

# Contracts – The Essential Law

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## Contracts – the Essential Law

### A. What is a Contract?

1. A contract is an agreement between two or more parties which is recognised by law and which is enforceable through the courts.
2. In general, there is no set form for contracts: they can be written, oral or implied by conduct. There are some exceptions to this basic rule, for example, mortgages, transfers of patents and contracts of guarantee must be in writing.
3. There are five essential requirements which must be fulfilled in order to create a contract:
  - 3.1 one party must make an offer to another party;
  - 3.2 the party to whom the offer is addressed must unequivocally accept the offer and communicate that acceptance to the party making the offer;
  - 3.3 consideration must flow between the parties;
  - 3.4 the parties must intend to create a legally binding agreement; and
  - 3.5 the terms of the agreement must be clear and certain.
4. An offer is an offer to do or to supply something on the basis that the person making the offer will be legally bound to carry out what it has offered to do by the acceptance of its offer by the other party. An offer must contain all the key terms of the contract.

5. Acceptance is any statement by words or by conduct which clearly and unequivocally demonstrates that the person making it agrees to be bound by the terms of the offer. Acceptance must be communicated to the person making the offer. Note that if a person purports to accept an offer but adds in any new term this will be a counter offer. A counter offer does not constitute acceptance.
6. Consideration is money or money's worth. It is usually payment in return for the performance of an obligation, but it could, for example, be the performance of an obligation by one party in return for the performance of an obligation by the other party. Consideration does not have to be adequate. Consideration cannot be past consideration.
7. Intention to create a legally binding agreement is usually presumed in business relationships. If you do not intend to be legally bound you should make this clear.
8. If there is a lack of certainty of terms there may be no contract. Note that agreements to agree are not legally binding. Note that, in the absence of certain express terms, terms may be implied into a contract by statute or by the courts, including:
  - 8.1 where services are being supplied, a term that such services will be provided with reasonable care and skill; and
  - 8.2 where goods are being supplied, terms that the seller owns the goods, the goods will correspond with any description by which they are sold, the goods will be of satisfactory quality, the goods will be fit for any purpose made known to the seller or, where the buyer makes no purpose known, fit for the purpose for which such goods are usually supplied and the goods will correspond with any sample goods supplied.

## **B. Key Issues in Contracts, Particularly Public Service Delivery Contracts**

Note: the following assumes that the charity is the service provider, rather than the recipient of the services.

### **1. Constitutional Ability to Enter into the Contract:**

- 1.1 the services must be within the scope of the charity's objects;
- 1.2 the charity's governing document must give the charity the powers to carry out everything that will be required under the contract;
- 1.3 make sure the correct entity enters into the contract. If the charity is a company, the company will be party to the contract and if the charity is a trust or unincorporated association the trustees or members will be party to the contract on behalf of the charity.

### **2. Service Specification:**

- 2.1 describe the services to be performed as completely, clearly and precisely as possible in order to avoid future disputes as to what it was intended that you would provide;
- 2.2 set out details of when the services are to be performed;
- 2.3 set out details of where the services are to be performed;
- 2.4 if relevant, specify the users or beneficiaries who may use the services and minimum / maximum numbers.

### **3. Service Levels / Performance Standards:**

- 3.1 service levels should be clear, precise, objective (not subjective or opinion based), achievable and capable of being measured;
- 3.2 service levels should measure outputs which are within your control;
- 3.3 consider the financial consequences of failure to meet the service levels. If service credits are to be payable remember that these are liquidated damages and, as such, should be a genuine pre-estimate of the loss that will be suffered as a result of the failure and not unenforceable penalty payments;
- 3.4 consider whether there should be a right to terminate the contract once failure to meet the service levels reaches a certain level;
- 3.5 set out details of how performance of the services is to be monitored.

### **4. Dependencies:**

- 4.1 the contract should set out all those things that you need the other party / a third party to do or to provide in order to enable you to provide the services;
- 4.2 if a third party is to fulfil any of the dependencies, remember that the third party is not a party to the contract and therefore there needs to be an obligation on the other party to procure that the third party will do or provide the relevant thing;
- 4.3 consider issues such as rights to access and to use premises, facilities and equipment, provision of information, documents and materials, access to personnel, rights to use software and IT equipment;

- 4.4 the contract should provide that you will not be liable for any delay or failure in performing your obligations that arises from a delay or failure in performance of the dependencies.

## **5. Fees and Payment:**

- 5.1 as a minimum, price should enable you to recover all your costs, both direct and indirect, in performing the services;
- 5.2 any surplus or profit should be utilised for the charity's objects;
- 5.3 charity funds may be used to subsidise a public authority's service provided that this will be in the best interests of the charity's beneficiaries and will constitute a proper and effective use of the charity's resources (the Wigan and Trafford decision);
- 5.4 consider a mechanism for price review and increase;
- 5.5 consider payment terms – when and how will payment be made, is the price inclusive or exclusive of VAT, will service credits be off-set against the price payable?;
- 5.6 include a right to charge interest on late payments – if the contract is silent, the statutory rate under the Late Payment of Commercial Debts (Interest) Act 1998 will be implied;
- 5.7 consider what provisions as to financial reporting, record keeping and audit are required.

## **6. Warranties and Indemnities:**

- 6.1 a warranty is a promise made in a contract, breach of which gives the other party the right to claim damages for losses which it suffers as, broadly, a reasonably foreseeable consequence of the breach. There is a duty to mitigate such losses;

- 6.2 an indemnity is a promise made in a contract, breach of which gives the other party the right to recover all losses that flow from the breach, regardless of whether they are a reasonable or foreseeable consequence of the breach. There is no duty to mitigate such losses;
- 6.3 giving indemnities should be resisted wherever possible as they expose you to greater liability than would be the case at common law and may prejudice your insurance position.

## 7. Liability:

- 7.1 consider whether to include a total cap on your liability under the contract, however arising (but note the comments at paragraph 7.6 below). If you are an unincorporated association, consider capping liability at a level which is equal to or less than the net value of the assets of the charity;
- 7.2 consider what types of loss you may wish to exclude liability for – for example, loss of profits, loss of business, loss of contracts, loss of goodwill. Often liability for indirect or consequential loss is excluded: these terms have no precise legal definition and it will be a question of fact in each case whether a particular loss is direct, indirect or consequential;
- 7.3 consider excluding liability for terms which would otherwise be implied into the contract by statute, to the extent that such exclusion is permitted by law;
- 7.4 provisions which exclude or limit liability will often be mutual (i.e. they will apply to the liabilities of each party to the contract). If they are not mutual, it is likely that the authority will seek to limit its liability to a greater extent than that to which the liability of the charity is limited;
- 7.5 remember that to be enforceable an exclusion or limitation of liability must cover the loss or damage which has actually occurred and if there is any doubt the courts will interpret the clause against the party seeking to rely on it;

7.6 remember that not all exclusions and limitations of liability are enforceable:

- (a) under the Unfair Contract Terms Act 1977 (“UCTA”) certain exclusions and limitations of liability are void (such as liability for death or personal injury arising from negligence, the implied term as to title in contracts for sale of goods and the other implied terms under the Sale of Goods Act in consumer contracts);
- (b) under UCTA certain exclusions and limitations of liability are only permissible if they are reasonable (such as liability for loss or damage (other than death or personal injury) arising from negligence, the implied terms (other than as to title) under the Sale of Goods Act in business contracts and all other exclusions and limitations of liability in consumer contracts and in business contracts where one party deals on the other’s standard terms);
- (c) the test of reasonableness under UCTA is whether the term is a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made. UCTA sets out additional guidance as to assessing reasonableness.

## **8. Data Protection Act 1998 (“DPA”):**

8.1 the DPA applies to personal data, being, broadly data which relates to an identifiable living individual which is held in a filing system or on computer;

8.2 the DPA confers obligations on the data controller, being the person who determines the purpose for which and the manner in which personal data is processed. These obligations include the data protection principles:

- (a) personal data shall be processed fairly and lawfully;

- (b) personal data shall be obtained only for one or more specified and lawful purposes and shall not be processed in a manner incompatible with those purposes;
- (c) personal data shall be adequate, relevant and not excessive in relation to the purposes for which it is processed;
- (d) personal data shall be accurate and up to date;
- (e) personal data shall not be kept for longer than is necessary for the relevant purpose;
- (f) personal data shall be processed in accordance with the rights that the individual to whom the personal data relates has under the DPA, including the right to prevent processing likely to cause damage or distress;
- (g) appropriate technical and organisational measures shall be taken against unauthorised or unlawful processing of personal data and against accidental loss or destruction of or damage to personal data; and
- (h) personal data may only be transferred outside the EEA if the country in question has adequate protection for the rights and freedoms of individuals to whom the personal data relates;

8.3 a person who processes personal data on behalf of a data controller is a data processor. The data controller must ensure that all processing carried out by a data processor is under a contract which is made or evidenced in writing and which requires the data processor to act only on instructions from the data controller and to implement appropriate technical and organisational measures against unauthorised or unlawful processing of personal data and accidental loss or destruction of or damage to personal data;

8.4 it is a question of fact as to whether a party is a data controller or data processor: the position cannot be changed by specifying otherwise in the contract.

## **9 Freedom of Information Act 2000 ("FOIA"):**

9.1 the FOIA imposes a prima facie duty on public authorities to disclose information which they hold, in response to requests for such information made by any person;

9.2 there are exemptions from the duty to disclose. Some exemptions are absolute, but others are qualified, meaning that if the information falls within the exemption the public authority has to assess whether, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing it;

9.3 in order to limit the risk of your confidential or commercially sensitive information being disclosed by a public authority in response to a request for information, consider limiting the nature of the information which you disclose to the public authority or requiring the public authority to inspect documents at your premises and not to take copies;

9.4 if you do have to disclose confidential or commercially sensitive information to a public authority, the disclosure of that information by the public authority in response to a request for information may be subject to an absolute exemption if the information is truly confidential and you would have a successful claim against the authority for breach of confidence if it were to be disclosed, or to a qualified exemption if its disclosure would, or would be likely to, prejudice the commercial interests of any person;

9.5 consider including contract provisions requiring the public authority to involve you in the process of deciding whether to disclose your information in response to a request for information;

9.6 remember, if you are holding information on behalf of a public authority it will automatically be treated as information held by the authority for the purposes of the FOIA, and if you are under contract to provide a service the provision of which is a function of the authority, the Secretary of State has the power to make an order designating you to be a public authority for the purposes of the FOIA.

## **10 Confidentiality:**

10.1 ensure that where you are under obligations of confidentiality the contract gives you sufficient flexibility to use the other party's information for the purposes for which you may need to use it and to disclose it to the persons to whom you may need to disclose, such as employees or sub-contractors;

10.2 conversely, where you are imposing an obligation of confidentiality on the other party, ensure that such party's rights to use and to disclose your confidential information are limited.

## **11. Intellectual Property Rights ("IPR"):**

11.1 consider whether you are to retain any IPR that you may generate in the course of providing the services and to grant the other party a right to use the same or whether you are to assign (transfer) such IPR to the other party. If the latter, ensure that you own the IPR before you try to assign it – don't assume that just because you have paid someone to create something for you that you will own the IPR. Specialist advice should be taken where necessary;

11.2 remember that it isn't appropriate to assign IPR if you will need to use it for another client or for another purpose;

- 11.3 consider whether the other party owns any IPR that you will need to use to perform the contract, such as a right to use logos or trade marks, and include a licence to use these in the contract.

## **12. Term and Termination:**

- 12.1 consider whether the contract is to last for a fixed period or until terminated by one party giving a specified period of notice to the other;
- 12.2 consider rights for either party to terminate the contract early, for example as a result of the other party's material breach or insolvency, or for reasons specific to the particular contract such as that the services are to be transferred back to the authority;
- 12.3 consider the consequences of termination - for example, are you to assist in handing over the services to a replacement provider or back in house? If so, will you be paid for providing this assistance? Will any of your employees TUPE transfer to the authority or to the replacement provider? Are there documents, materials or confidential information to be handed back? Premises to vacate? Will compensation be payable by one party to the other on early termination?.

## **13 Dispute Resolution:**

- 13.1 consider a mechanism for dispute resolution – usually escalation to senior officers within each organisation followed by a form of alternative dispute resolution;
- 13.2 mediation is not legally binding unless and until the parties enter into a settlement agreement. The mediator will assist the parties in reaching a settlement but has no power to impose a settlement;

- 13.3 arbitration is legally binding and the arbitrator has the authority to settle the dispute. Arbitration is a private, rather than a public, forum;
- 13.4 expert determination is usually used to settle disputes of a technical nature. The expert has the authority to determine the dispute and his decision is legally binding.

## **14 Variation/Change Control:**

- 14.1 the contract should include a provision which specifies how changes to the contract are to be made. At the least this should provide that variations are only effective if they are made in writing and signed by each party: neither party should have a unilateral right to change terms;
- 14.2 if the scope of a service may need to be substantially changed during the term of the contract, consider including a change control procedure which sets out the procedure to be followed in requesting a change, assessing its impact and agreeing the changes to the contract which are necessary to implement the change.

## **15 Contracts (Rights of Third Parties) Act 1999:**

- 15.1 the traditional legal position was that a person who is not a party to a contract cannot enforce the terms of the contract;
- 15.2 the Contracts (Rights of Third Parties) Act 1999 gives a person who is not a party to a contract the right to enforce the terms of the contract if the contract provides that he/she can do so or if the contract purports to confer a benefit upon him/her and on a proper construction of the contract the parties intended that he/she should be able to do so;

- 15.3 it is usual to exclude the rights of third parties under the Contracts (Rights of Third Parties) Act 1999 – for example, to prevent service users or beneficiaries from being able to enforce the terms of a public service delivery contract.

## **16 Assignment and Sub-Contracting:**

- 16.1 unless the contract provides otherwise, save for personal contracts, a party is entitled to assign (transfer) its rights under a contract to a third party without the consent of the other party to the contract;
- 16.2 the consent of the other party to the contract is required in order for a party to transfer its obligations under the contract to a third party;
- 16.3 sub-contracting is distinct from assignment or transfer of rights and obligations and occurs when a party to the contract appoints a third party to perform its obligations under the contract on its behalf. Notwithstanding the sub-contracting the first party remains liable to the other party for the proper performance of its obligations under the contract. Sub-contracting is permitted unless the contract provides otherwise.

## C Top Tips

1. It is very easy to enter into a legally binding contract: if you don't intend to be legally bound then make this clear to the other party, for example by using the phrase "subject to contract" on all correspondence and draft documentation.
2. Substance not form counts: you can't prevent a contract from being a contract simply by calling it something else.
3. Contract terms should be complete, clear and precise: if each party knows from the outset what it and the other party is supposed to do and when, this should help to avoid future disputes.
4. Make sure you can deliver before you commit to provide.
5. If in doubt, take advice.

This briefing note is intended solely as an overview of the law. It was last updated on 27 April 2006. No responsibility can be accepted for the completeness or accuracy of this briefing note and professional advice should be taken in relation to any specific problems.

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