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Drafting the perfect contract

A contract should give effect to the commercial bargain and explain the rights and obligations of each party to the deal.

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A contract should give effect to the commercial bargain and explain the rights and obligations of each party to the deal.

Good drafting should provide certainty and reduce the risk of disputes arising. Conversely, poor drafting may create obligations that don't work in practice, or don't reflect the commercial deal, requiring the parties to waste time clarifying ambiguity and significantly increasing the risk and likely cost of litigation.

Contractual interpretation

> *"The primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage."*
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> - **Bank of Credit and Commerce International SA (in compulsory liquidation) v Ali [2001] UKHL 8** per Lord Huffman at para 39.

English courts begin their consideration of any contractual dispute with a literal interpretation of the contractual provision in question, even when this may lead to an unfair outcome or one which appears contrary to common sense. There have been many recent cases where this has been illustrated. In this respect, interpretation of a contract is principally a matter of dictionaries and grammar, not 'fairness' or common sense. Where there is genuine ambiguity, the court will interpret the contract terms based on broad general principles, applied from the perspective of a 'reasonable person' with background knowledge of the transaction. However the starting point (and, often, the end point) will be the words themselves.

The court's reluctance to re-write the contract can be overcome, and additional terms implied, in limited circumstances. For example:

- the need to give 'business efficacy' to the contract. That is, if the contract makes little sense without additional wording, the court may imply it into the agreement; or
- even where the parties did not consider the matter at issue it is so obvious that, had an 'officious bystander' pointed it out at the time, they would have said 'ah, of course!' and included the relevant drafting.

This underscores the importance of ensuring that a contract states, in plain English, what the parties mean to achieve and have agreed, as a court will be very reluctant to translate the actual drafting into something more sensible, complete or equitable.

Moreover, the contra proferentem rule (which is relevant where one party has provided the drafting, and it is not jointly produced) requires that courts interpret ambiguous terms against the interests of the party who drafted them.

Using precedent contracts

Precedent contracts can save time and reduce the likelihood of drafting mistakes. However, precedents should always be used with care.

Always consider whether you have an appropriate precedent. Does it deal with the sale of goods, or services, the granting of a licence, or something else? Do you need a long-form contract because of the value of the deal or the complexity of terms, or would a short -form contract suffice?

Precedents are often drafted to the advantage of a particular party. Consider who you act for (buyer, seller, licensor, licensee, etc.) and ensure that your precedent is either neutral in approach or else is drafted to their advantage. Not only will you save time redrafting inappropriate clauses, you eliminate the risk that an unfavourable clause slips through the net.

Drafting notes will explain key clauses and may provide alternative formulations to assist you in drafting. However, drafting notes will not be provided for every clause and it's important to read each clause in the agreement carefully to identify any other terms that need to be changed.

Clarity

As a general rule, someone with no prior knowledge of the deal should be able to understand the parties' intentions from the contract alone. Ask yourself if a colleague with no knowledge of the project had to refer back to your contract some years later, would they be able to understand what had happened and what still needed to be done?

The background (or recital) section of the contract can be used to explain the commercial context in which the contract will operate. This section is not generally legally binding, so there is more freedom to provide information that will help people to understand the agreement.

Even when a good quality and tailored precedent is available, there will usually be something unique in the terms that will require some freehand drafting. Always write in plain English when you can, unless a specific legal phrase is better. For example 'reasonable endeavours' is more succinct (and better understood by other parties and the courts, should you have to rely on the clause) than 'we will try really hard to do this, but we won't spend lots of time or money on it'. But obscure Latin references are seldom helpful.

Drafting a robust specification and performance management framework

The specification is arguably the most important part of the contract. It should describe exactly what the supplier is obliged to deliver under the contract.

There are different types of specification, although the most common in contracts for public services are output or outcome based specifications. An output specification defines what is to be delivered and is primarily concerned with the supplier's performance levels against those deliverables. Conversely, an outcome specification requires the supplier to achieve a particular outcome but allows greater flexibility in how that outcome is delivered. Care is needed when using outcome specifications that the prescribed outcomes don't inadvertently drive undesirable behaviour from the supplier, for example by emphasising delivery of one particular outcome to the detriment of others, or by encouraging the use of shortcuts to hit KPIs.

Performance requirements should be specific, measurable, achievable, realistic and timely – SMART. Resist the temptation to include too many KPIs – they can easily become overly burdensome, encourage a bureaucratic approach to contract management and actually make enforcement of a breach less likely.

A robust performance regime is important to ensure that any losses arising from a breach of the contract will be adequately compensated but a performance regime should not be punitive. It is important to have regard to the commercial realities too. If a performance regime is particularly unfair to one party, they may decide to engineer a breach and terminate the contract instead of suffering sanctions under the contract.

Allocating risk

When drafting a contract there is always a temptation to pass all the risk onto the other party. However, a contractor will incorporate these risks into the price and the other party may receive poor value – paying more than it would had it had taken responsibility for a particular risk that it may have been best placed to manage.

It will sometimes be obvious which party is best placed to mitigate any particular risk or to deal with an issue once it has arisen. For example, where services are to be delivered from a purchaser's premises then the purchaser would be better placed to secure access for the supplier. Conversely, if the supplier is providing their own personnel and equipment, they would normally be expected to accept responsibility for risks relating to those matters.

Where a public body accepts responsibility for a particular risk under a contract then steps should be taken to minimise the likelihood of that risk materialising before the contract commences. Authorities may need to consider flowing certain risks down to other suppliers or

sub-contractors where appropriate or insuring against a particular risk if it cannot be minimised or the costs associated with a risk materialising would be significant.

It may be appropriate to exclude specific liabilities under the contract, but certain liabilities cannot be excluded (such as those arising from death or personal injury) and all exclusions must be reasonable. Caps may be more appropriate but the risk of an uncapped liability arising should be weighed against the impact of any cap on the purchase price or service charge. Public bodies should always bear in mind that some liabilities cannot be passed by contract, e.g. tortious liability arising from a breach of a non-delegable duty, and seek appropriate indemnities from their suppliers, backed-up by insurance (with insured risks carved-out from any cap on liability agreed) where necessary.

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