

CONTRACTS, MORE BASICS

Contracts are the foundation on which business is conducted. Properly drafted contracts can help you avoid unnecessary and costly disputes. This article discusses some of the items that you should consider having in your contracts with vendors and customers.

What Is a Contract? A contract exists when two or more parties agree to exchange either property (including money) or promises of future performance. Contracts can be verbal or in writing. Contracts can be part of an invoice or a purchase order, or they can be drafted as separate documents.

Verbal contracts are risky because the parties' memories or understanding of the deal may differ. Also, if a contract is verbal, it may be unenforceable due to a law known as the Statute of Frauds. This statute provides that verbal contracts which cannot be performed within a specified time (such as one year) or which involve more than a specified amount of money (such as \$500) are not enforceable. An exception to the statute may arise if one or more parties have partially performed their responsibilities under the contract. However, even if the exception applies, proving that your understanding of a verbal contract is the correct version may be difficult.

Some Key Provisions.

Even if your contract is in writing, you should make sure that it includes all the necessary provisions. Here are some suggestions.

1. Names. Your contract should correctly state the full name of each party. For example, if you or your customer have incorporated your businesses, the contract should state the entire names of the corporations.
2. Obligations. Make sure that your contract fully and completely states all the obligations of each party, including all deadlines for delivery and payment. If you are making several deliveries, consider requesting progress payments and specifying time periods for approval of each partial delivery. If your contract refers to other writings, copies of those writings should, whenever possible, be attached to the contract.
3. Personal Guaranty. You may deal with people who have incorporated their businesses. In those cases, only their corporations may be responsible to

perform under the contract. If you also want them to be personally responsible, you should indicate that fact in the contract, and they should sign it in both their personal and corporate capacities.

3. Excuses for Performance. Many contracts also have a provision known as a *force majeure* clause. This excuses performance due to events beyond someone's control, such as strikes, natural disasters, and so on. For example, if you will be unable to complete a job without information from your client, your contract should excuse your delay for that reason. You might consider adding a provision that allows you to terminate the contract if conditions that excuse performance persist for longer than a specified time.

4. Damages for Unexcused Failure to Perform. What happens if either party's failure to perform is unexcused? Your contract should specify the types of damages that will accrue, so that each side will know them in advance. For example, damages for nonperformance can include the cost of goods purchased or delivered and lost profits. The exact amount of damages (*liquidated damages*) can be specified in advance when, under the circumstances, proof of actual losses may be difficult. In deals involving unique property for which there are no reasonable substitutes, such as real estate or rare objects, the contract can require the other party to deliver that specific property (this is called *specific performance*). Also, your contract must expressly provide for interest and attorneys' fees if you want to recover those items.

5. Choice of Law and Jurisdiction if Multi-State Deal. Many business owners have transactions with someone who is not physically located in Illinois or who does not transact significant amounts of business with others in Illinois. This is becoming more common with the growth of Internet commerce. In those circumstances, your contract should specify which state's laws will govern the deal (such as Illinois) and the location at which the parties must appear to resolve disputes (such as the courts in Cook County, Illinois). Otherwise, you may be forced to litigate a dispute in a distant forum under unfamiliar laws.

6. Consider Arbitration. Arbitration can be an expeditious, inexpensive way to resolve disputes. Unlike court, arbitration does not necessarily require the assistance of a lawyer, and the procedural rules are relatively simple. If you have a complicated deal, arbitration may not be a good alternative because

the process may be too streamlined. If you want to require arbitration, you should state that in your contract.

7. Battle of the Forms. Often, business owners exchange purchase orders and invoices that contain conflicting terms. Without a prior agreement, resolving these conflicts can be extremely costly. Generally, the courts will compare all the forms. They will ignore all the conflicting terms and will apply all the terms that do not conflict. This can result in a deal different from the one you intended. So, you or your attorney should promptly read all the fine print on the contracts, invoices, and purchase order you receive from your customers and vendors. It's a good idea to exchange forms before either side performs. Whenever these contain provisions that you do not like or that conflict with your forms, you should discuss the conflicts with the other side as soon as possible. This should help everyone avoid the expense and adverse result that can otherwise arise.

8. Work for Hire. If you hire independent contractors to create any work that is subject to copyright laws, generally, the contractor will own the work and you will merely have the right to use it. To change this result, you should have a written contract with your contractor that contains provisions regarding the ownership and future use of the work.

Conclusion

Written contracts can save you time and money. You should consult an attorney to make sure that your contract is properly drafted and contains all the necessary provisions. You should carefully read the forms that you receive from your customers and vendors. Whenever they contain provisions that you do not like, you should discuss those provisions with your attorney or with the other party.