Common Purchasing Contract Traps

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Common Purchasing Contract Traps

If you work in procurement or purchasing, signing a contract is a regular part of your job and represents the end of an arduous journey of sourcing and negotiating. But these contracts – the very things that you put in place to safeguard your purchase – can be fraught with traps.

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These traps can damage your organization by reducing the efficiency of your supply chain, or they can directly sap your profits by wasting your time and your capital. Fortunately, all can be avoided with an element of legal savvy and the knowledge of what you need to be looking for. Read on for four of the most common contract traps for purchasers.

Force Majeure Clause

- Force Majeure clauses nullify contracts if an event occurs which is beyond the control of either party named in the document.
- A purchaser may protect themselves from these clauses by inserting specific provisions for certain occurrences which may be more likely than others.
- They may also ensure that the wording of the clause ensures that the supplier or manufacturer takes all possible actions to ensure the success of the transaction.

The French term ‘force majeure’ – literally meaning ‘superior force’ – is a common sight within contracts and other legal documents. In legal terms, the phrase describes a situation which is beyond the control of either party within the contract. With regard to purchasing and procurement, force majeure will usually refer to an event rendering a supplier or manufacturer unable to provide the goods required.

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Protecting the Purchaser

Standard Clause

A standard force majeure clause will cover only the provision of goods and not the cash transaction or any other payment. This means that a purchaser cannot use a force majeure clause as a defence in the case of late, incomplete, or missing payments, except in a few, highly specific cases. Instead, the supplier may initiate the clause, leaving the purchaser without the goods they had ordered.

If this occurs, it can put the purchaser or procurement agent at a severe disadvantage; so what can be done to prevent this? While it may appear that the force majeure clause is weighted unfairly towards suppliers and manufacturers, there are steps which legally savvy purchasers and procurement agents can take to ensure that they are not left disappointed and out of pocket.

Defining the Terms

The most effective way is to hold pre-contract talks with the other party to define the terms of a force majeure event. A force majeure clause will usually cover events such as accidental fires, floods, civil disorder, international conflicts, or other, far-reaching and uncontrollable occurrences. However, if either party decides that a particular transaction is at an inordinately high risk of one or more of the specific event types covered by force majeure, an agreement can be reached regarding the event or events in question.

The Wording of the Clause

A second method that a procurement agent can use to protect themselves is to examine the wording of the force majeure clause within the document. As discussed above, a standard force majeure clause may cover events beyond either party's control, but a modified clause will require that the seller or supplier takes all the necessary steps to minimize the risk of such an occurrence and to ensure the completion of the transaction to the satisfaction of all parties. The wording may even be extended to cover specific actions that a supplier or manufacturer must take in order to safeguard the product and the sale, providing extra levels of protection for the purchaser.

Termination

- Termination is a means by which a contract may be legally nullified by either party.
- There are three main forms of termination: frustration, breach of contract, or mutual agreement.
- However, a purchaser may take steps to protect their investment in the event of a termination.

Termination refers to the end of a contract. When conditions for a termination are met, neither party is bound by any terms outlined in the purchasing contract going forward, and the provisions of the contract are considered null and void.

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There are several situations which can cause a termination to occur. Of course, the reason for drawing up a contract in the first place is to outline a set of mutually acceptable and legally binding rules, regulations, and observances, which each party must adhere to. However, realistically, this is not always going to be the case. To cover these eventualities, contract law provides grounds under which contracts can be terminated.

Of course, this can cause serious problems for anyone working in purchasing and procurement as they discover that their previously watertight contracts are now worthless. Below we have outlined three common reasons for termination and how you can avoid each one.

Frustration

One way in which a contract can be terminated is by frustration. Frustration occurs when unforeseen events which are not caused or influenced by either party render it impossible – or unreasonably difficult – for one party to fulfil their contractual obligations. In this case, the entire landscape of the transaction is considered to have changed and the contract is deemed no longer fit for purpose.

An example of frustration in action is if a procurement agent agrees to purchase stock from a supplier, only for that stock to be destroyed in an accidental warehouse fire. In this event, neither party would be expected to fulfil the terms of the contract.

In order to protect themselves from frustration in this manner, a purchaser can ensure that the contract covers any risks that may apply to the stock and to the transaction in question. In truth, all contracts should provide this cover and most contracts will; however it is important for the purchaser to ensure that they are not left at a disadvantage should anything go wrong.

Mutual Agreement

A contract is designed to prevent conflict between procurement agents and suppliers, and to create a document which both parties can agree on. This agreement is key to the efficacy of a contract; the terms of a contract must be agreed on before it is actioned, and both parties must agree that they will be able to adhere to its provisions over the full length of the contract.

This means that, should both parties agree that the contract is no longer advantageous to either, the contract may simply be terminated without a drawn out process of legal wrangling.

However, this can prove dangerous for purchasers. Mutual agreement is by far the easiest and most attractive way to terminate a contract, and so some suppliers or manufacturers may attempt to use their influence or leverage to bring about this situation against the purchaser's will. This is illegal and is a breach of contract in itself. Any attempt to terminate a contract via coercion should be referred to the authorities of the respective state.

Breach of Contract

The most common reason for the termination of a contract is simply that one or more of its provisions or requirements were breached. A breach can be triggered by the actions of either party, and this party will then be held responsible for the annulment of the contract. Unlike the two scenarios listed above, the guilty party may find themselves obliged to pay a fine or a partial reimbursement, while the other party may be entitled to seek legal action.

The problems that breach of contract can cause for a purchaser are two-fold and depend on whether the purchaser is in the right or in the wrong. If the procurement agent or manager has been careless or negligent in his or her duties with regard to the contract, they may stray outside of the terms outlined within, which could then land them in legal trouble. Examining the contract carefully and acting with due diligence is the only protection procurement agents have against this.

On the other hand, the purchaser must ensure that the other party cannot easily break the contract and force a termination. The purchaser can avoid this trap by working strict punitive measures into the contract – for example heavy fines or obligations for those in breach of the terms – which should deter this kind of behavior.

Indemnification

- An indemnification works in a similar way to a breach of contract, but is more comprehensive.
- An indemnification clause requires that a guilty party covers the costs of all damages incurred by the other party in the event of wrongdoing.
- The clause also provides protection against legal action raised by a third party as a result of the guilty party's actions.

Indemnification literally means, to make amends after an initial wrong. In relation to contract law, it is a promise from either party to cover any losses, costs or damages that they cause to be incurred by the other side. This also extends to include third party legal proceedings, provided that the legal proceedings brought against Party A can be shown to be as a result of the actions of Party B.

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Protecting the Purchaser

Standard Indemnification Clause

Any procurement agent entering into a purchasing contract must first ensure that they and their organization are protected against the ramifications of the actions of the other party. By entering into such a contract, the agent and organization are effectively creating a partnership and an association with the other parties involved. It is important to ensure that this partnership is beneficial to all involved and that protections are in place to ensure neither party is exposed to any additional risks to finances, property or reputation.

In order to provide this protection, an indemnification clause must be inserted into the agreement and included in the legal wording of the contract. The standard clause ensures that – if either party is found guilty of wrongdoing – the guilty party shall bear the costs incurred by the other party and is usually designed to cover against legal action brought by a third party individual or organization, although additional wording may be added to the clause.

The difference between an indemnification clause and the simple breach of contract mentioned in the above section is that the indemnification clause ensures that the guilty party pays for all legal proceedings up front, so no costs are incurred by the other party at any stage.

Beware of Incomplete Clauses

Another potential trap relating to indemnification is an incomplete or inadequate clause. All contracts must be examined closely by a legal expert before being entered into. If the indemnification clause is incomplete, the purchaser may discover that their expenses are only partly covered. It is up to both parties to fully understand and to agree on all terms and all clauses within the contract before the document is signed.

Exculpatory Clause

- Exculpatory clauses can absolve a supplier of any guilt even if they were at fault.
- Reputable suppliers will not usually deploy this sort of clause.
- Raise the issue with your supplier if the clause appears in your agreement.

A contract may feature an exculpatory clause. This clause absolves the supplier or manufacturer of legal responsibility, even if they are in the wrong. In relation to purchasing and procurement, this would usually mean the supply of damaged or faulty goods.

It goes without saying that this sort of clause can be highly damaging to you – the purchaser – and to your organization. While such clauses are common, they are more likely to be included in waiver forms – for example, the forms used by dry cleaning businesses who handle high value goods – than in supply contracts. A reputable supplier or manufacturer will be more interested in securing your long term business and partnership than making a fast buck by off-loading poor-quality merchandise. If such a clause does appear in a contract, bring this up with the supplier and try to reach an agreement.

Preparation is the best defense, and pre-arming yourself with knowledge is the best way to avoid the traps and pitfalls which befall so many. Remember to take your time over the contract, to seek legal assistance if required, and to not be shy when it comes to striking a deal with your supplier.

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