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AGREEMENTS – A FIRST AMONG EQUALS

We recently advised a client on the importance of entering into written, enforceable agreements with its customers.

Our international client had supplied stock over a number of years to an Australian-based customer. However, our client's written supply agreement was entered into with a 'group of companies', described here in generic terms as follows (*the ABC Group*) and not with an actual legal entity, being either an individual or a company with an Australian Company Number (ACN).

On that basis, the recovery of a debt was, in effect, unenforceable, as there was no legal entity (individual or company) to recover the debt from.

Our client was not aware of the implications of not being able to recover the debt until such time as a dispute arose, and they sought to take enforcement action to recover the debt.

To avoid such problems, below is a summary of what businesses should seek when entering into agreements, and the type of agreements that can be entered into.

Contract

A contract is a legally binding agreement. The agreement must contain:

1. An intention by both parties to be legally bound;
2. An offer from one party that is accepted by the other party;
3. A benefit (consideration) provided by each party, such as services provided in exchange for payment for those services;
4. Legal capacity to enter into the contract, eg. a director signing on behalf of a company or the individual owner/director of the business.

Usually, verbal conversations and exchanges of email, followed by purchase orders and the provision of services/delivery of goods, constitutes a contract/agreement.

The best way to document an agreement, other than entering into a formal written contract, is to keep notes of conversations consistent with the parties' understanding.

The fundamental terms of a contract/agreement are: price; payment terms; whether the supply/service is GST inclusive or exclusive; the scope of the goods or services to be provided; the time period over which the contract is binding; and personal guarantees, if any.

Deed

A Deed is a binding contract between the parties, which removes the need for a benefit (consideration) being provided and received by the parties. Deeds are useful where one party provides an undertaking to the other.

Common deed agreements include Deed Poll, Deed of Guarantee and Indemnity, Confidentiality Deed, Deed of Termination and Deeds of Settlement.

Memorandum of Understanding/Heads of Agreement/Letters of Comfort

A Memorandum of Understanding sets out the common understandings and intentions between the parties to achieve a desired outcome with each other's assistance. Memorandums of Understanding do not necessarily require that a subsequent binding contract be entered into.

Heads of Agreement are usually used to set out the broad agreement between the parties, prior to entry into a legally binding, more detailed contract.

Letters of Comfort are used to provide support for the financial obligations of another related party. They are usually provided by a parent company on behalf of its subsidiary company, to a third party in support of the subsidiary company's financial obligations.

All of the above documents:

1. are used in pre-contractual stages of negotiations with the intention of entering into a formal contract at a later stage;
2. operate for the benefit of third parties, such as financiers or investors, and deal with pre-contractual issues such as exclusivity, confidentiality, due diligence and intellectual property;
3. provide some comfort to the parties prior to incurring further costs in preparation for formal contract.

The term *Subject to Contract* implies that the agreement is not binding until a formal contract is entered into between the parties. Further, the initial agreement between the parties prior to a formal contract may be too vague to be enforceable.

Regardless of what the document says, a party's conduct will also determine whether the agreement is binding, ie. if the parties act inconsistently with the terms of the agreement, a party may be:

- liable for misleading and deceptive conduct under the Australian Consumer Law (formerly Trade Practices Act), or
- bound by the terms of the agreement because of the parties conduct, especially if the other party relied upon that conduct.

Further, a disclaimer clause may be appropriate – specifying that no party can rely upon the other's conduct to assert that the agreement was binding or otherwise.

When entering into agreements, the most important point is to have them in writing, either by way of formal contract, exchange of emails or the issue of purchase orders, signed delivery dockets and/or invoices.

Please contact SRM Lawyers to answer any enquiry you have relating to your business and existing or future commercial agreements.

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