer views at lower prices.
>
> He complains to Mr Smooth about his misrepresentation of the market position of the house. In particular, he is angry about being told it is the best property of its kind in Sydney. He is of the view that this was simply a lie.

In this case there would be real doubt as to whether the investor had a genuine and sustainable claim against Mr Smooth.

It is a matter of common knowledge that salespeople, and in particular real estate agents, have a gift for hyperbole. This is a more polite way of saying that at times they oversell.

As stated, the law allows for a certain degree of puffery or chest-beating in a contract negotiation. It is highly likely the representation made by Mr Smooth (that this was the best property of its kind in Sydney) would be

considered a puff and therefore was not a representation on which a party such as the investor could rely in entering into the contract.

As a purchaser of a good or service your best guide as to whether you are dealing with a deceptive or shadowy seller is your intuition. It is remarkable how during the course of a negotiation and in conversation you develop a sense of the honesty and integrity of the person you are dealing with. Almost infinitesimal aspects of body language and the more subtle elements of communication create an impression of that person.

However, there are a number of signs or indicators that you can use to identify whether or not you are dealing with an overseller. These are detailed over the remainder of this chapter.

They talk the talk — where is the walk?

The classic formulation of the spiv is to congest their conversation with myriad concepts that both disorient and seduce the purchaser. It is important to be wary of fast talking and high-pitched promises that are grandiose. Assuming that the purchaser is a sophisticated acquirer of goods and services and knows what they want, they will have a sense of what the good or service can actually do for them in a business or other context. Promising the world when something less is actually what is asked for is both unwise on the part of the seller and is an early indicator that you may be dealing with a contracting counterparty who is less than frank. This is an early warning sign.

The talk and the reality don’t match

As set out above, it is important to always consider what you are being told in the context of the product, service or asset you are buying. This will provide you with a powerful insight into the honesty, integrity and confidence of the person seeking to sell it to you.

Example

Fred wishes to sell his Italian trattoria to Fletcher Food. The trattoria at maximum can feed 50 people in a sitting. It is only open for lunch and dinner and closed on Mondays

and Tuesdays. The sales figures presented to Fletcher by Fred reveal a thriving business that appears to be going at maximum velocity for each moment the doors are open. Fletcher, while experienced in the restaurant industry, has no personal experience of the geographical area in which Fred's business is located and has never run a trattoria before. Fletcher is enticed on the basis of the profit figures as presented, and enters into a contract.

Using the example of Fred and Fletcher again, at no stage did Fletcher ask for any of the information that he needed to verify the financial performance of the business. Given this was the thing that attracted him most, and ultimately was the issue that caused him to purchase, no amount of enquiry and research on this aspect is too little. Beware of the summariser!

In this example Fletcher is agog with the prospect of a highly profitable business. However, he has not sat back and objectively assessed whether the figures presented to him are a realistic indicator of the financial performance of the business. He needed to consider what the likely reality is in the context of what Fred said the business is doing. This would have given rise to further questions for Fred in drilling down or pursuing from him in more detail aspects of the business that give rise to such an apparently stellar financial performance.

Statements that seem incongruous with the product to be sold are of great concern in any negotiation.

I believe what you tell me, but I still want to see the paperwork

A hatchback is not a sedan, even if the person persuading you of this seems all wise!

It is one thing to be the beneficiary of an oral or even written representation as to the financial performance of a business or the qualities and attributes that a product or service has. It is another to actually see it. Generally speaking there will be a trail of paperwork or evidence supporting the representation. The prudent purchaser should always ask for

these. This is particularly so if the purchase is expensive and the good or service to be acquired is important for the purchaser's business.

Generally speaking you should be wary of summaries of financial or other data made by the seller of a good or service. It is possible to summarise the performance of a business or a product or service in a way that shows it to be vastly different from the reality. By failing to include salient information the overseller creates an image in the mind of the purchaser that does not match reality. They are not making any active misrepresentation as to the attributes. They will throw their hands in the air when accused and say, 'But I didn't say anything about that.' However, their failure to disclose all relevant information in relation to the product, service or asset is a fact that gives rise to a false impression as to what it is.

Example

An overseas private equity firm wishes to buy into an Australian retail business. The retail business is not listed on the stock exchange. During the course of the due diligence process, the retail business provides summaries of financial performance for the prior five financial years. It does not deliver to the overseas private equity firm the audited accounts, monthly management reports or any other 'hard' financial data.

The summaries are discrete and deal with only sections of the relevant information. This was done in a calculated way by the manager of the retail business so as to create an appearance of prosperity and no warranties are given in the agreement. The private equity firm does not ask for the hard data. After running the business for a while, the equity firm realises the summaries of the financial data were some distance from the truth in the actual financial performance of the retail chain.

While it may have claims against the vendors, its failure to drill down and ask for the hard data supporting or justifying the summaries has led to this problem. The private equity firm would not have bought the retail business if it had known that the financial position was as delicate as the hard financial data revealed.

The private equity firm is in a position of pursuing legal claims in a jurisdiction it is not familiar with against a now shadowy opponent with uncertainty as to where the purchase money has gone.

In this case a little more foresight and rigour in the due diligence process would have revealed that the summaries were inaccurate. Although they did not tell lies as such, they omitted details that were relevant and material to a proper understanding of the financial position of the company and its business.

Fast with the mouth, slow with the pen

Any representation made to you as the buyer of a product or asset should be something the seller is willing to put in writing. If they are not willing to do this, that should create a large degree of suspicion in your mind.

Putting something in writing has the benefit of permanency. If you receive a document making written representations as to quality or attributes, there is limited risk you will misperceive or fail to understand what you are being told if it is clear and reasonably expressed.

This is an echo of my prejudice for written contracts. Oral representations fall into the same trap as oral terms. In disputes in which oral representations are important, there is generally a vast difference of opinion as to what was said by the representor. He or she often denies saying anything like what the listener says they heard. The ability for denial in writing is far more limited. While there may be a dispute as to the meaning of the words used, this is more easily resolved. In most cases, the words simply mean what they say. Placing another interpretation on the words seems phoney.

Any person who makes a representation should also be willing to back it up by something in writing. This may mean an email or a letter where the sales person sets out what the product or asset will do. It may be a sales brochure. It may be a printout of a PowerPoint presentation. The form in which the writing is expressed does not really matter. So long as it is legible and comprehensible, you have improved your position strongly as a buyer if you enter the contract on the assumption or the belief that the product, service or asset has the qualities and attributes it is said to have.

Example

> Sarah goes to an electronics store to buy a notebook computer. She needs it to be able to translate handwriting in both English and French. She explains this to the salesperson

who recommends a particular notebook at the higher end of the cost scale. Sarah asks for a brochure on the notebook so as to make sure it can do everything she wants it to, but is told there are no more brochures left. She is loath to push the sales person too far by asking to send an email or a fax setting out what the functions are. In the true spirit of the impulse purchase, she buys the notebook.

A week later, when in Paris on business, Sarah attempts to draft a document that was to be quickly and electronically translated into French. The machine does not work. She later discovers the computer has no ability to interpret her English handwriting into French. This was an extremely important aspect of the deal and she wouldn't have bought that particular notebook if she had known it didn't have this function.

Although Sarah's unwillingness to push the salesperson to the point of getting the representations in writing (the brochure) was understandable on an interpersonal level, it has led to her problem. She was told (honestly or dishonestly) that there were no more brochures setting out the attributes of the notebook. She was given a categorical assurance by the salesperson that the notebook would do what she needed it to do. This was false. Sarah's unwillingness to have the salesperson commit in writing as to whether the essential elements she wanted in the contract were satisfied by the notebook caused the problem. She would not have bought the notebook if the true position had been represented or explained to her.

We don't provide warranties — company policy

Warranties can be an extremely useful device for a seller in making sure all the aspects of the good or service, and some underlying issues, can be resolved.

They act as express representations in the contract as to a fact or state of affairs.

Example

Rich Investment Company wishes to buy a piece of land owned by Boxy Storage as well as all the company's shares (and therefore the entire business). That means, given the law in the relevant jurisdiction, two contracts. One contract for the sale of land and the other for the sale of the shares and business.

In the contract for the sale of the business, various warranties are sought by the buyer in relation to the business and its financial performance. They also seek warranties in relation to ownership, intellectual property rights and other branding matters that the buyer is particularly keen on. As there is great potential for uplift in that aspect of the market, the purchaser wants to use the branding of Boxy as a platform to roll out a chain of branded storage centres.

The warranties involve an assertion as to the amount of prepayments that had been made by customers. They also contain assertions as to loans to directors and shareholders and that the company is not involved in litigation.

After the purchase is completed it transpires that the directors of Boxy had loaned themselves $700 000 immediately before the sale. This causes the warranties to be false. This may allow the purchaser to claim against the directors and shareholders of Boxy for the recovery of those monies.

Further, it transpires that the accounts that have been provided to the purchaser by Boxy were false. However, there was also a warranty affirming the accuracy of the accounts that had been provided. Again, a claim against the shareholders and directors of Boxy could be made by the purchaser.

This illustrates the utility of warranties in contracts. It causes the other party to commit to you.

If the seller is not willing to give warranties in relation to the product, good or service that should be a source of great concern. It effectively means they are willing to sell something to you that they are not willing to stand behind. While there is often a great deal of wrangling in negotiation about the precise terms of a warranty, a party's reluctance to give one at all is indicative of a lack of faith in their product, good or service. It is axiomatic that, if they have no faith in the product, neither should you! If

you are not getting warranties you should take all steps humanly possible to get as much information as you can about what you are buying.

Warranties look and sound like dry and tedious aspects of negotiating a contract. They are classic safety-net provisions. However, they can save a lot of anguish and heartache at the back end if they are given the attention they deserve and warrant.

Anyone who is not willing to give warranties on an in-principle basis essentially is not willing to stand by what they say they can deliver. If what they say is true, there should be no problem in them warranting it. Warranties are a big issue. You need to work out as a buyer what you want comfort in relation to. As a seller you need to precisely and in detail know what you can represent or warrant that is true and supportable.

Dealing in broad brush strokes — the big picture people

It is important to be wary of any seller who deals in generalities as their mode of business. As indicated, puffery and a limited amount of chest-beating is allowed at the outset of the negotiations. In the seduction or enticement phase, there generally needs to be a hook to attract your interest. However, once your interest has been piqued the work then starts. It is important to quickly get down into the detail.

Anyone who is willing to talk about the detail but not record it in the written agreement is a person to be wary of.

There is generally no good reason to avoid having a detailed and written agreement; avoidance is ordinarily used to enable one party to keep its options open. Anyone who as a seller wants to undertake a significant commercial transaction on a very broad and general purchase order or exchange of letters is possibly not someone you as the buyer want to do business with. These are standard contractual terms. The more of the safety net you can incorporate in a case like this, the better off you will be.

As a generalisation, the more broad-brush the agreement, the less of a safety net is incorporated. This is generally in the seller’s interest and to their benefit. On the other hand, it is generally to the purchaser’s detriment and against their interest.

These are our standard terms and conditions

There are no standard terms and conditions. Subject to terms implied or incorporated by law, everything in a contract is open to negotiation. Any vendor who proffers their terms and conditions as being standard, meaningless, mandated by law or ‘just there to keep the lawyers happy’ is a person to be wary of. Generally, those terms and conditions will be drafted in the favour of the seller. They will limit warranties and limit all sorts of prospective liabilities the seller has. If you are provided with a copy of these terms and conditions, even if you do not read them, you are likely to be found by a court to have agreed to them. Then it’s too late. Your position has been compromised. Closely review all terms and conditions provided by a seller of goods and services.

Do not blindly accept them on the basis of a strong assertion by a seller. The great skill of the seller may be to coerce you into executing or entering into an agreement that you do not have a chance to negotiate and that is against your interest.

These examples are by no means a comprehensive list of indicators that you are dealing with an overseller or a counterparty to watch vigilantly.

Your intuition is the key! If you have a bad or suspicious feeling about the person on the other side of the negotiation, you should take every step to make sure safety-net provisions are negotiated to the fullest extent possible and included in the contract to your maximum benefit and interest.

Keep asking for information in writing!

Chapter 8

The ‘red zones’

In the 1980s and 1990s Sun Tzu’s book *The Art of War* became a handbook for the entrepreneurial person in commerce. While elusive and sometimes requiring a degree of lateral thinking to understand what Tzu is saying, it contains many lessons for the contract negotiator.

Many people have used *The Art of War* solely as a guide to battle. In my view this is a mistake. What *The Art of War* teaches you is the prudence of when *not* to fight as much as technique and strategy when you are in the war.

The assessment of resources and strategy should lead to decisions not to engage in a battle as much as to leaping in. In my view, the greatest lesson in *The Art of War* is to assess and know your respective strengths and weaknesses.

Knowing your strengths is the easy part. Rare is the successful person who does not know how to fully exploit them. However, they may be less astute as to their weaknesses for whatever reason, be it ego or fear. Ignore them at great risk.

In this sense sport is instructive. Great athletes tend not to reach the pinnacle of success by consistently working on the strengths in their games. The true champions devote more time to the weaknesses and the areas of play in which they lack felicity.

It is almost impossible to be a contract negotiator who will always hold the leverage. There will almost necessarily be times when your counterparty has more influence, money, market share or need in all the circumstances than you do. This will mean that the leverage or general power in the negotiations is, at least at the outset, with them.

By using the negotiation techniques set out here, and in particular being fully prepared and considering at every level and in every way in the commercial context of the deal so as to allow you to make informed decisions during the negotiation practice, you will go some way to righting this imbalance.

It may be that, at the end of the negotiation and while you have done your best in an astute and skilled way, there are still parts of the deal that concern you. Of course this does not mean the deal cannot be done. Part of business life is living with ripples on the pond of perfection. Doing deals without getting everything and possibly having to give a bit more than what you would have liked is simply something we all have to live with.

In this sense, the approach of a champion athlete becomes important.

If you are properly prepared and have been sufficiently focused in the negotiations you will generally know where the ‘bodies are buried’ in and around the contract. You will know the parts that are of concern to you. Generally speaking, if you have negotiated the contract well enough, they will be reasonably clear in your mind. Assess them objectively. If they go to the fundamental commercial terms of the deal, you may have a problem.

The first step is to understand them.

This is where the strengths and weaknesses analysis becomes extremely important.

As if you are an elite or champion athlete eliminating flaws from your game or technique, focus on the troublesome areas of the contract so as to ensure you understand all of the implications they may have if things go badly or otherwise than as planned. These are, what I call, the ‘red zone’ moments.

Example

Big Green Tours is an eco-friendly tourism company. It is under-performing. Part of its problem is on a marketing level. It is flying its customers to eco resorts in jet aircraft when jets are commonly believed to add to Greenhouse emissions. Its patrons know this so it seeks to buy Little Props flying service, a small regional airline that operates only propeller planes. Big Green thinks that this will be a marketing tool to attract more business. It proposes running the airline as part of its business; however, the costs of financing and operating the airline will be high. It has no experience in running the airline. During the course of the contract it becomes clear that the operation of Little Props is moderately profitable based on the relatively low price for international aviation fuel in the two years immediately preceding the contract. Any spike in avgas prices will remove the profit. Depending on the extent of the increase, it may create a real problem in the airline’s profitability. However, with its eyes open and on the belief that it can make the situation work for it, Big Green continues on with the acquisition. It

puts into place some contingency plans, depending on the nature and extent of the fuel price hike.

This is an example of knowing the weaknesses of a contract. The executives of Big Green have peered down the pipeline. They forecast and plan for the business variables that may impact on the airline and the extent to which it will affect the business. This is an excellent example of understanding a red zone in a contract and planning and preparing for it.

It is a useful to deliberately undertake the exercise of analysing the weaknesses after you have entered into the contract. Look closely at the contractual terms you are concerned about and assess as best you can the dangers lurking behind them.

A proper red zone analysis of the contract contains three parts:

- understanding which terms are potentially problematic
- forecasting how the contract may work against you or circumstances conspire to create a red zone situation
- developing a contingency plan to address problems.

It is impossible to anticipate all the potential problems that may arise under a contract. Don’t attempt the impossible. Keep the analysis targeted but general.

Appointing someone in the organisation as the crisis manager — the appointment contingent on which term of the contract becomes a problem — may be a really important step. You may nominate a number of people in different parts of the organisation for separate potential issues. Identifying people in this way gives them accountability. They will need to be thinking that they will be the first to take charge of the problem and have the lead in fixing it. This will give them cause to think about the range and nature of problems that may arise prior to them coming up. This can have the benefit of, as President Bush calls it, the creation of ‘work arounds’.

Just as important is not overplanning for potential red zones that may arise. Structures, not precise fixes, are key. By putting the structures into place you serve yourself best in remedying them. By orchestrating a detailed plan, you run the risk of not being able to be as responsive as you

need to be to the particular circumstances. By applying a ‘cookie cutter’ you may be not addressing all of the issues as well as you might. A remedy of this kind tends to rely on execution without tailored planning.

Plan at a macro level for the problem to allow you to give precise thought about the problem on a micro level if the need arises.

The hot tips

- Be prepared — like exams, there is no point being overslept and under-studied. Preparation is everything.
- Be all knowing — know:
    - what you want
    - what you don’t want
    - what you will do
    - what you won’t do.
- Ask yourself — can I do what the contract says I should?
- Are they up to it?

Depending on the answers to these questions, the negotiation should address these strengths and weaknesses so as to ensure no-one overpromises to underdeliver.

- Know the creature you are dealing with. Are they a relationship developer or a contract tyrant? Who they are should regulate how you negotiate and perform your obligations and exercise your rights.
- Use the renegotiation recap — it can be invaluable. Treat it like half-time in a sporting event, a time to restore energy, gather thoughts and review and renew strategy. Consider a heads of agreement — does it

suit your purposes? If so, how binding should it be? Be as conscious of your weaknesses as of your strengths in the negotiation — keep an eye on terms that are evolving that may be a weakness. Psychologically bookmark these terms early and do your best to maximise your ability to fully perform whilst minimising potentially negative impacts of a term of this kind.

- As a seller, bear in mind all of the traps of pushing too far. At the risk of over-simplifying, simply tell it like it is — exaggeration may be your Achilles' heel.
- As a buyer, watch for the signs of the overseller. If they won't provide detail you should be concerned.

Part III

The relationship ends

Chapter 9

In the contract

Doing it the easy way

Of course the easiest way to manage contractual relationships is to exercise your rights and perform your obligations precisely in the terms of the contract. The best contractual relationships are always those where both parties perform to the letter. Contractual observance like this develops a sense of trust and respect between the contracting parties. What may create warfare in other contracts becomes only a small distraction that is fixed by both parties working together in a healthy relationship. They work together because they see the other side doing its absolute best and because of this want to help make the contract work.

This is easier said than done. There are many reasons, both fair and foul, why contractual relationships break down.

Know your product

If the relationship between you and your contracting party becomes troubled, it is essential that you understand the contract.

Your strategy in dealing with a prospective issue (which should of course be planned well ahead of any problem arising) is contingent upon knowing the document and what it says. If you have followed the recommendations earlier in this book, your rights and obligations are largely set out in the document. Knowing these means you know the landscape of any future battles. If common sense cannot prevail and the dispute cannot be resolved, it is the contract that the court will look at closely in working out who is in the right and who is in the wrong.

The following steps will help you in any issue you have. It may be a breach. It may be a request for a variation. It may be an assignment.

A useful means of identifying your rights and obligations can be to prepare a short document that summarises them. Of course it is only necessary to identify the contractual terms that relate to the dispute. A document that sets out your obligations may be of great assistance to you in working out which are the relevant contractual terms and what they mean.

Example

A textiles company makes suits for an airline. The suits are worn by all inflight staff and have been designed by an Italian designer of international renown. The contract says the suits must be made in that designer's factory. It holds the copyright and design rights. To save money, the airline makes some 'knock-off' garments at 20 per cent of the price using a local suit-maker. The designer threatens termination of the contract.

Tables 9.1 and 9.2 (on page 170) are possible versions of the 'cheat sheet' for both the airline and designer in analysing their positions and knowing the product.

Table 9.1: 'know your product' cheat sheet for the airline (the party alleged to be in breach)

Clause number	What does the clause say?	What do we have to do?	What do they have to do?	Breach	Options	Strategy	Timing
1.1	We have to use them for the suits	Use them to make the suits	Make the suits	By us—we used someone else on their design	• Use them again • Negotiate for purchase of design rights • Terminate with them probably to sue	Negotiate to purchase design if not able to terminate	ASAP—they want to terminate and sue
11.2	They retain copyright	–	–	By us—see above		Buy it?	See above
13.1	They can terminate if we use someone else to make the suits	–	–	–	See above	See above	See above

Table 9.2: ‘know your product’ cheat sheet for the designer (alleging the breach)

Clause number	What does the clause say?	What do we have to do?	What do they have to do?	Breach	Options	Strategy	Timing
1.1	Can only use our design for suits	Make the suits	Use us for suits	They have ripped us off in relation to the design	• Terminate • Keep contract but sue • Try to fix problem • Make an example of them • Go for broke on damages	• Try to fix it first — contract very profitable and airline growing • Can't fix it then keep rights to suits and option to sue still open — talk to lawyers	Non-urgent deed done — no more suits made until issue is resolved

This sort of analysis is equally effective when you are claiming breach or breach is being claimed against you whether you want the variations or assignment or not.

This example is written in a dispute context. However, a document like this can be used just as well when you simply want to know what the contract says for working out resourcing or simply what you have to do as a term of it.

The contract is the rules of the game between you and the other party. As in any game you need to know those rules so as to play effectively.

Contracts should not be lawyers' documents. They are for you. If you do not understand the terms of the contract, have them rewritten. You cannot perform a contract if you do not know what it says!

Know who you are dealing with

Their commercial position

This is extremely important at all times of a negotiation of a contract. Internet search engines can be a remarkably fruitful research tool. Talk to people who know the counterparty. How do they do their business? The more you know the better negotiator you will be.

When considering strategy in relation to any dispute under a contract it is useful to get a sense, to the best of your ability, of the business context and style of the other party. If they are trading badly or are in commercial difficulty, this may cause you to adopt a strategy that superficially helps them resolve their commercial issues but also serves your needs. This may open up many more avenues to resolve the issue than if you are dealing with a commercially successful party. A prosperous *and* strongly trading counterparty is more likely to want to hold you to the strict letter and terms and conditions of the contract. They want what they want and no less. You will ordinarily have less room to move. All other parts of their business are travelling well. If your relationship is causing them angst they are likely not to be flexible.

Agenda

As a part of understanding the commercial context of your counterparty, are you aware of any agendas they have? This applies for both the general management of the relationship and disputes. What is their contract position? Are they looking to grow? What are the factors that impact on their profit? In a dispute context, are they fishing for a basis to terminate the contract or do they think they can do a better deal elsewhere? Are they looking to move operations offshore? Are they looking to engineer a circumstance where you are in breach and therefore they can terminate the agreement?

If on the other hand they are simply and transparently complaining about the breach, this is also important to know. Can remedying the breach in the immediate future cause them to cancel the notice of termination and restore the equilibrium?

Generally speaking, if the other party is merely unhappy about the breach this may be enough. However, if this is one of a sequence of breaches and the straw that breaks the camel's back, it is unlikely you will be able to use this technique again. In this context the relationship has soured and any goodwill you had with them may have disappeared.

Leverage

This is held by the party with the most negotiating flexibility and influence. Who can use their position to greatest advantage? This generally depends on what the subject of the contract is and who the parties are. Is the contract a meeting of equals or does one benefit from it more than the other?

Who holds the greater control in the negotiations? Who will be hurt the most if the contract is terminated? This is an important consideration. It will be a very useful judgement to make to help you with deciding your strategy as to how to resolve any dispute.

Form a view about this early and be objective. Vanity is an evil to be avoided. You will disadvantage yourself if you are unwilling to see that your competitor has all of the leverage. This blindness stops you using strategies to right the imbalance. You can only fix a situation like this when you realise it is lopsided with you closer to the ground on the scales of position.

Scorched earther or a relationship developer?

One of the important aspects of contractual relationships is the interpersonal dimension between you and those with whom you deal. If there is a residual degree of trust and amity, it is likely that minor breaches will be more easily managed. If the relationship is more distant and austere, minor breaches could be taken very seriously and create problems for you that otherwise would not arise in a different type of relationship.

There are certain types of contracting parties who implement a ‘scorched earth’ policy. By that I mean they don’t care about personal relationships. They want exactly and absolutely what they have contracted for. They insist upon it with religious vigour. They are inflexible in the face of being provided with good alternatives and options as to the performance of the contract. They regularly threaten court proceedings and are insistent that your failure to honour the contract will cause them to suffer significant damages.

You will get a sense of who you are dealing with in the negotiations. The skilled scorched earther may initially project sweetness and light. Once they have the position they want they show their real modus operandi later.

Knowing that someone is of this character or type is important. In order to avoid wasted time and energy, it is often easier to simply do your level best to keep the contract on foot and not look to any solution other than performance of the contract to the letter. They are just not up for it. They are inflexible. After all, the only thing they should ask for is strictly performing.

On the other hand if you have a counterparty who is a relationship developer and wants to have a long-term connection with you and your business, you may be in a position to negotiate resolutions to problems or disputes that are more flexible in all the circumstances and are more commercially acceptable to both parties.

The history of the relationship is fundamental to the way in which it is likely the parties will deal with each other.

If your counterparty has been consistently in breach of the contract and has annoyed you with phoney excuses and clumsy solutions, you are

unlikely to want to give them another opportunity.

However if, on the other hand, they have been genuine in all of their attempts to fix problems and advance the mutual interests of the parties, then you will be more disposed to them.

It is also useful to consider the corporate personality on the other side. While you may be dealing with someone who is charm personified, the corporate attitude of the company may be more hard-edged. These apparent contradictions are quite regular in commercial relationships. The key is to work out what the bottom line is going to be. Preserving your friendship with your contact is valuable and important, but if that friendship prevails at the cost of being joined in court proceedings for breach of a contract that you could have otherwise remedied by doing a deal with the hard-nosed CEO, commercially speaking the option is clear.

Communication

In most contracts communication is the key to the happiness of the parties. If the contract is for a good or commodity, there may not be much need for it. Delivery on time of what was asked for may be enough.

In contracts for services, communication is essential. Even if the parties are model contractors and there is no need to adjust to changed circumstances, they will still need to talk.

The importance and skill with which you communicate is magnified with an impending dispute. Knowing the contract terms, understanding where the leverage sits and who you are dealing with are all important to deciding your communication strategy.

It is important to bear in mind that there is no general legal obligation to advise your counterparty when you may be coming across difficulties in honouring the terms of your contract. You have to perform your obligations. That is all. There is often no benefit to disclosing that there may be a problem in honouring your obligations. It may cause undue concern on the other side. It may prompt termination of the contract on the basis of an anticipated breach or alternatively to cause an injunction to be sought against you for specific performance.

There is nothing wrong at law with not disclosing difficulties you have with performing your obligations under the contract. If you meet these

obligations, that is all your counterparty is, and should be, legally concerned about.

However, when a problem has manifested and is unavoidable, communication can often be the best tool in seeking to avoid an ultimate problem.

The risk in communicating a prospective breach of the contract to your counterparty is that it may arouse legal rights with them. Depending on whether the relationship is generally good or bad, this may have beneficial or negative consequences.

As in any relationship, communication is important.

However, there can be too much communication and it is important to make a decision on when to talk. This can be very finely balanced and you need to consider factors like the following in making your decision:

- How serious is the problem or potential breach?
- Is it an ultimate breach in that there will not merely be a delay in the delivery of the service or product. A fundamental problem in being able to perform the contract will need to be closely considered and on different terms.
- What are the general circumstances of the relationship like — are they hostile or friendly?
- Is it likely the other party will seek to terminate? If they are a ‘scorched earther’ there is a real risk they will.
- What are the likely consequences for your counterparty of the breach? Will it cripple their business or merely act as a commercial and professional annoyance?
- What will happen to you? Consider all commercial and intra-business aspects of this.
- Are there general business reputation issues you need to manage?

The anticipated outcomes of early communication need to be a crucial part of your decision-making process. Only you can understand:

- the types of consequences you may have
- the commercial impact

- what you can live with commercially — what is a learning experience as opposed to apocalyptic and disastrous.

It is a big decision and should only be made when you have considered these points. It will generally commit you to a course of action in the future. Your first moves are important in charting the course ahead.

Tears on the pillow: without prejudice — secret but effective

As set out above, any disclosure of a likely breach of the contract may arouse rights in your counterparty to terminate or sue for breach. You want to be very careful as to when you make a disclosure in these terms.

One very useful way of doing it is to do it on a ‘without-prejudice’ basis. Without prejudice is a term used by lawyers to describe a secret communication. It is a communication that does not come to the notice of the court, tribunal or arbitration if there are any subsequent court proceedings. A full and proper without-prejudice communication is not admissible to the court as evidence of an admission of breach of contract.

However, the term ‘without prejudice’ is regularly misused. It must be in relation to the settlement of a dispute to have this protection. You will need to be quite skilled in your use of the term and speak to your lawyers about developing a greater understanding of what this principle is and how it works in practice.

However, if well used, it can be an excellent means of advising your counterparty of a problem under the contract without necessarily causing an ultimate breach.

Options — keeping the balls in the air

If a problem arises the best way to deal with it if there is no short-term solution is to look at all options.

Ask yourself: What steps can I take in order to fix the problem that I may have unintentionally created?

This has three primary benefits:

1 Depending on the terms of the contract, providing an equal and not inferior option to what you are obliged to deliver or do may mean you have not actually breached the contract. You have essentially provided the same good or service. If you procure or deliver that good or service for your counterparty you may not have a breach.

2 If your solution is a complete ‘patch’ it is unlikely that you are going to arouse the antagonism of your counterparty and therefore no breach of contract will be alleged against you.

3 It has a positive impact in showing you are a pro-active problem-solver in a contract and on that basis will be positively construed by your counterparty as a constructive contracting party who shows good will.

So when do I tell them there is a problem?

There is no right or wrong answer to this question. It depends on all of the above factors and the general contractual relationship. If you are uncertain, it may be appropriate to obtain legal advice so as to form a view with your lawyers as to whether you disclose a prospective or possible breach or not.

If you want to disclose, there may be ways you can do it deftly so you can be insulated against allegations of breach or damages claimed.

Every contract is different. Every contracting party has different commercial pressures, agendas and desires. On this basis there is no rule of thumb or prescription as to when a breach of a contract or a prospective breach should be disclosed.

However, it has been my experience that many a contractual dispute has been resolved by honest and open communication between contracting parties with a mutual goodwill to put the parties in exactly the same position as if a breach had never occurred. If both parties want to fix it there is very little reason why they can’t.

Chapter 10

What happens if the contract is breached?

Consequences for a breach of contract

There are a number of consequences for the breach of a contract. Primarily they are:

- an order for damages or the payment of financial compensation by the party making the breach
- an order for specific performance of the contract by the party in breach
- an injunction
- restitution.

Apart from an injunction, they all tend to arise after the contract has been terminated.

Damages

If a party breaches a contract and the suffering party can establish what they have lost arising from the breach, they make a claim to be compensated for that loss. It is necessary for loss to be proved. That loss may be of a number of different types. However, generally in breach of contract claims there are two types of loss covered.

The first is reliance damage. That is the loss that has occurred as a result of relying on the contract and this reliance has caused damage as a result of the breach.

Example

> Revisiting our dragline manufacturer example from chapters 2 and 3, assume it entered into a contract with the coal mining company to provide the dragline. It employed further staff, obtained more plant and equipment and turned away other jobs because the

contract was so large. Because of changed financial circumstances the buyer no longer seeks to purchase the dragline. The selling company may have a claim against the coal mining company on the basis that it had arranged its affairs and not taken other jobs assuming the contract would be honoured. Relying on the existence of the contract and the binding obligations between the parties, which was subsequently breached, has caused direct loss. The loss is the contracts it did not take up so as to ensure it could service its current deal. This is independent of any profit it may earn under the contract.

On the other hand, say the manufacturing company of the dragline delivered it as not being fit for purpose and of defective design, manufacture and construction. Put simply, it didn't work well enough. It regularly broke down, and as a consequence the mine suffered significant periods of downtime when production ceased. This is likely to be a breach of the contract.

The other type of claim is loss of profit.

If the contract has been properly drafted, express terms would have been incorporated requiring the manufacturer of the dragline to warrant that it was fit for its purpose and that it was built to a standard of manufacturing quality that was in all circumstances satisfactory for the use to which the company wanted to put it.

If the dragline failed and the loss suffered was significant, the company may assert a claim for loss of profit. That is the loss of production and profit that would have been earned from the mining of coal from the mine. If the breach had not occurred, the profits would have been earned and no loss would have been suffered by the company attributable to the failure of the dragline. The failure of the dragline has caused loss of profit and, as a matter of law, the company will assert that it should be compensated for this.

Damages for breach of contract can be in astronomical terms. A breach can be very, very bad for the victim of the breach and the party who has to pay. No-one wins in these circumstances.

Specific performance

Another consequence of a breach of a contract may be that the court orders specific performance of it. Courts will generally not order specific

performance of personal-service contracts. Where a party has to perform an obligation or deliver a service, the court will generally not oblige it to do so. It will leave the party who has suffered the breach of contract to its right to damages against the infringing party. There is a policy in the law against compelling parties to provide labour or services against their will. As a practical consequence it is unlikely, in general terms, that the contract will be performed to its letter when one of the parties to it is being compelled by the court to honour its obligations. Doing the minimum possible to try to scrape through is not considered compliance with the spirit and terms of the contract. A regular consequence of a specific performance order is that this is all the party that has been the victim of the breach gets.

However, where a contract involves the delivery of a good or product, specific performance may be ordered.

Again, take the example of the company and the dragline. If the manufacturer finds a way to do a better deal with a coal mining company for a much higher price on much more satisfactory terms, it may try to terminate the contract in relation to providing the dragline and attempt to enter into a new contract with the new customer. Depending on all the circumstances, it may be open to the company to seek orders for specific performance. That would mean the buyer would invite the court to make orders compelling, by force of law, the manufacturer to deliver the dragline as agreed to in the contract.

Restitution

If a party to a contract receives a benefit at the expense of the other party and it would be unjust to allow them to retain that benefit then the court may order that the proceeds of that benefit be paid to the suffering party. This is called restitution.

Injunction

An injunction is an order of the court that either:

- prohibits an act being done (termination of a contract or a step to be taken in breach of the contract)

- compels a party to take a certain step or do a certain thing under the contract.

Courts are more willing to grant prohibitory injunctions, that is stopping parties from doing things, than they are to compel them to do things. An injunction may be of great value when a party comes to notice the intention of their counterparty to breach the contract. They may want to ‘get their retaliation in first’ by seeking to injunct the recalcitrant party from the actual breach of the contract.

Example

> Ripper Mining agrees to sell a fleet of vehicles used in and around the mine to a fledgling business, Phoenix Mining, located nearby. All of the terms of the agreement are set. It is put in writing and a delivery date is determined. Two days before the delivery date Ripper Mining receives a better offer for the vehicles. It is 50 per cent higher than the deal it has done. It writes to the smaller mine operation telling it that it will no longer honour the deal and that all bets are off.
>
> The smaller mine operation seeks an injunction from the court restraining Ripper Mining from selling the vehicles to the other purchaser who is willing to pay a higher price and seeks the specific performance of the contract. The injunction is used to preserve the position. The ultimate claim is for specific performance of the contract.

This is a prohibitory or restraining injunction because it is stopping the party from doing something.

On the other hand, if the contract had effectively been consummated and the money paid by the smaller mine operation, yet the vehicles had not been delivered, a mandatory injunction may be granted compelling delivery of those vehicles by Ripper Mining.

This is relatively infrequently used in breaches of contract. Often it is difficult to have sufficiently clear evidence of the prospective or proposed breach. The court will need more than mere whispers or the beat of a jungle drum that a breach is imminent. It will need quite solid and clear evidence that the other party seeks to breach the contract before orders will be made. As a practical matter this evidence is generally very hard to get.

But I can’t perform the contract anymore — it’s not possible

This is a comment that is often heard from parties to contracts. It can mean any number of things — ‘I don’t want to be bound by contract anymore’, ‘I want to renegotiate and enter into a new contract on better terms’, ‘I am bankrupt or insolvent’, or the most genuine of all, ‘I can’t perform my obligations’.

It is possible to avoid your obligations under the contract. However this occurs in only very rare circumstances. It also requires you being able to prove that your inability to perform your obligations arises from something outside your control.

Frustration

There is a principle of law called frustration. As the name implies, it means the purpose and performance of the contract has been frustrated. This however does not mean that a party can necessarily engineer frustration. Equally unhappiness or emotional frustration about the terms of the contract is not frustration at law.

There are four steps necessary to prove that a contract has been frustrated:

1 An event has taken place causing a fundamental change in the nature of the contractual rights and obligations or in the circumstances of the contract.

2 Neither contracting party caused the event.

3 The event was not contemplated by the parties in entering into the contract, and therefore could not reasonably have been dealt with by a contractual provision or term.

4 It must be unjust to hold the parties to the contract to what they agreed upon in all the circumstances given 1 to 3 above.

Whether a contract has been frustrated is generally a topic of hot controversy. The party wanting to bind the other party to the contract generally alleges that what are alleged to be frustrating circumstances are not in fact so.

Often big factual questions arise like:

- Did the party relying on the frustration of the contract know the event was going to occur? If so, when did it know?
- When was the contract actually frustrated?
- Was the frustrating issue within the contemplation of the parties at the time the contract was entered into?
- What is the impact of the frustrating event on the rights and liabilities of the parties?

Example

> Profit Mining runs an open-cut mine. The mine produces a mineral daily that it then supplies to its customers. Those customers require the daily delivery of the mineral for their production of their product. If the daily delivery does not occur, those customers cannot produce. They do not stockpile the mineral.
>
> The mine is not necessarily known to be along a geological fault line. However, an unexpected earthquake occurs that causes a collapse of part of the quarrying walls of the mine and significant damage to plant and equipment. Production is stopped for one month.
>
> The customer complains of breach of contract by the failure of the mining company to deliver the minerals. On the other hand, the mining company says the contract has been frustrated by the earthquake.

There is a real chance the court would find the contract has been frustrated because all the elements set out above apply.

If a contract is frustrated it means that all future obligations are no longer enforceable. However, it does not mean that all claims in relation to past breaches dissolve. Frustration acts to terminate the contract on and from a certain date. It does not resolve the prior rights and obligations of the parties.

Force majeure

As discussed in chapter 5, the other way a party may deal with a generally frustrating event is to include a force majeure clause in their contract. This is an express acknowledgement by the parties that if a supervening event that causes the contract to be frustrated arises, all rights and liabilities on and from that date will be discharged.

This puts a party who is the victim of an unfortunate event in a much stronger position. Courts will, as a practical matter, be much more willing to find that a contract has been frustrated when a force majeure clause is present. It makes it easier to prove by the party who has been the victim of the event.

A simple acknowledgement that a supervening event is possible of itself is extremely useful to show the parties to the contract were conscious there were circumstances that might arise that would disallow the contract's completion.

Example

> Paper over the Cracks cosmetics has just undertaken a complete new fit-out of its CBD offices. It is a high-profile public company. For the office fit-out it has sourced and bought expensive and stylish contemporary furniture from France. Prior to the fit-out being completed and the furniture being ready for installation, it is being stored at the factory premises in an industrial part of town. An explosion occurs at an adjoining factory premises. It incinerates the factory storing the furniture and everything in it.
>
> The contract between Paper over the Cracks and the fit-out company had a force majeure clause. It provided that any event reasonably beyond the control of the defaulting party does not give rise to a claim against the defaulting party or cause the defaulting party to be in breach of the agreement.

This gives rise to an odd situation in the context of our discussion above. The fit-out company cannot satisfy its obligations under the contract. It cannot deliver the furniture. This is literally a contract breach. However, given that its failure to be able to deliver the furniture is caused by an event that was not created by itself, it is not considered a breach of the contract relevantly for the purposes of a damages claim.

In this context force majeure clauses are important aspects of contracts when and if you think there are likely to be events of natural disaster or other kind which may militate against your ability to complete the contract.

Force majeure clauses have great weight when contracts are performed in places of political and social instability. It may be that the contract cannot be performed because of this political and social instability. A force majeure clause will allow the defaulting party to avoid liability given the contracting parties contemplated the possibility that the contract would not be able to be performed because of the social context.

If I breach the contract are the consequences the same as if the other party breaches?

As a matter of law, the answer is yes. There is no bigotry of breaches. Just by virtue of being a buyer or a seller you are not better off. A breach of contract has consequences potentially allowing for a right of termination. Even if it does not allow for a right of termination your other party may have a damages claim against you for breach. If the shoe is on the other foot, you are in the same position. You may be able to terminate the contract. Alternatively, you may have a damages claim.

However, there are ways of constructing contracts so you are in a much stronger position when breaches arise.

Regularly contracts will provide different rights. Contracts may allow for one party, generally the drafter of it, to terminate on the basis of either:

- a serious and material breach of the contract (as generally defined in the seller’s favour) by the purchaser
- upon 30 days’ written notice (or some other time it considers appropriate although not generally less than 30 days) at the service provider’s discretion.

There is nothing at law stopping both parties from having this right. Generally the best interest of the more powerful party does not allow this in

negotiation. A service provider is given significant flexibility in terminating the contract on terms like this. It allows for immediate termination if the purchaser seriously breaches. On the other hand if it does not like the terms of the contract, and it thinks it could do a better deal with the same counterparty or in the market generally with someone else, it can terminate on 30 days' notice.

The rights given to the other party to terminate the contract are generally very limited. Often they can only terminate the contract on the basis of a serious or material breach. What is considered a serious or material breach by the drafter of the contract is defined much more narrowly than a breach by the other party. That means there can be two types of material breach definitions. A high standard for the drafter and a lower standard for the other party. The drafter has to do something really bad to materially breach the contract. Conversely, the person who is given the drafted contract may not have to be so remiss to arouse a material breach clause.

Further, there is generally no clause allowing the person given the draft contract to terminate 'at will' or without reason.

As is clear, parties can contract an agreed consequence in the event of a breach. While this does not necessarily exclude the law generally and potential unfairness, courts will generally look to uphold the contract between the parties. Therefore if termination clauses are clearly expressed and the terms are clear, the court may uphold the clause and the double termination standard intentionally incorporated in the agreement.

It all depends on what the contract says. It is for this reason that great care should be taken in drafting contractual terms, and in particular, termination clauses. An unhappy contract can be made even more gruesome by your inability to get out of it. For example, it is somehow more daunting and violating when as the purchaser you are stuck in the contract yet the vendor, with whom you have done a bad deal, can terminate at will and for no reason. A lack of attention to this issue at the outset can give rise to significant heartache during the course of the contract.

This again exemplifies the principle that your counterparty does not need to be nice to you in going into the contract.

Again, there are no standard terms. Everything in negotiating a contract is up for play. This is a blessing and a curse. It means you need to be extremely vigilant when going into a contract as to what the terms and

conditions are. At the risk of sounding pessimistic, prepare for the best but also plan for the worst.

Chapter 11

All good things come to an end — termination of contracts

There are three general ways in which a contract can be terminated:

1 by the term or period of the contract concluding

2 by the termination of the contract before its natural expiration by one or both parties

3 by termination of the contract at law for breach of it.

The term ends by time passing

Most commercial contracts have a limited duration. They run for a set period of time.

A limited duration has a number of benefits. It creates a sense of accountability in the person delivering the good or service. If they know they have to ‘audition’ for more business. It will tend to promote in them a higher service ethic and a stronger desire to keep the other party happy.

It also allows a party to exit an unsatisfactory or uncommercial deal. It is a common feature in commercial contracts that circumstances change during the course of them. Depending on whether the parties can agree a variation, they are generally bound even in circumstances where, with hindsight, they would not have entered into the deal as they have. A contract of a limited duration gives some hope that the pain will end and it will simply be necessary to grin and bear the unsatisfactory part or parts to the relationship until the contract ends.

On the other hand, in a contract that has worked well and the parties are happy, it allows negotiation for better or more satisfactory terms. This may be for the benefit of the buyer or the seller or both parties. In many ways this is the high point of contractual life. Both parties have had a relationship for a period of time in which they have achieved positive results. They wish to enter into a new arrangement on better and more commercially advantageous terms for each of them.

Once a contract ends, it is effectively dead. It is open to the parties to do what they want to. That may range from a parting of the ways to doing a new deal. The parties can revive the contractual terms in a separate agreement for a further period of time.

Generally speaking, contracts that reach their expiration date do so without there being any disputes or assertion of claims by one party against the other.

Termination of the contract by a party under its terms

The rights and entitlements of a party to terminate the contract by operation of a default or termination clause depend entirely on what the contract says. As indicated, there may be a demarcation of rights. One party may have a wider ability to terminate the contract than the other. Your rights in terminating the contract during the course of it will depend on what you have negotiated and how you have expressed those negotiations.

It is obvious that the maximum amount of flexibility you can import into the contract is desirable. On the other hand, you may want to make termination by your counterparty as difficult as possible.

There are many contracts that can still be performed adequately and satisfactorily even if there has been a souring or even a breakdown of that relationship. This is particularly so when the contract is for providing a good or commodity. Once the good or commodity is manufactured, it can be provided without the necessity for there to be amity or friendship between the parties.

In contracts for services where there is still human interaction as the cornerstone in the agreement, this is less regular. Often a breakdown of trust and affinity between the parties will cause the contract to be unworkable.

In broad terms, there are two types of term that are available:

1 the termination of the contract for no cause at all on an agreed period of notice (which can actually be nothing)

2 termination for breach of a term (be it fundamental or otherwise).

A clause of the second type is a limitation on your ability to terminate the contract. This is because you need to identify a breach on the other side before you can terminate. This does not allow termination on a whim.

A clause of the first type allows you to terminate the contract subject to whatever notice you need to provide.

Depending on the way in which the contractual term is constructed, there may or may not be residual claims and disputes arising from the termination of a contract by one of its own terms.

Obviously, if a breach needs to be identified before the contract can be terminated, residual unhappiness is a real possibility.

On the other hand, a contract that can be terminated without cause may be ended because of a change in commercial direction or there no longer being a need for the good or service. It does not necessarily mean anything adverse nor is it a negative reflection on a party's performance.

Termination at law

In general terms, termination at law only arises for breach of a fundamental term. When faced with a breach of a fundamental term, the victim can elect to continue or to terminate the contract and sue for damages.

The law of termination of contracts for breach is a detailed and complex set of principles and practices. It requires a precise analysis of the:

- terms of the contract
- subject matter of the contract
- conduct of the parties under the contract
- alleged breach of the contract
- implications of the breach of the contract.

There is no general rule applied to breaches of contract. Every breach is as different as each contract that in turn is as different as the parties to it.

Generally termination of a contract for breach at law will confer on one or the other party a right to make a claim against the counterparty for damages. This is because a breach needs to be identified before the right to terminate is triggered. Depending on the particular circumstances, it may be

that the breach is extremely serious and the termination paves a way for the replacement of the contracting party with another and for a damages claim.

Chapter 12

Things ended badly — how you know you are in a dispute

At the risk of sounding trite, it is not hard to work out when you are in a dispute.

You will generally be the accused or accuser of an allegation that you or another have not honoured certain of the terms of the contract.

A prudent contractual party will generally notify their concerns in writing.

You will know of their unhappiness from the letter if you are blamed. It will identify, possibly in general terms, the contractual term which you are bound by and set out your failure to honour or perform that term.

If you are accusing the breach, you will know that your expectations have not been met and therefore there is a problem that will need to be fixed one way or another.

At the earliest stages of a dispute it is critical to go back to the contract itself. If it is an oral agreement this is obviously difficult. There is no record of it other than recollection.

If the contract is written, then you need to review its details. Hopefully, it is clear enough for you as a non-lawyer to understand. Closely consider the clause that is in question.

Whichever side you are on, undertake the following process as your first step in analysing your position:

1 Identify the relevant part of the contract or clause in question.

2 Closely review the clause to identify what it means.

3 Identify the obligations or responsibilities that flow from the clause for one party or the other.

4 Are there any related clauses in the agreement? Is there an internal reference in that clause to another part of the contract?

5 In light of the obligations, closely consider the infringing conduct — is there a breach of the contract or merely different views of what should be performed?

6 What are the future implications for the performance of the contract in the context of the allegation of breach?

It is important to differentiate a breach of a contract from a party's disappointment that its expectations are not being met.

If there are no variations or subsequent representations as to what a party can do, the rules of the game are in the agreement itself. A party is not obliged to do any more than the agreement sets out. It is not obliged to meet the 'expectation' of the counterparty, be that reasonable or otherwise. Are the expectations in the contract? Have you agreed overtly to meet them? If not, then you are not obliged to.

The earlier you form a view about the dispute, the better position you will be in to assess your position and if necessary seek legal advice on the back of an independent and precise consideration of where you see the rights and liabilities as sitting.

While lawyers are experienced and skilled in construing contractual terms, the contract is your instrument. It should be sufficiently clear to allow you to understand it. If the contract itself is not clear, that is a bad sign. It means that it is not easy to discern the rights and obligations of the parties. This may allow for a more tenuous or marginal allegation of breach of contract to be made. The less clear the contract is, the greater the chance for it to be contended you have obligations that are greater than what was agreed.

The contract itself is your guide. Your understanding of the contract may be coloured by matters in relation to performance of it by one party or the other. It would be prudent never to make an allegation about what the contract says or does without actually reverting to the document itself. It is easy, in the process of performing the contract, to recall that it operates in a different way or manner from what it says. Again, your understanding or opinion of the contract term is not the important thing. It is what the contract actually says that rules. In determining any dispute, you will not be listened to very closely on what you 'thought' the contract meant. The contract should speak for itself. If it does not, this creates an unfortunate uncertainty for both parties to the dispute that means an easy and quick resolution may not be possible.

Asserting a dispute

Any party to a contract can breach it. Identifying a breach of contract is a relatively straightforward task. Again it requires a proper review of the contract and its terms. The primary question is what rights and obligations you and your counterparty have.

Depending on the precise terms of the contract itself, there may be a mechanism for notifying disputes under it. Some parties like to have a structured means by which disputes will be notified. A regular feature of contracts is a mechanism that follows the following general sequence of events:

1 The contract sets out a form of notice to be sent by one party alleging a breach by the other party and explaining the breach.

2 The contract allows for a period of time for that breach to be remedied — ordinarily 30 days but there is no hard and fast rule in this regard.

3 If there is no remedy of the breach then the party is left to its rights under the contract either to affirm it and continue trading notwithstanding the breach or to terminate it.

If there is a contractual regime where disputes are to be notified, it is important that you follow that structure. If you do not, there may be an allegation from your counterparty that any notification is invalid and that may affect the subsequent or consequential rights you have.

If there is no formal notification structure the ordinary way it is done is by letter from the party being the victim of the alleged breach to the other party. That letter should identify:

1 the contract by name and the date of its execution or the time it was entered into

2 the relevant clause

3 the alleged effect or meaning of that clause

4 what the breaching party has or has not done in relation to its obligations

5 what the victim of the breaching conduct contends should happen as a result of the breach

6 any claims for damages or other legal rights that the victim of the breach thinks they may have.

Each of 1 to 5 above can be expressed without necessarily the need for legal advice. It may be more complicated, however, to be asserting the legal consequences of the breach in 6 if you are not a lawyer. You may want the comfort of a lawyer's advice as to what the contract says.

The matters in 1 to 5 are, in broad terms, factual. If you don't get advice, there is often a little bush-lawyering in your interpretation of what the contract means. Generally speaking if it has been well drafted there should be no ambiguity as to what the terms and effect of the clause in it are. This will allow a person who is commercially savvy and intelligent, but not necessarily a lawyer, to fully and completely understand the terms.

If you are the victim of a breach of a contract it is generally best to notify the other side at the earliest possible time. If worst comes to worst and the matter goes before a court or tribunal, the person hearing the dispute will want to see that you have promptly and efficiently sought to enforce your rights. While it is not necessarily the case that your interests are disadvantaged if there is a delay from the time in which the breach comes to your notice and the time you complain about it, there can be a credibility gap. Generally breaches of commercial contracts are taken seriously by parties to them. Often the contract is important to the conduct of both party's general business. That means both parties rely on the performance of the contract in the conduct of their day-to-day affairs. There is an incongruity in sitting back and waiting for a breach to 'ripen' when in fact this never actually occurs.

It is difficult on the one hand to go to the court or tribunal complaining about the grievousness of the breach yet on the other having waited months or more from the time you came to notice it before complaining. There is an inconsistency with commencing court proceedings seeking to enforce your rights on the one hand, yet on the other hand having waited in your own good time for no apparent reason to complain of what you say is serious and terrible conduct.

If there is a good reason why you have delayed bringing the breach to the attention of the other party, it is useful to set that out in your correspondence before you make your first complaint. There may be myriad good reasons why you have waited so such a letter will generally be very helpful.

Again, every contract is different. That means every letter of demand is different. However, the following is a sample letter on a fanciful contract to

illustrate one way in which a letter might be sent.

To: John Orange

Orange Supplies

1 Orange Grove Road

ORANGE GROVE 1111

We refer to our contract entitled *'Supply of Oranges'* entered into on 1 January 2000.

Under clause 1 of that contract you are obliged to deliver to us three boxes of navel oranges by 10.00 am from Monday to Saturday at each of our CBD retail stores.

As you know, the oranges supplied are used by us to make orange juice, which is one of the staples of our business.

On 1, 2, 3, 4 and 5 February 2006 there was no delivery of oranges by you. This meant that even though the shops were open and we had employees at each site ready to make orange juice for customers, we were not able to conduct this part of our business.

We sell significant quantities of orange juice as a part of our business.

Your breach of clause 1 of the agreement in failing to perform your obligations has caused us damage.

Further, since 10 February 2006 you have delivered two boxes only of oranges to each of our retail stores. This is a further breach of the contract. The contract provides that three boxes of oranges must be delivered.

We reserve our rights to make a claim against you for your breaches of the contract in not providing three boxes of oranges to us on 1, 2, 3, 4 and 5 February 2006.

We also reserve our rights in relation to the failure by you to fully perform your contractual obligations since 10 February 2006 by the delivery of only two boxes of oranges.

> If any further breaches in the nature of the breaches identified above occur, we reserve our right to terminate this agreement pursuant to clause 2 of the contract being the breach of a fundamental term.
>
> Please provide us with your response in relation to the above and in particular how you propose taking steps to remedy the damage we have suffered.
>
> In the event we do not hear from you within 14 days from the date of this letter we may instruct our lawyers to commence court proceedings against you or your organisation for damages.
>
> Yours faithfully...

I have chosen this example because it is at the less complex end of the spectrum. There is no precise quantification of a money amount here. It is not possible to identify how much juice business was lost because of the non-deliveries. If yours is a case of a recovery of a debt (that is, you have sent invoices that have not been paid) you would replace the second last paragraph with something like, ‘Please pay the outstanding amount owed being $1 within seven days or we will sue.’

This is what lawyers call a ‘letter of demand’. As stated it is not necessary for a lawyer to send a letter of demand. However, it is regularly considered by business people that letters of demand sent by lawyers have more sting given that it is on a lawyer’s letterhead and that itself makes a statement to the breaching counterparty. This statement is essentially that, *‘we are so unhappy about your breach of contract we have sought legal advice and as a result our lawyers have written you this nasty letter.’* It escalates the dispute in a positive way for the party alleging breach. It is an implicit statement of strong commitment to the protection of their rights and interests under the contract.

Having a lawyer send your letter of demand may have this benefit in some, or even many, instances.

The clearer and more precise your letter of demand, the stronger the impression you make. A diffuse letter substantially limits its effectiveness. The important elements are the identification of the clause, a summary of

the obligation the clause imposes and a statement of how a counterparty has not met their obligations. The more detail you can add, the better.

Some lawyers and people in business favour a rhetorical approach to letters of demand. That is, they express their displeasure and sense of betrayal in emotional and direct terms in the letter. It is my personal view that letters of this kind are not helpful. While it doesn't diminish the position of the person who sends them, it is my preference as a matter of taste for letters to be more clinical, targeted and direct. In most instances the emotional content of a rhetorical letter has no effect on the party alleged to be the breacher. It often also contains statements that the author may otherwise regret with some time, distance and calmness.

Two views of the world when only one will do — the genesis of a dispute

There are a number of steps you can take within your business when a dispute is brewing to assist you in both the short and the long term.

In a nutshell, they amount to gathering and marshalling information. The more information you can collect in relation to the subject matter of the dispute (whether you are the victim or the breacher) the stronger your position will be in negotiation and, if necessary, in fighting it out.

Disputes are generated by two things:

1 acts or conduct by contractual parties

2 emotion, assumptions and expectations that are dashed.

If there is an act or conduct by a party that is in breach of the agreement, there is ordinarily an emotional response from the counterparty complaining of the breach.

Rarely in contractual disputes do counterparties who are victims of breaches shrug their shoulders and respond phlegmatically 'that's life'. There is regularly the sense of betrayal and a belief they have been abused given the trust they had placed in their counterparty. This gives rise to a strong reaction, in which the violated party complains about the ethics, morality and propriety of a counterparty in making the breach.

Although it is easy to say and hard to do, it is always important to temper your emotional reaction to either a breach by another party or an accusation

against you. This is because it clouds your objective judgment.

Over the years courts have been littered with disputes driven by ‘principle’. Principle is a noble thing. Many of the grand developments in our law have been pursued by people as matters of principle.

However, principle is not the same as the moral feeling that you have been mistreated. Do not let your feeling of unhappiness regulate the way in which you address the breach and, to the extent possible, negotiate a commercial resolution of it.

The greatest impediment to the settlement of disputes is emotion. The powerful factors in settling a dispute are reasonableness, strategy and compromise. Always emphasise the latter and never the former.

You will find your thinking is much clearer, your tactical approach cleaner and, in general terms, the result better and achieved more quickly.

Breaches of contract may be by omission or commission. By omission I mean that someone has failed to do something they should have done under the agreement. By commission I mean they have done something they shouldn’t have done or in a different manner from that required under the contract.

Neither is more serious than the other.

Your ‘belief’ that a counterparty has breached the contract is of limited use. To protect your rights you need to be able to prove that the breach has occurred and that, as a consequence, you have suffered damage.

Again, go back to the contract to identify the breach. This is essential in gathering information. You can only know the breach if you know the contract.

It is also important to bear in mind there are likely to be two perspectives on the alleged breach. Your counterparty rarely will admit to their infringement of your rights in clear and open terms. On some occasions the different perspectives are equally balanced.

Example

> Terry’s Timber and Waterside Construction enter into an agreement whereby Terry will deliver timber for a large riverside development as ordered. The agreement provides for Terry to deliver the timber by 7.00 am on the day after an order is placed. Terry has a stockpile of timber sufficient to meet any order that Waterside will make.

> Terry employs a truck driver who is a service-oriented person. For 11 months not only did he deliver the timber for Waterside but also unpacked it from pallets and prepared it so it could be efficiently moved around the development site by Waterside.
>
> Understandably the Waterside foreman and construction workers got used to this superb service as it made their jobs easier and the construction of the project more efficient.
>
> The employee leaves the employment of Terry to join the circus.
>
> He is replaced by another truck driver who, while technically competent, does merely what he is told and takes no extra steps. For the first five consecutive days that he delivers timber to Waterside he simply leaves it on the footpath outside the development and drives off. He has no personal contact with the foreman or any of the workers on site.
>
> Waterside complains about this conduct as a breach of the contract.

It is not a breach of the contract. The delivery of the timber was all that Terry and his driver were obliged to do. The fact that his prior employee had ‘gone the extra yard’ and helped Waterside was not something that was required under the agreement. There could be no steps taken by Waterside to compel Terry to do more than merely deliver.

This example illustrates that the perspectives under the contract can be equally valid. Waterside got used to the employee delivering the timber in the most user-friendly and time-efficient manner. It may not have gone back to the contract when it complained of a breach. It assumed that was what Terry had to do. The contract was in all likelihood in short form and merely prescribed delivery to a site being a street address. It had inferred that the contract contained this extra dimension because of the conduct of the service-oriented employee.

On the other hand Terry is strictly right when he indicates to Waterside that there is no breach of the contract. The contract requires delivery only and that is what is happening.

Putting aside relationship issues and the commerciality of the position, here there is an allegation of breach of a contract that is incorrect. However it is based on facts that, from a non-lawyer’s perspective, could reasonably

lead to a suggestion of a failure to perform obligations. This failure, if not to the letter of the agreement, was generally against the spirit of it and in accordance with the accepted practice between the parties.

One of the worst things to do in the context of a breach of a contract or in a dispute is to make assertions without having all of the information you need available to you to the fullest extent at the earliest possible time. In disputes over contracts, information is power.

Even though this seems self-evident, it is regularly a problem in a dispute resolution process that a party has made fairly wild and ultimately unsubstantiated allegations about the conduct of the other party at the outset. They have not done everything they need to, to check their facts. They have possibly relied on one colleague giving them a story that cannot be substantiated by the documents or the actual conduct of the parties.

Again, place emphasis on commercial and objective rationality. That means an assessment of all the objective factors. What did the contract say? What did they do? Whether you like the people on the other side or they satisfy all of the ‘relationship elements’ you wish from them, this will generally not matter under the contract.

I have set out below a staged sequence of steps that in many cases will be useful to follow in gathering information.

It is important to recognise that evidence is given before a court or tribunal generally on oath. That is, the person who gives the evidence must swear the accuracy of it. If the information is not accurate, there is a powerful sanction against the person giving the evidence. That is perjury. Perjury is a criminal offence and may see the perjurer or person giving the false evidence subject to a jail term. It is of the utmost importance that information is to the fullest extent accurate and is supportable as far as possible by documents or statements of evidence.

In the information collation system I have outlined below, I have assumed that a full and complete analysis of the contract has been undertaken and a view formed as to what the rights and obligations of the parties are. I also assume there is a general assertion of a breach of the agreement by a counterparty.

This system is set out in the context of the party alleging the breach gathering information. However, it applies equally to anyone in a contract who is seeking to initially establish whether or not it has a problem. Exactly

the same steps and essentially the same information should be sought by each side in the process of information gathering.

Further, the system is not a formula. It can be used interchangeably or remodelled as you need it. Some parts may not be relevant to you in your dispute.

Once you have formed your view on the contract, you will be in a position to quickly identify which parts of the system you think are useful and those that are not relevant.

Step 1: appoint a coordinator

The coordinator gathers and organises the information.

The coordinator is the person to whom those relevant to the dispute report. A coordinator must be a person trusted in your business and should be someone who is accountable at a management level.

It is important that the person is not involved in the dispute. This means it is highly unlikely they will ever become a witness in any disputed proceedings. The coordinator's job is to devise and implement the information gathering strategy.

On this basis, a coordinator should be involved in the process of ascertaining what the contract means. Their involvement will mean they have a more intimate knowledge of what the issues in dispute are. This will be helpful to them in that they will be involved in the process from the outset.

The coordinator must identify:

- the relevant people who need to prepare statements or summaries of their involvement in the matter
- documents or general categories of documents that need to be collated.

It is the coordinator's job to hold people to account on a fairly short leash to comply with the requests for things to be done in the information gathering process.

Step 2: stop the talking

It is of critical importance that prospective witnesses in the dispute do not talk to each other to ‘get their story straight’. This is an improper step and one that will have serious and dramatic implications in any dispute resolution proceedings.

A court, tribunal or arbitrator will expect that witnesses come to that forum giving their evidence honestly and to the best of their ability. That is, the evidence is solely to the best of their recollection. While they may refresh their memory from objective documents that may help their recollection of events during the course of the contract, they must not become aware of the versions of events of other prospective witnesses inside the organisation.

Many cases have been tragically lost by parties on the basis of the witnesses getting together and discussing their evidence at the outset and before lawyers become involved. Although this may seem understandable to a non-lawyer, it is a gross mistake to make if there is any prospect that a court, tribunal or arbitrator will be hearing the dispute in due course.

An all-points bulletin, being an email, memorandum or other notice must be circulated to all relevant people inside the business not to discuss with anyone else, including the coordinator, their recollection of the events in relation to the dispute until otherwise directed or authorised. It is also useful to add that the discussion of potential evidence between parties is a very serious matter that may not only have implications for the resolution of the dispute itself, but may also impact directly upon the witness. In this sense they have a direct personal interest in doing the right thing. Their personal interests may be compromised along with those of the business generally.

This cannot be stated strongly enough. Each person must keep their memories of the events to themselves and only share them with lawyers when and if instructed in due course.

Step 3: gather the paper

As a result of your detailed analysis of the contract itself and the relevant provisions, the categories and classes of documents you will need to gather should become reasonably clear.

In broad terms the following categories of documents will generally be relevant:

- correspondence between the parties directly addressing the underlying issues in relation to which the dispute has been generated
- documents that evidence the performance of a contract by one party or the other relevant to the issue at hand
- any variations to the agreement that again relate to the issue in dispute
- any internal memoranda or other documents in which there has been discussion about the issue in dispute between colleagues or any correspondence with third parties that addresses the issue in dispute.

You generally do not need to gather all relevant correspondence in relation to the contract. This is particularly the case if one part or term of a large agreement has been breached. If the parties have otherwise honoured their obligations under other aspects of the contract, there is no need to go into what are otherwise uncontroversial matters.

The coordinator must identify the relevant people in the business who had contact with the counterparty or may be able to assist in advancing the information gathering process. This is done by them giving a version of events which was will assist firstly in clarifying the position and secondly (hopefully), in advancing the positive resolution of the dispute.

The coordinator should take a broad view of who and what is relevant. It is better to have more statements from witnesses that say relatively little rather than being too targeted and running the risk of missing someone who did not seem immediately a big player but who can give evidence that is ultimately of high importance.

As stated above, it is not the job of the coordinator to review, redraft and prepare the statements. This is irrespective of whether they are a witness in the proceedings or not. The coordinator's role is simply that of a facilitator.

In this sense, the coordinator should send an email or correspond with the prospective witness asking them to set out to the best of their recollection all relevant events in relation to the issue in dispute including, but not limited to:

- any conversations they had with colleagues on this issue
- any conversations they had with their counterparty or the other side on this issue
- their internal correspondence

- any correspondence with the counterparty
- any documents that were prepared or had come into existence on the issue in question
- any communications, be they written or verbal, with third parties about the issue.

To the best extent possible, they should set out more rather than less in the witness statements. A ‘kitchen-sink’ approach seems excessive, but you will better assist your lawyers in due course by giving them more rather than less. Let the experts determine what is relevant and what is not. You would be surprised how frequently an off-the-cuff comment is made by an apparently peripheral witness that, when explored, becomes a crucial piece of evidence in court, tribunal or arbitration proceedings. The more you give your expert legal advisers, the better the position.

Witness statements, depending on the person’s importance and centrality to the dispute, may run to a significant number of pages and contain a lot of detail. This is an example to broadly set out the form and structure of a witness statement. It contains another fictional and imaginary set of facts.

Statement of Jane Jones

I am the Chief Operating Officer. I have held my position since 2001.

I am generally familiar with the contract with Fancy Footwork Pty Ltd. I have not actually read the contract. I was not involved in the negotiation of the contract. However, I have had a number of conversations with my people including John Roberts (Marketing Manager), James Jones (Procurement) and Amber Richards (IT) about it informally.

On or around 5 January 2006 I received a telephone call from a person who identified themselves as Tim Tam. Tim Tam indicated he was the Managing Director of Fancy Footwork. He said to me words to the following effect:

I am the managing director of Fancy Footwork. We have a problem with our contract. You have not provided to us the data we have repeatedly requested in relation to sales figures of the business we bought from your company. Our lawyers asked for warranties from your organisation because we had a limited due diligence. We want to make sure

that the summaries you provided to us are accurate. We are entitled to do this under the contract. I am putting this in the hands of my lawyers soon and we may have to sue you to get what we want. I hope this isn't the case.

I replied:

Tim, I don't know specifically what steps have been taken either at your end or mine. I will talk to my people here and get back to you. I don't want to have a fight with you. Whatever steps I can take I will to fix the problem.

Mr Tam replied:

Finally, some common sense from your end. I'm sorry to be so direct but I am extremely frustrated. I have been dealing with your CFO. He has been incredibly unhelpful. I can't help but think you've got something to hide! I'm going to send you an email summarising what we have discussed. What is your email address?

I replied telling him my email address.

A copy of the email is attached and marked Document 1. As a result of that email I forwarded it to Brian Smith, our CFO. Attached and marked Document 2 is a copy of that email.

On or about 6 February 2006 I received a further telephone call from Mr Tam. He said to me words to the effect:

I have heard nothing from you. I still remain concerned that we have not received the information we wanted. It's now been two weeks. I really have to go and see my lawyers now. This is regrettable. The next letter you get will be from Feisty, Frisby & Frosty, my legal team. Your conduct is taking the matter out of my hands and putting it in that of the lawyers.

I replied:

I have sent an internal email here and thought that would be followed up. Let me pursue it for you.

Mr Tam replied:

You can do what you like. Nothing has happened. I can't and won't wait any longer.

Immediately after hanging up the phone I sent a further email to Brian Smith. Attached and marked Document 3 is a copy of that email.

On or about 15 February 2001 I received a letter from Feisty, Frisby & Frosty. Attached and marked Document 4 is a copy of this letter. I scanned the letter and sent email copies to our managing director in the US, Chad Yankee. I do not have a copy of this email.

I have had no further contact with Mr Tam or anyone else from Fancy Footwork.

The above statement is a general summary of the type the coordinator should be looking for. Some people will have more to say than others. This person is a peripheral player in a dispute. I have chosen them deliberately. It is to show that the person giving the statement doesn't have much to say about what is clearly a much bigger dispute. They are saying only what they can from direct experience. They are not telling a story that they do not really know. However, it may be that the conversation she had with Mr Tam proves very important in the ultimate assertion of rights and liabilities. On this basis, and even though this person is not at the heart of the matter, it is important they add details like this.

In some disputes everyone from the most junior secretary through to the managing director may be important. Conversations held or documents received (or not received) may be extremely important in determining who is right and wrong and the validity of the claims. People at all levels of the organisation may become involved.

It is important that the managing director or senior management send a note to the people involved confirming it is a requirement that they assist and that all steps will be taken to assist them by the suspension or reallocation of other duties so as to make sure that all information can be gathered as early as possible.

Step 4: third parties

It may be useful to obtain evidence from people who are not employees of the organisation.

Generally speaking, even the most well-disposed customers or professional colleagues from other companies are reluctant to become involved in a contested dispute in which they have no direct involvement or stake. This is because it is a level of engagement that is often unrewarded and takes a lot of time. It also can be a good way to make enemies — that is, to side with one party over another in a dispute in which you have no role. However, if it is important to obtain evidence from third parties, it is best to keep your request in writing. This can be a delicate exercise.

Again, the coordinator should circulate a list of people who are third parties or people outside the organisation with whom the issue of the dispute should not be discussed in substance. Talking to them about the detail of the facts and evidence may corrupt their evidence in the same way as an internal discussion at the water-cooler may.

The coordinator must get them to set out their evidence to the best of their recollection in a similar form to that set out above.

Step 5: how the coordinator should receive the evidence

So as to minimise the prospect of the evidence being tampered with, the evidence should be provided to the coordinator confidentially in an electronic form that cannot be easily read (on a disk) or in hard copy in a sealed envelope. The coordinator should rise above their understandable interest in reviewing the evidence of each of the parties. This is to ensure that in due course if they need to give evidence about the system of collating the evidence, they can honestly and truthfully say they are totally unaware of what any party may say and that their role was simply to facilitate. If there is an allegation of collusion or tampering, it may be that the coordinator will need to give evidence about the system they actually employed. It would be in their interest to be able to tell the court that they played a role in coordinating by requesting the evidence, but had no knowledge at any stage of what the person was actually saying in reply to

the request for their evidence. A system of keeping the evidence confidential must be preserved at all stages.

Maintaining the secrecy of your communications

Legal professional privilege is an important aspect of Australian litigation law. It is the principle that protects secrecy of communications between lawyers and their clients.

One of the aspects of legal professional privilege is to protect documents created for the purpose of a company or business obtaining legal advice when litigation is considered or contemplated.

The above evidence-gathering process is expressly in contemplation of a dispute that may be litigated.

On this basis it has a legal professional privilege that attaches to it.

The key elements are that:

- a dispute and litigation is anticipated
- evidence is being gathered
- the evidence is being gathered for the purpose of being provided to the lawyers to be used in a potential dispute.

These elements give the creation of the witness statements a level of secrecy.

This secrecy is important as it stops the other side from accessing these documents during the course of the dispute.

However, this secrecy is easily lost.

On this basis it is extremely important that in setting out the rules of the evidence-gathering process steps are taken to make sure this privilege or secrecy is preserved.

A prominent heading should be included on the document to the effect that the statement is prepared in the context of proposed litigation and is for the purpose of providing it to lawyers for legal advice.

Further, every witness statement should be labelled at the top on the front page of the document that is ‘Prepared in contemplation of legal

proceedings and is for the dominant purpose of obtaining legal advice'.

This formula of words is extremely important. It makes an express statement to the reader of that document down the track that it has been prepared directly for advice for lawyers. This reserves its protection as being privileged.

Documents that are not generated in this way may be available for the other side to inspect.

This may have a terrible consequence.

During the course of the evidence-gathering process you may obtain evidence that is not especially helpful to your company's position. In a perfect world you will not want the other side to get access to the information. It may contain details that will help the other side. However, if there is any slackness or looseness in the preparation of the statements or the general circumstances in which they are obtained, there is a real risk of this taking place. This may actually make the difference between a successful resolution of the dispute for your side or having to give up on disadvantageous terms because the legal landscape is so bleak.

If you have any doubts at the outset about the evidence-gathering process, how it should be conducted and any rules of the game, it is important to obtain legal advice at this early stage as to how you should best commence the process.

You can't be too cautious.

Talk to your lawyer at the beginning for direct guidance as to the best means of doing so.

In the absence of having good and proper advice on this question all your good work may go to waste, or worse, be to the advantage of the other side!

What lawyers look for

In order to get the best out of your lawyers, the more evidence you can present in an orderly, structured and properly prepared way, the quicker you will get an advice on prospects and hopefully move to a resolution of a dispute.

It will be necessary for the lawyers to digest all the issues in relation to the dispute. This generally means a review of all the documentary and

written evidence. They need to know the facts before they can advise you on what your position will be.

Each of the steps above can be easily undertaken by lawyers. However, this obviously comes at a cost.

The evidence-gathering can be a time-consuming and expensive exercise. By undertaking the steps set out above, you will arm your lawyers with a significant amount of the information they are likely to need without incurring the costs of preparing it.

There is also a collateral benefit to maintaining the system. Compelling employees to prepare their own witness statements drafted in their own hand in their own time promotes a level of accountability and less scope for them to disavow the document or change their evidence in due course. They told their story first with no pampering, workshopping or filtering.

Remember, the key is certainty. While nobody ever wants to receive adverse evidence, it is better to get this up-front than to proceed on a misapprehension as to the strength of the case and find at some later stage very much down the track that your case is weaker than you thought.

There are many benefits to adopting this system; however, it is hard to do it partially. That is, it would be bad to adopt every part of the system except to have the coordinator act as an editor or re-drafter of the statements. This would be more detrimental than effective. In this context, it would be better to have the lawyers prepare the statements because it is accepted by the court that the lawyers will be involved in the final preparation of evidence and act as a gauge for what is relevant and irrelevant in the dispute.

I cannot overstate the importance of the coordinator being independent and at arm’s length from knowing the evidence the witnesses will give.

Another tip is to chronologically order all the documents you have collated that are relevant to the dispute. This is merely a step that the lawyers will likely take in the event that a box or boxes of undifferentiated material is given to them. Again, it saves time and money for there to be a neat and chronologised bundle delivered to them.

Chapter 13

Making peace early

From the perspective of the victim of the breach of contract, there are various options you can take. The line you pursue depends on who the dispute is with, the subject of the dispute, the strength of your position, the general commercial circumstances and the result you want.

Generally test the waters

Depending on the strength of your claim for breach of contract you may wish to wait to see what the response is from your contractual counterparty after your first complaint. Bear in mind there is nothing at law that requires them to make a response to a letter of demand. It is merely a claim you have asserted. It can be gloriously ignored by your counterparty. If that is the case then you need to make a decision as to whether you should:

- terminate the contract for breach
- affirm the contract but assert a right to damages or some other form of relief
- waive the claim either because of its lack of strength or your inability to prove it. On the other hand you might wish to ‘fight another day’ and in all the circumstances the nature of the breach is not serious enough to give rise to as grave a consequence as you originally thought.

Each of these strategic choices will need to be based on an analysis of the strength of the case. The stronger the case, the more decisive your action should be.

If you believe the case is strong you may wish to immediately commence court, tribunal or arbitration proceedings. This is the boldest and most aggressive move. The upsides of this step are:

- you make an irresistible statement to your opponent that you take this breach seriously and that you are looking to recover compensation or any other form of relief as is required so as to make good your loss
- you immediately commit them to a prospective risk of court orders against them and therefore focus them deliberately and precisely on the dispute
- you expedite the process of the determination of the dispute so as to ensure that you obtain a result at the earliest possible time.

The disadvantages to this response are:

- you generally commit yourself to a high level of cost and involvement in the determination of the dispute in a reasonably short time frame
- by suing, you bloody the nose of your opponent in such a way that they may seek to consolidate their position and act obstinately (and without commercial rationality) even if the case against them is strong
- you commit yourself to a course of action that is not without penalty if you seek to change it dramatically by stopping the court proceedings.

Generally speaking a court, tribunal or arbitrator will award the costs of the case to the other side if you seek to end it before it is heard and determined. The rationale here is that you pick the fight. You cannot elect when to stop it without penalty. The other side has generally incurred legal costs in the process of defending. They should not have to bear these costs if you as the party commencing the proceedings are not willing to see them to their natural conclusion.

The alternative course is to commence settlement negotiations.

These negotiations may take any form. There are generally three ways in which settlement negotiations at an early stage of a dispute are progressed:

1 a letter of offer is sent by one party to another seeking to resolve the dispute

2 an informal and without prejudice meeting is organised between the parties to see if there is a way to resolve the dispute

3 a mediation takes place that is a rather more formalised negotiation in which a ‘peacemaker’ assists the parties in bringing them together to settle.

The benefits of an early negotiation strategy are:

- you open a dialogue with the other side at the outset that may cause them to think of you as a reasonable person and therefore they are more receptive to an amicable resolution of the dispute
- you take the opportunity up-front to try to resolve the matters in question without committing significant resources to a course of action in court, tribunal or arbitration proceedings
- if successful, you have resolved the dispute generally on far more advantageous terms and with a great deal more amity in the relationship between you and your counterparty. This is particularly important if the contract is an ongoing one in that neither party has sought to terminate for breach as a result of the conduct of the alleged breaching party.

The potential disadvantages of an early settlement negotiation strategy are:

- the settlement is unsuccessful and you have ‘wasted’ time delaying in the commencement of court, tribunal or arbitration proceedings to have the matter finally determined
- you may feel you have compromised your position by disclosing your hand to the other side in the negotiations
- the other side may form a view that you have no honest belief in your case given that you are eager to try to settle it rather than drive it forward with gusto and advance your position asserting the case in a strong, decisive and powerful manner.

If I talk to them I can fix it — straightforward negotiation

There is nothing stopping you opening a dialogue with your counterparty in order to resolve the matters in dispute.

It would be unwise to do this without a strong sense of the strength of your position.

Given the information gathering system just outlined, it may not be possible for you as the negotiator to understand all the relevant facts and matters in issue. You may not have a detailed knowledge of all of your people's stories.

Generally speaking this will not be so important in a settlement negotiation.

Settlement negotiations should avoid dispute on fine matters of fact. Whether party A said something to party B is a matter in contest. Rarely will there be agreement on what was said and done. The negotiation will be bogged down. It is likely to be counterproductive to have fights about the honesty, credibility and competence of various people in the organisations. There will always be two versions of facts. Don't try to find 'the truth' or insist upon the other side accepting what you say or think.

In my view you should set aside any dispute on the facts at the outset by saying something like, *'We both have different views of the world. Let's not talk about who is right and who is wrong, let's try to work out a way of fixing the problem we both have'*.

This is a sound and effective premise to start negotiations. That is because you are expressly telling your opponent you are not willing to talk about the matters that may cause you to lock horns. Rarely in the negotiation will presenting a solution to a problem be inflammatory unless the solution is to 'do nothing' or it is a 'winner-takes-all' type of situation.

An attempt to work out who is right and who is wrong legally and morally will usually be counterproductive and possibly cause the parties to be further away from settling the dispute during the negotiations than they were when they first sat down around the table.

It cannot be emphasised enough that any negotiation, with or without lawyers, must be on a without prejudice basis.

I have set out above the broad principles of without prejudice negotiations above. This is a critical component.

It is a regular feature of negotiations that parties make concessions on the facts, on their claims or respective positions. This is what a negotiation is all about. If both parties stick to their stated best case scenarios, the discussions will be short and the negotiation is destined to be unproductive.

That is a case of the unstoppable force moving the immovable object.

One party is saying *'this is what I want';* the other says *'I'm not willing to give it to you'*. It is probably better described as not a negotiation at all. It is more a statement of position.

You need to be protected from the court, tribunal or arbitrator coming into knowledge of any concessions you have made. Concessions can be expressly or openly made without any admission that they constitute your real claim or are what you are entitled to (your actual or formal position being much grander than that you are willing to accept on a commercial basis). There is nevertheless a benefit in having all settlement negotiations as being without prejudice.

In fact the law broadly says that if your negotiations are in settlement of a dispute then they are not admissible to the court as evidence. However, this may not apply for tribunals or arbitrations.

On this basis, it is extremely important it is understood that the meeting is without prejudice before anything is said by one party to the other. It is also useful prior to the meeting to send an email, letter or fax to your counterparty telling them that the only basis on which you are willing to meet is that it is without prejudice and, unless you are advised to the contrary, you assume the meeting will be on this basis. Alternatively, ask them to confirm in reply that the meeting is agreed to be without prejudice. If you can, getting an express statement from them to an agreement in these terms is far more beneficial than a unilaterally imposed term or negotiating on the basis of an assumption. There will be no dispute as to terms.

Don't just expect that the Queensberry rules will apply and that the parties will honour the spirit of the negotiation.

Just as there are oversellers and dubious negotiators on contracts, the same character traits apply in settlement negotiations. Your counterparty may present a face of reasonableness and openness that later changes if they become unhappy at the manner in which the negotiation is progressing. You protect your position best by having a without-prejudice negotiation and no other.

Chapter 14

Getting help to fix the problem — but the warring parties decide

Everyone needs a little help sometimes

In the past 15 years or so mediation, which is otherwise known as ADR or ‘alternative dispute resolution’, has become an important part of resolution of disputes in the Australian business community.

What is a mediation?

A mediation is a mechanism for resolving disputes. It involves the parties seeking a negotiated resolution of their disagreements. It does not involve a decision being imposed on either party by any person. If the dispute is resolved, it is done so by mutual agreement and the parties themselves setting out the terms and conditions upon which the dispute is settled. There is no ‘evidence’ taken. There are no factual findings. There is nothing in the mediation process that is intended to affect, limit or minimise a party’s legal rights if the matter cannot be resolved during the course of the mediation.

A mediator facilitates negotiations and the mood of reasonableness parties may have in an attempt to resolve the matters in dispute.

Depending on the extent of preparation the parties undertake, their respective strengths and weaknesses, their legal positions and their willingness to resolve the dispute at an early stage, mediation can be an extremely useful time- and cost-effective means of resolving disputes, be they large disputes or matters of a lesser magnitude.

Why undertake a mediation?

It is becoming more and more common for commercial contracts to require parties to undertake mediation as an essential first step before they seek to enforce their rights in courts, tribunals or by way of arbitration.

Generally speaking, a clause in these terms will set out a timetable by which a party must notify of the dispute and what the consequences of failed mediation are. Clauses generally require the parties to, as far as possible, agree on who the mediator is to be. If they cannot, various professional bodies can be nominated to appoint a mediator.

On the other hand, even if a contract does not make reference to a mediation, courts are now compelling parties to undertake mediation very early in the process of the court proceedings. Judges appear to be placing a lot more faith in the ability of the mediation process to resolve disputes.

Further, parties who have had positive mediation experiences in the past may seek a mediation prior to any court proceedings or a dispute being formalised even without any agreement in their written contract.

It does not matter how the mediation arises. The same procedures and strategic considerations apply in relation to a mediation that is compelled by way of a contractual term, by court order or by the simple agreement of the parties.

Who pays?

There are no rules as to who pays for the mediator. However, it is regular for the parties to share the costs of the mediator equally. This is notwithstanding that one party may be making a claim that the other party denies and therefore, in this sense, the dispute is driven solely by one party's view of the contract and the performance of it. It is possible to negotiate any payment regime, although the 50:50 split of liability for the mediator's fees is the ordinary way the mediator is funded.

Further, many mediators require that payment be made up-front or on the day of the mediation.

What are the formal rules of the game?

Generally the mediators require the parties enter into a mediation agreement that sets out in very general terms:

- the terms of the dispute
- the way in which the mediation will be conducted
- that the mediation is confidential and any information given by one party to the other during the course of it is ‘without prejudice’ (that of course means that the information cannot be used for any purpose other than the mediation itself)
- the exclusion of any liability for the mediator for his or her conduct.

The most important aspect of the mediation is the clause setting out that any information disclosed is on a without-prejudice and confidential basis. This facilitates discussion. It means neither party has to have one eye on its future position as far as court proceedings are concerned while on the other hand seeking to, in the spirit of reasonableness, settle the matters in dispute. Although there are practical considerations as to the nature and the extent of concessions you will give (as set out below), there is no formal legal reason why a party should not be anything other than entirely candid and frank about its true commercial and legal position to the other side of the mediation. None of the information passed on in a mediation will come out in court proceedings and therefore formally prejudice a party before a judge, arbitrator or tribunal member.

Preparation for the mediation

There are two levels to preparation for a mediation. The first is the formal level. The second is the strategic level.

On the formal level, often a mediator will require a pre-mediation conference where all the parties come to a short meeting to discuss the date, the likely duration and the issues in the mediation. This gives the mediator a feel for the dispute and a sense of the respective parties’ positions. Also it is generally agreed that position papers will be exchanged at that meeting. A position paper is not a court pleading. It is a document that sets out the position of the respective parties so that the starting points for the negotiation and the other side are clear. It is effectively a summary of the sort of material you would assert in a court claim.

On a strategic level, a successful mediation is generally determined by the extent of preparation by the parties. A successful mediation generally means a result that you are commercially content or satisfied with. In this context it is important to know what your legal position is; that is, whether the claim you are asserting is strong. On the other hand, if a claim is made against you, you need to know whether it is strong or weak and why this is so. This often requires a detailed legal analysis of the issues in the case.

It is important for everyone who will be attending the mediation on behalf of your party to fully and completely know the facts in relation to the dispute. There should be nothing that comes up by surprise in the mediation as an allegation about which you could reasonably have obtained information. In a mediation it is always best to be in a position to respond to every allegation and fact made on the other side during the course of it with either an admission or a denial or a qualified admission or denial.

Attending a mediation where you have not ascertained the prospects of your claim or any legal liability will tend to inhibit your ability to successfully resolve the dispute. This is because a party's willingness to settle in a mediation is often regulated by what they think the claim or liability is worth. Without a detailed analysis of the legal position it is very difficult to form a view in broad terms as to this figure.

While it is possible to attend the mediation on limited preparation, the consequence is more likely to be that you are at a disadvantage in the negotiation because you do not have an analysis of the true factual and legal position. As a result you do either an unsatisfactory deal or no deal at all when one might have been available, simply because of a concern that you are not in a position to make an informed decision.

The sometimes regrettable consequence of this is that the settlement may only be available for a short amount of time at the mediation or immediately after. If you come to a view at some later time that the deal on offer at the mediation was a good one, it may not be open. You may have lost the opportunity to settle the dispute in advantageous terms at an early stage by not being as prepared as you might have been.

The mediation itself

There are six broad stages to a mediation. They are as follows:

Stage 1: introduction

The mediator introduces themselves and their role then sets out the general rules of the game. These are that parties must listen when someone else is talking and not speak over them. Mutual respect is a key aspect of a successful mediation. It cannot turn into a slanging match.

The mediator also stipulates that it is not their job to make a judgement or make findings of right and wrong. The mediator is there only to help the parties in dispute.

The parties then generally introduce themselves to each other and identify who they are and their role in the organisation that they represent.

Stage 2: the claimant sets out their case

Generally the position papers should be sufficient so that everyone at the dispute understands the claim being made by the claimant. However, there are occasions when that claim is reasserted by the claimant by oral statement. This can be extremely useful for a respondent because of the emphasis that is placed on certain aspects of the claim. While all aspects of the claim look equally important on paper, the matters that are stressed by the person speaking about the claim provide an excellent insight. It is the first step where the respondent gets a sense of where the pressure points and areas of greater sensitivity are with the claimant.

Stage 3: the respondent’s reply

Here the respondent sets out their view of the claim. This can be done in very general terms (that is, a general denial of any liability) or can descend into specifics.

In my experience it is of limited use to question and debate the facts asserted by the other side. It is useful to indicate that you deny that your view of the facts is the same as theirs. Generally there is no utility in undertaking an exercise where the respondent challenges all the facts set out by the claimant. This is because it is generally unhelpful. No resolution is likely if the parties become embroiled in a factual dispute. They will inevitably, and endlessly, have two views about the facts giving rise to the claim. To become too focussed on this aspect of it will cause delay and the

general spirit of reasonableness that may prevail at the outset of the mediation is poisoned. On this basis, it is best for the respondent to acknowledge there is a difference of view on the facts and look towards more generally seeing if there is a way in which the dispute can be resolved.

Stage 4: summary of dispute by mediator

At this stage the mediator generally likes to undertake a summary of the dispute. By this, the mediator may:

- seek agreement as to the issues in dispute with some precision
- seek to identify areas of common agreement, if any
- identify areas of dispute
- look at, in very broad terms, the legal consequences for one party or the other as a result of 1 to 3 above.

Stage 5: ‘shuttle diplomacy’

Once issues have been summarised, generally one party leaves the mediation room and the mediator commences a direct dialogue with the remaining party. It is generally the respondent who is asked to leave and the mediator commences discussion with the claimant. The matters mediators often raise are:

- that litigation is necessarily uncertain and even the best of cases can lose
- the cost of proceedings ahead
- whether as a commercial result the claimant needs to obtain its full claim in order to make good its loss
- whether there are ways other than the payment of money by which the dispute could be resolved or settled
- generally cajoling and encouraging the claimant to make an offer of settlement that is somewhat less than the claim they originally asserted in their position paper.

In this process the mediator expressly undertakes to keep confidential information that he or she is told by the claimant that thay want to keep secret.

After speaking to the claimant the mediator speaks to the respondent in similar terms. If an offer has been proposed by the claimant and conveyed by the mediator, the benefits of that offer are often recommended by the mediator. If there is no offer by the claimant the mediator seeks a counter offer by the respondent to the offer set out in the position paper.

Generally speaking one of the parties makes a concession on what they will pay or do. This starts a process of negotiation where the mediator shuttles between the two rooms advocating the reasonableness of each offer and seeking to have the parties strike agreement.

This period can take a relatively long time. It is in this stage that the majority of time in the mediation may be taken up.

The amount of time taken in the ‘shuttle diplomacy’ phase will depend substantially on:

- the reasonableness of the parties
- whether a settlement deal is genuinely in the offer or whether the parties are sizing each other up for the next round of the fight in court
- the ability of the mediator to be persuasive
- the level of frustration one party has with the passing of time in the mediation and therefore whether they may be willing to make an offer moving from their original position on the basis they want to get it ‘over with’
- whether one-to-one conversations between the representatives are useful
- whether having the complaining party express themselves directly and in passionate terms to the other party about their issues under the contract will be useful as a ‘clearing the air’ exercise and therefore make the financial aspect of the settlement easier to broker.

Stage 6: boom or bust

It becomes clear to the parties after a period of time whether they are going to settle all of the dispute, part of it or none of it. In large commercial

matters with substantial amounts of money at stake, mediations can take days. This is complicated by there often being multiple parties with different agendas, perspectives and views about the dispute. If the matter can be resolved, generally speaking, the parties execute a document at the mediation. This agreement, which may be conditional and informal in that it is handwritten, sets out the broad terms of what they have resolved.

Generally the parties agree that the settlement either is legally enforceable as at that time or possibly subject to final documentation.

There are good reasons for either approach depending on your position in the mediation and issues in relation to it. If there is no settlement generally the mediator will indicate to the parties that no resolution will be reached on that day and arrangements may be made for a further mediation, further contact with the mediator informally or for further dialogue between the parties. Alternatively, the parties may go their separate ways and be left to their devices to further the dispute, be it litigation, a tribunal hearing, arbitration or some other step.

Can we settle after the mediation?

Quite regularly mediations do not settle the dispute on the day. The submissions made, positions advanced and views expressed can substantially progress settlement negotiations and settlement may occur a short time after the mediation.

It is important if you are the party wanting settlement more than your counterparty that after the mediation you do not let too much time pass. The impressions created in the mind of your counterparties as a result of the mediation are important. Time will necessarily dim those impressions. If you remain optimistic that the matter will settle even though it didn’t settle on the mediation day, it is important to maintain your energy in trying to bring the matter to a resolution if you can as soon as reasonably possible after the mediation takes place.

Strategic considerations

Tactics and strategy in mediation are critical. In some ways, these aspects are more important in a mediation than in litigation. This is because in a

mediation the parties have much more control over the way in which the mediation takes place, what is done or said and the ultimate result. In litigation, a judge, arbitrator or tribunal member has a high degree of control over the manner in which the dispute is determined. Also, they sit in sole judgement of who is right and who is wrong and what the consequences are. A mediation is fundamentally unlike this.

Depending on the manner and style of the two parties and their commercial positions, they have much greater ability in a mediation to direct the way in which the dispute is progressed. On one view this increases the range of approaches one can take and therefore the tactics and strategy behind those approaches.

The tactics and strategy to be used by a party in a mediation depend on:

- the personal style of the representative of each mediating party
- your knowledge of the personal style of the mediating party on the other side
- who holds the most leverage — how well resourced are they to press the claim ahead even if the mediation does not resolve?
- how you can best use the mediator — this depends on knowing the mediator, their style and saying the right things at the right time to prompt them to put pressure on your counterparty while avoiding them doing the same to you
- whether you use the ‘good cop–bad cop scenario’ — how you structure your team and who plays these roles
- whether you choose to start as unreasonably single-minded and then become accommodating at the last minute? This is a style that can be very successful or disastrous depending on the circumstances of the mediation. Close consideration should be given as to how to approach it.

This is a merely a sample of the matters a party must think about when going into a mediation. Again, preparation is critical and the more preparation a party has undertaken going into a mediation the better the chance they are of making informed and advantageous decisions on these tactical and strategic levels.

Chapter 15

Getting help to fix the problem — someone else decides

The position of last resort

If you can't settle your dispute by discussion with your counterparty without the aid of a mediator or envoy, you may need the help of a person specifically appointed to decide the rights and wrongs of a dispute.

What you need to decide before you decide!

Escalating a dispute to the level where a third person or party is going to be determining who is right and wrong is a serious step.

By asking a person to make a decision as to who is right and wrong takes a lot of the control of the process out of the hands of the parties to the dispute.

Because it will involve assertions as to your legal position, it would generally be necessary to involve lawyers at this stage if you have not already done so. This has obvious cost consequences.

There is also a significant 'hidden cost' in retaining lawyers. That cost is lost management and other business time where your employees or members of staff are instructing the lawyers as to the issues in the dispute, the relevant facts and on strategic steps throughout it, and not working in your business.

You should think about the following before escalating a dispute to the level of a judge or someone else deciding it:

- How much is at stake in damages?

- How important to you commercially is getting your remedy?
- What will be the commercial and reputation implications of commencing the proceedings?
- Can you afford to lose this considering money and other commercial reasons? This is particularly important if you are suing a direct competitor and a victory for them in the case will give them a perception of market advantage.
- What are our prospects of succeeding?
- How much is it going to cost?
- How much time will it take from us doing our business?
- Is the door still open to an informal or mediated negotiation?

There are many parties who have commenced court or other proceedings in a fit of passion that they have been wronged and have then quickly lost the taste for the fight given the factors set out above.

Declining to commence court or other proceedings is not a statement of weakness or indecisiveness. On the other hand it can be the wisest decision you make depending on how these variables mesh with each other.

Where will the fight be held?

When a dispute escalates to what are essentially litigated proceedings, there are generally three venues in which it may be fought:

- in court (through court proceedings)
- at arbitration
- in a tribunal.

In different states of Australia there are a range of different courts, tribunals and legal requirements as to arbitration.

I will not pretend to summarise or set out the differences in each state. They are subtle and complex.

This is a matter that would need to be specifically addressed by you depending on where your dispute is to be held.

Court

In Australia there is a complex and interlocking web of courts.

There are courts at both federal/national and state levels. In general terms there are three levels of courts in the states:

1 The Supreme Court in each state that generally has an unlimited power to hear most sorts of disputes.

2 The District or County courts that hear disputes to a set amount of the claim (generally at about $100 000 and above to about $750 000).

3 The Local or Magistrates courts that hear small disputes involving claims of less than $50 000 to $100 000.

In the federal system there are also broadly three levels of court:

1 *The High Court* — this court hears appeals from decisions of the courts of appeal and the supreme courts of each state and on certain constitutional and other specified legal issues.

2 *The Federal Court* — this is a court that hears a range of cases arising generally from legislation made by Commonwealth Parliament but also involving other areas of law.

3 *The Federal Magistrates Court* — again, this court tends to hear cases involving specific legislation enacted by Federal Parliament.

There is a degree of crossover or overlap in the responsibilities of each court. A party often has a degree of choice to decide which court it will start the proceedings in.

Each of the people determining disputes in any of the courts set out above has what are broadly called judicial powers. However, they are generally called judges only in the two highest courts in the hierarchy (for example, the Supreme Court and District Court). Generally speaking the person who sits on the bench in the Local or Magistrates Court is called a magistrate.

Judges and magistrates are invested by law with very broad powers as to determining disputes between the parties.

Importantly, bear in mind that under the Australian system judges and magistrates have either no or limited inquisitorial powers. That means they cannot undertake enquiries of their own as to the rights and wrongs of the

dispute in determining it. They are essentially bound by what the two parties deliver to them as to the facts and the legal consequences of those facts. While they may ask questions of the witnesses and the legal representatives of the parties themselves, the court does not of itself and of its own volition issue subpoenas and call witnesses.

If there are any deficiencies in a case brought by one party or the other as to the evidence or legal analysis, that remains the problem for that party. The court is not empowered to call the witnesses it thinks would have helped that party's case or cover evidentiary deficiencies in that way.

Judges and magistrates apply the law in the context of the facts of the particular case. They must essentially undertake four steps in deciding who wins and loses:

> 1 Establish what the legal issues are. Is it a case of a breach of contract or some other claim and therefore what are the legal tests and principles to be applied?
>
> 2 Establish what the evidence says. In the context of the legal principles and tests to be applied, what did the parties do as revealed by the evidence.
>
> 3 As a result of identifying the legal principles and tests and deciding on balance what has more likely than not happened in the relationship between the parties, establish whether the conduct of one party or the other gives rise to legal rights.
>
> 4 Decide the consequences of the conduct — an award of damages or some other remedy or order.

It is important to remember that the law generally confers a wide range of discretion on judges in making decisions.

It is not a once-size-fits-all approach. It is an inherently human system. The way a party presents its case, the way in which it analyses its legal position, the evidence it tenders, and its willingness to be reasonable in the context of the dispute are all matters that will affect a judge's discretion.

It has been my impression that you will stand a much better chance of having a full and complete hearing, and possibly winning the case, if you appear to be reasonable, sensible and commercial in the hearing of the dispute. Parties that take an overly literal approach to procedure and an excessively formalistic approach can sometimes add to the time taken and cost incurred in the determination of the dispute and on this basis be

perceived by the court to be less than cooperative in the just, quick and cheap resolution of the dispute.

The courts are generally circumscribed by the rules of evidence. Those rules regulate the way in which evidence can be presented to the court and they are quite restrictive in what they allow a witness to say. The rules also require a high degree of formality in the way in which the evidence is presented and the court case is conducted.

It is important you obtain information from your lawyers as to those rules. Often parties to proceedings are surprised and aggrieved by the way in which the rules of evidence may apply to preclude them from presenting evidence that they see as being important and conclusive in the case.

Parties are often unhappy about the hearsay rule which essentially means that a person can only give evidence as to their direct experience.

Example

SMS has sued Text as a result of allegations that Text is trying to keep SMS out of the market for phone communications in breach of the Trade Practices Act. SMS alleges Text is colluding with some large overseas telecommunication interests to drop the price of the service so as to drive SMS out of business and thereby ensuring Text has a much greater market share.

The managing director for SMS tells his lawyers that he heard from another colleague in the industry that there was a midnight meeting between Text and representatives of the overseas telecommunications providers for the purposes of identifying the floor price for the product in Australia with the intent to drive SMS out of business.

The managing director wants to put that in her witness statement. The lawyers tell her she cannot on the basis it is hearsay. It does not prove the meeting took place. It is something she has been told about. She does not have any direct experience of it.

At best the evidence could prove that she had a conversation with her colleague and informant about this issue; however, this does not go very far and is not very helpful in the case. The fact she wants to prove is that Text and the overseas telecommunication providers got together to commercially disadvantage her company. Without proving that fact, her case is at risk. Proving that she had a conversation with an informant doesn’t help in establishing that essential fact.

It is regularly a source of frustration of the parties to litigation that they cannot, in their view, fully and clearly present their case.

It is important to bear in mind that court proceedings are limited in what they allow you to say and do. The rules of evidence may inhibit you from presenting your case as fully and completely as you may hope.

The key is to have direct proof of what you are asserting to the fullest extent possible. That is, in the case of SMS and Text, if possible obtain the evidence of someone who was at the meeting in which the anticompetitive conduct was proposed. If you can't do this, to the best of your ability obtain an objective record such as minutes of the meeting, notes or a later email that appear to confirm what was discussed and agreed. Anything less than this would give you great difficulty in successfully bringing the case. The repeating of rumours, innuendo or scuttlebutt will not be satisfactory as evidence to prove your case. If this is the best evidence you have then you must obtain precise legal advice and closely consider the utility of bringing the proceedings on a limited foundation like this.

Arbitration

This is a process generally arising out of an agreement entered into between the parties at an earlier time to have an arbitrator rather than a court determine the dispute.

An arbitrator is someone either appointed by the contract itself to determine matters in dispute or is someone who is later agreed by the parties if they remain in deadlock as to their conduct and alleged breach.

Arbitrations are generally used in specific kinds of business activities such as construction and engineering. Often judges do not have the qualifications and professional expertise to determine whether a construction contract has been fully and adequately performed. They are, understandably, heavily reliant on expert evidence. They need the experts to tell them whether there has been a breach of the contract or otherwise. In some contracts this is hard to discern without knowing construction techniques. This is generally hard. One expert will say there was no breach and the other will say there is. The judge, by virtue of qualifications and

experience, is not necessarily in a position to be able to discern between two credible, competent and otherwise genuine experts giving evidence.

That is not to suggest that the experts are merely acting as advocates for their client's case. They both may genuinely and honestly hold strongly the views they are giving to the court. This puts the court in an extremely difficult position and gives rise to a great deal of uncertainty for the parties. Over time parties have decided that they would take more control over the determination process and have sought to appoint experts, who are generally lawyers also, in a particular field of endeavour to decide the rights and wrongs of the dispute.

Also, an arbitration is the more informal process. Depending on what the parties agree, it may or may not be subject to the rules of evidence.

In each state there are relevant statutes broadly controlling the manner and style in which commercial arbitration proceedings must be undertaken. It is important that you obtain advice on the steps that need to be undertaken in each state prior to firstly deciding on arbitration in your agreement and then undertaking the process itself.

An arbitration does not have the degree of formality of a court. It is generally undertaken in a room in which the parties sit around a table together.

There is not a judge's bench as such and all parties, including lawyers, dress informally and not in barrister's robes.

The other perceived benefit of arbitration is that it can be quicker and cheaper. In a sense all that needs to be organised is the arbitrator's free time to hear the dispute, consider the issues and hand down a decision. This contrasts with a court where there are literally thousands of cases in the queue to be heard. The parties may be otherwise ready to have their dispute heard yet given the busyness of the court a significant period of time may pass from the time in which they are ready until the actual hearing date. An arbitration can generally truncate this time as long as the arbitrator is available when the parties are.

Tribunals

In the past 25 years or so there has been a strong trend in many states of Australia for tribunals or newly created dispute determination bodies to

have a much greater role in determining disputes between parties to contracts, leases and in other contexts.

A tribunal is a body generally created by the Parliament of a state or the Commonwealth for a particular purpose. For example, a national tribunal, the Administrative Appeals tribunal, was expressly set up to give people an avenue to complain about decisions bureaucratically made by the relevant arms of the Commonwealth government.

Tribunals have very broad rules of operation. They may or may not be staffed by lawyers. They are generally not circumscribed by the rules of evidence. They are expressly constructed so as to allow non-lawyers to appear at what is hoped is not a significant disadvantage. They are, in broad terms, an attempt to make justice more accessible by allowing those without legal representation to advance their positions more easily and efficiently. While it is possible for a person who is not a lawyer to appear in court in their own case, it is practically more difficult for this to successfully occur. In my experience judges have been extremely accommodating of non-lawyers before them in court but the rules of evidence and the general formality of court proceedings, and an ordinary member of the community's unfamiliarity with these processes, makes it difficult for them to properly advance their position to the fullest extent possible.

Chapter 16

Preparing for battle — getting ready for the hearing

There are essentially eight stages in preparing a matter for determination, be it by court, an arbitrator or a tribunal.

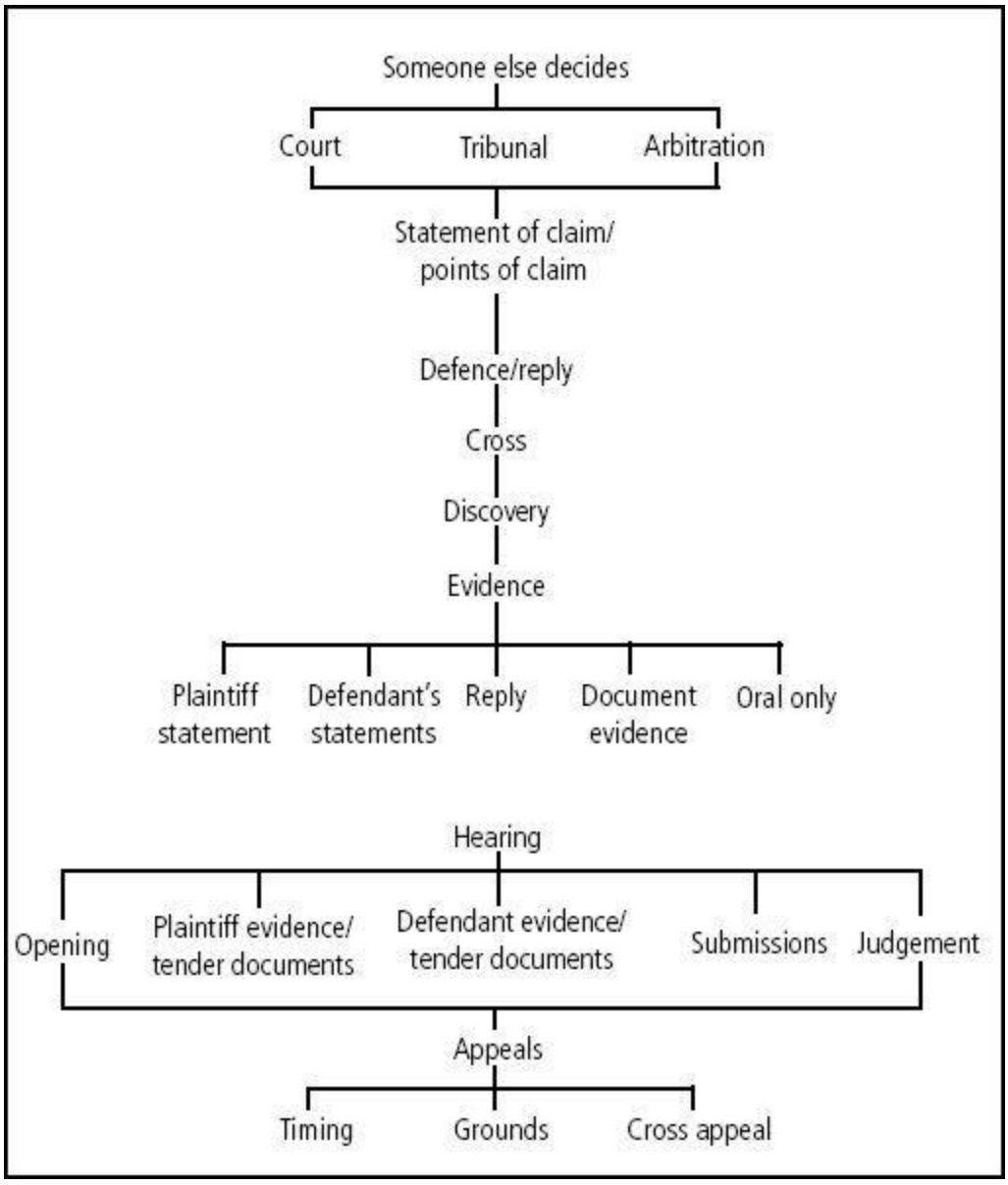
The overarching principle is to ensure that every party has an opportunity to fully and completely put its case as it wishes. An ordered and structured preparation for hearing ensures to the fullest extent possible that there is no trial by ambush where a party presents to a counterparty at the end of the process a large amount of information that would have changed the counterparty's view of the case or caused it to take other and different steps in its own interest.

The key is to ensure an orderly, rational and timely preparation of the case. This means that not only should everyone have the opportunity to put their case, but that the counterparties should be fully and clearly aware of the position of the other parties to the dispute.

Clarity is the key. It is important that everyone knows what everyone else is saying about the dispute and the result they think is fair, appropriate and within the bounds of the law.

Figure 16.1 (overleaf) sets out the general stages of the dispute.

Figure 16.1: general stages of a dispute



It is important that a party engaged in the dispute has some familiarity with the language of the court, tribunal or arbitration in which they are involved. The law is infused with jargon and technical terms. Many of these technical terms are merely names. They are labels for what are otherwise reasonably straightforward and simple concepts. However, the use of these jargon terms by lawyers can tend to intimidate and alienate the non-lawyer.

The glossary at the back of this book simply defines a number of terms relevant to contract negotiation and disputes. Although by no means comprehensive, it provides a snapshot of the kinds of language that a party should or may become familiar with during the course of a dispute.

Chapter 17

Preparing the case for hearing

In each of courts, tribunals and arbitrations, the following general steps are followed in preparing a case for hearing.

Stage 1: starting the dispute — statement of claim

This is the document that kicks off the court, tribunal or arbitration proceedings. It may also be called a points of claim. In jurisdictions that still use more old-fashioned language, it may also be called a writ. It should have four general sections (although it may not be marked clearly in sections in this way):

1 identifying who the parties are and whether they are corporations, individuals or some other type of legal entity

2 setting out the facts in relation to the claim (for a breach of contract it will be necessary to set out all of the contractual terms, the date the contract was entered into and other relevant information)

3 setting out the legal consequences that flow and identifying in very broad terms what aspects of law have been infringed

4 identifying precisely and clearly the consequences that flow from the breach of the contract or other infringement of rights.

A short-form sample statement of claim follows.

Statement of claim

1 The plaintiff, Andy Orange trading as Orange Juice to the World (‘OJ’) conducts a business being the sale of orange juice at 10 CBD retail outlets.

2 Fruit Wholesalers Pty Ltd (‘FW’) is a company duly registered and liable to be sued in its corporate name and style.

3 On or about 1 January 2001 OJ and FW entered into an agreement for the delivery and provision of oranges by FW to OJ.

Particulars

Agreement in writing and constituted by the document entitled ‘Orange Delivery agreement’.

4 The Orange Delivery agreement contained the following terms:

4.1 That FW would deliver to OJ 10 boxes of navel oranges at or before 7.00am to each of the OJ CBD retail outlets on each business day (excluding public holidays and weekends)

Particulars

Clause 1.1

4.2 If FW for any reason outside of its control or power could not obtain navel oranges then it may in performance of its obligations under the contract provide OJ with oranges of a similar quality, taste and juice extraction ratio expressly with the written consent of OJ and on no other basis.

Particulars

Clause 2.2

4.3 In the event of any breach of the agreement by FW, OJ is entitled to withhold payment of any and all outstanding invoices unpaid as at the date of the breach in its absolute discretion and subject to the breach being remedied or any damage suffered by OJ as a result of the breach being remedied.

Particulars

Clause 2.3

5 On 1, 2, 6, 10 and 15 December 2001 FW made no delivery of oranges at all to OJ in any of its CBD retail outlets.

6 On 7, 11 and 20 December 2001 FW delivered 3 boxes only of Valencia oranges to the retail outlets conducted by OJ at Grosvenor Place, Prosperity Square and Quay but to no other CBD retail outlet conducted by OJ.

7 The failure of FW to deliver oranges as pleaded in paragraphs 5 and 6 above constitutes a breach of the Orange Delivery agreement.

Particulars of breach:

i FW failed to deliver any navel oranges to any CBD outlet of OJ on 1, 2, 6, 10 and 15 December 2001 in breach of its obligations set in clause 1.1 of the Orange Delivery agreement.

ii FW failed to deliver any oranges of any type to any OJ CBD outlet on 7, 11 and 20 December 2001 other than the Grosvenor Place, Prosperity Square and Quay outlets.

iii Further to paragraphs 1 and 2 above, FW failed to deliver 10 boxes of navel oranges to all 10 outlets of OJ on 1, 2, 7, 10, 11, 15 and 20 December 2001.

iv On 7, 11 and 20 December 2001 FW delivered Valencia oranges to the Grosvenor Place, Prosperity Square and Quay outlets of OJ without any written or other consent by OJ to the deliver of oranges of that type.

8 As a consequence of the breaches set out in paragraph 7 above, OJ has withheld payment of an invoice rendered by FW to OJ dated 30 November 2001.

Particulars

Invoice from FW to OJ styled as tax invoice and dated 20 November 2001 in the amount of $30,000.00.

9 As a consequence of the breaches of the agreement as pleaded above by FW, OJ has suffered loss and damage.

Particulars of damage:

i Loss of profit on the sale of orange juice from each of its CBD outlets on each of the respective dates upon which the contract was breached.

ii Wages, rental and other ancillary business costs thrown away as a result of the breaches by FW.

iii The cost of acquiring replacement oranges by OJ at a rate of $100.00 per box being $70.00 per box higher than the rate per box as mandated under the Orange Delivery agreement.

10 And the plaintiff claims:

10.1 Damages

10.2 Interest pursuant to Section 100 of the *Xxxx Act 19xx*

10.3 Costs of and incidental to these proceedings.

This is not a perfect statement of claim and is a pretty fanciful example. They are very expensive oranges. I hate to think what the juice would cost!

As you will see, the statement of claim is a formal document that essentially tells a story. While it employs some official legal language, it sets out all the relevant facts and issues in relation to the dispute. If you

read a statement of claim on the assumption it merely tells a story, much of the otherwise intimidating formality a document like this has will fall away and it becomes much easier to understand.

Stage 2: defence

The defence is the opportunity that the defendant or respondent has to tell its version of events. A defence should respond directly to the claim.

In a simple form defence there are essentially three responses, they are:

1 that the defendant/respondent admits an allegation as made in the statement of claim

2 that a defendant/respondent denies an allegation as made in the statement of claim

3 that the defendant/respondent does not admit an allegation in the statement of claim.

It is important to bear in mind that any admission is formal and binds the defendant. This means that the dispute on that issue no longer exists. For the purposes of the court proceedings the court considers that the point raised has been conceded and it is no longer an issue that needs to be determined.

A denial is an allegation that the contention in the statement of claim is not correct. It is contested, that is, a matter in dispute.

A non-admission is between the two. It means that the defendant/respondent does neither admit nor deny the allegation. It is putting the plaintiff to proof. That is, the onus is on the plaintiff to establish the allegation is correct. The defendant/respondent reserves its right to challenge the plaintiff/applicant on this point but it does not have the information to hand or is not in a position to make a clear and comprehensive denial of the fact.

Once the direct allegations have been responded to, a defendant/respondent may make further allegations.

These are often other matters it wishes to put in its defence that it considers to be helpful to it and are in addition to or further to the issues pleaded in the statement of claim. The defendant/respondent is not bound simply to reply in a straightforward and direct way. The defence allows it to

relevantly raise any matters that are in its interest that the court should be aware of to assist in the determination of the dispute.

A specimen defence to the hypothetical statement of claim is set out below.

Defence

In answer to the matters pleaded in the Statement of Claim, Fruit Wholesalers Pty Ltd ('FW') says:

1 FW admits paragraph 1 of the Statement of Claim.

2 FW admits paragraph 2 of the Statement of Claim.

3 FW admits it entered into a contract on or about 1 January 2001 styled Orange Delivery agreement, does not otherwise admit paragraph 3 and will rely on that agreement for its full terms and effect.

4 FW admits it entered into a contract on or about 1 January 2001 styled Orange Delivery agreement, does not otherwise admit paragraph 4 and will rely on that agreement for its full terms and effect.

5 FW admits paragraph 5 of the Statement of Claim but relies on the matter pleaded below in paragraphs 11 to 13 as to the variation of the Orange Delivery agreement and denies any breach of the agreement as pleaded or at all.

6 FW admits paragraph 6 of the Statement of Claim.

7 FW denies paragraph 7 of the Statement of Claim.

8 FW admits paragraph 8 of the Statement of Claim.

9 FW denies paragraph 9 of the Statement of Claim.

10 FW denies that the plaintiff is entitled to relief claimed or at all.

11 In further answer to the whole Statement of Claim, FW says that the Orange Delivery agreement provides for the oral variation of it by notice of a representative of one party to a representative of the other.

Particulars

Clause 10 of the Orange Delivery agreement.

12 On or about 1 November FW on each business day advised orally the plaintiff that FW was not able to make a delivery of oranges on 1, 2, 6, 7, 10, 11, 15 and 20 December 2001 on the basis of industrial action at its supplier causing that business to not be open on each of those dates.

Particulars

Conversation between Andy Orange and Terry Ripe (CEO of FW) on 1 November by telephone at approximately 3.00 pm.

13 As a consequence of the matters pleaded in paragraph 12 above the agreement was varied pursuant to its terms.

14 On and from 1 November 2001 the plaintiff/cross-defendant raised no complaint or allegation of breach of the Orange Delivery agreement against FW.

15 As a consequence of the matters pleaded in paragraphs 11–14 above the defendant further denies any liability to the plaintiff as pleaded or at all.

As you will see, the defence directly responds to the statement of claim.

Stage 3: cross or counter claim

Once proceedings are commenced by a plaintiff on a statement of claim, at the same time as the defence is filed the defendant/respondent may file a counter claim. This is generally known as a cross claim.

A cross claim is a document that sets out a claim that the defendant makes against the plaintiff. It may arise from the same issues as the statement of claim. It will look and sound a lot like the statement of claim itself. An example is set out below.

Cross claim: against plaintiff — new facts

1 Fruit Wholesalers is a company duly incorporated and entitled to sue in its corporate name and style ('FW').

2 Andy Orange trades as Orange Juice to the World ('OJ').

3 On or about 1 January 2001 OJ and FW entered into an agreement for the delivery and provision of oranges by FW to OJ.

Particulars

Agreement in writing and constituted by document entitled 'Orange Delivery agreement'.

4 The Orange Delivery agreement contained a term that entitled FW to render invoices for deliveries of oranges in the preceding month on the last business day of each month with terms for payment being 14 days.

Particulars

Clause 3 of the Orange Delivery Contract.

5 In or about November 2001 FW delivered 10 boxes of navel oranges to each of the CBD retail outlets of OJ in performance of the Orange Delivery agreement.

6 On or about 30 November 2001 FW rendered an invoice to OJ.

Particulars

Tax Invoice dated 30 November 2001 from FW to OJ in the amount of $30 000.

7 In breach of the agreement OJ has failed to pay, and continues to fail to pay, the sum claimed in the invoice pleaded in paragraph 6 above.

8 FW claims an amount of $30,000.00 together with interest at the rate prescribed by Section 1 of the *Xxxx Act 19xx* being from 30 November 2001 to 30 December 2001 at 10 per cent pa (30 days) being $246.00 and continuing at that rate of interest at $8.21 per day.

9 And the cross claimant claims:

i Damages in the amount of $30 000.

ii Interest as pleaded in paragraph 8 above.

iii Costs.

On the other hand it may make an allegation in relation to a claim that is unrelated to the matter the subject of the statement of claim. It may be a separate area of law and on totally different facts. The specimen cross claim below illustrates this point.

Draft cross claim

1 Fruit Wholesalers is a company duly incorporated and entitled to sue in its corporate name and style ('FW').

2 Andy Orange trades as Orange Juice to the World ('OJ').

3 On or about 1 January 2002 OJ and FW entered an agreement in writing.

Particulars

Agreement in writing and constituted by a document entitled ‘Orange Delivery agreement’.

4 On and from 2 January 2002 the parties have performed their rights and obligations under the agreement.

5 On or about 22 December 2001 the cross-defendant, Andy Orange, made the following oral representations to Jack Soft, the CEO of the Big Pillow Hotel Chain:

i FW had breached its contract with OJ.

ii FW was dishonest in the conduct of its business.

iii FW could not be trusted in the conduct of its business.

iv FW was insolvent.

Particulars

The representations pleaded above were made during the course of a meeting between Andy Orange and Jack Soft at the offices of the Big Pillow Hotel Chain on 22 December 2001.

6 The representations were false in that:

i FW has undertaken no breach of any contract it has with Andy Orange or any business conducted by him.

ii FW does not conduct its business dishonestly or dishonourably.

iii FW is trading profitably, successfully and solvently.

7 The above representations are false and are misleading and deceptive or likely to mislead and deceive in the terms of the *Trade Practices Act 1974*.

8 In reliance on the representations pleaded above, Big Pillow Hotel Chain has terminated an agreement with FW for the delivery of fruit.

Particulars

Agreement between the Hotel Chain and FW entitled Fruit Delivery agreement dated 1 February 2001.

9 As a consequence of misleading and deceptive conduct pleaded above FW has suffered loss and damage.

10 And FW claims:

i damages

ii interest

iii costs.

The third basis on which a cross claim may be drafted is to bring in new parties to the proceedings. This is called ‘joinder’. This is generally done when the defendant/respondent alleges that there is another party who is partially or entirely responsible for any liability that the defendant has to the plaintiff. It can be an allegation that the plaintiff has got the wrong person or that the real agent of destruction causing the breach or damage was the party who is newly joined. It is alleged the new party should be partially or ultimately responsible for the problems they have caused and the formal means of holding them to account in this way is by filing of the cross claim.

Below is a specimen cross claim of this kind:

Cross claim — new party

1 Fruit Wholesalers Pty Ltd ('FW') is a company duly incorporated entitled to sue in its corporate name and style.

2 Orange Cooperative Pty Ltd ('Coop') is a company duly incorporated and liable to be sued in its corporate name and style.

3 On or about 31 December 2000 FW and Coop entered into an agreement entitled Wholesale Fruit agreement.

4 That agreement contained a term that Coop would make available at its Sydney market premises in Flemington fruit in the following categories and quantities on a daily basis or as required by FW:

i Navel oranges	100 boxes
ii Granny Smith Apples	100 boxes
iii Nashi pears	100 boxes

Particulars

Clause 1 of the agreement

5 In reliance on the terms of Clause 1 of the agreement, FW entered into further agreements for the supply of fruit to third parties.

6 On each of 1, 2, 7, 10, 11, 15 and 20 December 2001 Coop did not provide to FW fruit items as set out in paragraph 4 above or at all.

7 As a consequence of the conduct of Coop as pleaded in 6 above, FW defaulted under contracts it had entered into with its customers for the provision of fruit.

8 As a consequence of the above:

i FW has been sued for damage under contracts with Andy Orange trading as Orange Juice to the World and Super Juice Pty Limited.

ii FW was unable to perform its contractual obligations in relation to contracts with the following parties who have terminated their agreements with FW:

(a) The Big Hotel Chain

(b) Freddy's Fruit Shop.

9 As a consequence of the breaches of Clause 1 of the agreement, FW has caused the commencement of proceedings for damages against Coop and for damages and the termination of further agreements FW had entered into with third parties and FW suffered loss and damage.

Particulars of damage

i An indemnity against prospective liability on litigation commenced against FW by third parties arising directly from the breach of Clause 1 of the agreement.

ii Termination of contracts it had with third parties causing loss.

10 And the cross-claimant claims:

i damages

ii interest

iii costs.

These documents are collectively called pleadings. That is, they set out the pleas or allegations that the parties wish to make to the court. They are formal documents that allow the court to, in an easy and clear way, identify what the factual and legal issues are in the dispute. The pleadings are

effectively closed when the defences and cross claims have been filed. The next stage is the collation of evidence.

Evidence

There are two primary stages in the evidence gathering process:

1 discovery or the document trail

2 affidavits and telling the tale.

Stage 4: discovery

Discovery is a process where the parties to the dispute must gather all relevant documents they hold to be produced to and shown to their opponents.

This process disallows the famous Perry Mason golden-document tactic. Countless American TV shows have highlighted a lawyer waving a ‘smoking gun’ document in court that entirely confounds the other side’s case and causes them to lose publicly in a hail of embarrassment.

The system in operation in Australia works against this process. It is generally considered inappropriate that a magic document is disclosed at the last minute that, if it had come to the notice of the parties at some earlier time, would have saved costs and trouble in having a trial. If such a magical document exists, the earlier the party who is the ‘victim’ of it knows, the better. If they are sensibly advised and behave rationally they should either stop their claim or admit the claim the other side has made and allow everyone to move on to more prosperous and profitable things.

In current practice before the courts the discovery process operates as follows:

1 The parties write to each other identifying classes or categories of documents they wish to see from the other parties.

2 There may be a reply to those categories indicating they are not relevant or are oppressive or that they require too much work in the context of the dispute.

3 Once any difference of opinion as to categories has been resolved the parties must compile lists of documents that itemise specifically each document within a category.

4 A bundle of those documents is prepared and each document is cross-referenced to the list by a number. The number ensures the document can be readily identified from the list and an affidavit sworn stating the list contains all documents relevant to the categories.

5 Inspection and if possible photocopying of those documents takes place.

The process of discovery can be itself a fertile ground for dispute within litigation.

A further sanction for a party not doing its job properly in this context is that they often in time must eventually swear the affidavit that has the party itself or a representative of it telling the court, tribunal or arbitrator and the other party that there are no other relevant documents within the categories that they hold in their possession, custody or power. Of course swearing a false affidavit constitutes perjury.

However, in general terms there is a disinclination by a party to disclose material that it considers to be adverse. This does not matter. A party cannot withhold adverse information simply on the basis it does not wish the other side to see it because it will give them new confidence when proving their case. In fact, that is the very point of the process. Discovery cannot be selective or discretionary. If a document falls within a category that has been sought, it must be disclosed in the list.

Stage 5: telling the tale — affidavits and statements

Affidavits are written statements of evidence provided to a court that comply with the rules of evidence. As set out, the rules of evidence are restrictive and limiting. They do not allow for all types of information to be put before the court. Essentially, only information or conduct of which a witness has direct experience is relevant to be admitted.

The chief requirements of affidavits are:

- they have a formality of structure

- they should not contain conclusions of law (such as ‘we entered into a contract on 1 August 2000’)
- they must contain representations of fact from the direct experience of the witness
- any conversations must be in direct speech — that is, they should read like a movie script or a play.

Courts will generally order affidavits. The key element in the value of an affidavit from the court’s perspective is that it must be sworn on oath. That is, the witness must swear an oath that the contents of the affidavit are true. If they knowingly swear a false affidavit this constitutes perjury, the sanction for such an offence being jail. While it is quite rare for a person swearing an affidavit to go to jail, it is an order that is available to the court to make if it forms a view that the witness is baldly lying.

Because of the necessity to swear an affidavit on oath, it should be comprehensively and precisely reviewed by the person swearing it. Even though it is prepared by a lawyer in draft form, it is the witness’s evidence. There is no comfort for the witness in saying ‘but it was prepared by someone else’. It must be read and considered in absolutely minute detail by the witness. It is the witness’s document.

On the other hand, in a less formal context the court may order statements of evidence. These statements merely need to be signed by the witness. They are not verified on oath. They set out in broad terms the nature and type of evidence that the witness will give. They may or may not have the formality and precision of affidavits. It depends on the circumstances in which the court requests statements of evidence and the agreement between the parties what level of detail the statements will have.

Preparing affidavits is often the most crucial part in the litigation process. It is the stage where the allegations in the statement of claim, defence or cross claim are either backed up or not. If they are not, there are likely to be real problems for the relevant party. They cannot prove what they said they could in their pleading document.

This can be an extremely expensive and time-consuming part of the process. It is necessary for the lawyers and the party itself to ensure that every possible piece of evidence that advances the case is fully and properly set out in the affidavits. Any gaps or weaknesses in this regard will be possibly fatal at the trial.

Preparing affidavits can take a long time. The more witnesses, the more complex the process.

Importantly, witnesses must not confer as to their evidence. It is possible that at trial they will be asked questions about who they have spoken to in preparing their evidence. If they give evidence honestly that they have spoken to other witnesses in an attempt to ‘get their story straight’ there may be a strong submission made to the court that they are not a witness of truth and that their evidence has been tainted by this hot-housing process. The submission is likely to be that the court will not and should not accept their evidence on the basis that it has been either concocted or created by a ‘committee’. The emphasis in an affidavit is on the individual witness’s best and sole recollection of the relevant issues. The ‘workshopping’ of the content of affidavits is not only in breach of all relevant principles of law and practice, but is unwise in every sense.

In the process of finalising affidavits the parties should collate all documentary evidence they contend to support their case and that they wish the court to see in support. Generally speaking, those documents are put to the court through the witnesses. That is the witnesses annex or append documents to their affidavits by making direct reference to them in the document itself. This process is a kind of authentication or verification that the relevant email, letter or document was drafted and sent by a particular person to another on a relevant day. When a witness makes reference in that context to the document they are formally telling the court the document was either received or sent by them or they had a hand in the authorship of it.

As a general rule of thumb all documents that a party wishes to put before the court ultimately at the hearing should be through affidavits. The only real exception to this is documents produced by other parties who are not involved in the court case on subpoenas.

In a case in which oral evidence is provided by parties, the affidavit process is not necessary to a matter of the court order.

However, it is highly likely that documents that will look very much like affidavits will be prepared by the lawyers for either party but not given to the court or provided to the other side. It is generally important that the lawyers know with precision the story that the party is going to tell the court. On this basis they wish the witness to commit in writing what their

likely version of events is going to be so that they have predictability and certainty in the running of the case.

Stage 6: hearing or trial

The hearing is when all the preparation culminates and the evidence is presented to the court, arbitrator or tribunal allowing them to finally make their decision.

Again, subtly different procedures apply in relation to court proceedings, arbitrations and tribunal hearings respectively. However there are common features to each.

There are generally five stages to a hearing. These stages can be relatively brief or can take a long time. The hearing can range from one hour from start to finish to multiple months in duration. The length of the hearing will generally be affected by the number of issues in the dispute and the amount of evidence. The smaller the number of issues and the fewer the statements or affidavits the more likely it is the case will take a short amount of time. While this is not an absolute rule, it is a general indication that in my experience has been a good guide.

Opening

Often the plaintiff will open the case to the judge, arbitrator or tribunal member. They explain the scope of the dispute, the issues involved and present a broad précis of the evidence lodged. The emphasis here is placed on being even-handed and explaining in fairly neutral and objective terms the issues before the court.

Sometimes the defendant/respondent will be given a chance to reply although this is fairly rare. If a fair rendering of the case has been made in the opening, generally a reply at this stage is not necessary.

Taking of the plaintiff’s evidence

In a case that involves affidavits each of the affidavits to be tendered is handed to the court/arbitrator/tribunal and admitted into evidence. This process may be relatively formal (court) or relatively informal (tribunal).

Where there are no written statements of evidence the witness is invited to give oral evidence as to their version of the facts and circumstances giving rise to the dispute. This is generally done by the lawyer for that particular party asking questions of the witness that are very open-ended in an attempt to elicit their evidence. These questions cannot have implied or assumed answers and must be in very general terms. The emphasis is placed on the witness giving honest and clear evidence as to their version of events. They are not to simply elicit evidence that is in the benefit of the plaintiff's case at the sacrifice of the truth.

After the evidence of the plaintiff has been either lodged in documentary form or given orally, the other parties to the proceedings are generally offered the opportunity to cross- examine that witness. This involves asking questions of that witness that test their version of events in a more or less polite manner. Lawyers have a vast range of different cross-examination styles that lawyers have. Some are nursing and cajoling. Others are belligerent and hostile. Depending on the facts, the court may give a wide degree of latitude the person cross-examining as to the nature and terms of questions they may ask. They of course cannot ask about anything they want. It needs to be relevant to the matters in dispute and generally of assistance to the court, arbitrator or tribunal in deciding who is in the right or wrong.

During the course of the examination in chief or the filing of affidavits all relevant documents that the plaintiff wishes to be tendered to the court are to be provided.

Once all the evidence has been provided to the court the plaintiff wishes to tender or leave if the case is closed.

Defendant's case

The defendant undertakes a similar process to that of the plaintiff. All their statements or affidavits are submitted to the court. All documents they wish to tender are in due course submitted to the court. Each witness, if they are giving oral evidence, provides their version of the facts and events in the same way as the witnesses for the plaintiff. They are cross-examined in a similar manner. Almost identical rules apply in relation to the admission or acceptance of evidence by the court.

Submissions

Once all the evidence has been accepted by the court, arbitrator or tribunal it generally then invites the parties to make submissions on the consequences of that evidence in the context of the issues pleaded in the case. This means that the representatives for the parties need to marry what they tell the court to what the issues are in the pleadings and the way in which the evidence has come out.

The submissions generally are concerned with who is to be believed on the respective versions of events and the consequences of those submissions. They can sometimes be called addresses.

At the end of the submissions generally the trial ends and either the judge, arbitrator or tribunal member comes up with a decision on the spot or ‘reserves’ their decision. A reserved decision means they wish to go away and consider the evidence, submissions and all the issues in relation to the case in coming to their conclusion.

Judgement

The final stage in the process is the court issuing a judgement on the matters in dispute.

There is a wide range of potential results that a court, arbitrator or tribunal may determine as being appropriate in normal circumstances depending on the nature of the issues, the evidence and the terms of the submissions.

In this context every case is different and subtle variations of fact in two otherwise similar cases may yield vastly different results.

Stage 7: appeals

Generally speaking there is an appeal mechanism in relation to decisions initially made. This is a complex and detailed area of the law and appeal rights vary in different courts, tribunals and under arbitration rules.

It is not possible to summarise efficiently each of those rules (without reducing the reader to extreme boredom!). However a common theme across all jurisdictions is that grounds of appeal need to be identified. It is

necessary to clearly set out why the judge, arbitrator or tribunal member erred in making the decision they did. It is necessary to point to an error and not merely that you do not like the result.

Generally those errors need to be on matters of law. That is the judge, arbitrator or tribunal member did not properly apply the legal tests or misapplied some aspect of the law to the facts in the case. Generally you cannot appeal successfully on the basis the judge did not believe your story or simply got it wrong in your view of the facts.

Rarely do successful appeals rest if the judge, arbitrator or tribunal member has formed a view that the witnesses or a particular party was not credible or was not telling the truth. It is a matter that is generally within the province of the person hearing the evidence and appeal bodies are extremely loath to upset any findings of the person hearing the evidence in this way. The rights of appeal are a complex area and should be given close consideration both as to whether any appeal credibly rests as a result of the determination and secondly the prospects of succeeding on an appeal if brought.

Stage 8: settlement in the process — is it possible?

It is always possible to settle in the course of the determination of the dispute. In fact it is becoming a regular theme in courts, arbitrations and tribunals for the person determining the dispute to strongly encourage the parties to seek mediation or to discuss further potential resolution of the dispute during the course of the preparation of the hearing.

In broad terms the same rules apply as in a pre-proceedings negotiation. However, ordinarily you will have the support of your legal advisers in any negotiation that is undertaken once the proceedings have been commenced. They should and will be able to look after you in relation to strategy, tactics and ensuring that your interests are at all times and to the fullest extent possible protected during the course of the negotiations.

It would be a trap to think that just because you have been sued you still cannot resolve things.

Often commencing proceedings against another party is the ultimate trigger for resolving the dispute. Up until that time the counterparty’s

approach is to put the person making the claim to the test in that they want to assess how firmly resolved they are. Once the claimant makes a statement to the counterparty that they are willing to have the case heard and finally determined, the defendant/respondent forms the view that the claim is credible and, in the face of proceedings, starts to seriously negotiate.

This technique should not be underestimated when you have a valid and sustainable claim against a counterparty who is obstinate or unwilling to negotiate a resolution of the dispute early on.

The hot tips

- Know your product — what do you need to do to perform your obligations and exercise your rights?
- Communicate astutely — there can be too much candour when a little will do. On the other hand, don't try to mask the transparent truth.
- Make an informed decision on communication after thinking about the pros and cons of what you're going to say.
- Contracts die in three ways — time passing, termination without breach or termination as a result of a breach. All are different and have different consequences. You should be conscious of each.
- The death of a contract is not always a case for mourning; however, consider the commercial implications of the contract ending and the position it leaves you in.
- When a dispute is brewing, do yourself and your lawyers a favour by gathering all the information you can. This is not necessarily a straightforward task — there are risks in not doing it the right way.
- Only consider settlement once you've gathered a significant amount of information in relation to the dispute and have a sense of the strengths and weaknesses of your position. Be prepared and considered in whether you embark on a settlement negotiation, let alone in the negotiation itself.
- Mediation is a useful tool but only if used properly and wisely.
- Having someone else deciding your dispute is necessarily uncertain and there is always risk.

- Don’t forget it’s your case and you should understand it as best you can. Be involved. If you don’t understand something, do your best to have the lawyers explain it to you in more user-friendly terms. Remember you are in the realm of the lawyers but that doesn’t mean you become as uninvolved in the process as a patient on the surgical table under a general anaesthetic.
- Lawyers can’t fix the facts — the most brilliant lawyer can’t win a case when the facts are in the other side’s favour. The winning and the losing of the case is almost always with you. Trust your lawyers to advocate your case as best you can; however, they are merely the engine that you fuel with instructions, data and detail.

Chapter 18

In summing up

Negotiating contracts can be an exciting business. As is clear from this book, it is a blend of a whole lot of different impulses, styles, strategies, desires and wishes.

By applying some of the lessons of this book, you will significantly increase your chances of doing better deals. I have attempted to distil some of the key messages in short phrases in the appendix called ‘the cheat sheet’.

By being more prepared and having completely considered all of the issues relating the contract, you are likely to create an even better springboard.

By weighing the detail precisely in the safety-net aspects of the contract, you have taken every possible step to protect yourself in the event of things going badly or not as contemplated or, if worse comes to worst, a ‘red zone’ event occurring.

Without being smug, you can feel confident that all of those you will be negotiating with may not have the benefit of these insights.

Bad commercial practices do not create a disaster every time. In fact I have sometimes marvelled at people in the business world using the most loose and reactive negotiation techniques, yet proceeding for many years without any problem. When a difficulty arises, it costs them a huge amount of money in legal expenses (and potentially damages) and significantly distracts them from the primary purpose of their own business — making money and doing deals.

I hope that this book has helped you to get better results in your contract negotiations and ultimately to do better business.

Appendix

The cheat sheet

For even the most sophisticated contract negotiator the combination of legal concepts, strategic considerations and theatre that is a negotiation can be intimidating.

Throughout this book I have tried to identify some rules of thumb that tend to operate as mental anchor points if you find you are being overwhelmed or feeling disoriented in a negotiation. Below are some phrases that crystallise these rules. They are:

- *Keep in mind the springboard and the safety net* — contracts are a combination of entrepreneurialism (the springboard) and a fail-safe system (the safety net).
- *You can't be too prepared for a contract negotiation* — the more time you put in before it starts in understanding what precise outcomes you want from the commercial relationship, the closer the contract will actually match your desired reality.
- *Be knowing!* — by that I mean:
    - know what you can do
    - know what you can't do
    - know what you're willing to do
    - know what you won't do
    - know what you want
    - know what you don't want.

- *Don’t rely on the ‘it will all right on the night’ philosophy* — as skilled and intelligent a negotiator you may be, failure to fully think through all issues can mean you make decisions on important contractual issues on the run or impetuously. Impetuous decisions are almost always bad decisions.
- *Look at the ‘boring’ parts of a contract* — they are a Trojan horse and are significantly more important than they seem.
- *If you are the seller, play as straight as you can* — given the current state of the law the art of salespersonship still lives, but to a limited extent. Being too ‘enthusiastic’ can cause you problems.
- *If you are buying, always keep your senses alert* — look for the signs of the overseller. If you develop a sense you are dealing with a person like this listen to them with a critical ear and look at them with watchful eyes.
- *During the course of the contract understand the who, the what and the how of your counterparty* — knowing the other party to the relationship (be they friend or foe) can only help.
- *Knowing the personality, style, commercial context and agenda of your counterparty is important* — it can be the difference between a limousine ride or bumpy trip on an off-road track.
- *If a dispute is brewing don’t stick your head in the sand* — gather as much information as you can at the earliest possible time about the facts and what has given rise to the dispute.
- *Assess closely how you deal with the dispute* — your approach needs to be strategic and considered.
- *In any dispute the smart player knows their strengths and weaknesses in equal measure* — without this you can’t see where the leverage is.
- *The more you know about the positions of the parties the better off you will be* — cast the net wide to gather all details you can but the process is almost as important as the information itself.
- *Decide how you want your dispute to be determined cautiously but strategically* — unassisted negotiations, mediation or fighting can each have respective strengths and weaknesses. There is no rule — each case is different and should be considered closely and the facts looked at in detail.
- *Give away what doesn’t matter* — don’t fight every point; it saps energy and resources and will rarely help you get the result you want.

Glossary

affidavit: a statement sworn on oath by a witness complying with the rules of evidence. It is a written document in which the court requires all of the party's evidence be set out. There may be various affidavits for different witnesses and witness may swear a number of affidavits.

applicant: like plaintiff, the party who brings an application to the court, tribunal or arbitration.

assignment clause: sets out the rules by which one party can assign their rights or obligations to another person who is not a party to the contract. It may involve the assigning party being released from any further obligation.

cross claim: a claim in the nature of a counter claim brought by a defendant against the plaintiff. Structured like a statement of claim it may either contain a claim that is related to the subject matter of the dispute on the statement of claim or be a separate claim entirely.

counterparty: the opposing party or parties in a contract negotiation.

cross-examination: the process where the other party tests the evidence of a witness during proceedings. Probing and searching questions may be asked in a more or less polite manner as to the witness's version of events and the honesty, credibility and truthfulness of it.

clause: a paragraph, part or section of a contract. Generally a clause is numbered or is separated from other parts of the contract by a heading. A term of the contract may have many clauses within it, each usually dealing with a specific issue.

damages: the order the court makes for one person to pay another an amount of money to make good a loss under a contract. It is the sum of money that the breaching party must pay to the innocent party to compensate them for the breach.

examination in chief: a process where written evidence from a witness is not delivered to the court. It is where a party gives oral evidence on the basis of questions asked by its legal representatives.

discovery: a process during litigation where parties in turn disclose documents or written records relevant to the matters in dispute. It is to avoid trial by ambush and allows parties to make a rational assessment of their prospects early on by seeing the other side's evidence.

express terms: written terms set out in the agreement in contrast with implied terms that are incorporated 'silently'.

force majeure: a contract statement that neither party will be held to its obligations due to an event outside its control. This generally involves what lawyers call 'an act of God' such as a fire, explosion or act of war.

implied terms: terms not explicitly appearing in an agreement but incorporated either by law (that is, the law says they must be in certain types of contracts) or to give the contract 'business efficacy' (meaning that without it the contract has no business or commercial effect).

indemnity: a 'safety blanket' to make good a loss that a party has suffered as a consequence of the act of another party. This would include a loss suffered as a result of the misconduct of or poor performance by a subcontractor not explicitly named in the contract.

injunction: an order of the court either to compel someone to do something or to stop them from doing something. An injunction is generally only granted by the court when a legal principle is being breached or the rights of one party are being infringed by another.

joinder: joining several courses of action or several parties in a single court proceeding

novation: the replacement of one of the parties to a contract by another by the agreement of both the party remaining in the contract and the new party

plaintiff: the person, company or entity starting court proceedings

re-examination: the process where a party's own witnesses are re-questioned after cross-examination. Its purpose is to clarify any uncertainties that may have arisen through questioning by the opposing party's lawyer.

reliance damages: a subset of the general law of damages. They involve the court forming a view as to what loss has been suffered by a party who is a victim of a breach in reliance on the contract. They do not relate to loss of prospective profits or what the party may expect to have achieved during the course of the agreement.

respondent: like defendant, the party who is being sued or joined to the proceedings

restitution: when the plaintiff in a case recovers something from the defendant that belongs, or should belong, to the plaintiff

statement of claim: a document prepared by the plaintiff or applicant that sets out the facts in relation to the dispute and the legal claims made as a result of those facts. It outlines the remedies or damages that the plaintiff or applicant says it is entitled to as a result of the conduct of the counterparty giving rise to the claim.

submissions: matters put to the court by one or other party in support of their case and making direct reference to the evidence that is given either in affidavit form or orally by way of examination in chief

subpoena: requisition issued by the court at the request of a party for another party to appear before the court or to produce documents.

tender: the formal means by which documentary evidence is given and accepted by the court

variation clause: a term of the contract that deals with how the contract itself may be varied by the parties during the course of it. This is open to general agreement and negotiation by the parties. Generally it requires that

any variation of the contract be either signed in writing by both parties or at least recorded in a letter from one side to the other.

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