

Setting-up service agreements & other contracts

This FAQ sheet forms part of a series prepared by postgraduate students from the University of Manchester's School of Law, in conjunction with the Legal Advice Centre. They are intended as an introductory guide to commonly asked questions by those approaching the Manchester Enterprise Centre when seeking advice on starting up new businesses.

These guides provide only a basic overview on key issues to be considered and do not constitute legal advice. Further detailed advice should be sought as necessary from appropriate professionals such as a solicitor or accountant.

This FAQ sheet focuses on the issues that should be considered when putting together a contract for the supply of goods or services. Specifically this FAQ sheet will set out to answer the following questions:

1. What are the key issues that should be covered within a contract?
2. How can you set up a contract to deal with the risk of late payments?

Q1: What are the key issues that should be covered within a contract?

A contract, in order for it to be binding, must comprise four key elements: offer, acceptance, consideration and intent by the parties to create legal relations.

For information, the following is an outline of the structure of a basic commercial contract:

- Front and cover page, back sheet.
- Commencement section and dates.
- Parties.
- Background.
- Operative part.
- Definitions.
- Conditions precedent (a clause in a contract that provides that the contract, or certain obligations under the contract, will only come into force if and when specified conditions are met).
- Performance obligations.
- Payment obligations.
- Limitations and exclusions (clauses to limit liability for breach of obligations).
- Boilerplate or standard template / content with blanks to be filled.
- Schedules (may contain, for example a description of the services or invoicing requirements).
- Execution.

When setting up a contract or agreement it is important to have a clear understanding of the basis, i.e., the terms and conditions, of the arrangement you are entering into. You need to clearly describe the goods or services you require, as this, as well as other key terms such as delivery date, price and any requisite limitations will form the contract with the service provider or supplier of the goods.

Negotiating a contract will invariably involve an element of negotiation and you should be clear on what terms you require and importantly understand the exact terms of any contract you enter into. Once you have made an offer, the potential supplier or service provider will then consider whether or not to accept this offer, they may make a counteroffer, for example by negotiating the price. Bear in mind it is important that both parties negotiate, agree and are clear on all the terms of the agreement.

Although there are a number of clauses that form a standard contract (see above), we have set out in further detail some key considerations that you should take into account when entering into a contract:

Authority to bind

You should ensure that the person you are engaging with is authorised by his/ her company to negotiate and/or execute contracts on its behalf.

Levels or Quality of Service

You have to agree on the level and quality of service required. It is important that this is stated expressly in the contract, as this eliminates ambiguity and serves as evidence if there is a dispute.

Agreed Outputs

There has to be a consensus by both parties on the service to be provided or the goods to be supplied. This should be stated expressly in the contract.

Penalties for Breach

Despite reaching a consensus on the terms of the agreement, there may be a breach of the contract terms and conditions by either party. The party responsible for the breach may be held liable for damages, or may be ordered to perform the contract by the courts. The party in breach may also be ordered to provide compensation to the other party. In addition to damages available for breach of contract, consideration should be given to penalty clauses and liquidated damages clauses. These are clauses that expressly state that if the contract is breached, a specified sum will be payable or that goods will be forfeited. Any such clauses such be drafted by a suitably qualified lawyer.

Ownership of Intellectual Property

The contract has to be clear on who owns any intellectual property that may be created under the contract or on what terms intellectual property is licenced to a party under a contract. The contract should also state at what point ownership in the intellectual property will pass to the intended owner and under what conditions any royalty payments are due to the service provider.

Predicting Eventualities

Although you enter into a contract with the intention that the relationship with the other party will run smoothly, consideration needs to be given to what may happen in the future and what eventualities you want the contract to cover. For example, what termination rights do you require? You may want the right to be able to terminate the agreement on, say, a month's notice whereas the supplier may want more certainty and require a longer notice period. You may want to set out what happens if the other party becomes insolvent; do you require an automatic right to terminate the agreement and recover the work they have performed to date? By mapping out what may happen during the period of a contract you will be clearer on the eventualities you may want that contract to cover.

Q2: How can you set up a contract to deal with the risk of late payments?

Your contract may contain an interest clause. This provides for a contractual sanction if payments are made late. It should, as a minimum, state the interest percentage to be charged for late payment and the period over which it will be charged. This is usually a fixed percentage over above the Bank of England's base rate. If you are purchasing the services you should consider your cash flow position and the likelihood of your supplier enforcing such a clause against you.

You should only enter into a contract if you understand its terms and conditions. You need to be as clear as you can in regards to what you require under the contract and what you will pay in return. The more you [correctly] stipulate in a contract, the less chance there is for ambiguity and, consequently, disputes.