

## Strong Terms and Conditions of Trade - essential in recessionary times

### It is prudent business practice to have strong terms and conditions of trade in place

With the slowing economic conditions and likely recession, the importance of terms of trade increases. Terms of trade form the basis of a written contract between the supplier and the customer and provide certainty around the key terms of trade, along with reducing the risk of a dispute arising and increasing a supplier's chances of recovering an amount that is owed to it.

Importantly, terms of trade allocate risk between the supplier and the customer, they appropriately limit the liability of the supplier, they provide security of payment and they allow the supplier to recover not only the principal amount owed to it, but costs of recovery including interest and legal costs. We address each of these aspects below.

#### Certainty

For a contract to exist in relation to the supply of goods and services the key terms must be sufficiently certain. This includes what is being supplied, the price and the term of the contract. While this can be achieved verbally or through an exchange of emails, the chances of misunderstanding or lack of certainty greatly increase. There is no substitute for a written contract.

#### Creating a binding contract

If a supplier of goods and services seeks to recover the costs of those goods supplied, the opportunity for the purchaser to resist payment on the grounds of uncertainty in relation to the price, quantity or nature of goods and services being provided greatly increases in the absence of binding terms and conditions.

It is important to have a process in place where the customer becomes bound by the terms and conditions. Many suppliers make the mistake of having invested time and money in preparing detailed terms and

conditions only to fall down in relation to the process when they discover their customer is not bound by the terms and conditions of trade.

In an ideal world, the customer signs a credit/customer application setting out their details and agreeing to be bound by the terms and conditions that are attached. There is therefore a written record of the acceptance of the supplier's terms and there can be no arguments going forward. Once signed, the customer is bound for all future sales by the supplier.

However, this may not be practical in many circumstances (including in relation to existing customers), so it is often necessary to have some fall-back mechanisms including giving notice to the customer of the terms and conditions prior to supplying the goods and services and invoicing. The terms and conditions may also appear on the supplier's website and be referred to in the invoice or on the reverse of the invoice. The supplier is then left to argue that the customer is bound by the terms and conditions by notice - i.e. the customer has had notice of the terms and conditions in advance of the goods and services being supplied and the customer has ordered the goods or services on that basis

That said, written acknowledgement of the terms and conditions by the customer (either by signing the credit application or providing an email response confirming agreement to the terms and conditions) is the gold standard. Agreement by notice is valid (though not bulletproof) as it is always open to an unhappy customer arguing that they did not receive notice of the terms and/or did not agree to them.

#### Allocation of risk and insurance

It is important for the terms of trade to set out when risk passes from the supplier to the purchaser of goods. This is usually on delivery of the goods from the supplier to the customer. The next issue is when does this delivery occur? Does delivery occur at the factory door, the customer's premises or a distribution centre?

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The terms and conditions need to provide for when delivery occurs and options if there may be more than one type of delivery. In addition, if the supplier provides goods to overseas customers reference needs to be made to the appropriate international terms of trade or incoterms. For example, goods could be delivered "Free On Board" (**FOB**), "Cost, Insurance and Freight" (**CIF**) or "Ex-Works". If delivery occurs on an "Ex-Works" basis, this essentially means that delivery will occur when the goods leave the supplier's factory, FOB means that risk passes when the goods go over the ship's rail or onto the aeroplane. CIF is where the goods are delivered to an overseas customer's premises with the supplier paying for the cost of insurance and freight to their premises.

It is important to ensure that delivery and the passing of risk align with the supplier's insurance policies - i.e. if delivery is on the customer's premises then the supplier will need to ensure that the goods are insured for transit to the customer's premises.

### Limitation of liability

Well-drafted binding terms of trade are also an opportunity for the supplier to limit their liability in the event that liability arises in respect of the supply of goods or the services provided. Typically, liability for consequential loss (such as loss of profits) is excluded, with liability being limited to repairing or replacing the goods or remediating the work done (in the case of services). A Court can sometimes overturn exclusion or limitation of liability clauses if it considers them to be unreasonable or unfair and so care needs to be taken in drafting these provisions to provide fall-back mechanisms. For example, a common fall-back position is:

*In the event that the supplier is held to be further liable for any reason then the liability shall be limited to the value of the claim or the value of the goods and services provided in the last 12 months, whichever is the lesser.*

### Security for payment - PPSA

Historically, terms of trade sought to retain title to goods supplied so they could be recovered in the event of non-payment. These unregistered forms of security are now called "*security interests*" under the Personal Property Securities Act 1999. Terms of trade in relation to the supply of goods should provide for a security interest in the goods supplied. Assuming that the customer is bound by the terms and conditions, this creates a valid "security interest", but for that security interest to be "perfected" it will need to be registered on the PPSR.

The value of perfection through registration is that it will give the supplier a "super priority" ahead of a bank's General Security Agreement. In the absence of registration, the bank will have priority over the goods ahead of the supplier. An unperfected security interest still gives priority ahead of unsecured creditors.

Some suppliers go to the next step of perfecting their security interests and some don't. The important thing is to have the option within the terms of trade and then to take a view depending on the relationship or the nature of the business. Large suppliers typically have whole administration departments that are ensuring that they have registered security interests over all of their key customers. Smaller operators may only seek to do this with a client from whom they have significant money owing from time to time.

### Interest and costs

In the absence of a clause allowing the charging of penalty interest and recovery of enforcements costs, the supplier will not be able to charge interest or recover these costs. Typically, terms and conditions should provide for the charging of default interest at a specified rate if payment is not made on the due date. In addition, the terms and conditions should provide for the recovery of legal costs on a "solicitor-client basis" which will allow the supplier to recover the full amount of their reasonable legal costs. It may be that for relationship

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reasons penalty interest is not charged for late payment but the fact is the term of trade provides to ability to do so creating a "stick and carrot" that can be used to encourage timely payment.

If suppliers of goods and services do not have terms of trade in place then it would be prudent to obtain legal advice to have these prepared. In addition, if the terms of trade have not been reviewed for some time it would be important to review those terms of trade to tighten them up and amend them where appropriate given the introduction of recent legislation including the changes to the Fair Trading Act (regulating unfair terms). The legal costs and time involved are relatively modest compared to the risks that are mitigated with well-drafted terms of trade and a process that ensures the customer is bound.

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### Want to know more?

If you have any questions about terms of trade, please contact our specialist [Commercial Team](#).