Business Law Newsletter

Professional Contract Drafting for Business

Autumn '23 Edition

www.contracts-direct.co.uk

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Editorial

SMEs are the beating heart of our economy here in the UK. As the dominant driver of our business landscape and of employment.

It's therefore disappointing to read that the UK Government's spend with the SME sector has fallen to just 26.5% of its total procurement expenditure for 2021/22, despite a year on year increase in its SME spend from £19.2bn to £21bn.

This drop has not gone unnoticed by those representing SMEs.

The Federation of Small Businesses national chair, Martin McTague, has said: "*The rise in overall procurement spend doesn't reveal the whole narrative. While the overall spend with small businesses has* grown, they're actually getting a smaller slice of the pie."

He goes on to say:

> "*The government may be heralding these figures as a success, but its own target is nowhere in sight. In fact, it has fallen woefully short of that figure. The government should own up and confront these blatant shortcomings. Failure to contract with a wide range of businesses is bad for the taxpayer, bad for public services and bad for the economy*."

The British Chamber of Commerce's director of policy and insight, Alex Veitch, is quoted by the online news feed Supply Management as saying:

> "*It is vital that public bodies always consider SMEs when designing contract tenders. It is encouraging the government is currently seeking to change procurement legislation. Businesses up and down the country want to see a reformed process in which they can properly compete*."

These are strong sentiments coming from SME representative groups.

The Government clearly needs to listen to these and related voices, especially now, when the effect of multiple interest rate rises are starting to eat into profit margins.

SMEs need greater access to publicly funded work.

Perhaps, as a start, the Government could look again at its standard short form contract which it uses for low value procurement.

We have included a review in this edition on the short form contract and offered some suggestions on how it could be improved.

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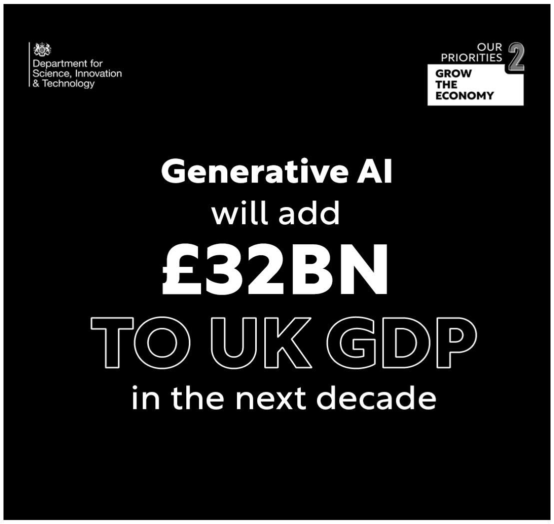
AI Corner

GOOD IDEA, BUT HOW?



This very definitively worded image was included in a recent and Tweet from the Department for Science, Innovation & Technology which said:

"There is so much potential within the AI sector, and if we take advantage of this emerging tech, it could help boost the UK's economy drastically. As a country we are taking the necessary steps to develop safe AI, so everyone can benefit from the opportunities it can bring."

But how does this bold and pretty precise prediction get tested against reality?

What forms of AI will be included as part of the bold new world of AI?

There seems to be little doubt that something of an AI revolution is breaking, but how exactly it will bring about such GDP growth is hard to fathom- unless of course you are in the DSIT.

https://twitter.com/SciTechgovuk/status/1696772269404463218?s=20

Cold Calling and Harmful Websites

The Information Commissioner's Office (ICO) and Competition and Markets Authority (CMA) are calling for businesses to stop using harmful website designs which can lead customers into providing more of their personal data than they would have otherwise.

Read the ICO's statement here

The ICO has also published a reminder about receiving cold calls under the headline ***'Hang up, report them to us- you don't owe nuisance callers your time.'***

The Government has announced plans to consult on a ban on cold calls to sell financial products including mortgages, insurance and crypto currency. Calls to sell pension products are already banned.

Read the ICOs statement here and reach the ICO's online reporting too here.

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Companies

ELECTRONIC SIGNATURES

The Companies Act 2006 states that a contract can be made by the company in writing under its common seal or on its behalf by any person acting under its authority. This usually means a director signing a contract on behalf of a company. A company should pass and be prepared to disclose the relevant board resolution evidencing the authority. A company can also enter a contract by Deed, requiring slightly enhanced formalities.

With so much business being done online, businesses increasingly want to make their agreements more efficiently than using physical documents and 'wet ink' signatures.

Enter the electronic signature. These are different from exchanging by email (or fax) a scanned copy of a physical 'wet ink' signature.

"Electronic signature" means "data in electronic form which is attached to or logically associated with other data in electronic form, and which is used by the signatory to sign".

E-signatures can come in different formats:

- Name only - typing in a name into an electronic (i.e. online) version of a contract document;
- Signature image – inserting an image of a signature into an electronic version of the contract;
- E-signature platform –clicking to add a typed font, a scanned handwritten copy of a 'wet ink' signature automatically inserted into the electronic version of a contract; and
- Touchscreen – using a finger, light pen or stylus and a touchscreen to write a signature electronically.

Under the Electronic Communications Act 2000, electronic signatures are admissible in evidence in any legal proceedings if they are incorporated into or logically associated with a particular electronic communication.

However, the validity of electronic signatures, whatever their format, is still subject to other legal considerations, such as whether the person who signed electronically had the necessary authority to do so at the time.

Contracts

TREATING COMMERCIAL CONTRACTS AS BUSINESS ASSETS

Computers and other equipment are purchased or hired as business assets- things that allow businesses to be run and managed on a daily basis. They are treated as assets in the accounts.

What's maybe less apparent is that contracts and commercial agreements are also assets, just not in quite the same sense, as they exist on paper or in electronic form and aren't subject to the same accounting treatment as physical assets.

When considering the price of generating or negotiating a commercial contract, it's well worth taking into account all of the following factors:

- The potential income generating value of the contract over it's intended lifetime;
- The cost-benefit % of the contract using the following formula:
  Projected lifetime income of contract / Cost of contract preparation
  e.g. £35,000 (income) / £750 (cost) = 2.14%
  £150,000 (income) / £1600 (cost) = 1.00%
- The risk protection a contract provides against potential liabilities.
- The negotiating advantage of having a well-prepared contract.
- Brand and reputational advantages of presenting a well-prepared contracts.

It's also worth looking at the generally accepted accounting treatment of commercial contracts, when compared with tangible assets?

Paper Based Commercial Agreement:

A paper-based commercial agreement, such as a contract between two parties, represents a legal obligation but is not a tangible physical asset. In terms of accounting treatment, commercial agreements are typically not recorded on the balance sheet as tangible assets. Instead, they might have implications for revenue recognition and potential liabilities.

Revenue Recognition: If a commercial agreement involves the provision of goods or services, the revenue related to the agreement is generally recognised when the performance obligations are satisfied and the revenue can be reliably measured.

Liabilities: In cases where the commercial agreement includes obligations that the company needs to fulfil in the future, such as warranty obligations, these might be recognised as liabilities on the balance sheet.

Disclosure: Depending on the nature of an agreement and its financial impact, there might be disclosure requirements in the financial statements to provide information about the terms, risks, and potential financial impacts of significant contractual agreements.

Tangible Business Assets: These are physical assets that have a physical form and can be touched or seen. Examples include buildings, machinery, vehicles, equipment, inventory, and land. The accounting treatment of tangible business assets involves recording them on the balance sheet and recognizing their costs over their useful lives through depreciation.

Initial Recognition: Tangible assets are initially recognized on the balance sheet at their historical cost, which includes all costs necessary to get the asset in place and operational. This includes purchase price, delivery costs, installation costs, and any other directly attributable costs.

Depreciation: Tangible assets with a limited useful life are subject to depreciation, which is the systematic allocation of their cost over their estimated useful lives. Depreciation is an accounting concept used to match the cost of the asset with the revenue it generates over time.

Balance Sheet Presentation: The net book value of a tangible asset (historical cost minus accumulated depreciation) is presented on the balance sheet. The accumulated depreciation is recorded as a contra-asset account to reduce the asset's carrying amount.

Impairment: If there's a significant reduction in the asset's value due to impairment, its carrying amount may need to be adjusted downward.

In summary, while tangible business assets are recognised on the balance sheet and subject to depreciation, paper-based commercial agreements typically impact revenue recognition, potential liabilities, and may require relevant disclosures.

The treatment of these two items in financial statements differs due to their distinct nature and purpose. It's important to consult with accounting professionals for precise guidance based on your specific business circumstances.

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BUILDING AN ONLINE E-COMMERCE STORE

Retailers are reporting that customers will linger in a virtual store environment for 73% longer (and that purchases will thereby increase by 184%) as compared with a physical store offering the same goods.

These numbers can be enhanced by introducing gamification elements and other immersive experiences, such as augmented reality (AR) try-on functionalities (particularly for fashion and cosmetic goods), chat rooms and social or other interactive experiences, including virtual sales assistants.

Embracing these technologies means contracting third parties to build, develop and deploy the virtual store. This new contractual relationship can create risk and liability exposure that's essential to bear in mind throughout a virtual expansion. These are our top 3 recommendations when contracting to build, develop and deploy a virtual store.

Ownership of rights—a retailer needs to consider the ownership of rights in the application programming interface (API) and its outputs. The data and other outputs generated by the service will, from the customer's perspective, be something that should be owned by that customer, but the nature of the service may mean that it is restricted in its ability to use that data outside of the confines of the AI system itself. In addition, there is a more fundamental question around who owns rights that are effectively created by the AI system itself, without human involvement. In any event, the licence should extend to whatever use cases the customer has in mind (i.e. there should be no relevant restrictions on use and no requirements of, for example, attribution).

Disclaimers—retailers will want to place adequate contractual obligations and warranties on the service provider to ensure that their end-customer's experience is as accurate and seamless as possible. Even so, retailers will need to ensure that adequate disclaimers are included in their own terms with end-customers so that those end-customers cannot seek recourse if, for example, a frying pan, door handle or pair of shoes does not look exactly the same through the AR as in real life. They will also need to be transparent about the limitations of AI systems, for example, end-customers should be made aware if they are interacting with a chatbot instead of a human

Liability—retailers should be beware of service providers trying to exclude liability for matters that are within their control. Determining the extent of what is within an AI service provider's control can be difficult due to the nature of AI and the 'black box' problem it creates whereby a system can develop after purchase. The service provider should be asked to provide an indemnity to protect its client in case of damage caused by the output of an AI system. This is especially important considering the often complicated value chain involved.

With thanks to Lexis Nexis and Bird&Bird

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WHAT DOES A WELL-DRAFTED CONTRACT SAY ABOUT YOUR BUSINESS?

Well-drafted contracts say a great deal about a business and its management. Aside from a websites and social media marketing efforts, contracts and commercial documentation provide a critical shop window into how a business is being run.

We would point to the following as the key benefits flowing from well prepared and presented contracts:

1. **Professionalism:** A well-drafted contract demonstrates that the business takes its commitments seriously and operates in a professional manner. It reflects a level of care and attention to detail that can instil confidence in partners, clients, and investors.

2. **Reliability:** A comprehensive and well-structured contract conveys to counter parties that the business is reliable and committed to meeting its obligations and .

3. **Legal Understanding:** A well-drafted contract indicates that the business has a good understanding of the legal implications of a deal and is willing to protect its interests through legally sound agreements.

4. **Risk Management:** Contracts that address potential risks and contingencies demonstrate the business's commitment to mitigating challenges that may arise during the course of the relationship.

5. **Transparency:** Well-drafted contracts demonstrate transparency and a willingness to confront relevant commercial issues up front, rather than leave them to be decided when there's a disagreement.

10. **Negotiations**: Well-drafted contracts can help speed up the negotiation process. Clarity and structure reduce the need for extensive back-and-forth, showing that the business values everyone's time.

12. **Investors**: On a due diligence exercise by a potential investor, a set of well-structured contracts will help provide a level of confidence in the way the business is being managed.

In summary, well-drafted contracts reflect management's values and approach to business and they play a crucial role in establishing credibility and reducing risks.

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GOVERNMENT CONTRACTS

The Government's standard issue so-called 'Short Form' standard contract template low value non-complex goods and services, which can be found here: https://www.gov.uk/government/collections/short-form-terms-and-conditions

Short is not how we would describe the document!

The template runs to 63 pages, with 37 clauses, 9 Annexes, a Cover Letter, an Order Form and a definitions sections that is itself 9 pages long and consists of 22,500 words. There's also a 17 page 'Buyer's Guide', (i.e. any Government or public sector purchaser). One helpful instruction given in the Guide reads as follows:

> *"For the Contract to be subject to the Conditions, you must not accept any Supplier terms and conditions that are sent to you, or attached to the Order Form or the Conditions. If any of these events occur you must ensure that any Supplier terms and conditions are rejected and the rejection is recorded in writing." https://www.gov.uk/government/publications/guidance-on-the-short-form-contract*

So, good luck with trying to get your own Ts&Cs accepted, although we'd always recommend that contract terms are at least negotiated by suppliers to reduce or eliminate any that aren't suitable.

Disappointed, but perhaps not surprised, at the length and relative complexity of the Short Form Contract template, we thought we'd ask an AI Chatbot why they are so long and what can be done to shorten them. With some editing by us, these are the answers we got and we approved them in the round:

Why are they so long?	Ideas for shortening them
1. Transparency and Accountability: Contracts involve public resources, demanding transparency for justifiable fund use. **2. Complex Projects:** Government endeavours are intricate with stakeholders, regulations, risks, warranting thorough coverage for clarity. **3. Manage Legal Risks:** Contracts must be precise to reduce litigation risks and evidence intentions during disputes. **4. Regulatory Adherence:** Government projects adhere to numerous rules, necessitating detailed contracts for compliance and deviations.	1. **Language Clarity:** Simplify contract language, ensuring accuracy while avoiding complex terms and structures. 2. **Redundancy Removal:** Identify and remove redundant clauses for a streamlined contract. 3. **External References:** Reference external documents to reduce contract length while preserving necessary information. 4. **Focus on Essentials:** Prioritize key provisions defining parties' rights and responsibilities. 5. **Visual Aids:** Use tables, charts, and bullet points to convey complex data concisely.

Why are they so long?	Ideas for shortening them
5. **Public Interest Protection:** Contracts ensure efficient delivery of public-interest services like infrastructure and security. 6. **Multi-Stakeholder Involvement:** Involvement of diverse entities necessitates lengthier contracts addressing their diverse interests. 7. **Adapting to Changes:** Extensive contracts incorporate change provisions to ensure project adaptability. 8. **Anti-Corruption Measures:** Detailed contracts deter corruption, promoting ethical conduct.	6. **Avoid Overload:** Be specific without unnecessary details unrelated to contract core. 7. **Centralised Definitions:** Group term definitions for easier navigation and less repetition. 8. **Cross-Referencing:** Use links to related sections to prevent repetition and maintain focus. 10. **Trim Boilerplate:** Remove irrelevant standard clauses to tailor the contract.

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Contract Tips for the Autumn

Review and Update Business Contracts: Take this time to review your existing contracts. Ensure that they are up-to-date, reflect any recent changes in your business, and that they align with your business aims and objectives.

Be Clear on Terms: Clearly define the terms and conditions of your contracts. Ambiguity can lead to misunderstandings later on. Make sure all parties are on the same page regarding payment terms, deliverables, timelines, and any potential penalties.

Consider Force Majeure: As autumn can bring unpredictable weather and potential disruptions, consider including a force majeure clause in your contracts to protect your business against unforeseen events. These clauses outline what happens if events, like natural disasters, prevent one or both parties from fulfilling their obligations.

Include Dispute Resolution Clauses: To avoid costly and time-consuming legal fights, it's worth considering having an alternative dispute resolution clause in your contracts. This can outline steps for resolving disputes, such as negotiation, mediation, or arbitration.

Intellectual Property Protection: If your business involves using, creating or managing some kind of intellectual property (IP), make sure your contracts clearly state who owns the IP and how it may be used. This is especially important if you're collaborating with other businesses or individuals.

Data Protection and GDPR: Ensure that your contracts comply with data protection laws, especially the General Data Protection Regulation (GDPR) in the UK. Clearly state how personal data will be collected, processed, and protected.

Payment and Late Fees: It's crucial that all SMEs define their payment terms and expectations. Consider including late payment fees to encourage timely payments. This can help maintain healthy cash flow for your business.

Renewal and Termination Clauses: If you're offering services that have a defined term, include clauses that address contract renewals and terminations. This can help both parties understand their options when the contract period ends.

Maintain Communication: Keep open lines of communication with your contractual partners. If any issues or changes arise, address them promptly and professionally. A proactive approach can prevent misunderstandings and conflicts.

Document Everything: Maintain a clear record of all communications and changes related to your contracts. Whether these are emails, WhatsApp messages, letters or notes of phone conversations. Documentation can be critical if any misunderstanding or disputes arise.

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Influencers

With influencers in the news, most recently, Carrie Johnson (wife of ex-PM Boris) joining their ranks, we thought we'd take a look at what they are and how they regulated.

Influencers are ephemeral beings, popping up everywhere on social media platforms under this somewhat ambiguous word with almost implications- influencing us to do what exactly and with whom?

It seems that the world of influencers is rapidly evolving and, while most so-called influencers are not household names, they are now at least a recognised and rewarded service and firmly part of the marketing eco-system.

Their prime purpose- to help raise brand awareness and drive up sales. Influencers achieve this by virtue of an extensive social media following.

In the UK, content is considered an influencer 'endorsement' or advertising where an influencer works with a brand owner to create content that they will post on their own channel and:

- the influencer has received 'payment' by a brand in relation to that content, and
- the brand has some form of 'control' over that content.

Where content is considered to be an endorsement or advertising (as described above) it should be labelled as such.

According to the Advertising Standards Authority's UK Code of Non-broadcast Advertising and Direct & Promotional Marketing (CAP Code) all ads 'must be obviously identifiable as such'.

Both the influencer and the brand owner are responsible for ensuring the content is clearly labelled as an advertisement. The only fail-safe option is to include the word '*ad*', '*advert*', '*advertising*' or '*advertisement*' as part of the content. Numerous other labels have been rejected by the ASA including '@brandname', '#spon', including a promotional code, 'support by', 'gifted', 'in association with', '#brandambassador', 'affiliate'.

Read about the ASA's CAP Code here.

Late payment to small businesses

Late payment of invoices and long payment terms are key issues that businesses, especially SMEs, highlight as a barrier to their growth. Owners and managers are forced to spend disproportionate time chasing payments; resulting cash flow problems cause even good, viable firms to struggle.

The Department for Business and Trade (DBT) has announced tougher measures to decrease late payments to small businesses through the upcoming Prompt Payment & Cash Flow Review. The Secretary of State for Business and Trade noted late payments were a massive barrier to growth.

The measures include delivering an improved payment culture, providing greater advice to small businesses on negotiating payment terms and managing cash flow, extending the Reporting on Payment Practices and Performance Regulations 2017 and broadening the power of the Small Business Commissioner to publish reports based on anonymous information. These measures hope to encourage timely payments to SMEs to boost the economy by £2bn annually

Read the full announcement here

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