CONTRACTPROBE

12 Crucial Clauses Suppliers need in any Contract of Services

The leadup to a service contract is often a fast, high-stakes endeavour. Because of the rush to commence work, important contractual issues can sometimes be overlooked, which can create large costs and fallout for both parties. ContractProbe can speed up this process, while reducing the chance of errors.

1.Clear description of scope

Without clearly defining the scope of services to be provided, both parties are in the dark regarding the very nature of the contract. A thorough and unequivocal definition of the scope will always be required to ensure the parties' expectations are aligned. In this way, the provider will not need to do more than what they agreed, and the customer will not be disappointed if the services are not as assumed.
All deliverables and exclusions should be present, along with measurable objectives and milestones.

Tip for suppliers: List specifically anything that you need the customer (or anyone else) to provide in order for you to perform your services.

2. Rock solid payment provisions

The right to payment by the customer should be unconditional. It is unreasonable to expect a supplier to perform their side of the contract, but still risk the prospect of not being paid for their work. Rights to payment should accrue upon performance. Restrictions such as "pay when paid" clauses generally create an unreasonable risk for suppliers to take.

Tip for suppliers: Avoid invoicing clauses that do not require payment to be made until the customer is satisfied that something has been done. The right to render an invoice should be as objective as possible.

3. Interest on unpaid amounts

When an amount is paid late, the supplier will miss out on any profits they could have made through interest and investments, while also being potentially liable to other debtors who they would pay with the customer's payment. For this reason, the customer should be liable to compensate the supplier for any late payments, with a reasonable rate of interest.

Tip for suppliers: Make sure interest will apply to amounts the customer has not paid because they are in dispute.

4. Force Majeure

The force majeure clauses are often tucked away at the back of a contract and given scant regard during negotiation. In supply contracts, they are far too important to be treated in that way. Supply contracts are often disrupted by unforeseeable events like natural disasters or even global health pandemics. When these disruptive events occur, parties become unable to perform their obligations. The contract becomes “frustrated”, and automatically comes to an end.
A force majeure clause will list a range of potentially frustrating events and the consequences of them occurring. For example, an airline, or shipping company may have force majeure clauses which limit their liability in the event of a hurricane. Instead of the contract automatically ending, performance of a contract may also be merely suspended temporarily, and parties may decide for themselves who bears the risk of a particular event occurring.
Force majeure provisions typically operate for the benefit of the supplier in a contract, and that party needs to check first that one is present and secondly that, if it is present, its terms are appropriate for that contract and not just boilerplate generic language.
Force majeure clauses often contain a provision requiring the affected party to give notice to the other party of the occurrence of the force majeure event. This provision is of critical importance. If you are the customer under a supply contract, make sure that giving notice within a set number of days is a condition precedent to the protection afforded by the force majeure provision. If you are the supplier, avoid the condition precedent language and ensure the requirement to give notice is stated as a separate obligation, so that failure to give notice as required does not necessarily prevent you from taking advantage of the force majeure provision.

Tip for suppliers: Check that the definition of what constitutes a “force majeure event” starts with the word “includes”, rather than “means”. This will allow you to argue later on that something is still a force majeure event even if it is not expressly referred to in the definition.

5. Fast dispute resolution mechanism

Contractual disputes are common when doing business in modern times. Planning for such disputes is critical to reducing both parties’ risk.
Alternative dispute resolution methods should be exhausted before any issue is referred to a court of law. This way, the parties can ensure that large legal fees are avoided and amounts in dispute get resolved and paid quickly.

Tip for suppliers: Mediation can be a useful process to determine if there is any merit to either side’s position in a dispute. But ensure that the body who will appoint the mediator is named and has rules that allow for the fast resolution of disputes and those rules are specified. A canny customer can use any ambiguity in the mediation clause to protract resolution, and hence payment, for many months.

6. Limitation of Liability

A party's contractual and tortious liability can sometimes be unpredictable and beyond what was envisioned while entering contracts. For this reason, the amount the supplier is liable for should always be limited to some specific amount. Major companies have gone broke because the losses on a particular contract far exceeded their ability to pay. Ideally the maximum amount for which a supplier may be liable under a particular contract should not exceed the total amount they should be paid under that contract.

Tip for suppliers: Make sure the cap on liability refers to the "aggregate" or "total" liability under the contract. Otherwise you could end up limiting the liability only for each individual breach, which leaves you exposed if there are multiple breaches.

Bonus Tip for suppliers: In a long term contract, make sure the cap on liability is stated by reference to the fees paid in the last 12 months of the contract.Otherwise your liability keeps increasing as the contract continues.

7. Exclusion of certain types of loss

The losses that a party suffers from breach of contract are referred to at law as being either "direct" and "indirect". A direct loss is typically the value which was lost as a result of incomplete performance of an obligation. For example, a car manufacturer who contracts to have 10 tonnes of steel delivered, but receives only 7, may sue for the cost of the 3 tonnes which were not delivered.
"Indirect" (also known as "consequential") losses are losses beyond a party's direct loss. This may include loss of profit on subsequent transactions. For example, if insufficient steel was delivered, the car manufacturer's inability to meet pre-orders may cause them further losses in cancelled orders, lost customers, and wasted parts. The amount of indirect losses is much harder to predict in advance and can include factors over which the supplier has no control.
It is normally in the supplier's interests to exclude indirect losses totally from the contract. The wording of such exclusions is very important. Contrary to popular belief, a clause which merely excludes "consequential loss" will not necessarily exclude liability for loss of profits. Lost profits should therefore be expressly referred to as something which is excluded, even if the profits are later found by a Court to be a direct loss at law.
Consequential losses are only recoverable if they are not too "remote". This means it must have been reasonable for the parties to have contemplated the losses at the date of contract. Nevertheless, what a court considers as a contemplatable loss may still be extremely expensive, hence the need to ensure you limit your liability with an exclusion of consequential loss clause.

Tip for suppliers: Exclude lost profits separately, not as being part of indirect or consequential losses.

8. Warranties

Wherever warranties are included in a contract for services, they should always refer to objectively measurable representations and promises.
Some specific warrantees such as to use “best practices” or to perform the services to the “highest standard” are difficult to quantify and result in uncertainty for the supplier. Any warranty that services will be “fit for purpose” must also include a clear definition of the relevant purpose.
Where possible, you should also use an “entire agreement” clause to remove verbal warranties or promises which may be ambiguous and uncertain in scope.
If this can be considered a consumer contract, you must also be mindful of the application of the Australian Consumer Law (“ACL”). Provisions which conflict with ACL requirements are void to the extent of the conflict and may even be considered misleading and deceptive conduct: sometimes resulting in multi-million-dollar penalties.[1]
A consumer contract includes contracts in a commercial setting where the price of particular goods or services is less than $100,000.

Tip for suppliers: Reject warranties that refer to “merchantable quality” or “fitness for purpose”. They can lead to later dispute and it will be difficult to assess your exposure under that type of warranty.

9. Indemnities

Some services naturally include significant risks to the supplier which only the customer can prevent, and vice versa. For example, if the supplier is operating on customer premises, the customer has a responsibility to ensuring that such premises are safe for supplier personnel.
Where such a risk is present, it is fair that the party responsible is also obliged to bear the financial risk of this. Indemnities require the other party to pay for any loss incurred from a certain cause and are an effective tool for shifting the allocation of risk.
However, be sure to ensure that indemnities contained in the contract do not cause you to take on risks which are beyond what is reasonable. Indemnities should never cover losses which arise from the customer’s own actions or could not have been prevented by the supplier. Some insurance policies may also deny a claim if a party has assumed more risks than are applicable at law.

Tip for suppliers: Reject an indemnity for breach of contract – if you do breach the contract then the customer will have its remedy in damages and should not have a much broader payment afforded by an indemnity.

*E.g. [1] E.g. Australian Competition and Consumer Commission v Valve Corporation (No 3) [2016] FCA 196.

10. Proportionate Liability

Depending on which State laws governs the agreement, there are different legislative provisions which allocate liability for loss, according to the proportion each wrongdoer contributed to such loss. The provisions can generally be contracted out of, explicitly or impliedly, and if this happens you should be aware of the agreed new allocation of liability.
It is generally in the supplier's interest to maintain the application of proportionate liability legislation. This is because the legislation will generally protect the supplier from being liable beyond the proportion they contributed. If the legislation is excluded then the supplier may be liable for the full extent of any loss even if they only contributed to a small part of it. Contracting out of proportionate liability legislation may also reduce the wrongdoer's ability to claim for loss on insurance, as they have assumed liability beyond that at law.
A supplier should also be aware that in some specific cases, proportionate liability legislation can reduce their protection. For example, if several parties including the customer contribute to a loss by the supplier, but only the customer has the funds to pay, the supplier cannot elect to claim the full amount from the customer, but can only claim from the customer the percentage for which the customer is to blame.

Tip for suppliers: Workshop the various scenarios in which loss might be caused under the contract.If there is potential for other parties to contribute to loss that you might cause then do not accept the exclusion of this legislation.

11. Insurance

Many contracts will mandate that a party enters into insurance agreements. These ensure that a party can pay for losses it is liable for. While having your own insurance arrangements is generally a good idea, ensure that the contract does not oblige you to procure insurance beyond what is reasonable. Otherwise, you will be paying premiums which are not in your interest.
Specifically, ensure that the type of insurance covers losses which you are likely to incur while performing the services. For example, public liability insurance may be required if the services include extensive construction work but would not be so applicable if activities only include consultation or professional services.
If there is any possibility that the other party may be required to pay damages beyond their means, ensure that they are obliged to procure and maintain insurance which will cover such loss.

Tip for suppliers: Don't accept clauses that require you to obtain insurance covering all your liability under the contract. If the contract contains indemnities then it is likely to be impossible to obtain insurance covering such liability, or at least at an affordable price.

12. Payment terms

The exact amount to be paid should always be specified, along with the time at which this payment should be made. Provisions which allow for delayed payment are especially onerous for suppliers and can result in significantly reduced cashflow. Ensure that the customer is obliged to pay the supplier on well-defined milestones or dates.
Also note that for construction contracts, most States have additional requirements regarding prompt payment terms under security of payment legislation.

Tip for suppliers: Don’t accept payment terms that refer to the date of a “properly issued” invoice or similar. Those words can have the effect that payment is not due even if there is only a technical problem with the invoice or only part of it is disputed.