Top tips for drafting good business contracts

It goes without saying that a good contract is important, given it is a legally binding document that both parties agree on to ensure that they are appropriately compensated for their work, money or goods. Writing a business contract which accurately reflects the intention of the parties is critical to its success.

So without trying to do ourselves out of a job we have put together some top tips to help you with business contracts. However, it is useful to understand the pitfalls of commercial contract drafting, it is always advisable to ask a solicitor to draft or review an existing one, particularly if it contains technical or complex provisions, or if the agreement is intended to be used for a long time.

Define your terms

You need to take care when using defined terms in a contract. They are important because they save time and can create certainty and consistency in a contract. However, you should only use them if you are happy that the term is to have a specific meaning in every instance where it is used.

Battle of the forms

If each party to a contract states that its own terms and conditions will apply, generally speaking, the last party to make that statement will take precedence, unless there has been an express agreement to the contrary. However, this may be difficult to show evidentially. If you do not want to contract on another party's terms, you have to make it clear at every opportunity that the contract is based upon your terms and conditions.

Having signed the contract, act in accordance with its terms

Once a contract is concluded and signed, you should ensure that you act in accordance with its terms and that you do not vary them orally or by your conduct.

In a recent case an exclusive supply agreement contained a clause that said it could only be amended by a written document signed by both parties. The court decided that such a clause did not stop the parties from varying the contract by oral agreement or by conduct. It said under English law parties can agree whatever terms they wish (subject to public policy limits) whether in a document, orally or by conduct. Accordingly, such a clause does not prevent the parties from later making a new contract, which varies the original one, by oral agreement or by conduct.

Should you include restrictive convenants?

You need to take great care in drafting restrictive covenants/ non-compete clauses. If you get them wrong the meaning of the contract will be uncertain and the restrictive covenants could be unenforceable. If they are drafted too widely or are too onerous the courts will not be keen to enforce them.

Differing rules will also apply depending on the type of contract in which the restrictive covenants are included. For example, the courts are willing to accept a longer period of time in which the restrictions will apply in a share purchase agreement (where the buyer will have paid for the goodwill of the company) as opposed to restrictions which are placed into an employment agreement or settlement agreement.

Consider confidentiality

When you enter into a contract, you will often be giving the other party confidential or sensitive information about your business. You may not want this information to be used by third parties. We recommend you insert a provision into the contract, to ensure that the other party cannot share this information but must keep it confidential.

What are you 'endeavouring' to do?

'Best endeavours' is an onerous phrase in a contract. It generally means that you will leave no stone unturned when attempting to comply with its terms, which can even include an obligation on you to sacrifice your own commercial interests in order to comply. As a compromise, 'reasonable endeavours' is normally agreed, which imposes a lower level of obligation on a party.

Case law suggests that to satisfy 'reasonable endeavours' you only have to take a single course of action to achieve a particular aim to satisfy the obligation. Unlike 'best endeavours' you can also have regard to your own interest in the contract.

If included, these words are not always defined in an agreement and can therefore lead to ambiguity and uncertainty. Therefore be very careful when using such phrases.

Have you included a penalty clause?

You should take care how you draft a clause which stipulates that a sum of money is payable on a breach of contract. Such clauses may be deemed by a court to be a 'penalty clause' and, if so, will be unenforceable.

The test is whether the sum is out of all proportion to the innocent party's legitimate interest in enforcing the contract. It was established in the case of *El Makdessi* in 2015 (as reported in *Law News Spring 2016*). Previously the test was whether the sum payable on breach was a 'genuine pre-estimate of loss' and therefore compensatory, or whether the main aim of the clause was to deter the breach and therefore was a penalty clause.

So under the new test, a clause may be enforceable even if it does not represent a 'pre-estimate of loss'. However, the question of what will be a legitimate interest and whether the remedy is out of proportion to that interest, is open to debate. As a useful rule of thumb therefore, the previous traditional test

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of a genuine pre-estimate of loss should usually be adequate to ensure the validity of the clause.

Who owns any intellectual property rights?

If the contract will create new intellectual property (IP), it is important that you decide who will own it.

If you will be helping to create the IP but the other party is to own it, they will want to know that any rights you have in the newly created IP will be transferred to them without any defect in its ownership.

Where you are supplying IP which belongs to a third party, it is highly unlikely that you will be able to pass this over without first getting permission to license it.

Terminating the contract

You should ensure that you specify the events that allow you to terminate the contract. Commonly these include the failure by one party to fulfil their obligations (eg non payment) or service of a termination notice.

Once an agreement has been terminated, you will want to ensure that any information which you have passed to the other party, either when negotiating it, or during its life, remains confidential. It is therefore important to include obligations for one party to return or delete the other's information on termination.

What law will apply?

It is important to include a clause specifying that English law will apply to the interpretation of the agreement and its effects, in the event that a dispute arises between the parties. This is especially true if one of the parties is based outside the jurisdiction of England and Wales.

Expertise

Our experienced team of commercial lawyers help businesses with a whole range of contractual issues from drafting and negotiating complex agreements to providing ad-hoc advice on particular clauses in contracts. They are consistently rated year-on-year by independent UK legal guides.

Whatever your size of business we will ensure that our commercial advice suits your needs.

Contact

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