Commercial Business

OASISAIRBRIDGE

A basic guide to commercial business: to help in the formulation of a commercial contract

By David Robinson

1. Introduction

There is always more than one party to a contract and two sides to it – the business side and the legal side. The principles of any contract should define, in advance of the actual contract, the objective(s) the parties wish to achieve. These objectives should be understood early on in the business winning process and, to be effective, should be informed by both the legal and business aspirations that exist for the deal.

It is hardly possible to exaggerate the uplifting effect that a successful and well formulated commercial contract has on those that help create it. It is vital to the success of any business that every approach to deal making is made with the intention of developing a well formulated commercial contract which has considered all aspects of the business from the application of technical and scientific aspects, the inter personal relationships, the financial well-being of the business, to encompassing the strategic intentions of the business at that time.

This booklet, which forms part of the business framework, is a guide written in layman's terms to help newly appointed deal makers to create value for the business whilst also protecting it. This guide is not exhaustive as it only touches on some very specific areas of commercial contracting and commercial deal making such as: key terms and conditions, export finance, payment insurance and some particular international (local to country) approaches to business, as well as some "off contract" advice relating to Anti-Bribery and Corruption and the employment of in-country advisors.

Most aspects of contracting, outside of the standard terms of the domestic commercial contract, are complex areas which will require advice from experts in banking, finance, insurance, legal and tax domains. Please make certain that you tap into these areas of expertise when deal making and formulating a commercial contract.

Please use this guide as it was intended - as a guide. Use it to help give you advantage where you can, certainly, but don't let it inhibit your deal making. Someone once said: "Logic shall get you from A to B. Imagination will take you everywhere" and I must say, I thoroughly agree with them.

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2. The Formulation of a Contract

Bid Preparation

Prior to the seller approaching a buyer with an offer; the seller must think about the architecture of the deal in order to make the best and most favorable offer for them.

It is all very well the seller worrying about how they may positively influence their customer sufficiently to be included in a tender opportunity but the reality is that the seller must have a very clear understanding of the likelihood of winning the deal from the offer it makes. The seller should possess a very clear idea of its own capability within the marketplace when considering making an offer. Sometimes the seller may be confident that their in-house capability (in terms of available resource and technical competence) is, on its own, credible. Should the seller not be confident that the most favorable offer it could make would be to go it alone, they may decide to attempt to secure a contract through partnering with another company. The seller may choose to partner with another company for many reasons some of which are not immediately obvious; such as to limit the competitive landscape (to improve their chance of winning the deal) or it could be to share the risk in accepting the deal or even to develop a new and improved capability combining different ideas and knowledge with other providers which may offer advancement on other opportunities as well as the one being bid for.

Partnering with other similar businesses is commonplace when there are resource constraints within the business, even if both the partnering companies have the capability to win business in their own right. Whatever the strategy or the reason for partnering or not, the architecture of the deal should be at the heart of the offer.

Sellers may decide to work together on a prime/sub-contract relationship. In this circumstance, the offer can be made by the Prime seller with input into the proposed offer by the sub-contractor. However, sometimes, investment by the sellers into the bid preparation, in order to generate an offer, may be required prior to the offer being made to the buyer. This investment may be the creation of a new capability or solution where the sellers have to share their Intellectual property with each other to create a jointly owned capability. Here then, agreements need to be made between the sellers. These agreements are nearly always Non-Disclosure Agreements but may also be Teaming Agreements.

Teaming Agreements

A Teaming Agreement (TA) is when two or more parties wish to work together in order to combine capability to help improve their chances of success in the market place. Often a Teaming Agreement is formulated between sellers when the market presents an opportunity for an offer to be made which requires the delivery of a service, capability or solution, which falls within the portfolio of the sellers.

The TA should clearly express the relationship between the parties (i.e. the sellers) and what they are setting out to achieve, prior to an offer being made. Typically, the TA falls away upon the award of a contract, when one of the sellers places a sub-contract on the other party (ies) to the TA. The TA should clearly state who is the lead party and what happens upon the award of a contract by the buyer, i.e. what is the agreed work share of the parties and who places a sub-contract on whom.

"The more parties to an agreement, the more difficult it can be for the parties to find agreement"

Sometimes there are more than two parties to a TA. In this instance, a multi-party TA can be formulated. However, the more parties to an agreement, the more difficult it can be for the parties to find agreement with the terms and conditions of the TA. Often, when multiple sellers wish to work together the lead seller (Prime Contractor) places a separate and individual TA on each party. This methodology can help speed up the process of agreeing the various TAs but can prove to be unworkable when there are interdependencies between all of the parties.

Prior to a TA being formulated, it is common practice for the parties to formulate a Heads of Agreement (HOA) or a Memorandum of Understanding (MOU). These two types of agreement, which are principally the same type of arrangement but with a different name allow the parties who wish to work together the opportunity to set out the principles of the TA they wish to formulate. Approaching the formulation of a TA through the use of a HOA or a MOU speeds up the process of securing a TA because the principles of the "why" and "how" are written down prior to the drafting of the TA. These principles may be fairly broad, for example, the principles may cover how Intellectual Property is to be shared and used by the parties to the agreement, but they may also highlight how the parties engage with each other at the working level (open, honest and acting in a way which drives for success). MOUs and HOAs are good agreements for the deal makers to fall back on, when negotiations on the TA start to go astray. Simply put: a HOA or an MOU is an agreement to make an agreement and you can place within the HOA or MOU anything you like. HOAs and MOUs are rarely legally binding.

Making an Offer

There are many different ways to price an offer. Within this guide we will explored the following, which can be found within the pricing section: Indicative, Rough Order of Magnitude, Fixed and Firm, Fixed, Firm, Cost Plus and a Gainshare. (See pricing)

Prior to making an offer to a potential customer the information you are intending to provide in your offer may be commercially sensitive to your business therefore you may wish to make your offer subject to a Non-Disclosure Agreement (NDA), or a Confidentiality Agreement (CA) - again, there is a section on this aspect within this guide. Likewise, if you are teaming with other parties in order to formulate an offer together you may wish to enter into CAs or NDAs with your partners in order to for each party to understand how they may or may not use any information they have been provided with and understand to what extent other parties' information needs to be protected.

In making an offer to a potential buyer you may be required to follow the process and procedures laid down in the tender documentation by the buyer – this may include: a requirement for a compliance matrix against the terms and conditions which the buyer has proposed, a compliance matrix against the scope of supply, an executive summary detailing the seller's capability and delivery record, and an opportunity for the seller to demonstrate any innovative and or efficiency initiatives.

However, some buyers are less prescriptive when seeking an offer, which provides the opportunity for the seller to choose how best to make the offer.

Sometimes, and particularly when the scope of supply is not fully understood by either the seller and/or the buyer, the seller may choose to simplify the offer through providing a brief document which includes "Heads of Terms" along with other assumptions and exclusions against a description of the scope of supply. This is the simplest form of offer and typically attracts an indicative or Rough Order of Magnitude ROM price due to the lack of clarity surrounding the way in which the contract is to be traded, what the scope of supply is and the nature of the deliverables.

"Heads of Terms" (HOTs) are a list of principles from which a set of terms and conditions can be developed. For example, HOTs may include statements such as the extent of the liability the seller is willing to accept under the contract as well as payment terms and other such terms which have a direct impact on the price which the seller has offered.

"Very often a simplistic approach... saves time and effort"

When a buyer receives a simplified offer, described as a "Heads of Terms offer" as above, the buyer may start negotiations with the seller or indeed accept the seller's offer (as something to explore further rather than in the legal sense) and begin to formulate a scope of work and a contract based upon the assumptions and exclusions and the HOTs as presented by the seller. Very often a simplistic approach such as this saves the seller time and effort – drafting a complete contract and creating a detailed scope of supply may take time but may be futile if the buyer is not completely confident of what they want and how they want to contract for it.

An offer needs to have been made by one party to another and be made with the intention of the offer becoming binding. Sellers may also make offers to buyers which are "not capable of acceptance". This language is used because in making an offer the seller is asserting to the buyer that they have the capability and wherewithal to make the offer against certain assumptions, exclusions at an expressed price. The buyer may therefore take up the seller's offer through accepting it, without going through the process of a negotiation or discussion. When an offer is made "not capable of acceptance," the seller is informing the buyer that the offer requires further understanding which can be gained through negotiation, discussion or the provision of more information in order for the seller to be satisfied with the shape of the deal prior to a contract being formulated.

Acceptance of an Offer

Acceptance of the offer is generally made by the buyer through immediate acceptance of the seller's offer in placing a contract upon the seller, on the basis that the seller made an offer to the buyer which was capable of acceptance. However, prior to the buyer accepting the offer they may choose to have further discussion and negotiation around the scope of the offer, including terms and price, as well as the term of the contract and how the performance of it is measured.

Often, when the buyer is in receipt of a number of offers as a result of the buyer running a competition, concurrent negotiations may take place between the competing sellers and the buyer in order for the buyer to satisfy themselves the contract they place offers them the best value for money.

Formation of a Contract

As described above, there are two fundamental constituents to the formation of a legal contract; offer and acceptance. One party makes an offer or agreement to provide a service and the other party accepts the offer. By setting out the terms and conditions of offer and acceptance a legally binding contract has been made. If the contract is broken, or breached, then the law can used to enforce the contract.

Although a written contract is usually the wisest option, legally binding contracts do not just apply to contracts set out in writing. Under the eyes of the laws of England, verbal contracts are just as legally binding as written contracts. A contract is basically an agreement between two or more parties, for example, one party supplies the goods and or services and the other party buys the goods and or services (and pays for them).

Consideration

Consideration and intention are two other factors that are important in a legally binding contract. "Consideration" is usually the exchange of something, such as wages for work with an employment contract. "Intention" is where both parties make a contract with the intention of that contract to be a legally binding one. These terms are used more in "common law" and may not hold any weight if a dispute reaches the law courts. If a dispute does reach the law courts then a judge will be looking closely at the terms and conditions of the contract in place.

It's worth further exploring the terms "Consideration" and "Common Law".

Consideration

Consideration can be anything of value (such as an item or service). As expressed earlier, each party to a legally binding contract must agree to an exchange if the contract is to be valid. If only one party offers consideration, the agreement is not legally a binding contract. Something must be given or promised in exchange or return for the promise (quid pro quo). A contract must be "met with" or "supported by" consideration to be enforceable and only a person who has provided consideration can enforce a contract. In other words, if an arrangement whereby a promise is not supported by consideration, then the arrangement is not a legally enforceable contract. Mutual promises constitute consideration for each other (I'll promise you that I will do X, in consideration for which you promise me that you will do Y").

Common Law

Common Law is the law established by judges, through their decisions in court as opposed to civil law, which is predominantly established by codified statutes, such as an Act laid down by parliament (e.g. the Freedom of Information Act). In common law systems, such as English Law (where common law has its origins) laws which have been passed (and amended) evolve and change over time according to published judicial opinions (known as case law). In civil law systems (e.g. Napoleonic code, as exists in France and other European countries), a law cannot be changed unless another law is passed which replaces or modifies it. Civil law tends to deal with the law as written, not the law as is practiced or interpreted in society.

Legally Binding Contracts

Further to what has been said within "consideration" above - Many of us are unaware that we enter into legally binding contracts every day: the simple act of purchasing food from a shop is a legally binding contract between shop owner and the buyer (consumer); a simple agreement to have someone cut the grass in your garden for some form of payment is a legally binding contract. Disputes usually occur when one person decides not to abide by one or more of the terms of the agreement – and it is therefore useful for contracts (other than for everyday transactions) to be set out in writing, such as for the sale of property, shares, and intellectual property rights. By far the best way of making a contract is for both parties to sit down and draft a contract in writing with all the terms and conditions expressed within it - then any breach of contract can be legally disputed.

Unfair Terms of a Contract

Although the contracts as described above are legally binding, it does not mean that there is no way out of them. The terms and conditions set out in a contract are important when in dispute and very important when disputes reach the courts or tribunals. Unfair contract terms and a lack of good faith on behalf of the seller may mean that the contract is not legally binding. Transactions between businesses are covered by the Unfair Contract Terms Act of 1977. However, please note that under this Act businesses don't have the same protection as individual consumers. Understanding what may constitute unfair terms (or, indeed, the 1977 Act) is beyond the scope of this guide - it may be easier, and far more enjoyable, to speak to a legal person about the principles of the Act rather than read the Act itself.

Certainty of a Contract

If a contract issue does reach the courts then there must be a certainty of contract. This means that for the contract to be legally binding it cannot be vague. The terms and conditions of the contract must have been clearly laid out and not just described as a principle or as a set of assumptions and exclusions. A judge may sometimes look at unclear terms and then try and clarify them but this will be dependent on the individual case appearing before the court.

A Framework Agreement - A Contract with a Different Layout

A Framework Agreement is often used when the seller is contracting with the buyer over a long period of time for the provision of goods and services. These goods and services may be contracted for in discrete parts during the term of the framework agreement and the scope of supply (of each task) might be different each time.

The framework contract is commonly made up of three elements: The general (standard) set of terms and conditions to which all Tasking Orders apply, the Tasking Orders themselves (which provide information of the scope of supply for each particular task, as well as any specific terms and conditions related to the scope of supply), and thirdly, any schedules in the Framework Agreement which are common to the entire contract. An example of what you may find in a Framework Agreement is below:

1. General (standard) terms and conditions appropriate to the entire framework agreement, which shall likely include: Preamble, Parties legal entities, Law, dispute resolution/ arbitration, termination provision, payment terms (i.e. net 30 days, BACS) etc.

2. The Tasking Order (an attachment to the Framework Contract referencing the framework Contract), which should include: a statement of work, delivery terms, a list of dependencies, a contract effective provision (when working within an international context), payment profile, acceptance and rejection clause and other bespoke terms and conditions which are specific to the task. It may, sometimes, be appropriate to amend the general (standard) terms and conditions within the Tasking Order but this is not typical.

3. The Schedules, which are often a general (standard) aspect of the framework agreement. Within the schedules you may find all or some of: a pro forma bank guarantee, performance bond and advance payment bond pro forma, and an invoice pro forma.

Typically, agreeing a Task Order will include matters of the price, specification and any special terms & conditions applying to the order. Precedence between the Framework terms and special terms must be laid out, especially if the Task Form tries to override the Framework Agreement.

A Confidentiality Agreement

A Confidentiality Agreement, also known as a Non-Disclosure Agreement (NDA), is a contract between two or more parties where the subject of the agreement is the exchange of information to be kept secret (i.e. confidential).

The confidential relationship between the parties to the agreement can either be "mutual", meaning all of the parties are under an obligation to maintain secrecy, or "unilateral", meaning that only the receiving party is obliged to maintain secrecy.

A mutual agreement is useful when all parties will be disclosing confidential information.

A confidentiality agreement can be used to protect any information that is not generally known. It is really the creation of a confidential relationship, the terms of which are defined in the agreement.

Drafting a confidentiality agreement

A confidentiality agreement should:

- create an obligation of confidentiality
- restrict the use and disclosure of information
- limit access to information
- describe explicitly the items to be kept confidential

If the confidential agreement covers all these points it will then be easier for an organisation or individual to defend its rights if the confidentiality is violated.

When to use confidentiality agreements

A confidentiality agreement is the best way to protect business information that must be kept secret. It is particularly important if the holder intends to register IP, such as a patent, as it prevents any written description from being considered as published.

Why use a confidentiality agreement?

A confidentiality agreement:

- shows that a confidential relationship exists
- gives written proof that a company considers the information disclosed as being confidential
- provides continuing protection after the implied confidential relationship ends (e.g., restrict use and disclosure by former employees)
- enables a person or organisation to state how and where any dispute will be legally settled

3. Terms and Conditions

Terms and conditions are something we deal with every day and most of us have, at some point in our consumer lives, read terms and conditions and understood the principles which they are setting out.

Below is a brief explanation of the main principles of terms and conditions which are generally used to formulate a commercial contract, from standard “boilerplate” terms, such as Survivability and Third Party Rights to more important and complex terms such as Acceptance and Rejection, Termination and Dispute Resolution.

Sometimes individual terms and conditions have effect on the appropriateness and shape of other terms and conditions - the seller and the buyer should always review all of the terms and conditions together rather than individual terms in their own right.

As mentioned within the introduction - any contract is made up of the business side and the legal side. Setting out the principles of the contract ahead of agreeing the contract terms and conditions are important, with the basic two principles being that of timely delivery and timely payment.

4. Liquidated Damages

General damages (or un-liquidated damages) are one of the most important remedies for a breach of contract, however for a successful claim, the non-defaulting party (i.e. most likely the buyer) is required to prove: 1) that it has incurred actual loss as a result of the breach and 2) that the loss is not too remote (i.e. the loss suffered is not too distant from the cause of the breach and can be related to the breach).

A liquidated damages (LD's) clause avoids the two requirements of proof as stated above, as the buyer only needs to prove that a breach of the contract terms (typically a delay in delivery) has occurred in order to claim damages. The calculation of loss does not need to be demonstrated as it would be based upon an estimate of the costs incurred resulting from the non-performance of the seller, calculated and agreed between the buyer and the seller at the outset of the contract (i.e. prior to the contract being signed by the parties). This estimate of costs is often referred to as "pre ascertained loss".

Sometimes LD's can be a sole remedy (in full and final settlement of any other claim by the buyer upon the seller) stating an amount or rate calculated in advance of the contract being signed for late or non- delivery or performance failure is the maximum amount which can be recovered from the seller. Having LD's as a sole remedy within a contract prevents the buyer from claiming further loss from the seller, directly or through the courts, when the loss they incurred is attributable to the cause to which the LD's were associated with.

LD's are usually expressed in the contract as a fixed sum calculated at a daily or weekly rate from the point at which the contract is delayed. Typically, a LD's provision may be measured as a percentage of the value of the deliverables, or total contract value (e.g. 10% of the value of the deliveries or 10% of the value of the contract price). The rate of recovery of liquidated damages by the buyer from the seller may be expressed as a percentage rate per day or per week (e.g. 0.1% of the value of the delayed deliverable or the contract value per day/ per week).

The rate of recovery of the LD's may be capped to a maximum 10% of the value of the deliverables being made, the deliverables in total or indeed the entire contract price. Should this cap not be stated as being in full or final settlement and as a sole remedy then the buyer will have the right to claim any additional or further loss from the seller.

Sometimes the value of the deliverables within a contract may be less than the total contract value as the contract may have other aspects of cost which are not attributable to the value of the deliverables. One way to determine the value of deliverables is to find out what their insurance value is (for the cost of replacement).

“It is important for the Seller to mitigate the risk of LD’s being enforced”

However, for a LD’s clause to apply successfully the value must be a ‘genuine pre-estimate’ of the buyer’s anticipated loss in the event of delay or failure to perform. The onus is therefore on the buyer to predict (and genuinely estimate) what the loss would be to the buyer’s business in the event that the seller fails to fulfill delivery obligations in the contract.

It is important for the Seller to mitigate the risk of LDs being enforced. Mitigating a LD’s condition can be achieved through adopting one or more of the following approaches:

1. Providing for a “grace period” within the contract from the time of the delivery to the enforcement of the LD’s. This grace period allows the seller the opportunity to get their delivery programme back on track should they miss the delivery date and avoid paying LD’s.

2. Agree delivery dates to be within a calendar month rather than a specific date within the month, thus providing the flexibility of a delivery “window”.

3. Agree to LDs being only applicable to the final delivery rather than each delivery. If the seller is late on the first delivery and has to pay LD’s then the seller may, as a result of a programme which has slipped, be liable for liquidated damages on each subsequent delivery. Alternatively, consideration may be given to the inclusion of a provision within the contract which enables the seller to re-negotiate the delivery programme in the event of LDs being paid on the first delivery, should there be subsequent deliveries.

4. Provide limitation to the LD’s condition through negotiating them as a sole remedy as explained above.

5. Refer to the Force Majeure condition within the LD’s provision to provide protection from being liable for the payment of LD’s should a Force Majeure event be the cause of the delay.

6. Seek to agree a condition where the payment of LD’s is reimbursed at the end of the contract, the “penalty” being late payment rather than a reduction in price.

7. Seek to agree delivery dates with the customer which are later than the internal delivery forecast date, thus building in delivery headroom.

8. Build into the overall contract price a provision for risk to mitigate against the impact of being charged LD’s for late delivery. This approach can often be referred to as an incentive based contract: Meeting the delivery date enables the seller to better its margin as the risk of late delivery has not impacted.

5. Termination

A contract should always include a provision for dealing with how a contract may be determined by way of termination. A termination condition is typically split into two straightforward aspects: (1) the situation that has occurred which presents the need for termination (often referred to as “cause”) and (2) the consequences for the contract and the parties obligated to it when the contract is terminated (known as “effect”).

Cause

There may be good reason to terminate a contract. Mostly, termination of a contract is due to the seller breaching the contract through not meeting one or more of its obligations. Termination may also occur due to the outcome of a dispute between the buyer and seller.

However, the buyer may wish to have the right to stop the contract at any time for whatever reason and may negotiate a provision in the contract to allow them to do so. This type of termination right is often referred to as “termination for convenience” or sometimes “termination without cause”. This type of termination provision may seem harsh on the seller, who may, in turn, want to include a provision to ensure that the seller should not suffer financially should the buyer demand the right to terminate the contract at any time for whatever reason, at their convenience.

Effect

Just as a termination provision has to be clear on what is the cause for termination, it needs to be clear what effect contract termination has.

Should the Seller be in breach of contract, the effect of the termination provision could be that the buyer has the right to return the goods to the seller and recover any and all monies paid. Conversely, it could be that the buyer retains what has been delivered by the seller and the seller retains the money paid in proportion to the value in what has been delivered. These two examples are common place and both present a good basis for agreeing “effect” when formulating a termination provision.

The drafting (and agreeing) of a termination provision becomes more complex when the scope of supply is greater than that of a straightforward off-the-shelf product delivery contract.

For example, a contract which contains:

1. a bespoke realisation, design and development aspect within its scope of work as well as physical deliveries built as a result of the realisation and design and
2. each of the deliverables are made in stages and
3. the contract deliveries are paid for against each delivery stage and
4. the acceptance of the delivery is against each item delivered and
5. performance acceptance of each of the deliverables is post a brief test carried out at each delivery stage with a final extended performance acceptance test of all of the deliverables when they have been integrated together.

In this example, if the seller fails to pass the final extended performance acceptance test when the deliverables have been integrated together the buyer may demand from the seller the right to recover what the seller has so far been paid and reject all of the deliveries so far made (and possibly recover additional losses from the seller). This would seem reasonable given the buyer can't use the capability in its entirety which consisted of multiple deliveries, and the buyer was unable to determine performance until all of the deliveries were integrated and tested together.

The seller, however, may feel that a reasonable percentage of the contracted capability has been delivered to the buyer, accepted by the buyer as delivered and each delivery has been demonstrated as performing. Therefore, the buyer can enjoy and use, say, 90% of the capability delivered. If the bespoke product cannot be sold elsewhere, the seller may feel they have the right to be compensated by the buyer for at least 90% of the contract price.

The answer to the above opposing views lies within the drafting of the contract, and often that drafting is away from the termination clause.

To understand the “effect” of termination one has to consider the following conditions, as an example:

Acceptance and Rejection

This area of the contract is important when considering termination as the buyer will have a defined period to reject the deliverables. At some point the buyer will lose the right to reject the goods delivered. The seller may want staged acceptance to protect itself from the entire contract being rejected at the completion of all of the deliverables. In the above example; upon completion of the design stage it would seem reasonable for the seller to have the design accepted and certified by the buyer ahead of the build and delivery of the goods. In certifying the design and having it accepted by the buyer the buyer may have waived its right to reject the design later in the programme when the goods delivered don’t perform. If the buyer can’t reject the design phase then it is unlikely the buyer can recover this element of payment made to the seller.

Intellectual Property

Again taking the above example, should the contract be terminated for default, where the seller has breached a material aspect of the contract during the delivery of the goods after the design has been certified, the buyer may seek to recover monies paid to the seller by not paying the seller for the delivered goods. However, having paid for the design of the goods the buyer may want an alternative seller to build and supply the goods using the design, which the buyer considers a sound design. The intellectual property conditions will determine who owns the design (typically the seller) and what user rights the buyer may have to the design. If the intellectual property conditions of the contract prohibit the buyer from using the design other than for very prohibitive purposes then this could work in the sellers favour as the buyer may be forced to negotiate a revised contract for delivering the goods with the seller rather than determine the contract for default. Alternatively the Seller may be happy to sell the design to the buyer for a price, to enable the buyer to find an alternative supplier to build and provide the product against the design.

Stage Payments (Progress Payments)

Should the contract be terminated in part, where the seller is able to always retain monies paid against progress payments as a result of the acceptance of staged deliveries, then the seller should make certain that the amount of each progress payment reflects the cost of the work so far completed. There is little point in having progress payments which do not represent the cost and effort of the work completed to the point at which the stage is completed. Should the buyer wish to have the majority of the contract payments towards the end of the delivery profile, despite the contract being paid in stages, the seller may choose to agree a "termination account" with the buyer to determine the true cost to the buyer as the contract progresses. This termination account will enable both the buyer and seller to understand what monies should be owed to whom in the event of termination.

"Should a contract be terminated for convenience by the buyer, the seller should not suffer due to the buyer's right to terminate for convenience"

Should a contract be terminated for convenience by the buyer, the seller should not suffer due to the buyer's right to terminate for convenience. The seller ought to take time and effort to set out in the contract what compensation they are entitled to should the contract be determined in this way. Typically, the phrase "cost incurred up to the point of termination" is often used as a way of protecting the seller's interests, but this might not be sufficient. It is good practice to also include loss of profits and loss of future business. Note: it is beneficial in this context to ensure that "cost" is defined, for example to include retrenchment costs (the additional overhead burden which may have been incurred to enable delivery of the contract).

6. Force Majeure

An “Event of Force Majeure” means an event beyond the control of the seller and the buyer, which prevents a party from complying with any of its obligations under this Contract, including but not limited to:

- act of God (such as, but not limited to, fires, explosions, earthquakes, drought, tidal waves and floods);
- war, hostilities (whether war be declared or not), invasion, act of foreign enemies, mobilisation, requisition, or embargo;
- rebellion, revolution, insurrection, or military or usurped power, or civil war;
- riot, commotion, strikes, go slows, lock outs or disorder, unless solely restricted to employees of the Supplier or of his Subcontractors; or
- acts or threats of terrorism.
- Events more specific to the scope of supply (such as closure of an airport)

Consequences of an Event of Force Majeure

Neither the buyer nor the seller are considered in breach of the Contract to the extent that performance of their respective obligations (excluding payment obligations) is prevented by an Event of Force Majeure that arises after the Effective Date of Contract.

If and to the extent that the seller is prevented from executing the obligations of the contract by the event of Force Majeure, while the seller is prevented the seller shall be relieved in providing its obligations of the contract but shall endeavor to continue to perform its obligations under the Contract so far as reasonably practicable and in accordance with “Good Operating Practices”.

Should the seller incur additional cost in continuing to perform the contract during the event of Force majeure, the seller shall be entitled to the amount of such cost only where the contract permits the recovery of such costs. Typically any additional cost agreed shall be without profit as the seller would have taken reasonable steps to mitigate the additional cost.

“Irrespective of any extension of time, if an Event of Force Majeure occurs and its effect continues for a period of days........either the buyer or the seller may give to the other, a notice of termination”

However if an event of Force Majeure results in a loss or damage to a facility or any other assets owned by the seller, which have not been or due to have been paid for by the buyer under the terms of the contract but required by the seller to perform the contract, then the seller shall rectify such loss or damage to the extent required by the buyer. However, the costs associated to the rectification of the seller owned assets shall rest with the seller (who may be insured).

If and to the extent that the seller suffers a delay during the Contract period as a result of the event of Force Majeure then it shall be entitled to an extension for the time for completion.

Should there be a core element within the contract (often associated to availability of services whether utilised or not), then it is important to recognise within the contract that the core element should continue to be paid for by the buyer.

It is normal to include a provision whereby either party is able to terminate the contract in the event of an extended Force Majeure event. Irrespective of any extension of time, if an Event of Force Majeure occurs and its effect continues for a period of days, for example 120 days, either the buyer or the seller may give to the other, a notice of termination. This termination (for Force Majeure) should take effect after an agreed period of time, such as 28 days from provision of Notice. If, at the end of the 28 day period, the effect of the Force Majeure continues, the Contract shall terminate.

After termination for Force majeure the provisions of the termination condition should be complied with to determine the correct termination account is agreed.

7. Dispute Resolution

Dispute resolution clauses are often left to be agreed at the end of contract negotiation or are dismissed as “boilerplate” and given standard wording without any thought as to the relevance of the clause to that particular contract/ agreement. Dispute resolution Clauses have implications for how any dispute is resolved and how the contractual rights and obligations are enforced, and are therefore important.

A Dispute resolution Clause should consider:

a. Is the dispute to be decided by a panel of arbitrators or by a judge?

b. Where will the case be heard? Asia, in Europe, or in another part of the world?

c. Will the dispute resolution method take months or years, and can it then be appealed?

d. Will it result in a judgment that can be easily enforced or something that will need further litigation before it can be translated into monetary value?

e. What language shall the dispute be heard in?

f. What law should apply to the dispute?

These questions are answered by looking at the dispute resolution clause in a contract. Litigators (in Court) turn to such clauses as the very first step in examining a dispute: these, together with the governing law clause, are the basic rules of engagement in any dispute and any contract deal maker must view dispute resolution clauses in this light when sitting down to negotiations.

The dispute resolution clause should be clearly drafted and not open to interpretation. Should the Dispute resolution clause not be clear and indeed open to interpretation because the clause has been poorly drafted, the parties (the seller and the buyer) could find themselves in a different forum to the one they thought they chose. This interpretation of the clause is as determined by the courts at the outset of formal dispute.

There is a difference between the governing law clause and the dispute resolution clause. The governing law clause deals with the law governing the agreement. The dispute resolution clause sets out the law in which the parties want any disputes arising under the agreement to be resolved. It is easy to confuse when both governing law and choice of law for disputes are dealt with in the same clause. As a matter of best practice they should be dealt with separately.

When drafting the dispute resolution clause, the first decision to make is which forum to choose for the resolution of any dispute arising under the agreement. Without wanting to over-simplify matters the decision boils down to either court litigation or arbitration.

Generally speaking, arbitration awards are easier to enforce than court judgments.

"In arbitration, the parties are generally free to agree a suitable process for resolving the dispute"

Most court trials are open to the public except for some exceptional circumstances (e.g. Official Secrets Act). What happens in the court - the notes taken - are publicly available (unless the court orders otherwise) and judgments are published in the public domain. In comparison, arbitration tribunal hearings are held in private and the documents produced and awards issued are generally confidential. Thus commercial secrets and "dirty linen" need not be exposed in public.

If a dispute is likely to be technical (not legally technical) or scientific, arbitration allows the parties to choose a tribunal with the relevant technical expertise. Depending on the nature and type of the dispute this can be of great help compared to a court where you may have a trial before a judge who doesn't possess the technical or scientific knowledge and has to have it explained at length, and cost, whereas more technical and scientific individuals would accept the explanation immediately.

It used to be said that arbitration was quicker than litigation. However, this has become less true over time with the increasing involvement of lawyers in arbitration together with the difficulties in convening a three-man tribunal. The process has now slowed down to a similar pace to that of the courts. Today it is difficult to make a comparison between the speed of arbitration tribunal and litigation as this will depend on many factors. It is relevant to note here though that if there is an appeal of a court judgment, arbitration will be significantly faster. In truth - the secret is to of course to try and resolve your dispute outside of an arbitration tribunal or a Court. Anything involving lawyers costs time, and why have one lawyer when you can have five?

In most jurisdictions, the circumstances in which an arbitrator's award can be appealed is very limited. However, most court judgments can be appealed easily, involving more delay, cost and continued concern that the dispute remains unresolved.

In international contracts it can be seen as a disadvantage in having a dispute referred to the "home" court (particularly if the buyer is a State entity). Arbitration enables the parties to refer their disputes to a neutral territory. In addition, the parties can ensure that the makeup of the tribunal, as well as those sitting as arbitrators, are neutral.

Arbitration is often seen as being cheaper than litigation but this is now rarely the case. The fact that parties are not required to pay for the judge's time and the hire of the court, mean that court litigation can be cheaper. However, there is a substantial amount of front loading of costs in court proceedings, in arbitration flexible and more cost efficient procedures can be agreed, but this is dependent on how the parties work together.

A final and enforceable outcome can, however, generally be achieved only by recourse to the courts or by arbitration. It is in both parties' interests to find a final and binding decision. Softer dispute resolution mechanisms, like mediation, have various benefits for appropriate cases, but a successful outcome depends, ultimately, on the goodwill and cooperation of the parties. Goodwill and cooperation are desirable in arbitration as well, but not necessary because the outcome does not depend on the parties reaching an agreement. Rather, the arbitral tribunal is empowered to make a final, binding award.

Dispute resolution and off contract agreements

Providers of payment and bond insurance as well as financial institutions providing CILOC (Confirmed Irrevocable Letter of Credit – see later in this guide) and ILOC (Irrevocable Letter of Credit – see later in this guide) payment mechanisms insist on arbitration clauses to be included in the 'supply contract' and for the arbitration proceedings to be in a different legal jurisdiction to that of the buyer.

Some Middle East countries, in particular, insist upon any arbitration being within their own country governed by their own law. Whilst this may not be a problem for securing a CILOC, it may be an issue for securing other letters of credit which require payment insurance. Should it not be possible to negotiate arbitration in a different country with the customer, then it may be possible to agree with the payment insurance providers that the exporter would be willing to enable the payment insurance company to have the exporter dispute handled by the International Chamber of Commerce (ICC), without the exporter or their customer in attendance, where the ICC ruling would be final. The exporter would have to cover the cost of all of the arbitration proceedings and this would be very costly.

It is highly unlikely that any claim for payment could be made from the payment insurance company (in part or whole) against an insurance policy without going through some form of arbitration proceedings outside of the customer's country.

British companies are likely to favour arbitration in the English language and the preferred arbitration bodies are:

- The London Court of International Arbitration (LCIA)
- International Chamber of Commerce Arbitration Service (Paris or Geneva)

8. Acceptance & Rejection

It is vitally important for the business to understand when its obligations and liabilities within the contract fall away, as well as understanding the point at which the business has fully met its obligations and has no further liability to the other party. There tends to be greater dependency on the acceptance and rejection criteria in international contracts than there may be in domestic contracts, due to other off contract agreements the exporter may have in place. Having said that - the Acceptance and Rejection condition is one of the most important conditions in any contract.

As always, there are two main principles of acceptance and rejection, as follows:

- Delivery acceptance and rejection and
- Performance acceptance and rejection.

Delivery Acceptance and Rejection

Acceptance of deliveries is exactly that: have the goods and/or services been delivered? Have the Goods and services been delivered on time (and therefore penalties for delay do not need to be made) and are the goods the right shape, size and type as ordered? If the answer is yes to these questions then the buyer can provide a certificate to the seller (where there is no automated certificate, such as an airway bill or a bill of lading) to state that the goods have indeed been delivered.

Upon the buyer inspecting the goods, if they are deemed to be damaged or not what was ordered then the goods/services can be rejected and therefore the goods are deemed not to be delivered and penalties for late deliveries might apply. This act of deeming the goods/services as not being delivered is known as “rejection” of the goods and services. It is important for the seller to place a timeframe upon the rejection period (typically 30 days) as delivery of the goods very often provides for the right of the seller to be paid.

It is fairly standard to state in the contract that a delivery certificate shall be issued upon physical delivery of the goods. Should the goods not be rejected within 30 days of delivery then the goods shall be deemed to have been delivered as they can no longer be rejected as having not been delivered. It is good practice to have payment 30 days from issuing of the invoice upon the receipt of the certificate of delivery. This way, should the goods be rejected and the deliveries be considered as not delivered the invoice can be suspended until the delivery has been appropriately made.

NB: The important point here is the act of securing delivery. When payment is against delivery, the seller can claim it has the right to be paid only when the goods are deemed as having absolutely been delivered. The goods may not work or not be fit for purpose however if the buyer does not reject the goods within the rejection period the seller is still entitled to be paid.

Performance Acceptance and Rejection

Similarly to Delivery acceptance and rejection there are two parts to this important aspect of the contract.

Performance acceptance for goods and services occurs after delivery acceptance. The goods and services need to have been delivered prior to their performance being judged.

Performance acceptance is specific to the scope of what is being supplied. Should multiple deliveries be made during the course of the contract it may be possible to trial and test the deliveries to ensure they meet the performance criteria. Sometimes however, only a certain level of individual delivery performance testing may be possible and a final, combined, trial and test period may be required for all of the deliveries together at the end of the contract.

Again, similarly to delivery acceptance and rejection, the rejection period should be specified as a period of time and if that time has passed then the goods could be deemed as having been accepted as meeting the performance criteria.

Should the performance of the goods/ services not meet the criteria and the goods are rejected the terms of the contract should determine the parties remedies, rights and obligations for dealing with this scenario, particularly if stage payments, milestone payments or progress payments form the remuneration conditions of the contract. (Please see payment in this section).

Implied law may play a part in performance rejection periods (such as the Sales of Goods Act).

It is important that the effect of both of the above are considered against other conditions when trading internationally, namely:

- Off-contract payment mechanisms
- Shipping
- Payment insurance
- Return of goods/replacement of goods (warranty period)
- Performance Bond
- In country advisors (agents)

Off-Contract payment mechanisms

Off-contract payment mechanisms are mainly relevant to international contracts. Payment to the exporter, other than payment in advance of work, is typically made against agreed contractual performance criteria such as physical deliverable under the contract or some other recognisable point of achieved performance.

Customer acceptance for performance and/or delivery is likely to occur after some form of customer approval. The customer may demonstrate their approval by requiring the exporter to go through an agreed acceptance process, as detailed within the contract. The agreed acceptance process may include the issue of a certificate to the exporter, by the customer, to confirm acceptance is deemed to have been completed.

When an off-contract payment mechanism is in place (such as a Confirmed Irrevocable Letter of Credit – CILOC – please see international payments within this guide), the acceptance criteria within the delivery contract should take into account the existence of the off-contract payment mechanism. The exporter's receiving bank will not release payment to the exporter until they are satisfied that all aspects of the contract, which enable the payment to become due, have been met. Where the acceptance criteria include some form of customer approval, the receiving bank will not release payment until the exporter can provide evidence of the customer approval to them.

It is therefore important, when off-contract payment mechanisms are in place, for the exporter to agree acceptance and rejection conditions in a way which enables the exporter to have as much control as possible of when the payment becomes due. For example, for training contracts, a time based acceptance payment mechanism could be agreed (e.g. completion of month 6, month 12,) which would trigger payments from the receiving bank following completion of the stages/milestones at points in time, rather requiring customer approvals.

Sometimes, time based acceptance conditions are agreed whereby the customer has a period of time to reject the stage/ milestone and offer certification for acceptance within a defined time period, such as 30 calendar days. In this scenario the exporter could draft the contract to state that if, upon completion of the stage/ milestone an acceptance certificate not provided to the exporter by the customer within 30 days (during which time the customer has the right to reject the stage/milestone) then the stage/milestone shall be deemed to have been accepted.

Acceptance/ rejection conditions drafted in a way which provides the exporter as much control over the acceptance criteria as possible enables the exporter to approach the receiving bank for payment, providing piece of mind when forecasting cash flow (and potentially revenue forecasting).

Should the receiving bank be a recognised bank with which the exporter has formulated a good working relationship the bank is likely to advise the exporter, during the customer negotiations, on how to formulate the terms and conditions of contract relating to payment, acceptance and other areas which may affect the letter of credit.

Often the contract effectivity period (please see Contract Effectivity within this guide) within the exporter's contract with the customer provides time to work through any contract drafting issues the receiving bank may have, should these issues have been unresolved with the bank prior to contract signature. The banks do recognise that international contracts are somewhat difficult to change during negotiation and often the banks may feel more comfortable with the terms of the contract once the contract and its scope of supply have been discussed and explained directly with the bank.

Shipping

When delivering physical goods to an international customer, there are likely be a number of points within the contract which class as acceptance. Typically, these acceptance points include: Site Acceptance Test (SAT), Factory Acceptance Test (FAT), arrival at dockside/port acceptance, delivery to customer's premises acceptance, as well as other forms of acceptance such as customer inspection, integration, trial and test, operation and completion of the warranty period.

The use of Incoterms (International Commercial Terms) is a tried and trusted methodology for defining points of acceptance and rejection up to the point of completing deliveries. (Incoterms rules are published by the International Chamber of Commerce and the current version is Incoterms 2010, which came into force in January 2011. Please see the section on Incoterms for more detail). Therefore, when an international contract has physical delivery of goods, Incoterms should be used wherever possible. The Incoterms clearly define; who is liable for the goods during delivery, who has title and risk of the goods and when title and risk may pass from one party to another.

Incoterms acceptance points are therefore a perfect vehicle for attaching payment milestones to for the purposes of off contract payment mechanisms (see above). The Incoterms acceptance points often generate certification (such as an air waybill) which clearly demonstrates the completion of a delivery stage enabling the exporter to unequivocally demonstrate to the bank that payment is due without having to wait for customer approval.

Any other specific acceptance and rejection criteria within the contract, associated to the delivery of goods and services, should be drafted in such a way as to not conflict with the Incoterm.

Warranty periods (please see warranty below) typically start from the completion of a point of delivery, but this is not always the case. It is important, therefore, that the exporter understands how the relevant incoterm works when drafting a warranty condition.

Payment Insurance

Should the exporter insure their contract with the customer for non-payment (please see payment insurance), it is important to consider the effect of any acceptance/ rejection condition upon the exporter's ability to invoke the guarantee with their insurance company. The exporter will not be able to invoke the guarantee of payment from the insurance company unless the exporter has the right to payment from the customer. The exporter has to satisfy itself that payment is due in order to make a claim from the insurance company.

The exporter's right to claim for payment from its payment insurance will be dependent upon a number of additional factors, not least the customer acceptance criteria and the customers' ability to reject the exporter's delivery performance either in whole or in part, during the course of the contract and at the completion of the contract. The type and level of non-payment insurance procured by the exporter should inform the composition of the acceptance and payment criteria of the exporters' contract with their customer.

Whatever is proposed or negotiated by the exporter, it is valuable to have a good understanding of the type and level of non-payment insurance otherwise there may be a danger that the non-payment insurance cover shall not work efficiently with the exporters' contract.

Often businesses do not recognise revenue ahead of receiving cash for an export contract unless the contract is insured or provided for by a CILOC. Given the cost of non-payment insurance, the excess threshold and the cover provided (which may be only up-to 85% of the contract value) there may be limited value in having non-payment insurance other than to comfort the shareholders that revenue deserves to be recognised.

Return of Goods/Replacement of Goods (Warranty period)

Where the contract calls for the provision of goods and services overseas, where the contract is not governed by English law, it is wise to remember the UK Sales of Goods Act will not apply. In this circumstance, it would be sensible to draft a condition within the contract which expresses:

- The start of a warranty period
- The term of the warranty period
- The terms of the warranty condition (e.g. repair, replace, and extension of warranty due to repair and or replace)

Whatever is drafted within the contract for warranty it is best to have customer acceptance of the goods and services granted during the delivery process as early as possible, with a limited period to reject the goods when physical deliveries are being made. Incoterms again serve as a good set of delivery terms which tie the start of warranty for the delivery of physical goods (e.g. ex-works for goods).

Performance Bond

A performance bond (please see performance bonds within this guide) can be drawn upon by the customer during the performance of the contract. It is likely the customer shall be able to draw on the performance bond for some period after the completion of the delivery of the contract to cover a period of customer warranty. It is therefore important to understand when the performance bond falls away in line with the acceptance criteria of the contract and exposure under the bond ceases. The exporter is able to cancel the bond only when the actual point within the contract has been reached which enables the bond to be cancelled. Care should be taken to express exactly when the exporter can cancel the bond through the issuing bank. Should the expiration of the bond term be open to interpretation, then the issuing bank will not close down the bond.

If the performance bond has been insured for unfair calling, then again it is important to understand when the bond liability falls away so as to advise the insurance company, and the exporter can stop paying the premium against the bond for unfair calling.

A specific and detailed warranty condition helps the exporter in having clarity within the contract to help in the closure of bonds and guarantees.

In-country Advisors (agents)

Tying in acceptance of the advisor performance with the exporter alongside the performance of the exporters' contract with the customer would be beneficial for the purposes of measuring the advisors performance. The advisor will almost certainly be remunerated in a paid when paid fashion which will enable a level of financial governance of his performance.

A Contract Effective condition should be included within all international contracts as having this condition provides both parties to the contract a defined period of time to set up and arrange Bonds, off contract payment agreements, Visas, Export licences and Advance payments prior to either party having any performance or delivery obligations. A contract effective condition is not so important for domestic contracts.

During the Contract Effective period, the terms of the contract are NOT in force.

An example of a typical contract effective condition is written as follows, to include a number of conditions subsequent to signature (or conditions preceding effectivity). Depending upon the terms of the contract, not all of the conditions subsequent to signature, as listed below, may be required.

Contract Effectivity

"The Contract will become effective upon completion of all of the following:

1. Signature of Contract by the Buyer and the Exporter
2. A Confirmed Irrevocable Letter of Credit (CILOC) between the Buyer and the Exporter
3. An Advance Payment of 30% of the Contract value by the Buyer to the Exporter.
4. The granting of an Export Licence from the Exporter's Government
5. The Issuing of Visas to the Exporter's named personnel by the Buyer's Government
6. The Issuing of the Advance Payment Bond by the Exporter's Bank
7. The Issuing of a Performance Bond by the Exporter's Bank
8. The return of the Exporter's Tender Bond

The conditions of Contract will come into force only upon contract effectivity. Should the conditions subsequent to signature 2) through to 8) not be met within 120 days from contract signature the contract will not come into force. Any extension of time to the 120 days shall be agreed between the Parties in writing."

Subcontracts

All subcontracts should reflect the Contract Effective condition within the prime to sub contract. A validity period, from the subcontractors, should reflect the period of time associated to the Contract Effective condition.

Price

The prime contractor should reserve the right to inflate the agreed contracted price should the contract effective condition be extended post the agreed period. Should this not be possible then a risk provision for delay of contract effectivity should be considered.

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10. Intellectual Property

Introduction

Wikipedia offers a fairly succinct definition of IP:

"Intellectual property (IP) refers to the ownership of an idea or design by the person who came up with it. It is a term used in property law. It gives a person certain exclusive rights to a distinct type of creative design, meaning that nobody else can copy or reuse that creation without the owner's permission. It can be applied to musical, literary and artistic works, discoveries and inventions. Common types of intellectual property rights include copyrights, trademarks, patents, industrial design rights and trade secrets. Intellectual Property (IP) refers to the protection of creations of the mind which have commercial value".

With the above definition in mind active management of IP, by the creator and owners of the IP, can add unique dimensions to service and other commercial offers, enhancing the baseline for negotiation, adding to market appeal and making a business more attractive to partners. Steps taken in the design and structuring of business proposals will often be essential to realising both the immediate, and enduring, value from IP.

Sometimes IP terminology can be difficult to fathom. Phrases such as "background Intellectual Property" and "foreground Intellectual property" as well as "jointly owned Intellectual Property" are often heard during the development of an offer or during negotiations surrounding IP. These phrases are used to help the deal makers categorise IP to enable a better understanding of who owns what and which party may have IP rights in others work. There are some definitions to these phrases in the following tables.

Figure 1: IP terminology

Background IP	Often a term referring to IP that exists before the contract start date and/or created by a party outside of the contract. It can also be known as "Pre-Existing" IP. Note also any relevant contract definition of "Pre Existing". Important as having strong Background IP enables creation of value propositions, and a platform to compete for business. Companies should seek to Protect its background IP.
Foreground IP	Often a term referring to IP that is created under the contract. Note also any relevant contract definition. Seek to secure rights to Foreground IP to enable future growth.
Intellectual Property (IP)	A wide range of intangible assets that enable business performance. Care is needed to ensure that, where it is defined in the contract, the definition suits our needs. Once secured as an asset, the business can choose whether to exploit and/or protect it.
Intellectual Property Rights (IPR)	The rights and protection that stem from creating, owning, or obtaining a licence relating to IP.
Jointly owned Foreground	Two or more parties own the Foreground IP. More often than not, to hold IPR jointly is not appropriate and can create more problems than it solves. There are however, some circumstances where jointly held IPR makes commercial sense. In these circumstances, to avoid pitfalls and ambiguity, the joint owners should agree a collaboration agreement to express how the ownership and use of the Foreground IP will be managed and protected. E.g. agree provisions where one party can only act on/sub-licence the Foreground IP with permission of the other party; cross-licencing to enable future use. In general, jointly owned foreground requires significant effort in licencing to enable onward exploitation. This should take advantage of a strong bargaining position i.e. before any concepts, IP or know-how is released to the partner.

Licence	The document an IP owner uses to grant another person permission to use IP whilst retaining ownership of that IP. A licence can set out restrictions and conditions to limit and/or control the licensee's use.
Licences - Exclusive Licence	The ability to do what is set out in the licence to the exclusion of all others, including the owner of the IP. The person granting the licence cannot: 1) grant further licences; or 2) do what is set out in the licence. Typically, only the person with the licence can exploit the IP. This type of licence gives the recipient the widest rights.
Licences - Non-Exclusive Licence	Unlike an Exclusive licence, the person granting the licence can: 1) grant further licences; or 2) do what is set out in the licence. Typically, many people can exploit the IP. This type of licence gives the recipient the narrowest rights.
Licences - Sole Licence	The person granting the licence cannot grant further licences but can do what is set out in the licence. Typically, the person granting the licence and the recipient can exploit the IP. Unlike exclusive and non-exclusive licences it is important to set out what is meant by "sole" in the relevant contract, particularly for US transactions.
Object Code	Means the platform dependent machine code or platform independent intermediate code/byte code which has been created through compilation of the Source Code and which is ready to execute or interpret on the target platform. (e.g. Executable files or Java bytecode).
Source Code	A computer programme written in its original programming language. In source code form a program is intelligible to a suitably-trained human being. To be intelligible to a machine it is translated (compiled) into object code.

General Scope of IP

IP is often referred to in terms of intangible assets owned by a company which can be legally protected through formal registration under a Patent, Design or Trade Mark.

This is a relatively narrow, legal description of IP and overlooks IP which cannot be registered. Unregistered IP is also valuable to a business and is protected and exploited through careful control and managed licensing arrangements.

It is presented in two distinct parts:

1. Registrable IP
2. Broader IP, where design of solutions and sensible treatment yields dividends

Both parts are fundamental to creating a strong IP asset base.

Registrable IP

Types of Registrable IP

- Registered Trade Marks(®)
- Patents
- Registered Designs

There are implications of choosing to pursue registration of IP. Before a decision is made, registration costs and enforcement need to be considered.

Costs

Registration costs can be significant, and they continue past initial registration. Where there is a cost of registering IPR, a business case is needed to justify the cost of protection of that IP. If future exploitation is a possibility, that business case shall include:

- the whole-life cost of registration;
- the territories where protection is sought;
- the desired benefits, including best and worst case outcomes; and
- a plan for actively securing the benefits over the life of the registration.

Case Study 1. Patents

In this example, a business filed a patent in October 2000 for an algorithm. While undoubtedly extremely clever, no commercial market was readily apparent.

In 2009, however, a partner of the patent holder requested a licence to the algorithm. According to due diligence at the time, the algorithm was useful in a limited number of relatively outdated systems. These were mainly sold at low value to third-world users. As the sets were relatively inexpensive they would not support a large licence fee. The licence was therefore worth less than £1000 per year, diminishing. Patent costs were £35k set up and then £5k every five years for renewals across a range of countries.

Lessons learned:

- The idea or technology may be clever, but is it valuable to another user and, if yes, how valuable?
- Before embarking on protection develop a business case investigate the costs and setting out the revenue potential
- If something is to be protected, a marketing strategy should be created at the same time; and
- Ensure exploitation fits within the overall commercial strategy.

Enforcement

If the IP is copied or infringed, will that make a difference to the business case? If yes, a portion of royalty or revenue should be set aside to fund enforcement action, which can be very expensive.

Unregistered IP

Not all IP is registrable. Unregistered IP creates weaker rights, but when managed effectively provides valuable commercial opportunities.

- Copyright. Copyright arises automatically when a work that qualifies for protection is created – it is the expression of the idea that is protected, not the idea itself. This is the right to copy of the whole, or a substantial part of, for example, source code, or a report. While this is valid protection, a common problem (particularly with code) is that it is difficult to establish copying. This can be restricted in contract by stating that the restrictions extend to copying the code, and/or the functionality generated by the code. Accurate wording in the contract is very important, however, as the functionality can only be protected through the law of contract and not through the law of IP – see commercial / legal.

- Copyright also belongs to the creator, unless there is a written contract stating otherwise. Who actually pays is irrelevant. This can have a major impact on commercialisation. Again, accurate wording in the relevant contracts is very important.
- Unregistered Designs (3D only). Limited protection to 3D designs.
- Trade Marks. Marked TM rather than ® and of less effect, but acts as a deterrent to those who would otherwise rip-off the mark. Note that relying on a unregistered Trade Mark is not good protection for a new product that relies (or will rely) on brand or goodwill – this should be protected by a Registered Mark.
- Open Source. Open source software is now used in many applications. It also comes with requirements and conditions. As with any third-party input, proper due diligence is required to ensure compliance with the conditions and the impact on commercial exploitation.

Information

Any business is underpinned by a wealth of data, information, processes and procedures. All of these play a role in delivering revenue:

Confidential Information

The increasing focus on cyber security reinforces the importance of appropriate treatment of confidential information. Standard disclaimer wording and the Protective Marking Scheme as set out in annexes 6 and 8 also support protection of confidential information.

Trade Secrets

A trade secret is confidential information, including key business concepts and processes, that is protected by secrecy. For novel concepts which might normally be protected via IP registration, consider developing and protecting it as a trade secret rather than registering the IP. Confidentiality agreements can be used to help protect secrecy – see Annex 9. There are other practical ways of protecting trade secrets which should be considered for example limiting the amount of internal people who are aware of the secret; or creating locked or encrypted password protected areas to contain the secret.

The advantage of using a trade secret is that registration incurs considerable costs. Further, the registration process means that the concept must be made public, and registration is only as good as the appetite to maintain and defend the IP.

Case Study 2 – Simulation tools as a trade secret

The example company has some key simulation tools. This is valuable IP and it is closely guarded, remaining within the business, and used to support a service. Arguably, these tools are trade secrets, and the names become a "brand" for the IP. The IP is protected by controlling release and maintaining confidentiality, through the use of confidentiality agreements to ensure that all parties know that the IP is secret. Customers place a value on being able to benefit from the tools, to maintain the revenue it makes sense to retain control over their release.

Know How

This is the confidential information, processes and procedures that underpin a company's business performance. Know how could be regarded as a trade secret as in Case study 3. Know how is sometimes tied to particular members of staff or teams which creates its own issues.

The Design of solutions and services

The architecture of solutions and services with respect to how IP is positioned, used and protected can have a significant impact on the immediate and future value that a business is able to generate.

Internal Data

Solutions built on our unique internal data can provide a valuable differentiator against competing products. Increasing the amount of data available for analysis could provide the basis for future services.

Exclusive rights to data/IP in the solution or service

Securing unique access to data, or a unique combination of data, provides the basis for compelling future services.

Controlling a layer of the value chain – a ransom strip

It is not always necessary to own the end-to-end value chain; concentrating on a strong offer in one layer can secure durable revenue.

Leveraging the supply chain

Use partnerships or relationships with the supply chain to create unique offers.

Customer Data

Capturing customer data, with appropriate rights, enables creation of second-order value – e.g. benchmarking or other multi-source analysis.

Third Party IP and Data

This represents both an opportunity (see exclusive rights above) and a threat – It is fundamental to secure sufficient rights from the third party to enable commercial intent.

The content we release to others

Creating competitors

Be wary of putting the whole answer into the public domain. When engaging a subcontractor, and designing the relationship with that subcontractor, be clear on the difference between:

- Buying a product from the subcontractor (likely to increase their background IP); or
- Paying for labour from them to create a product where the buyer owns the IP.

Consultancy

In any consultancy output, be wary of releasing background IP and know-how to the extent that it reduces the ability to exploit these assets in future.

Reports

Reports are an opportunity to:

- grow a problem in the mind of a potential customer; and
- highlight potential solutions.

Once again, consider how much know-how is released. Precedent report wording is included at Annex 6.

Outsourced Services

IP can generate savings over an outsourcing term. The tools used should be protected, particularly in the outsourcing contract, so that the business model is scalable and can be replicated elsewhere.

Detail on Registered IP

Registered rights. These rights are granted on application to an official body, such as the UK Intellectual Property Office. Registered rights are monopoly rights. This means that, once registered, the owner can stop others from using the right without permission. They include:

- patents;
- trademarks; and
- registered designs.

Unregistered rights. These arise automatically, give protection against copying or using the right, and include:

- copyright;
- unregistered trademarks;
- unregistered design rights; and
- confidential information.

Patents

Patents provide inventors with a legally protectable monopoly over their inventions and protect new and inventive technical features of products and processes. They last for a limited period (20 years in most countries).

To qualify for patent protection, an invention must:

- be new;
- involve an inventive step;
- be capable of industrial application; and
- not be specifically excluded from protection (for example, methods of doing business).

To obtain a patent, it is necessary to file an application for one, normally with the Patent Office of the country where the inventor works.

Patents can provide a high level of protection and are essential for some industries (for example, pharmaceuticals, where years of research and development are necessary to commercialise a new product).

However, patents are expensive to obtain and maintain. They also involve public disclosure of technology, which could enable a competitor to develop a competing product without infringing the patent.

Trade Marks

A trade mark is a sign or symbol used by a trader to distinguish its products or services from those of other traders. For example:

- a brand name;
- a company logo; or
- packaging.

A trade mark can also consist of the shapes of products or their packaging (for example, the Coca Cola bottle), and colours associated with a trading style (such as the Cadbury's purple colour for chocolate), as well as sounds, smells and slogans. However, it is more difficult to register these marks.

Trade mark owners can apply for a UK or a Community trade mark (CTM). (There is also a system for international trade mark registration). A UK-registered trade mark is only enforceable in the UK, while a CTM is enforceable throughout the EU. Both registrations last for ten years, but are renewable for further ten-year periods.

To be registrable, a trade mark must be:

- capable of being represented graphically;
- distinctive;
- capable of distinguishing goods or services; and
- not excluded by law.

Goodwill in an unregistered trade mark can be protected in an action for passing off. However, an action for passing off can be both difficult to prove and expensive. It requires:

- proof of a reputation in the mark;
- a misrepresentation that could mislead the public; and
- proof of damage (for example, financial loss or damage to goodwill).

Registered designs

A registered design provides a legal monopoly. As with registered trademarks, design owners can apply for a UK registered design or a Community Registered Design. A registered design must be:

- novel;
- of individual character; and
- not excluded by law.

Protection lasts a maximum of 25 years, with registrations renewed every five years. Design registration is relatively low-cost and is particularly appropriate for industries where design is instrumental in selling the product (for example, fashion).

11. Payment

The right for the seller to be paid is one of the most important aspects of any agreement for the seller, however, it is also in the buyers best interest to know at what point payment, becomes due to the seller. Clarity around payment has to be uppermost in the deal makers minds when constructing a commercial contract.

It is most important for the buyer and the seller to clearly outlay within the contract at what point the seller has the right to claim for payment from the buyer. Once this important aspect has been clearly determined, the contract should then clearly express what rights both the buyer and the seller have, working from the point at which the buyer has to make payment to the seller and the seller has the right to receive payment from the buyer. For ease we could refer to this point (the right for the seller to claim payment) as point A.

From point A, the seller can calculate: any Foreign Exchange liabilities, any costs it is entitled to receive for late payment or non-payment from the buyer and its cash forecasting as well as a measure of the value of the goods and services so far delivered against the amounts paid. The buyer, on the other hand, can calculate from point A; its budgetary outlay (spend) and the value profile (the amount of money paid verses the quantity of goods and services received at the time of payment) as well as the amount of money it has at risk should the goods and services not ultimately perform.

Both the buyer and seller may formulate termination conditions and termination accounts from point (s) A.

Depending on the scope of delivery of the contract, it may be possible through the drafting of the contract, to agree to progress payments whereby the payment made by the buyer to the seller is settlement for work completed by the seller up to the point of the milestone or stage achieved within the contract. Using this payment methodology, the seller is entitled to payment upon the customer acceptance criteria being met and the seller is entitled to keep all payments due or made by the customer irrespective of overall (final) performance of the goods and services associated to the contract. Drafting a contract in this way would make the payment insurance more worthwhile to the seller (more likely when acting as an exporter) and it would be easier (and quicker) for the exporter to make an insurance claim for late or non-payment.

Interim contract payments (where the final contract payment represents the retention of the overall and total payment) may have been agreed between the seller and the buyer. Interim payments, similar to progress payments, occur at specific points within the contract. Should an interim payment be withheld or not paid by the customer to the exporter when due (provided the customer acceptance criteria has been met), a claim for non-payment by the seller (when acting as an exporter) to their payment insurance company may be possible. However, if the seller enters into a dispute with their buyer regarding overall performance of the contract, the seller may not be entitled to keep the amounts that fall due to the seller. Contracts with interim payment conditions often have to go through a process of arbitration prior to the insurance company paying the seller for payments not made which are due.

A best practise approach to payment (in terms of keeping it simple) would be to follow, as closely as possible, the following principles:

Payment, other than a payment in advance of the contract deliveries, could become due upon the delivery of the Goods and Services - once the goods/services have been delivered (i.e. sighted as delivered or proved to have been delivered - such as an airway bill) then payment becomes due to the seller by the buyer. If the goods are rejected when delivered after inspection (i.e. incorrect or damaged, in terms of Goods, or poorly delivered in terms of Services) the buyer will reject the goods and services (within a limited rejection period, say 15 days), then payment will no longer be due and the seller will no longer have the right to claim for payment.

Advance Payment

An advance payment is a payment made by the buyer to the seller in advance of the contract deliveries being made by the seller. In international contracts an advance payment is more often than not made ahead of the contract being made effective and is often considered as one of the mechanisms which makes the contract effective. Buyers, when agreeing to an advance payment, often require an advance payment bond. This bond ensures that the advance payment can be recovered should the contract not become effective or the seller becomes in default of its obligations, when under contract, and as a result of the default the contract is terminated with the buyer recovering monies paid to the seller. Often the advance payment bond will reduce in value as payments are made against the contract.

Should a 20% of contract price advance payment be agreed and a bond provided for, then each payment milestone made thereafter will be discounted by 20% of the milestone value to recognise the 20% advance payment. The bond value of 20% of the contract price will then reduce by 20% of the associated milestone, upon the milestone being paid.

An advance payment is not a “first” payment. A first payment is a payment made, possibly ahead of deliveries being made to the buyer by the seller, but paid against an invoice and after the contract is effective. First payments are rarely, if ever, bonded.

Payment Retention

A payment retention is an un-bonded reverse of an advance payment. The buyer may insist on an amount of money (say 10% of the contract price) to be retained until a period of time after the contract deliveries have completed. Buyers often insist on a payment retention to ensure that the seller remains committed to the performance of the goods and services being delivered.

It has been known in some instances, particularly when contracting into some international regions, that the payment retention is never paid back to the seller by the buyer and the seller may accept that the cost of recovering the retained payment will be greater than the value of the retained payment itself. The seller may then decide to write off the loss. These situations are not common and are less likely when the buyer is one who requires future contracts with the seller.

Other than the financial loss the seller may incur when a retained payment is not made, the seller has to be aware of the Anti-Bribery and Corruption laws it abides to as not making a determined effort to recover monies not paid for services delivered could raise questions surrounding the agreement made between the buyer and the seller.

12. Boilerplate terms

Counterparts

This clause simply clarifies that separate copies of the same agreement (contract) which is a copy of the original may be executed by different parties and each copy will be considered to be an original.

No Partnership

A “no partnership” clause seeks to clarify what relationship the parties have to each other in terms of them working together as signed parties to the commercial contract or agreement. Specifically, this clause states that the parties are not forming a partnership or acting as agents to each other, and also that neither party is entering the agreement as the agent of another undisclosed party. It is important to state that there is no intention of inadvertently forming any legal relationship, therefore the laws associated to forming that legal relationship (e.g. Joint and several liability, and laws associated to Agents) do not apply.

Non-Solicitation

This is a clause which prevents one party to the contract from actively soliciting employees from the other party to the contract (offering them employment). It would be disadvantageous to one party had they entered into a contractual relationship in order to perform their obligations to the other party only to be inhibited from being able to perform those obligations because the other party has employed their staff.

Notices

Notices simply means the process one party has to adopt in order to formally advise another party. Should a notice of delay be required or a notice to stop work be required to be issued it is important that the process of issuing Notices is followed in order to make sure the notice is sent in the right format to the correct individual within the correct timeframe. Having a defined approach reduces confusion and the likelihood of blame and ultimately dispute. Failing to follow the Notices procedure could be deemed as a breach of contract.

Survivability

A survival clause specifies which clauses in a contract will survive termination, and is often included in the clause dealing with the consequences of termination. If you terminate a contract without a survival clause it may be difficult to proceed to Dispute Resolution as defined within the now terminated contract. Again, if a contract is terminated it may be prudent to allow the confidentiality provisions within the contract to survive the termination to protect the interested parties.

Severance

This is a clause that seeks to ensure that an agreement will continue to be enforceable even if one of its terms is found to be illegal, invalid or unenforceable.

Third Party Rights

This is a clause, specific to English Law, which excludes the rights of third parties to enforce contract terms generally and under the Contracts (Rights of Third Parties) Act 1999. There is no reason why this condition cannot be included in International Contract although its reference to the Act would have to be removed.

Entire Agreement

This is a clause that seeks to prevent statements or representations that are not set out in a written agreement from having contractual force - influencing the written agreement made or helping in its determination. It also usually seeks to restrict liability for claims based on misrepresentation.

Waiver

This clause, again specific to English law but adaptable to International Contracting, deals with the situation where a party to the contract, who has the right to enforce or seek rectification under the contract from the other party but chooses not to do so immediately does not waiver their right to enforce the contract for that rectification at a later time.

13. Contract Pricing

Introduction

It has been often said that the first rule of commercial deal making is to “chase the money”. Should this be the case then perhaps the second rule should be to get as much value out of the “money” as possible.

The construct of some contracts has become more sophisticated; far more so than they were a few decades ago as both the buyer and the seller seek ways to meet their needs through constructing quantifiable deals which benefit more wide ranging parameters other than delivery and payment. Getting as much value from the “money” has become more of a commercial art, as value comes from not just the payment aspect of the contract but from the knowledge gained whilst negotiating and delivering the deal. This knowledge may include the development of Intellectual Property, the relationship with the customer, the development of future opportunity pipelines, learning the culture of the environment as well as meeting opportunities to diversify and lead the market. A carefully crafted commercial deal maximises the chance of realising the true value available.

It used to be said that the first Rule of Government Procurement was “why have one when you can have two for twice the price” however this is becoming less true as the Governments around the world are becoming much more commercially savvy when they measure value for money. The improved and more sophisticated Government contracting methodologies enable the smart seller to shape a deal from which they can maximise value.

A more sophisticated deal can be supported through the construct of the pricing methodology. Below is a list of different types of commercial pricing.

Firm-Fixed Prices

Firm Fixed Prices (often referred to as “firm prices”) are not normally subject to any adjustment unless there is a change to the contract such as additional scope. Such prices are usually capable of acceptance by the customer, and any submission to the customer should make clear whether they are or are not an offer capable of acceptance.

Firm fixed price contracts are usually negotiated where definitive specifications/ definitions of requirements are available, and where costs and risks can be estimated with reasonable accuracy. A firm fixed price contract places maximum risk on the seller as the seller will have to take full responsibility for unforeseen cost escalations and full responsibility for any and all increases to costs or performance potentially resulting in a loss making contract. Conversely, should the costs on the contract reduce and the performance criteria become less onerous through time then the return to the business can be realised by improved profitability*. A firm fixed price contract therefore provides for a strong incentive to control costs and perform the contract efficiently.

*Note. Under UK Government contracting rules (as well as some overseas Government contracting rules) an equality of information (EOI) statement is required from the seller at the time of signing a firm fixed price contract where assertions about the accuracy of the price estimations are made by the seller. Should exceptional profits be made under a firm price contract by the seller, the Government may have the right to audit the contract (post cost) and recover exceptional profits. An EOI is more likely in a Government single source procurement or a large competitive procurement where the seller is down selected post the competitive process and engages in a value for money negotiation with the Government.

Fixed Prices

Fixed prices are similar to Firm Fixed prices as the cost base of the contract (labour and materials) is firm and cannot be varied, however the fixed portion of the contract (the recoveries – such as inflation and other economic factors (i.e. the market price of materials such as aluminium) may be subject to a variation provision sometimes referred to as "economic price adjustment". This economic price adjustment is often calculated through the use of off contract financial indices such as the Retail Price Index (RPI) or Consumer Prices Index (CPI). Whilst movements will normally be upward and will result in price increases, they can also potentially be downward unless explicitly excluded in the contract. Additionally, a percentage of the variable fixed element of the price may be calculated as a firm price: typically 10% of the variable element is contracted as part of the firm price.

Fixed prices are particularly useful in longer term contracts where inflationary changes to costs become increasingly hard to predict. They can thus result in more competitive pricing to customers as a portion of the price attracts less of a risk provision as we do not have to cost in the risk of inflationary pressures being higher than they actually end up being.

Firm Prices

Firm Prices usually have the same meaning as Firm Fixed prices. As the term is used differently in some industries and countries, it is always prudent to spell out under what circumstances the price may be varied, in particular through economic price adjustment formulae.

ROM or Rough Order of Magnitude Prices

ROMs are prices which are given to customers as approximate, “ball park” figures. They are often used to help customers set future budgets, or else when a quotation is requested in shorter timescales than would enable us to complete a full costing exercise and put this through our internal governance. As a result, these prices may be inaccurate and should not be offers capable of acceptance by the customer. Some customers will treat ROM quotations as worst case scenario prices and will assume that there has been included a generous risk provisions, against the ROM, to protect against inaccurate cost assumptions. For this reason, it is good practice to include a generous ROM margin (usually at least 10%) over and above the cost and price estimate which includes full recoveries and a level of margin.

Great care should be exercised in providing verbal ROM prices as they can still set an expectation which can be held against us and furthermore there is a risk of differing recollections of the ROM offer precisely because it has not been properly recorded, in other words, given in writing. A verbal ROM should be referred to as “Budgetary” or “Indicative”.

Budgetary or Indicative Prices

These prices are effectively the same as ROM prices but are more often than not provided verbally.

Cost Plus Prices

These are prices based on actual costs incurred by the seller when under contract with the buyer with the addition of an agreed percentage mark-up for profit (which is sometimes referred to as a “fee”) Cost Plus prices may be appropriate when the solution or full requirements are not fully defined at contract award with the solution and requirement being defined during the performance of the contract.

Cost Plus Contracts are common to large value procurements and long term contracts such as the design, realisation, build and support contracts.

Target Cost Incentive Fee Priced Contracts

This pricing arrangement is where the seller’s profit increases when actual costs are below the target cost and the seller’s profit decreases when the target cost is exceeded.

Not to Exceed (NTE) or Maximum Prices

These are prices which allow the seller to be paid actual costs incurred plus a fee subject to a ceiling price which is sometimes referred to as the buyer's limitation of liability. Any cost overruns by the seller are at the seller's risk and cannot be passed on to the customer.

Gainshare

This is an arrangement under which savings made by the seller during the performance of the contract, against an agreed cost baseline, are shared in some way with the customer. The respective shares of gainshare savings will be the subject of negotiation and this requires specialist consideration by the Commercial and Finance teams. Gainshare arrangements require a degree of cost transparency to be given to the customer so that the level of savings achieved can be verified.

Service Incentives

These are a type of bonus where the customer commits to paying the seller a sum of money in return for achieving specified performance targets described by Key Performance Indicators (KPIs), or charging penalties where targets are not met, usually be calculated as a percentage of the contract price.

Rate Cards/Man Day Rates

These are appropriate for use in small, discrete time-based jobs such as consultancy support.

List Prices

These relate to standardised, repeatable packages of work such as training courses or potentially IP licences. These prices will be valid for a pre-determined period of time and made available to any customers who wish to avail themselves of them.

Bonus Fee

These arrangements can apply where the seller achieves a particular performance measure, KPI target or milestone which is of particular value to the customer. Bonuses can be calculated using various different methodologies including a fixed sum of money or a share of some value generated for the customer.

14. Limitation of Liability

The phrases “Unlimited Liability” and “Limitation of Liability” seem to be something one hears more and more during business discussions these days. This may be because we are becoming a more litigious as a society with commercial disputes turning to tribunals or courts more often than they used to - or it may be because more companies and businesses are owned by large more risk adverse corporate shareholders rather than individuals, as used to be the case. Perhaps it is a combination of the two.

For whatever reason, it is becoming increasingly important to have an understanding of what constitutes an unlimited liability, and how and if a liability may be capped or mitigated.

Firstly, what is a liability? The Oxford English Dictionary helpfully describes a liability as “The condition of being liable or answerable by law” with the definition of liable being “Bound or obliged by law or equity; bound by law”. Gently placing the Oxford Dictionary to one side, it’s probably safe to say that having a liability means that you are accountable and have a responsibility under the law. The extent of that liability depends upon the law under which you are working.

In English law there exist liabilities which can be “limited” (by their nature* and under law) and liabilities which are “unlimited”, meaning in some circumstances you are unable to cap your financial limit, should a liability be realised.

Remaining with English law: an unlimited Liability would be a liability for injury or death which cannot be capped. The party responsible for the person suffering injury or death therefore bears an unlimited liability to a claim for damages (and compensation). This claim may be settled through the courts. The extent of any financial claim for damages and compensation for the injury and death cannot be pre-limited through discussion and negotiation to a capped financial figure either under the contract to which the person was working or in any other agreement. If a contract, governed by English law, expresses a financial cap for death and injury, the courts will ignore it.

As you will imagine, businesses do not like having liabilities which cannot be financially capped in an agreement as permitted by law. Therefore, in such circumstances, businesses (or contracting entities) have insurance, such as personal liability insurance, to protect themselves against claims.

Some liabilities can be capped under law. Direct loss and indirect loss (Consequential losses and special losses) can have an agreed financial cap, but this financial cap has to be expressed within an agreement, such as a contract between two or more parties. The agreement would state that losses (both direct and indirect) are financially capped to the value of the contract, or a percentage of the contract value.

*It is important to recognise that "direct loss" and "Indirect loss" are, by their very nature, self-limiting. To determine a direct loss under law, or under the terms of a contract, the loss has to be reasonable and demonstrable. A contract may specify what constitutes direct loss (e.g. loss of income) the extent of which is determined by the parties, up to a financial cap (if one has been agreed). Defining "direct loss" and "Indirect loss" under the terms of any contract limits what can be claimed - but it is always prudent to express in the contract a financial cap of what can be claimed.

Occasionally you may hear a person, often an unhappy person, claiming that they are going to sue you. They may have good reason to sue you, but, under the laws of England, they have to ascertain (and mitigate) their loss in order to make a successful claim against you. As you may not have had a contract with the unhappy person, the liability you may have would not have been financially capped but it is financially limited by the fact that the loss has to be ascertained, mitigated and deemed fair and reasonable.

There are a number of liabilities which cannot be excluded under English Law (i.e. you cannot exclude these liabilities when entering into a contract which is governed by the laws of England), as follows:

- A business cannot exclude or restrict liability for death or personal injury caused by its negligence.
- Liability for breach of the statutory implied condition in section 12 of the Sales of Goods Act (good title and no encumbrances) cannot be excluded.
- Liability for death, personal injury or loss of or damage to property caused by defective products cannot be excluded (section 7 of the Consumer Protection Act 1987).
- Liability for your own fraud and fraudulent misrepresentation cannot be excluded as a matter of public policy.

The following exclusions of liability are allowed:

- Negligence (other than where death or personal injury is caused);
- Breach of the statutory implied conditions in sections 13, 14 and 15 of the Sales of Goods Act;
- Breach of contract; or
- Misrepresentation, Indemnity.

Other Laws, around the world, have different types of Liabilities some of which can be financially capped and or excluded. Whatever law you are agreeing to it is always best to seek advice from a registered lawyer who specialises in that law.

Watch-outs

Limitation of Liability conditions are not always easy to understand from first reading. Seasoned commercial mangers and lawyers often have to re-read Liability conditions before they are confident they understand their meaning. Some Limitation of Liability conditions are self-referencing where they may state that a contract is capped to a value or percentage but refer to sections of the contract (or the governing law of the contract) stating exceptions to the limitation. These causes within the same conditions are sometimes referred to as "carve-outs".

Any Liability condition has to be carefully read in conjunction with other aspects of the contract to make sure that the extent of the liability is understood. Should a liability condition state in one clause that the liability for breach of contract is 100% of the contract value and in another clause of the same condition state that the liability for damage to property is limited to 100% of the contract one may assume the contract is capped at 100% of the contract value. On the face of it this would seem a reasonable assumption.

However, if there exists no termination for convenience, the party (seller) could cause damage to property and have to recompense the other party (the buyer) to the tune of 100% of the contract value and then continue to honour the obligations of the contract. Should the seller fail to honour the obligations of the contract and is found to be in breach of contract then they may have to recompense the buyer 100% of the contract value once more.

Without having an aggregate liability cap within the contract, where permitted by law, (i.e. not for death, Injury and fraud) is important to really understand the full extent of the liability.

Where a liability is insurable, for example damage to property, a seller ought to consider the insurance as a mitigator. Taking the above example of two clauses within one condition: the liability cap may be 200% of the contract value but one could argue half of that liability (minus any insurance excess) is covered through being insured.

15. Negotiation (Deal shaping)

Successful negotiators tend to be those who have found comfort with their own style, tailored and crafted over time. Skilled deal makers tend to learn the mechanics of their trade and then develop it through practice, recognising that each negotiation is different from the last. This approach is no different from learning and developing any other skill.

Take learning to drive a car: Your driving instructor throws lots of information at you whilst you are trying to master the foot pedals, the steering, the gear changes, engine revs, braking distances; you are regularly checking the mirrors looking out for other road users and pedestrians all whilst reading information on road signs. However, aside from the mechanics of driving, the purpose to driving the car is to reach a destination by going on a journey. Early on in your driving career, less time is spent enjoying the journey and concentrating on reaching the destination, as most of your concentration is taken up with the mechanics of driving the car and remaining safe. If personal experience is anything to go by - prior to Satellite Navigation, I suspect that most new motorists spend a great deal of time getting lost.

"In business as in Life, you don't get what you deserve, you get what you negotiate"
(Dr Chester. L. Karrass)

Similarly when negotiating deals the less experienced deal makers are constantly considering and checking their own performance; the way they talk, hold themselves in meetings, their level of engagement, the dynamics of the room, the effect created by what they say (which might have a bearing on the negotiation), the appropriateness of getting their point across – all very important stuff. However, as the deal maker becomes more experienced (like an experienced motorist driving a car), the mechanics of the negotiation should operate in the background, almost unconsciously, with the crafting of the journey, and the outcome of the deal - (the destination, if you like) - being uppermost in the mind.

Experienced deal makers, just like experienced motorists, have a habit of making their job look easy. Don't be fooled – commercial deal making is not easy, so be prepared to put the time and effort in to get the experience and learn the technical subtleties so you can develop your own craft. Prepare for every negotiation, and then prepare again. Don't go and jump in a Bugatti and race it down the road if you have little experience of driving, and if you are experienced at driving; check the car, the road, the weather and the track prior to setting off.

There are many courses which you can go on to help improve your negotiating skills. Some courses are more suitable to some than others. Body language courses can be helpful, but not always. The art of mirroring your opponent's behaviours, for example, can be beneficial but only when that mirroring occurs unconsciously as the two individuals naturally start to harmonise. Purposefully attempting to mirror your opponent looks wrong; even daft, and sometimes demonstrates a complete lack of natural behaviour which will not instil trust in the person being "mirrored". Actively and purposefully over using your body language to influence a negotiation tells a seasoned negotiator that you are concentrating on your own behaviour rather than the deal at hand – you could be in danger of giving away your lack of experience.

"Let us never negotiate out of fear but let us never fear to negotiate"
(JFK)

Experienced deal makers make mistakes. Fact. There is nothing shameful about recognising you have made a mistake. Making technical mistakes or committing a faux pas is as much part of deal making as it is in life. Don't worry about being wrong. Learning how best to recover from making mistakes and being wrong comes through making mistakes and being wrong. Often it can be helpful to openly admit to your opponent that you have made a mistake rather than try to cover up the fact.

It is unlikely that you will attend a negotiation on your own – very few people who work within large corporations have the legal, financial and product technical knowledge to be able to attend a negotiation on their own. Additionally, and quite often, different people can hear the same thing said in a different way and therefore it can be helpful to have two or more people attending a negotiation, for communication and verification purposes, as well as to aid in technical competence.

Try not to be disheartened if your opponent is awkward to deal with or is being downright unreasonable. A difficult negotiation due to difficult negotiators is not always a sign that the relationship of the two parties' delivery teams (when under contract) will be a poor one. Should a negotiation be uncomfortable and you have concerns about the relationship going forward, concentrate even more on the deal at hand through using the terms of the contract and the scope of work to make sure the obligations of the parties are clear and as less open to interpretation. Also, ensure the delivery programme is realistic. In achieving this the chances of dispute arising, during the contract delivery phase, will be less likely - so the chances of returning to the negotiation table are much reduced; and let's face it: more time spent with pleasant people provides for a better quality of life.

Difficult individuals do exist in life as in business so try not to take verbal and personal attacks on your character to heart - some negotiators can get a bit too personal - it's just their style. Should someone be acting unreasonably by behaving in a way which you see as personal to you - don't react to it. Try and introduce a period of silence if you are feeling a bit personally battered. Give your opponent the chance to consider their behaviour in silence, after all: they are only seeking a reaction from you, and a straight face kept during a period of silence doesn't give anything away.

Over time your ability to deal with poorly behaved negotiators will improve as time spent with them will enable you to develop tools to help you manage them.

If you are inclined to make rules, one good one to make is to always be polite and courteous when you are negotiating anything, as a buyer or a seller. That is not to say you have to be submissive and too agreeable. Sometimes your opponent may "stonewall" you; particularly if they have something you and perhaps your competitors really desire. "Stonewallers" will, irrespective of your approach, take control of the negotiation through setting the scene by placing stakes in the ground early on in the negotiation which you have to find a way of overcoming. Often, good stonewall negotiators will put some stakes in the ground for matters they are not concerned by, but use those particular stakes to take you away from the issues which do matter to them. This approach is designed to wear you down. In situations such as this there is no harm in trying to "mix it up" a bit – change style, or better still - bring in a colleague temporarily to help change the negotiating dynamics. There are many ways to "mix it up" a bit and seasoned negotiators will do so quite ably. Those new to negotiations may be surprised how some go about changing the dynamics of the negotiation but if those new to negotiation are on your team you should have briefed them to prevent too many surprises and unhelpful reactions. Provided you remain polite and courteous, even when being more assertive than usual, then you can leave the negotiation in the knowledge you did the very best you could.

"K.B.O."
(WSC)

Negotiating deals overseas, particularly outside of the European and North American geographical areas, can be challenging due to cultural differences which may have an effect on the way business deals are shaped and agreed. There is no single answer on how to formulate a deal which fits into one region or country as there are too many variables to consider. People will behave differently depending on their position within their respective society or business; most nations outside the sphere of influence of western cultural have a more hierarchical society than western culture does: the hierarchy needs to be understood as well as respected.

It is therefore important to engage expertise with knowledge of the country or region prior to entering into customer negotiations or discussions – ideally, a local advisor should have been selected and appointed well ahead of the negotiation process and they should be more than capable of offering good advice on how to work with the customer and understand the important cultural differences likely to be encountered. If an advisor has not been appointed, other companies (not competitors), such as KPMG or PWC or HSBC, may have advice on how to shape a deal with a particular customer. This may sound like obvious advice but the importance of understanding the local environment cannot be over-emphasised.

Most Middle East countries, as an example, employ well educated English speaking lawyers, commercial representatives and accountants (typically Sudanese or Lebanese nationals) who negotiate a business deal through adopting a similar style to that of a business negotiation within the United Kingdom. However, during the course of your dealings you may find the negotiation moves up the customer's hierarchy, away from the Lebanese or Sudanese nationals, to be further conducted by a national of the country in which you are working and a very different style of negotiation may ensue. In these circumstances, it is strongly recommended that professional advice is sought before entering these discussions as they are likely to be very different to negotiations experienced with the Lebanese or Sudanese team. It is more likely for a deal to be broken through discussion with more senior nationals of the country due to the exporter misunderstanding cultural issues and not respecting hierarchical individual responsibilities.

Some pointers when negotiating overseas:

- Always be prepared prior to engaging with your customer. Have some understanding of your customer's procurement process and where customer individuals sit within that process.
- Make certain that all of those attending a customer negotiation from your business fully understand what you are setting out to achieve and how you intend to try and achieve it.
- Choose one person to lead the negotiation and agree that the lead has control.
- Expect discussions over tea/ lunch/ introduction with your customer to form part of the negotiation.
- The negotiation is not about you and your place within it. It is about shaping a deal between two or more entities. The negotiation is, however, about your customer and their place within it.
- Never attend a commercial negotiation alone. There should never be a circumstance where you need to discuss the terms and price of a deal on your own.
- Be prepared to achieve very little during your first few meetings and to revisit, at a future meeting, what was agreed to during previous meetings.

- Make sure any verbal agreement made is written down within the contract and the contract is uplifted and provided to the customer ahead of the next negotiation. If you are the lead negotiator from your business, get one of your colleagues to take notes during the negotiation. Don't expect what you have agreed in writing to always form part of the final version of the contract.
- The customer's negotiating team may change individuals on a meeting by meeting basis.
- Always support your co-workers in front of the customer – don't be dismissive of your own business or anyone who works within it.
- Humour tends to align itself differently with different cultures, as does expression. Be careful: "Bear with me" may see your customer wondering what exactly you wish them to do.
- Have a good understanding of the financial aspects of the deal and always be prepared to discuss the price.
- If possible, take your own translator.
- Don't react (badly or otherwise) to chaotic meetings, raised voices, side conversations, people entering and leaving the negotiation room or behaviours which would be deemed unacceptable within the UK.
- Don't be afraid to stand up for your business or yourself – being challenging does not have to invite conflict.
- No long monologues: keep your explanations short and to the point.
- Never refuse the hospitality (unless it's illegal!).
- Don't be bullied into making a deal.
- If you are employing local in- country legal advice during the negotiation, don't let them run off with the negotiation. It's your deal, not theirs.
- Have a very clear understanding of how and when a contract becomes legally binding.
- If in doubt: try and smile.

Negotiation Pricing

In the United Kingdom, it is likely that face to face discussion and negotiation with the customer have been the result of a formal and detailed tender process. More often than not, it is likely the pricing aspect of the offer to the customer is dealt with through correspondence, providing Best and Final Offer (BAFO), pricing breakdowns and options, etc. In this scenario the commercial deal maker may have an understanding of the make- up of the price but will doubtless refer back to the business, away from the tabled discussions, to the finance team who manages the pricing model spreadsheet and the cost base when and if the price is challenged by the customer.

With overseas deals, however, it is more likely you have to negotiate the price directly with the customer during the face to face negotiation process. It is therefore important that the commercial deal maker has a good understanding of the make-up of the cost base and the make-up of the price, as well as a clear understanding of what mandate has been given through the business governance process to take into a financial negotiation.

Pricing Breakdown for Negotiation

Provided on the opposing page is an example extract from a price breakdown. This example demonstrates the main aspects of the deal including pass through, risk, commercial adders and recoveries. It is good practice to agree a reserve price with the business prior to making a customer offer. This reserve price does allow some flexibility during the pricing negotiation ahead of changing the scope and risk profile of the deal in order to meet the required margin for the business, whilst still meeting the customer's requirements.

Figure 2: Example extract from a price breakdown

Total Labour		175,187	£7,007,467
Other Costs:			
ENG materials (Incl Inflation)			£51,514,706
Expenses (Incl Inflation)			£2,655,715
Sub Contract			£565,000
Purchased / Contracted Labour			£137,916
TOTAL BASE COST			**£61,880,804**
Risk/Contingency:			
Weighted Risk Analysis			£15,086,438
Estimated Labour Contingency		10.00%	£700,747
Estimated Material Contingency		7.00%	£3,655,234
Estimated Expense Contingency		15.00%	£398,357
		Sub-Total	**£81,721,579**
Warranty:			
Warranty Labour		20.00%	£1,401,494
Warranty Materials		5.00%	£2,603,986
Overhead Recoveries:			
Labour		26.36%	£6,413,875
Materials & Sub Contract		11.65%	£6,679,489
		Sub-Total	**£98,820,424**
Company inc Mark up		0.00%	£
Management Contingency		5.00%	£4,941,021
TOTAL WORKS COST			**£103,761,445**
Profit (Margin on reserve price). Min 10%		20.00%	£29,034,867
Memo: Mark-up on Works Costs	Goal Seek	27.98%	
		Sub-Total	**£132,796,312**
Financing & Commercial Costs:			
Financing:		% of Offer Price	
Project Funding		1.00%	£1,528,151
Exchange Rate Risk		0.35%	£534,853
ECGD/NCM (Insurance)		1.75%	£2,674,264
Commercial Costs and Other:			
Bonds		1.00%	£1,528,151
Commission / Agency Fees		1.00%	£1,528,151
Liquidated Damages		3.00%	£4,584,453
TOTAL RESERCE PRICE			**£145,174,334**
Memo: Company Ltd Reserve Price		£145,174,334	
Memo: Commercial Costs (Incl. warranty)		£16,383,502	
Negotiating Margin		5.00%	£7,640,754
COMMERCIAL OFFER PRICE		**£152,815,088**	

Total Base Costs

The Total Base Cost represents the true known costs of completing the work, including labour, Expenses, Purchased Labour and Sub Contract. Some of these true costs could have been established using single point estimating or three point estimating. In the case of subcontracts the price may have been established through a competitive process. The costs which are in this category are without contingency or risk. Setting out the costs in this way enables the deal maker to have a clear understanding of the true cost of the work irrespective of the commercial, technical and other risks which may vary during the negotiation. Knowing the true cost of the work also enables the deal maker to separate the cost of the scope of the work from the risk, enabling the true cost to be amended during negotiation, e.g. in response to scope changes, without impacting the allocated risk but keeping the estimating contingencies (calculated as percentages of the true costs) in proportion to Base Costs.

Total Works Cost

The Total Works Costs includes; the monetary value of the risk register, the estimating risks (the estimating contingencies of the Base costs), the warranty costs (expressed as a percentage of the Total Base Costs plus the contingency to those Total Base Costs), the overhead recoveries, company mark ups and management contingencies. These costs add to the Total Base Costs to formulate a Total Works Cost.

Setting out the price in this way enables the deal maker to clearly see the size of the risk and business recoveries against the Total Base Cost (the true cost).
The proportional difference (ratio) between the Total Works Cost and the Total Base Cost demonstrates to the deal maker how the business sees the deal - risky (possibly outside the normal course of business) or less risky (possibly within the normal course of business).

Financing and Commercial Costs

As the commercial costs - foreign exchange, letters of credit, payment insurance, liquidated damages are not included within the Total Works Cost the deal maker shall have a clearer understanding of the risks to delivering the work irrespective of interference from the contractual arrangements which normally attract the bulk of the contractual costs.

Total Reserve Price

The Total Reserve Price typically indicates the minimum price the business is prepared to win the contract against (based upon the offer). Should market intelligence indicate that the win price is below that of the reserve price, then the negotiation margin can be entered as a negative to meet that win price. This would make the offer an investment. On negotiating the investment the deal maker then has a clear understanding of the size of the investment against the reserve price (which includes a fully recovered price, including profit.

Should the deal maker be able to increase the offer price, in an investment scenario, then the size of the negative negotiating margin may decrease as does the percentage of investment. Using this approach provides for a more healthy analysis of the investment, for the reserve price includes a level of profit.

Typically, however, the negotiation margin represents a price which would be higher than the reserve price. Having a negotiation margin enables the deal maker to reduce the price without reducing the scope of work or the risks to achieving that scope of work. Seasons deal makers tend demand something for something and therefore when reducing the negotiation margin to reduce price is often as a result of the removal of a risk, such as Liquidated Damages.

The Commercial Costs are included within the Total Reserve Price as these costs are subject to the terms of the contract as agreed and should each be calculated upon the final price. The payment of Liquidated Damages, Advisors and Banking Arrangements is always calculated as part of the final price.

Commercial Offer Price

The Commercial Offer Price is calculated as the Reserve Price plus (or minus) the negotiation margin. This is the price which is offered to the customer - determined by the market, the customer's budget and/ or the business need, and not necessarily by the cost.

Formulating a Negotiation Strategy

A simple way of formulating a negotiating strategy is to draw up a matrix against the contract (and possibly the Scope Of Work), to determine three basic categories:

1. Must keep
2. Nice to have
3. Prepared to give away

These three categories are typically formulated during the offer phase when establishing the risk profile of the deal.

A more sophisticated way of formulating a negotiation strategy is to use "Business Success Criteria".

An example of Business Success Criteria is set out overleaf.

16. Business Success Criteria

Following on from the Negotiation Section and working on the principle that business success is far more about meeting a spectrum of achievement rather than a single goal - the achieving of that business success can become more challenging.

For example, if you were to define ultimate business success as meeting three principles, the following three principles may be acceptable:

1. to offer goods and services to your customer which represent value for money
2. to make sufficient profit to both invest in the business and provide a reasonable return to the shareholders
3. to provide a safe and enjoyable work environment to your employees to enable them to provide for their families.

From these three principles, the business could define what it wants to achieve and how it might set about achieving it.

Business Success Criteria are the criteria which collectively determine the needs and outcomes that the business expects to fulfil through winning the contract as a result of the offer. The criteria can address the needs of the entire business from the delivery part of the business right through to the corporate group, or parent company.

Systematic categorisation of the Business Success Criteria can help develop the thinking behind them, for example - what does the business, within its different tiers, require from the financial aspect of the deal, the technical aspect of the deal, the investment aspect of the deal and even the programme of the deal itself?

Once the deal maker has an understanding of the Business Success Criteria then they can be used to shape the negotiation. The deal maker can see what their company or business require from the deal being negotiated. Profit, for example, may not be one of the top objectives, and the right to commercially exploit IPR developed through the performance of the contract may be a higher priority than profit.

Improving knowledge may be more important than securing future business. Having real clarity around what the business requires form the deal enables the contract and the scope of work to be negotiated and agreed in a way which will generate the most value for the business - making the most from the “money” paid.

Figure 3: A three tiered Business Success table could look like the following:

Strategic Objectives			
Importance	**Thread**	**Specific Objective**	**Measure**
Medium	Customer	Set the standard with the customer at the senior CEO levels and Ministerial level	
High	Performance	Help secure future pipeline through building relationships	
High	Strategic	Diversify the business capability through use of customer funded development of IP. retain in house user rights	

Service line (P&L) Success Criteria			
Importance	**Thread**	**Specific Objective**	**Measure**
High	Strategic	Attempt to secure the output as "a state of the art approach" as a reference model to help demonstrate to other domestic and international customers our capability	Right to advertise and promote within the contract, including future potential customer visits to the customers facility
Medium	Investment	Invest in the building of relationships with the customer as they also own other airports which we would like to secure work at in the future	The securing of future work
High	Performance	Achieve exceptional product performance with the customer to enable us to secure the future pipeline	
High	Strategic	Develop a partnering approach with our strategic partners to enable a joint bid on other similar future opportunities	Manage and measure the relationship with our teamed partner

Opportunity Success Criteria			
Importance	**Thread**	**Specific Objective**	**Measure**
Medium	Strategic	Retain ownership of IP (with right to future exploit)	Signing of contract
High	Performance	Help deliver better profitability to help recover from previous contract providing a low level of profit	Outturn of costs
High	Investment	Provide training for the project manager and development team in a new way of working	Completion of contract

17. International Business

Introduction

The following part of this guide looks at International Payment mechanisms, Anti-Corruption and Bribery, the appointment of Advisors and various other aspects of International Contracting and deal making. Again, the detail is not exhaustive and I would encourage you to consider speaking to those who are expert when formulating and International Contract.

International Contract Relationship Diagram

The diagram below demonstrated the full structure of an International Business arrangement for a UK seller contracting directly and indirectly (with Offset) into an International buyer utilising off contract payment mechanism. Although the diagram represents one way of doing business, it provides a pictorial view of the subjects discussed and you may wish to refer to it as you read.

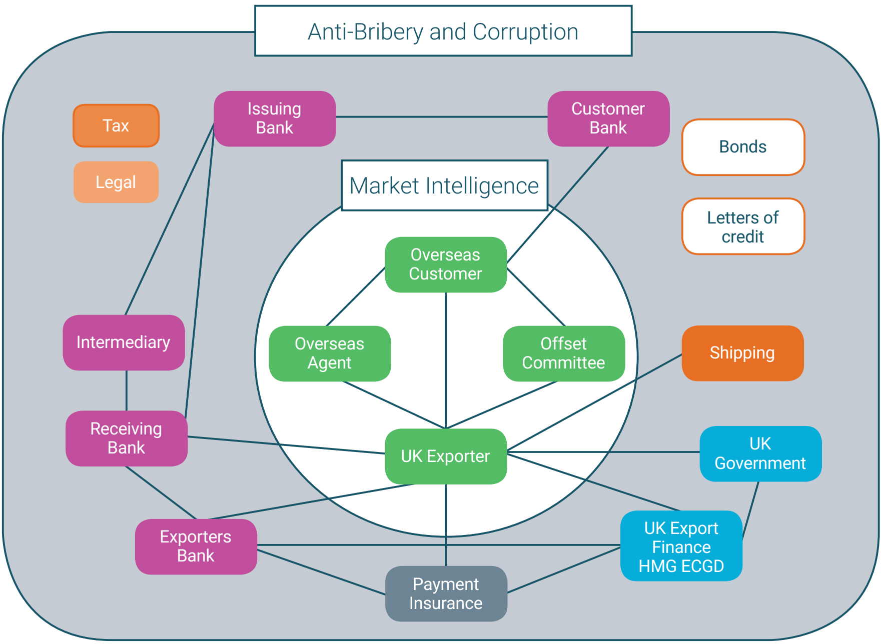

Figure 4: International Contract Relationship Diagram

18. Gathering Market Intelligence

Similarly to successfully winning business within a domestic market, winning business successfully overseas requires all available help. When working overseas you just need more help from a more varied set of individuals. Often customer opportunities and requirements, formal and informal tenders are not well advertised, particularly if the incumbent provider has anything to do with it. Advisors (agents) should have their ear to the ground and be aware of opportunities even when they are in their early stages of development. However, advisors are often thinly spread throughout a region and can miss potential leads which may give rise to wealth generating opportunities.

Exporting businesses are likely to employ a market intelligence department (often part of the strategy group) who have the ability to gather intelligence in the regions in which the business is operating. A Strategy group is able to support international business development at both a strategic and tactical level in a number of ways.

At the strategic level, the group may provide international prioritisation recommendations on a country by country, or region by region basis. This is achieved through considering each country or region in terms of those opportunities, both in the near term and long term, which are likely to become firm requirements, either through the customer recognising the need or the business having the ability to encourage the need.

At a country specific level, the strategy group is able to provide strategy development support analyses such as national business product and their related services roadmaps, development plans, identification of key business risks, economic analyses and competitor activity. Continuous market intelligence on a range of relevant issues can be provided in order to support long term country or regional campaigns.

At a tactical or bid specific level, the strategy group may provide a range of analyses designed to maximise the business win probability. Thus, early in the opportunity capture cycle, the group is able to identify the need for, and propose potential allies or bid partners. In addition, the group can systematically and objectively assess the potential partners with respect to the project specific requirements, as well as more general requirements associated with the market environment, and thereby make recommendations regarding teaming strategy.

The group will be able undertake thorough assessments of competitors and a range of analyses in order to support recommendations on how the win probability of the business can be improved. Thus, the group can characterise a competitor's win strategy in terms of its solution, marketing and positioning. These articulations will describe each bidder's strengths and weaknesses which can be used to optimise the exporting business win strategy. In some cases, the competitor analysis can also include an estimate of a competitor's cost structure and price, knowledge of which can be used to define a business target price and therefore define price targets to inform the solution design.

It is vitally important that the strategy (or market intelligence) group has a link to the in country representatives and advisors, not only to provide information to them but to qualify information with them, and assess information and intelligence received by them. Far too often businesses make the mistake of following a line of intelligence, without verifying it and then providing a proposal to a customer, based upon a single line of intelligence, which proves to be off the mark. Good lines of communication and solid vetting of intelligence is not only vital in winning business overseas for the exporting business but vital in building confidence with the exporting business deal makers.

19. Advisors (agents)

An advisor may often be referred to as:

- An agent
- An in-country agent
- An overseas advisor
- An in-country specialist.

The role of an in-country advisor is often two fold:

a. to help win business within the buyer's country

b. to help manage the delivery of business within the buyer's country.to your employees to enable them to provide for their families.

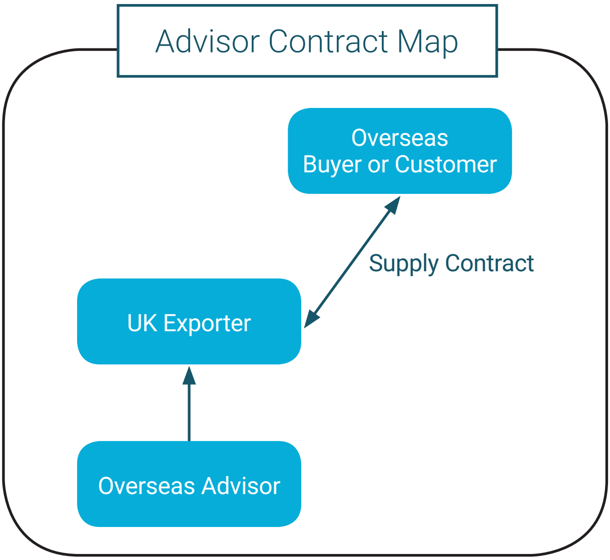

Figure 5: Relationship diagram with the interaction of the roles.

Advisors are often more than not employed by the exporter to do both A and B above.

It is not typical to employ an advisor to carry out A or B only, although in some countries, such as the USA, lobbyists can be used to help win business only. See guidance under Lobbyists below.

The benefits of engaging an advisor

An advisor can help an exporter win business in the buyer's country by providing the following services:

- Introduction of buyer stakeholders to the exporter
- Help for the exporter to understand the culture, as well as the social and geo-political environment of a country
- Organisation of visas, travel arrangements and accommodation for the exporters personnel
- Translation services, oral and written
- Support for the exporter to select in-country suppliers
- Explanation of the customers' bidding/ tendering expectations to the exporter
- Supply of tenders, documents and notices between the exporter and the buyer
- Provision of customer and competitor intelligence to the exporter
- Arrangement of meetings between the exporter and any in-country customer or client
- Identification and notification of opportunities to the exporter
- Assistance in identifying, introducing and vetting potential in-country partner company(ies)
- Help for the exporter/buyer to set up bonds and bank guarantees.

An advisor can help exporters manage the delivery of business within the buyer's country by providing the following services:

- Management of on-going customer and client engagement
- Support for formulation of contract variations
- Support for resolution of any disputes
- Assistance to secure/confirm imports and exports of goods
- Organisation of visas, travel arrangements and accommodation
- Translation services, oral and written
- Help for the exporter to generate further wealth within buyer country

- Registration of contracts, execution of tax authorisations and audit bureaux approvals
- Establishment off-contract banking arrangements with in-country issuing banks
- Removal and closure of bonds.

The risks of engaging an advisor

It is important the exporter has a reasonably good understanding of the relevant country (and region) and the strategy it wishes to adopt within that country or region. Individual advisor capability comes in many different shapes and sizes with different levels of experience, networking breadth and charging rates. Without a reasonable understanding of the aspirations of the business within a particular country or region it can be difficult to know which advisor or advisors to engage, and the extent of that engagement. Additionally, the engagement of advisors presents a number of consequential business risks, which will vary in significance between countries, for example:

1. The advisor may expect to continue to be remunerated for some time (possibly years) post the expiration of the advisor agreement if the delivery contract between the exporter and the buyer is extended through amendment (or is an enabling arrangement)

2. The buyer may introduce a “no advisor” policy which may require the declaration to the buyer by the exporter that an advisor has not been previously engaged in that country. Failure to make such declarations, or inaccurate declarations, can lead to substantial fines

3. The appointed / contracted advisor may at a later date form a relationship with a customer or act in a way which may place the exporter in breach of the Anti-Bribery and Corruption guidance. (ABAC)

4. It may be more difficult for the exporter to divest the business assets/ legal entity in whole or part if agreements are in place with advisors.

Choosing and managing an advisor

There are good performing advisors and poor performing advisors. It is important when selecting an advisor that sufficient due diligence is carried out on the advisor (and any relevant limited company they may own) to satisfy the ABAC guidance as well as relevant internal business unit needs. Some advisors are aligned to certain products and services, other advisors are aligned to particular customers. The vast majority of advisors are aligned to countries or regions. Very few advisors operate from a global network – those that do employ more local in country advisors to help them.

There can be many operatives in a country or region who refer to themselves as advisors but in reality, the vast majority of them are people looking for employment with an overseas firm on the basis that advisors are fairly well remunerated. Again, sufficient due diligence should provide information on the advisor relative to their past experience and success.

Poor performing advisors may negatively affect the exporter's competitiveness and at worst inhibit the exporter's ability to win business in the country.

Good performing advisors tend to be individuals who are well connected with a wide network of contacts and can easily demonstrable proven past success, working with customers located in the target country or region. Good advisors tend to be busy and constantly in demand by exporters. They are unlikely to agree to represent one exporter exclusively, but rather insist on country / regional exclusivity for a number of exporters. Good advisors tend to be wealthy individuals and as a result can be difficult to engage (with) on the more mundane administrative areas, such as organising visas, meeting rooms, accommodation and transportation for the exporter when they are in the advisor's country.

"Good advisors may be expensive but as always, underpaid servants can be more costly."

While appointed advisors will be expected to work with the regional/country business development representative(s) of the business they should, if possible, be managed by the exporter manager who appointed them. Taking this management approach helps divorce any potential dispute between the advisor and the exporter from the business winning environment.

Advisors, on the whole, can be challenging individuals to manage. Their personal profiles are likely to be ruthless, self-serving, highly confident, good at engaging with others and persuasive in argument. Therefore, effective and close management of advisors is required from the outset of the relationship to avoid the advisor becoming the tail that wags the exporter's dog and undermining the strategy for winning business in the advisor's country.

An advisor will not take title and risk of your goods or services. A delivery contract that an exporter has with their customer will not involve the advisor in a legal supply chain context. Sometimes the advisor may see themselves, and sell themselves to others, as the exporter's appointed "approved distributors", but this is not the case in the true sense of the meaning of approved distributors unless they become a seller in the supply chain.

Accidental Advisor Engagement

Accidental advisor engagement occurs when an exporter unintentionally utilises the services of an individual located in the same country as a customer from whom they have secured business.

Real care is needed in the engagement of advisors and when working with influential individuals overseas, a strict process should be followed in order to mitigate risks of accidental advisor engagement - see advisor engagement process. Without the benefit of a strict process, advisors can easily be accidentally engaged and potentially cause substantial financial loss to the exporter.

Advisors are aware that accidental advisor engagement can prove to be a lucrative means for the advisor to accrue substantial sums of money from an exporter with minimal effort.   Some less scrupulous advisors attempt to contrive circumstances under which accidental engagement would transpire. This is because courts tend to rule sympathetically towards advisors when the advisor claims for compensation through the courts from an exporter.

Additionally, courts have been known to award advisors compensation in excess of the remuneration that the advisor may have earned under the terms of a formal legally binding advisor agreement with the exporter. This is because the compensation awarded to the "advisor" would be awarded as a result of the exporters contract with their customer, and not prior to the winning of the exporter's business. The amount of compensation awarded to the advisor by the court would not be limited by any local anti-corruption or anti-bribery legislation governing the size of advisor fees.

Due to the leanings of the courts, exporters tend to settle out of court if they believe the advisor is likely to win any claim for compensation if the matter was brought before a court. These out of court settlements could reach anywhere between 6% and 10% of the value of the contract that the advisor has "facilitated", depending on the type and level of engagement which the advisor is able to demonstrate when making the claim.

When seeking assistance from any in-country individual (who may or may not be an experienced advisor), it is better to keep the request for assistance an oral request rather than a written request. Prior to any formal agreement between an advisor and an exporter it is better not to engage in written correspondence, including e-mail.

Accidental advisor engagement is likely when a written contract or agreement is not in place between the exporter and the advisor but written correspondence is sent by the exporter to the individual relating to any of the following:

- An introduction to a customer
- The delivery of documentation between exporter and buyer
- Requesting attendance at customer meetings
- Open correspondence with information flow between the exporter and the advisor related to any business prospect such as a tender or bid
- Requesting the delivery of (and/ or receiving) a customer tender from an individual and bidding against that tender
- The provision of a letter authorising the advisor to be a representative of the exporter (please note – these letters can be issued but not ahead of a contract).

Care is therefore needed in drafting all correspondence with in-country individuals and small companies when working overseas. If in doubt, always refer to the Commercial department and the legal department.

Advisor Engagement Process

An example of an Advisor Engagement Process is as follows:

1. Set up an Advisor Selection Team (AST).
2. Provide information to the AST on possible in country advisors and territory strategy
3. AST member visits country and meets potential advisors either known to or not yet known to the exporter
4. AST writes to advisors requesting them to provide a due diligence (DD) report and to sign an exporter NDA.
5. AST carries out due diligence on the potential advisor and their company(ies) using:
   i. Appointed companies such as Control Risks or Salamanca information
   ii. The information provided in the DD report
6. AST selects which advisors to interview
7. AST provides a recommendation to the relevant sponsoring Exec
8. AST engages the exporter's Legal department to formulate legal agreement
9. AST completes a relevant exporter ABAC form (process), approved by the exporters Legal department
10. AST makes an offer to an advisor post Exec approval.

Formulating an advisor agreement

As a principle, advisor agreements should be very specific regarding the scope of the advisor's engagement as well as their relationship with the exporter.

An advisor is likely to require country exclusivity or regional exclusivity with the exporter, but this does not necessarily mean the exporter will be restricted to engaging only one advisor in-country. An advisor having regional or country exclusivity may allow the exporter to engage other advisors but the advisor with country or regional exclusivity is likely to demand a percentage of any customer contract signed in that country or region by the exporter, including those which they have not actively facilitated. Agreements such as this may cause the payment of multiple success fees relating to the same contract, which will have a negative impact on the profitability.

The form and objectives of the advisor's agreement should be designed to complement the respective country/region strategy and the intended mix of business to be generated between the target customer set. The following aspects of an advisor agreement could be considered:

1. Purpose of the Agreement

The advisor agreement ought to have a specific and clear purpose, in order to limit the activity for which fees may be claimed. A good way of achieving this would be through agreeing as limited a scope as possible, e.g. "the provision of ILS equipment into Kuwait City International airport as contracted by the Kuwait Air Force department only".

It would be less preferable for the exporter to agree a broad purpose, for example: "to help the exporter win business in Kuwait".

The latter risks having to remunerate the advisor against all business won in the country of Kuwait irrespective of the activity and value the advisor may add (which may be no activity or value whatsoever!).

2. Law of the Agreement and customer declaration

An advisor agreement may be in English Law or it may be in accordance with the law for the country in which the advisor resides. It is advisable to seek local to country legal advice if you intend to make an agreement with an advisor in a law other than English law.

The advisor agreement ought to have a provision for termination by the exporter should the customer declare that the use of advisors, either for a particular tender or as a blanket piece of country legislation change, is prohibited. Should the advisor agreement be terminated early due to the customer declaration, then any advisor compensation payable to the advisor must be declared to the customer or it is likely that a hefty fine will be payable and/or participation in other tenders will be prevented. The local to country legal team should always be engaged.

In the event that a customer declares that advisors are not to be employed, must not be related to or recovered against the customer's contract! (i.e. should not be included within the customer price).

3. Exclusivity

It is unlikely the advisor will want to be completely exclusive to the exporter; however the exporter may want the advisor to have some level of exclusivity with the advisor, to prevent the advisor engaging with the competition.

Typically, the agreement of the scope (purpose) of the advisor agreement and the terms of remuneration are negotiated around the extent of the exclusivity of the relationship between the exporter and the advisor. Advisors who are in demand tend to act as exclusive to the exporter but typically the exclusivity is against a specific customer tender or opportunity, rather than the exporter's capability or product. Advisors who are less in demand tend to seek exclusivity with the exporter for the exporter's product or service, helping get that product and service sold to any customer within the country or region. More senior and well-seasoned advisors tend to seek country exclusivity from the exporter on the basis that they employ other advisors to aid them win business for the exporter. Although this approach by the well-seasoned advisors may not necessarily prove to be more costly to the exporter, (in terms of any percentage award fee paid), the exporter is likely have less control over the activities of the advisors who are acting on their behalf.

Any agreement with the advisor ought to take into account the short, medium and long term aspirations of the exporter in the country and or region.

4. Fee (Advisor remuneration) and payment

It is a matter for the exporter and the advisor to agree on how the advisor is remunerated for their services. Provided the cost to the exporter of using an advisor is reasonable, following ABAC guidelines, both the exporter and advisor can agree any financial method they feel comfortable with. It could be that payments to the advisor by the exporter are on a sliding scale, incentivised, profit share or target based.

The traditional way of remunerating an advisor is by way of a percentage of the total contract value agreed between the exporter and the customer, this is often called "percentage award fee" (please see ABAC for guidance for help on establishing the fee). Sometimes advisors may seek, in addition to the percentage award fee, a monthly retainer to cover their costs leading up to the award of contract to the exporter by the customer.

4.1. Percentage award fee

The percentage award fee, as agreed between the advisor and the exporter, represents a fee payable to the advisor calculated as an agreed percentage of the total value of the contract awarded to the exporter by the customer. Any future amendments and variations to this contract, which increase the value of the original contract, shall also increase the amounts to be paid to the advisor in line with the original agreed percentage award fee.

When agreeing a percentage award fee within the advisor, the exporter should recognise that the percentage award fee represents the most the advisor is to be remunerated by the exporter during the course of the exporter's contract with their customer. Payments of the award fee become due to the advisor when payments have been made to the exporter by the customer. This paid when paid approach protects the exporter against having to remunerate the advisor should the exporter's contract with their customer become frustrated, reduced in scope, terminated early for whatever reason or become a variable maximum price agreement.

4.2. Monthly payments (Monthly retainers)

The advisor may seek a monthly payment, as a form of retainer, from the exporter during the business winning period. Although monthly retainers are not uncommon, it is preferable to have a percentage award fee only.

Monthly retainers are sometimes agreed between the exporter and the advisor when the exporter is new into the country or region.

In some instances, the advisor and his staff may also seek recovery of reasonable costs incurred from the exporter for providing translation services and other service (such as clerical and administrative). The price of providing these services should be agreed upfront, listed in an agreement between the exporter and the advisor and paid as incurred against invoices raised. These costs must be reasonable and related in value to the service provided otherwise it will contravene ABAC guidance.

Should the advisor request either, a monthly retainer or payments for reasonable costs incurred ahead of any agreement for a percentage award fee, consideration should be given to the formulation of an agreement with the "Advisor" wherein they act as a subcontractor to the exporter, in the capacity of a consultant. In this circumstance, the exporter ought to agree a detailed scope of work within the agreement and refer to the advisor as a consultant only. Any subcontract agreed with the consultant could have the following statements, or something similar, within it:

In the below example the Supplier is the advisor acting as the consultant and the Buyer is the exporting company intending to sell into a region:

> "For the avoidance of doubt:
>
> 1. Nothing in this Agreement shall be deemed to constitute a Party in law as a partner, agent or legal representative of another Party for any purpose whatsoever. No Party shall have the right or the authority to assume or create any obligation or responsibility on behalf of or in the name of another Party or to bind any Party in any manner whatsoever.
>
> 2. Payments made by the Buyer to the Supplier shall be in full and final settlement of any future claim by the Supplier. Any additional representation or work provided by the Supplier, outside of the work detailed within this Schedule, shall be provided for by the Supplier without the right of the Supplier to be remunerated or recognised in any way by the Buyer unless otherwise expressly agreed in writing by the Buyer."

5. Term and Termination of the Agreement

The term of the advisor agreement should, ideally, not exceed three years. To avoid a claim by the advisor beyond the three year period, a further term of one year, with a reduced percentage award fee, could be agreed with the advisor, during which period the advisor does not undertake any activity or services on behalf of the exporter.

This additional period of time is often referred to as “a tail”. This “tail” is often agreed to because the customer could
(a) delay placement of a contract (for whatever reason) and the advisor agreement may have expired with neither party willing to or able to agree terms of an extension or (b) the customer could extend the original contract and the advisor would feel entitled to be awarded remuneration having aided the placement of the original contract. When agreeing a “tail” it should be agreed on the basis that it has been offered to the advisor, as an extension to the agreement such that upon completion of the tail term the advisor waives all rights to any future claim for remuneration from the exporter. (The courts would likely see the “tail” as a fair and reasonable approach).

Alternatively, and particularly if a monthly fee had also been paid to the advisor, it may be possible to agree a full and final settlement within the advisor agreement against amounts already paid, whereby the advisor waives all rights to any future claim should the exporter receive a late or extended contract from the customer outside the term of the original advisor agreement with the exporter. Again – all of the above is food for thought when formulating a negotiation position but it is advisable to be clear on when the advisor's agreement terminates and when the exporter no longer has any liability to the advisor.

Any agreement made with the advisor ought to be governed by a termination provision for non-performance, insolvency and a breach of contract, (including ABAC guidance) by the Advisor.

6. Teaming with other Companies.

The structure of the exporter's contract with their customer is often unknown when the advisor is formally engaged by the exporter. Care has to be taken by the exporter when making an agreement with the advisor, to avoid agreeing an award fee which may place the exporter in a financially non-competitive position with their customer. It is not in the advisor's interest to support an exporter who is likely to be financially uncompetitive. However the advisor, having spent time and effort helping the exporter, is not likely to look too kindly on any renegotiation of their fee just prior to the exporter placing a bid into their customer.

Should the exporter decide to team with other companies as a prime contractor or as part of a teaming agreement the percentage award fee payable to the advisor could be substantial when measured against the net income of the exporter's work share as prime contractor, due to a high rate of pass through. The exporter (and their teamed partners) may feel uncomfortable about awarding such a large share of remuneration to the advisor, particularly if the other teamed partners of the teaming agreement have their own advisors to remunerate.

In such circumstances the advisor is likely to expect a percentage award fee in line with the order intake of the exporter they have the agreement with, as the make/ buy decision of the exporter is not their concern.

In order to avoid conflict with the advisor, and for the sake of the success of the exporter winning the business deal with their customer, the exporter could agree, within the agreement with the advisor, a rough order of magnitude of the exporter's direct (net income) business likely to come from the country or region against the product or service over a period of time. This net income calculation could be used to agree a percentage award fee with the advisor.

Additionally, any percentage award fee agreed with the advisor could be subject to renegotiation in the event of the exporter entering into a consortium, joint venture or teaming agreement. Combining this approach with the rough order of magnitude, in calculating the expected net income of the exporter, should help enable future discussions with the advisor surrounding his percentage award fee.

It is unusual for the exporter to be able to reduce the advisor percentage award fee due to a change in the exporter's preferred business winning strategy. The ability of the exporter to reduce the advisor's percentage award fee would be as much dependent upon the relationship as well as the scope of the agreement between the advisor and the exporter.

Finally; if the exporter's strategy in a particular country or region is to be or become a subcontractor through a foreign company (domiciled outside the customer's country,) or a prime contractor with an in-country incorporated joint venture entity, then engaging an advisor would be of questionable value.

Lobbyists (in the USA)

What is a Lobbyist?

The principle of lobbying in the USA, i.e. the promoting of special interests to elected representatives, is lawful and based on sound democratic principles.

A lobbyist is paid by a special interest group or a company, such as cotton farmers or defence companies, to influence, secure funding from, or bring issues to the attention of those in power.

While there are any number of lobby groups intent on gaining support for issues like the environment, immigration and human rights – the real heavy hitters are the extremely wealthy industrial and business lobbies, keen to protect their industries and maintain their profitability. This is where things can get murky.

The lobbying industry was worth about $3 billion in 2011, with the biggest spenders in the last 6 years being the Health, Banking (Finance), Insurance and Real Estate.

There are currently just over 12,000 registered lobbyists (since 1995 all lobbyists have been required to be registered). During the presidency of George W Bush there were over 34,000 lobbyists. Compare that to the 100 senators and 435 congressmen and it is clear there is a problem of influence.

"A lot of lobbyists are ex-politicians with friends still in power"

In fact, the salary of the lobbying occupation lures nearly half of all lawmakers once they leave congress.

Typically lobbyists are used to win business for companies who improve the welfare of a deprived area or State of the USA. This is usually achieved through employment or by using small business within those deprived areas to aid in the delivery of the contract.

Lobbyists are often paid an award fee.

Japanese Trading Houses

Japan is home to some extraordinary, unparalleled, giant Trading Houses, which have a network of branches throughout the whole country and across other parts of South East Asia providing extensive reach for products and services with a large potential for generating revenue. The big markets in Japan are all very different and reasonably stovepipe: Tokyo, Osaka, Nagoya and Hiroshima. The islands of Hokkaido and Shikoku and Kyshu tend to have their own trading houses.

Trading Houses handle approximately 70% of Japan's imports and about 60% of Japan's exports, as well as approximately 25% of Japan's domestic trade. There is nothing like this anywhere else in the world of business. The Japanese Trading Houses do not specialise in any particular commodity; they cover goods and services (typically lines of spares) in anything from noodles to nuclear energy.

The basic premise of a Trading House is to import, market and sell raw materials to Japanese companies who are left to concentrate on efficient production. Although this seems a fairly clear division of responsibility the entire make-up of the relationship between the Trading Houses, the manufacturers and the banks becomes confused when the complex web of investment is considered: Trading Houses may invest in manufacturers – manufacturers may in turn own shares in the Trading Houses and the banks' loan to both. It is difficult therefore to fully and clearly understand who owns what and how investment is directed.

An example of how Japanese Trading Houses affect the market is as follows:

> A Mitsubishi employee can drive a Mitsubishi car, travel in a company-made bus, buy petrol from his firm's chain of petrol stations and drink the company group beer, whilst his clothes are made from their own synthetic fibres, the raw materials having been carried in bulk cargo ships built by Mitsubishi, using home-made steel. At home his electric fan, refrigerator, scooter, washing machine and the very building materials used to build his house, not to mention the bulldozers and excavators used to build it, can all come from group factories (belonging to Mitsubishi). The central financer of Mitsubishi is the Mitsubishi Bank.

In brief, a Japanese Trading House can:

- Control a very large slice of the Japanese market
- Be accessible in most parts of the world
- Handle almost any product
- Have an especially good entrée to their own group companies
- Cut across group structures to deal with rival groups; and
- Have the network and finance to reach any sector of the Japanese market on behalf of foreign goods and services.

Trace Report / Due Diligence Report (DD)

Prior to engaging an advisor some form of due diligence on the advisor and the company or entity to which they belong. There are many companies which specialise in providing DD reports but the quality of DD reports can vary. DD risk assessment reports should, at the very least, provide information on the following:

- Full legal registered name and any other trading names
- Date of Registration
- Commercial Registration Number
- Place of Registration Number (place of origin)
- Full contact details, postal and physical addresses
- Number of Employees
- Capital Structure Information, number of shares issued and value of shares
- Company Ownership details including names of the shareholders, their nationality, their ID particulars, their percentage held
- Historical information and amendments made at the commercial register regarding change of name, address, shareholders and directors, capital and business activities
- Company affiliation, list of names and contact details of any companies affiliated or associated to the subject
- Description of the business operations
- Financial information available
- List of agencies, brands sold and supplier's names
- Trade supplier's reference obtained where possible
- Local Default Cases search

- Legal proceedings search
- Bankruptcies records search (available in some countries)
- Litigation and public information/records search
- Unpaid cheques or loans
- Registered Mortgages
- Registered Seizure of Assets
- Credit Databases search
- Debt Collection Agencies search (available in some countries)
- National Gazettes Searches
- Internet portals search in Arabic, English and French (as and where applicable) for adverse media information
- Publications, media, newspaper articles archives, magazines and periodicals search in English and other languages including international, regional and local business and financial affairs publication
- Adverse Media Search, Search into an expanded media database, which has an immense historical archive of grey data. It also covers Politically Exposed Persons (PEPs) and their associates and close family members, it also comprises entities who are suspected of wrongdoing but have no conviction or enforcement action against them, those suspected of engaging in criminal or fraudulent activities, those involved in unsavoury or high-risk areas of business, and those who may be tarnished by association with a known corrupt individual, company, or regime
- Searches against international crime watch lists, association with sanctions lists, convictions, fraud, corruption, bribery, money laundering, alleged terrorism, violent and sexual crimes from sources such as the UN, Interpol, HM Treasury (formerly Bank of England), OFAC and the like
- Local reputation and any other information uncovered
- A general comment including ownership brief, trade history brief, any derogatory information, public and media information, any affiliations to any business conglomerates or politics, ruling or royal families etc. written by our credit analysts who are multi-lingual and have several years of experience in their field and very good knowledge of the local and regional business environment.

It is advisable to appoint one company to carry out DD/Risk Assessment reports for a period of time in order to have some consistency with the information provided.

20. [Anti] Bribery and Corruption (ABAC)

UK anti-bribery legislation is the most comprehensive in the world, enhancing the UK's reputation as one of the safest commercial environments in which to do business.

Companies based in the UK are forbidden to pay bribes to win/influence or gain business anywhere in the world - even in areas where these types of deal "sweeteners" are commonplace. It is a criminal offence and a corporate one if a company is found to have failed to prevent bribery. In 2011, the UK government brought in a new bribery act as it wanted to take a leading role in the global fight against bribery.

Below are some answers to questions regarding bribery and corruption. Please refer to the business policy on anti-bribery and corruption for every lead, bid and contract that may be considered.

How do you define a bribe?

The Ministry of Justice has a cut-out-and-keep guide to the bribery act. Please go to

http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/181762/bribery-act-2010-guidance.pdf

Basically, "bribery" is defined as giving someone a financial or other advantage to encourage that person to perform their functions or activities improperly or to reward that person for having already done so.

What about corporate "treats"?

The guide says that taking clients out - for example, to a big Rugby game at Twickenham - "better to present products and services, or establish cordial relations", is fine. It's an established way of doing business. But it also says, "hospitality and promotional or other similar business expenditure can be employed as bribes". If in doubt ask the Legal department.

Aren't bribes normal in some countries?

Yes. But if you are a UK company registered company, you will still be in trouble if you go along with this.

What are the penalties?

Up to 10 years in prison and an unlimited fine for people, and companies can also face unlimited fines.

Any defences against bribery charges?

Organisations are not liable as long as they tried their best to prevent bribery. Chiefly, this would mean it had strong systems in place discouraging bad behaviour. These could include providing anti-bribery training to staff, carrying out risk assessments for certain markets, or checking the people's backgrounds. Please see "country corruption index" below, and the section on appointing advisors.

Any grey areas?

The use of "contractors" and "subcontractors" is one. The Ministry of Justice's guidance says you only have to perform due diligence on those who actually supply goods or services to you. Another point for debate is the question of liability between a parent company and a subsidiary - if a bribe has been paid by a subsidiary, and the benefit is solely to that subsidiary, then the parent company is not liable. You could, of course, argue that a parent profits when a subsidiary gains.

How does the UK compare with other countries over tackling bribery?

In covering bribery between businesses, the UK's legislation goes further than the Foreign Corrupt Practice Act in the US, which makes it illegal for companies to give foreign officials improper payments.

What must I do to protect myself and the organisation I work for?

You must complete   GUIDANCE course and have a good understanding of the company policy prior to engaging with or working in business. Should you have any concerns that your activities, or those of others either within   or outside of it, may go against the ABAC GUIDANCE policy then speak immediately to the Legal department.

Country Corruption index

First launched in 1995, the Corruption Perceptions Index has been widely credited with putting the issue of corruption on the international policy agenda. Please see below the 2013 Corruptions Perceptions index provided by Transparency International.

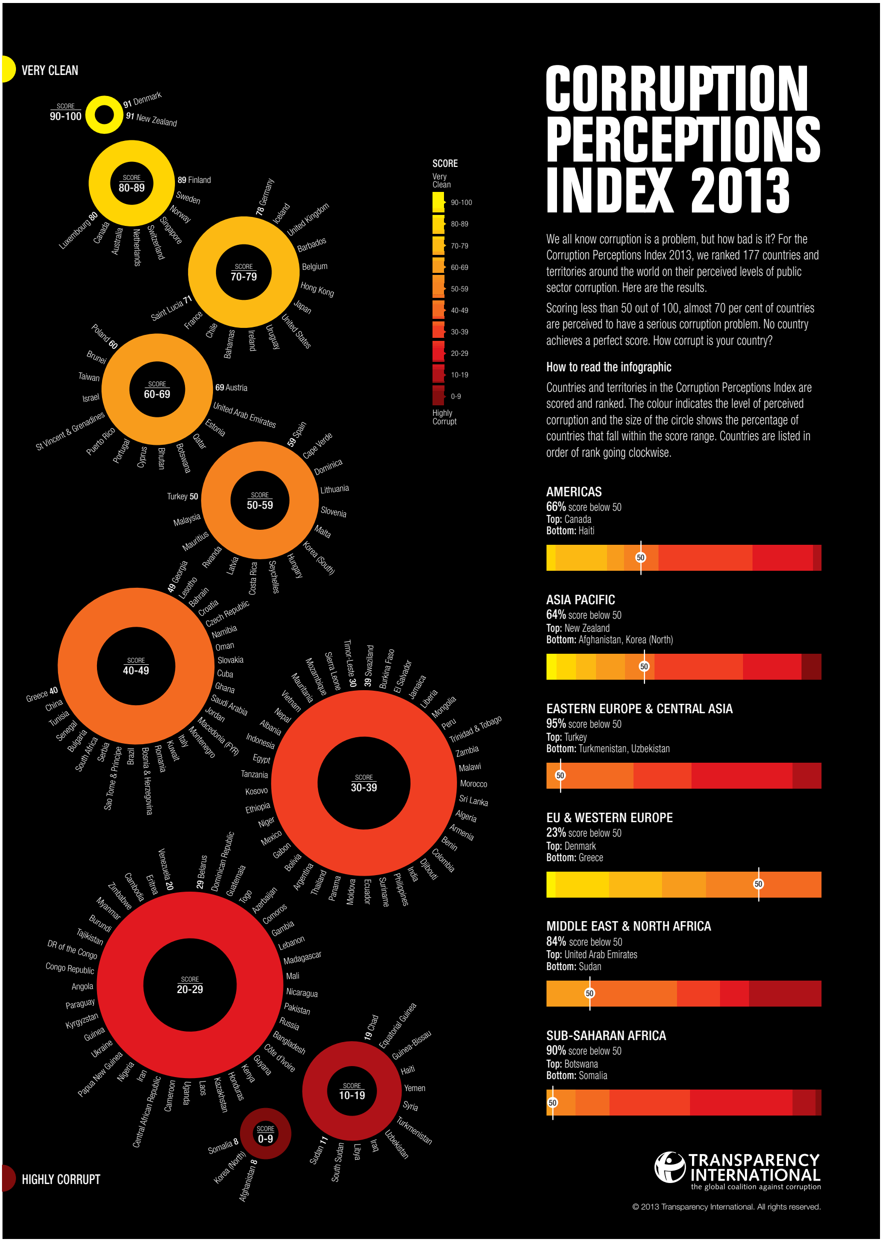

Figure 6: Corruption Perceptions Index 2013

21. Bonds and Bank Bonds

A bank bond is an arrangement between two banks wherein the beneficiary's bank (the customer's bank) and the benefactor's bank (the exporter's bank) agree to transfer funds from the benefactor's bank to the beneficiary's bank when conditions of the contract related to the bond are not met. The conditions related to the bond are expressed within the terms of the bond either as a copy of a contract (in the case of an advance payment bond and performance bond) or the terms of another agreement (such as the terms of a tender bond).

Often, international customers may use the term "bond" which does not involve a bank. This is typical when the customer requires a cash payment for a tender bond or retains a percentage of the contract as a retention bond, payable to the exporter at the completion of either a warranty period or an extended testing period.

Tender bond (bid bond)

A tender bond (or bid bond) is when a buyer is obtaining tenders for a contract and requires a bond as security against the risk of the successful bidder failing to enter into the contract.

A single page document gives the beneficiary the right to call the bond or draw upon the bond on demand, within a specified period of time and for a maximum specified amount.

A tender bond where two banks are involved (the exporter's bank and the buyer's bank) is not a transfer of money from the exporter to the buyer, but a credit which may be drawn upon by the buyer if the exporter does not fulfil the obligations of the tender bond. Sometimes the buyer (tenderer) makes a demand for a cash bond.

Any tender bond must have within it a closing date (or a return of monies). Please see "Contract Effective Condition" within this guide.

When negotiating a tender bond it is preferable to have bank bond in place. The exporters Treasury department will make arrangements for the bank bonds to be set up between banks and will require details of the tenderer, all tenderer documentation and of course a booking code.

When negotiating a bank bid bond, Treasury will agree with the bank a period of time during which the bond can be drawn by the tenderer, after which the ability of the tenderer to draw down the bond will fall away. It is important that Treasury understands the terms and conditions of the tender bond.

Should there be the opportunity to negotiate a tender bond (which is not always the case), the following should be sought:

1. An agreed term, which is as short as possible - this is very important
2. The return of funds (in the case of a cash bond) to a named individual from an individual nominated by the tenderer
3. Interest to be paid on the cash bond
4. A denomination in US dollars or UKGBP or Euros in case of cash bonds
5. The termination or repayment of the bond should the terms of the tender and/or scope of work of the tender change during the tender period. Note this may affect the exporter's desire to remain as a tenderer
6. A Force Majeure condition.

Note that a subcontractor to a prime contractor, where the prime contractor has to provide a tender bond, may be required to take some liability for the risk of the bond being drawn upon. In this instance it is advisable for the subcontractor to agree terms and conditions with the prime contractor which clearly set out the subcontractor's liability to avoid becoming liable for the cost of a proportion of the bond should the prime contractor or another subcontractor to the prime contractor withdraw from the tender. Typically, this agreement with the prime contractor is achieved by way of a side letter with the prime contractor.

Advance payment bond

An advance payment bond is a guarantee supplied by an exporter receiving an advance payment from the buyer. The advance payment bond provides that the advance sum will be recovered by the buyer if the contract under which the advance payment was made cannot be fulfilled, for whatever reason.

The advance payment made by the buyer to the exporter is exactly that: a payment in advance and not a "first" payment. The contract should recognise the amount of advance payment paid as an advance of each payment milestone. The advance payment bond, made as a result of the entire advance payment, should reduce accordingly as the milestone payments are made under the terms of the contract.

Figure 7: An example of an Advance Payment bond template (between the exporter and buyer)

Dear Sirs,

Our Guarantee Reference: x

We understand that you have entered into a Contract No.x (the Contract) with x (the Applicant) x for the supply of x and that under the Contract the sum of x, being x per cent of the total Contract value is payable in advance against a bank Guarantee.

In consideration of your making an Advance Payment of x (the Advance Payment) to the Applicant we, THE BANK OF X, Address U.K., hereby guarantee to refund to you up to x (Say x) in the event of the Appicant failing to fulfil the Contract.

This guarantee shall remain valid until close of banking hours at this office on x (Expiry) and any claim hereunder must be received in writing at this office by hand, by post or by courier before Expiry accompanied by your statement, bearing your original handwritten signature, that the Applicant has failed to fulfil the Contract and such claim and statement shall be accepted as conclusive evidence (and admissible as such) that the amount claimed is due to you under this guarantee.

Claims and statements as aforesaid must bear the signed and dated confirmation of your Bankers that the signatories thereon are authorised so to sign.

This guarantee shall become operative automatically on receipt of the Advance Payment of x on the account of x at our x (sort code x).

This guarantee shall become operative upon issue of our amendment making it effective, which will be issued upon receipt by us of written confirmation from the Applicant that the latter has received the Advance Payment.

Upon Expiry, this guarentee shall become null and void, whether returned to us for cancellation or not and any claim or statement received after Expiry shall be ineffective.

This guarentee is personal to yourselves and is not transferable or assignable.

This guarantee shall be governed by and construed in accordance with the Laws of England and shall be subject to the exclusive jurisdiction of the English Courts.

Yours faithfully

Countersigned

Authorised Signatory

Authorised Signatory

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Performance bond

A performance bond covers the damages suffered by the buyer in the event of non-performance of the contract by the exporter. Performance bonds may be required across a wide range of commercial situations and in international business are typically for 10% or 20% (i.e. not a value in between) of the contract price. Amounts can vary depending upon the legal jurisdiction of the contract and the buyer's specific requirements.

Performance Bonds are often agreed to by the exporter to remove the likelihood of a parent company guarantee. Similarly, offering a performance bond reduces the likelihood of a buyer requesting a parent company guarantee.

Sometimes performance bonds are referred to as "topuppable". This term, although not a recognised word, means the customer expects the bond to be reinstated by the exporters bank if the bond has been drawn upon by the customer due to poor performance by the exporter (when the contract has not been suspended or terminated due to poor performance or dispute).

N.B: Take care, when agreeing the terms of the bond that you are not agreeing to an unlimited liability with the bank.

Figure 8: An example of a Performance bond template (between the exporter and buyer)

Dear Sirs,

Our Guarantee Reference: G ☐

We understand that you have entered into a contract No. ☐ (The Contract) with ☐ (The Applicant) for the supply of ☐ and that undersuch contract the applicant must provide a bank preference guarantee for an amount of ☐ being ☐% of the value of the contract.

We, the bank of X, Address U.K., hereby guarantee payment to you on demand of up to ☐ (Say ☐) in the event of the applicant failing to fulfil the contract, provided that your claim hereunder is received in writing in this office by hand, by post or by courier before expiry accompanied by your statement, bearing your original handwritten signature, that the applicant has failed to fulfil the contract. Such claim and statement shall be accepted as conclusive evidence (and admissible as such) that the amount claimed is due to you under this guarantee.

Claims and statements as aforesaid must bear the signed and dated confirmation of your bankers that the signatories thereon are authorised to sign.

This guarantee shall expire at close of banking hours at this office on ☐ (Expiry) and any claim and statement hereunder must be received at this office before expiry and after expiry this guarantee shall become null and void whether returned to us for cancellation or not and any claim or statement received after expiry shall be ineffective.

This guarantee is personal to yourselves and is not transferable or assignable.

This gurarantee shall be governed by and construed in accordance with the laws of England and shall be subject to the exclusive jurisdiction of the English Courts.

Yours faithfully

Countersigned

Authorised Signatory

Authorised Signatory

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Unfair Calling Insurance (Bonds)

Unfair Calling Insurance is procured insurance cover, (typically through the bank or UK Export Finance – see later in this guide), to protect the exporter who has issued demand guarantees or bonds against an unfair or abusive call of the bond/guarantee by the customer (i.e. one which is not truly based on non-performance by the exporter).

Unfair calling insurance protects a company against the arbitrary or unfair calling of all "on demand" bonds, such as bid, advance payment, performance, retention or warranty bonds, where the exporter is not in default of its contractual obligations. Cover is available for bonds issued to both public and private sector companies.

Policy terms would follow the tenor of the underlying bonds and may be insured on a one-off basis or through a portfolio approach.

Bonds can be insured either contract-by-contract for their full duration, or annually on a portfolio basis, the latter being a cost-effective and administratively efficient alternative. Insurers typically require a waiting period of 180 days before a claim is payable.

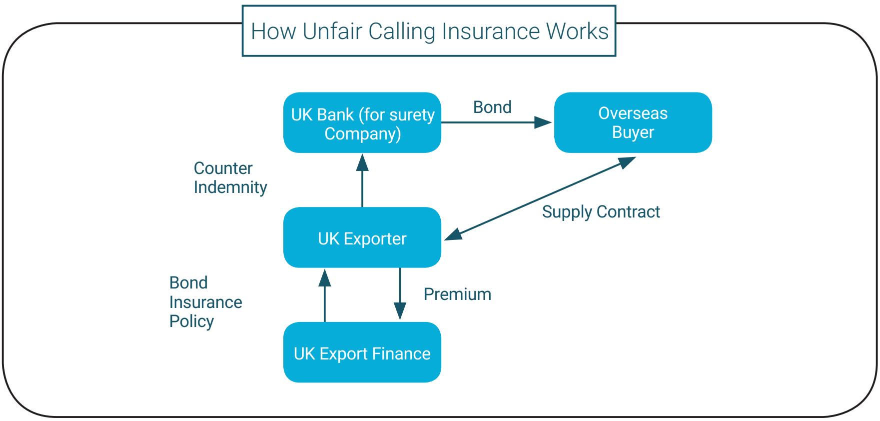

Figure 9: How Unfair Calling Insurance works

Risks that are covered and protected against typically are:

- Arbitrary and unfair calling of a guarantee by the buyer or of any related counter-guarantee by the local bank
- Legitimate calling of a guarantee due to actions by certain political events such as government actions, either the foreign government or the buyer's government (including the cancellation or non-renewal of export or import licences)
- Calling of a guarantee due to the outbreak of war, revolution, insurrection hostilities, civil disturbances and similar events
- Non-honouring of an arbitration award when the buyer has obtained an arbitration award in its favour.

Note the UK government, acting through UK Export Finance, provides Bond Insurance Cover to support UK business undertaking international business. Details of how to apply can be found the UK.gov website (https://www.gov.uk/bond-insurance-policy).

Costs

The premium payable for cover is determined on a case by case basis but typically in the region of 2%-3% of cover value (bond value).

22. UK Export Finance - previously the Export Credit Guarantee Department (ECGD)

UK Export Finance (UKEF), or ECGD as it is still often referred to, are the UK's export credit agency. They help UK exporters by providing insurance to exporters and guarantees to banks to share the risks of providing export finance. In addition they can make loans to overseas buyers of goods and services from the UK. UK Export Finance is the operating name of the Export Credits Guarantee Department (ECGD).

UKEF work closely with exporters, banks, buyers and project sponsors and have 90 years' experience of supporting exports to, and investments in, markets across the world. UKEF do this principally by providing loans to buyers of UK goods and services and guarantees, insurance and reinsurance against loss, taking into account the government's international policies.

They:

- insure UK exporters against non-payment by their overseas buyers
- help overseas buyers to purchase goods and services from UK exporters by guaranteeing or funding bank loans to finance the purchases
- share credit risks with banks to help exporters raise tender and contract bonds, in accessing pre- and post-shipment working capital finance and in securing confirmations of letters of credit
- insure UK investors in overseas markets against political risks.

Priorities

UKEF priorities are to:

- fulfill its statutory remit to support exports
- operate within the policy and financial objectives set by the government, including international obligations
- achieve fair competition by seeking to establish a level playing field internationally, through obtaining multilateral improvements in export credit policies and practices
- recover the maximum amount of debt in respect of claims paid, taking account of the government's policy on debt forgiveness.

In recent years, UKEF have supported business in the aerospace, automotive, construction, healthcare, industrial processing, oil and gas, petrochemical, water treatment, and satellite sectors and they offer support for all exporters, large and small, and all types of UK exports (goods and/or services). UK Export Finance cover is available for most overseas markets.

The UKEF webpage lists UKEF "country cover policy and indicators" to find out what cover is available for the particular country in which business activity is being considered.

UKEF Products

The following products are available through an application to UK Export Finance. Applications for loan guarantees will need to be supported by a financing bank.

Credit insurance

This is to insure against the commercial and political risks of not being paid under an export contract. UK Export Finance can also provide insurance protection to exporters against the unfair calling of contract bonds.

UKEF tend not to provide export insurance cover for exports to any EU country (except Greece) and certain countries (Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland and the United States of America) belonging to the Organisations for Economic Co-operation and Development (OECD) where the manufacturing period under the contract, plus any period of credit given to the buyer, is a total of less than 2 years, unless it can be demonstrated that cover is unavailable from the private sector.

Overseas investment insurance

Overseas investment covers investors against losses on overseas investments arising from political risks.

Loan guarantees to banks

Medium and long-term loans to finance UK export contracts such as:

- Buyer credit
- Supplier credit financing
- Lines of Credit.

In some circumstances, UKEF may be able to lend directly to an overseas buyer to finance the purchase of capital goods and/or services, or support a Buyer Credit with the Export refinancing facility.

Schemes available through banks

The following UK Export Finance schemes are available through an application to a participating bank, and are designed to make it easier for exporters to get the support they need.

If difficulty is encountered in getting the necessary support from a bank, it is recommended that the use of these schemes is proactively proposed to the bank and, if necessary, direct support from UK Export Finance is sought.

Bond support

This offers support to banks issuing advance payment, progress payment or other contract bonds in relation to UK exports.

Working capital support

Banks providing working capital loans to UK exporters.

Letter of credit guarantees

These are given to confirming banks against the risk of not being reimbursed by overseas bank issuers of letters of credit in favour of UK exporters.

Cost of UK Export Finance products and services

UK Export Finance charges a premium on transactions on a case-by-case basis.

For the Letter of Credit Guarantee, Bond Support and Export Working Capital schemes the guaranteed bank pays UKEF a guarantee fee, which is typically a proportion of the fee which the bank receives from the exporter for providing the facility in question. UKEF do not charge the exporter a separate fee.

23. Incoterms

The Incoterms (International Commercial Terms) rules are an internationally recognised standard, used worldwide in international and domestic contracts for the sale of goods. First published in 1936, Incoterms provide internationally accepted definitions and rules of interpretation for most common commercial terms.

Incoterms help the buyer and the exporter avoid costly misunderstandings by clarifying the tasks, costs and risks involved in the delivery of goods from exporters to buyers overseas including;

- The transfer of title and risk.
- The party responsible for insuring the goods.
- When and how the goods are accepted as being delivered.
- Cost of delivery (shipping).

Incoterms rules are recognised as the global standard for the interpretation of the most common terms in foreign trade.

Please note that the current set of Incoterms is Incoterms 2010 and all contracts made under Incoterms 2010 remain valid even after 2011. A copy of the full terms is available from the International Chamber of Commerce.

Group 1
Incoterms that apply to any mode of transport are:

EXW - Ex Works

means that the exporter delivers when it places the goods at the disposal of the buyer at the exporter's premises or at another named place (i.e. works factory, warehouse, etc.). The exporter does not need to load the goods on any collecting vehicle, nor does it need to clear the goods for export, where such clearance is applicable.

FCA - Free Carrier

means that the exporter delivers the goods to the carrier or another person nominated by the buyer at the exporter's premises or another named place. The parties are well advised to specify as clearly as possible the point within the named place of delivery, as the risk passes to the buyer at that point.

CPT - Carriage Paid To

means that the exporter delivers the goods to the carrier or another person nominated by the exporter at an agreed place (if any such place is agreed between parties) and that the exporter must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.

CIP - Carriage and Insurance Paid To

means that the exporter delivers the goods to the carrier or another person nominated by the exporter at an agreed place (if any such place is agreed between parties) and that the exporter must contract for and pay the costs of carriage necessary to bring the goods to the named place of destination.

The exporter also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIP, the exporter is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the exporter or to make its own extra insurance arrangements.

DAT - Delivered at Terminal

means that the exporter delivers when the goods, once unloaded from the arriving means of transport, are placed at the disposal of the buyer at a named terminal at the named port or place of destination. "Terminal" includes a place, whether covered or not, such as a quay, warehouse, container yard or road, rail or air cargo terminal. The exporter bears all risks involved in bringing the goods to and unloading them at the terminal at the named port or place of destination.

DAP - Delivered at Place

means that the exporter delivers when the goods are placed at the disposal of the buyer on the arriving means of transport ready for unloading at the named place of destination. The exporter bears all risks involved in bringing the goods to the named place.

DDP - Delivered Duty Paid

means that the exporter delivers the goods when the goods are placed at the disposal of the buyer, cleared for import on the arriving means of transport ready for unloading at the named place of destination. The exporter bears all the costs and risks involved in bringing the goods to the place of destination and has an obligation to clear the goods not only for export but also for import, to pay any duty for both export and import and to carry out all customs formalities.

Group 2
Incoterms that apply to sea and inland waterway transport only:

FAS - free alongside Ship

means that the exporter delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) nominated by the buyer at the named port of shipment. The risk of loss of or damage to the goods passes when the goods are alongside the ship, and the buyer bears all costs from that moment onwards.

FOB - Free on Board

means that the exporter delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards.

CFR - Cost and Freight

means that the exporter delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The exporter must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

CIF - Cost, Insurance, and Freight

means that the exporter delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The exporter must contract for and pay the costs and freight necessary to bring the goods to the named port of destination.

The exporter also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. The buyer should note that under CIF the exporter is required to obtain insurance only on minimum cover. Should the buyer wish to have more insurance protection, it will need either to agree as much expressly with the exporter or to make its own extra insurance arrangements.

Figure 10: INCOTERMS

INCOTERMS	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAF	DES	DEQ	DDU	DDP
Services	Ex Works	Free Carrier	Free Alongside Ship	Free Onboard Vessel	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid To	Delivered at Frontier	Delivered Ex Ship	Delivered Ex Qual Duty Paid	Delivered Duty Paid	Delivered Duty Unpaid
Warehouse Storage	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Warehouse Labour	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export Packing	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Inland Freight	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Terminal Charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Forwarders Fees	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading on Vessel	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Ocean / Air Freight	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Charges Upon Arrival	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Duty, Taxes & Customs Clearance	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Buyer	Seller
Delivery to Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller

some exporters are unable to get help from these private sources, UK Export Finance may also be able to assist – Please see UKEF within this guide.

Ensuring payment for services rendered or goods delivered can be the most contentious aspects of negotiating contracts across international boundaries. There are many different types of international payment mechanisms and the subject matter is complex, therefore the following is as a guide only and the setting up of any off-contract payment mechanism must be carried out with the engagement of Commercial and Treasury departments.

Below are the preferred payment mechanisms for international business, in order of preference:

For European Governments:

a. Upfront payment

b. Open account

c. Advance Payment (with BACS payment milestones).

For all regions and customers other than European Governments:

d. Upfront Payment

e. Confirmed Irrevocable Letter of Credit

f. A Letter of Credit with Payment Insurance.

Upfront Payment (also known as Cash in Advance)

Receiving the entire payment at the outset of the contract removes the uncertainty of receiving payment during the course of the contract. It is difficult to achieve upfront payment on any international contract greater in value that £500k. An upfront payment, or Cash in Advance of payment, is different to an Advance Payment (see below).

Open Account

An open account is the standard form of payment whereby the contract deals with how payment is made typically against a BACS process, upon the raising of an invoice upon achievement of milestones or agreed contractual stages without the need for an issuing or receiving bank.

Advance Payment

An initial percentage payment of the entire contract value (often referred to as an advance payment) is typical in international contracts, particularly when the prime contractor has any one of the following within the contract with the customer:

- Customer vested rights in materials or other goods
- A subcontract
- Initial prime contract ramp up or retrenchment costs, to enable performance of the contract
- Setting up of in country legal entities.

Typically an advance payment is no greater than 30% of the contract value.

The customer often requires an advance payment bond to be in place when agreeing to an advance payment. Please see section “Bonds” within this guide.

Advance payments are often part of the Letter of credit (but not always).

Letters of Credit – Introduction

A letter of credit is basically a guarantee from a bank that an exporter will receive a payment due from a buyer. The bank guarantees that the exporter will receive a specified amount of money within a specified time. In return for guaranteeing the payment, the bank will require that strict terms are met an exporter should be aware that it will only receive payment if it keeps to the strict terms of the letter of credit. The exporter will need to give documentary proof that it has supplied exactly what it contracted to supply to the buyer. Using a letter of credit can sometimes cause delays and other administrative problems.

Letters of Credit are most commonly used when a buyer in one country purchases goods from an exporter in another country. The exporter may ask the buyer to provide a Letter of Credit to guarantee payment for the goods.

It’s important to be aware of the additional costs involved in using a Letter of Credit. Banks make charges for providing them, so it’s sensible to weigh up the costs against the security benefits.

Letters of credit and how they work

Irrevocable Letter of Credit (ILOC)

An Irrevocable Letter of Credit is a Letter of Credit that cannot be revoked or changed by the customer for any purpose. An Irrevocable Letter of Credit is governed by a defined period of time as agreed between the customer and the exporter’s bank. The ILOC provides a payment mechanism between the banks of the customer and the exporter. Both Banks have established the customer has funds available for the agreed period of time to pay the agreed value against the ILOC. With an ILOC, the money has not been guaranteed by the customer or the customer’s Bank and the value associated to the ILOC has not been underwritten by the exporter’s Bank.

Payment Insurance is required to be taken out by the exporter to cover the possibility of the exporter not being paid under an ILOC (not required under a CILOC – see below) for whatever reason (such as unavailability of funds, customer bank collapse and expiration of time). Please see “Payment Insurance” and “ECGD” within this guide.

Acceptance and rejection clauses are of primary consideration for ILOCs. Please see “Acceptance and Rejection” within this guide.

Confirmed Irrevocable Letter of Credit (CILOC)

According to one high street bank, Confirmation means

“A definite undertaking of the confirming bank (receiving bank), in addition to that of the issuing bank, to honour or negotiate a complying presentation”

In short - By confirming the letter of credit, the second bank agrees to guarantee payment even if the issuing bank fails to make it. So a confirmed letter of credit provides more security than an unconfirmed one.

When a CILOC is in place the exporter does not need to insure for non-payment by the customer, as it would have to under an ILOC, wherein the monies are not ring-fenced by the issuing bank and guaranteed by the receiving bank. As in the case of a CILOC, the receiving bank (the exporter's bank) guarantees the ring-fenced money held by the issuing bank should the bank default or fail (i.e. collapse). Please note, however, the receiving bank may not automatically insure the ring-fenced monies, held by the issuing bank, and guaranteed by the receiving bank for political or "country" risk and therefore the exporter may have to contract this additional insurance or approach ECGD for this insurance (ECGD shall engage directly with the bank on the exporters behalf). Should a country collapse due to political instability then the receiving bank may not honour payment unless the exporter has further underwritten the CILOC.

When the exporter performs the contract and a milestone point of payment is reached and payment is due, the exporter approaches the receiving bank and gets paid. It is important, therefore, that the contract does not rely too heavily on customer acceptance of the milestones. Please see section "Acceptance and Rejection" within this guide.

The receiving bank will almost certainly request sight of the exporters' contract with its customer prior to granting some letters of credit. Should the bank take a view that the contract is not drafted clearly they are likely to refuse to offer some payment guarantees (such as a CILOC) unless the exporter is able to reopen negotiations with the customer in order to satisfy the needs of the bank. The bank will take a particular interest in the process relating to acceptance and payment, within the exporter's contract with the customer.

Any export contract should not become effective until the Letter of credit is in place and, sometimes, this may include an advance payment. Please see section "Contract Effective Condition" within this guide.

The setting up process for a CILOC is time consuming for a number of reasons:

1. Both the exporter and the buyer have to provide identical and original contracts to their banks (one slight error and the delays can be long).

2. Both banks have to agree trading terms with each other, which is simpler if the banks have existing arrangements in place between them; sometimes the issuing bank and the receiving bank can be the same bank, which greatly simplifies the process.

3. The exporter will have to agree terms (and costs) with the receiving bank.

4. The exporter may be required, by the receiving bank, to negotiate clearer, less ambiguous, trading terms with the customer.

Under CILOC arrangements, the customer is not able to withdraw the ring fenced funds from their bank for the duration of the CILOC.

Other Letters of Credit (apart from Irrevocable and Confirmed Irrevocable)

The following Letters of Credit are available as an off-contract payment mechanism and should be used only in exceptional circumstances. There are five commonly used types of letter of credit. Each has different features and some are more secure than others. The most common types are:

- revocable
- unconfirmed
- transferable

Other types include:

- standby
- revolving
- back-to-back

Revocable letters of credit

A revocable letter of credit can be changed or cancelled by the bank that issued it at any time and for any reason.

Transferable letters of credit

A transferable letter of credit can be passed from one 'beneficiary' (person receiving payment) to others. They're commonly used when intermediaries are involved in a transaction.

Standby letters of credit

A standby letter of credit is an assurance from a bank that a buyer is able to pay an exporter. The exporter doesn't expect to have to draw on the letter of credit to get paid.

Revolving letters of credit

A single revolving letter of credit can cover several transactions between the same buyer and exporter.

Back-to-back letters of credit

Back-to-back letters of credit may be used when an intermediary is involved but a transferable letter of credit is unsuitable.

Costs of setting up Letters of Credit

Banks play a key role in letters of credit transactions. Issuing banks open letters of credit for the account of applicants and in favour of the exporter (beneficiary). In doing so, they have to bear certain risks and allow the applicants to benefit from their credit worthiness. As commercial institutions, issuing banks provide these services with the sole objective of making money, which is the main reason why letters of credit are so expensive compared to other payment methods. Similarly, confirming banks collect fees from the letter of credit parties with the same objective in mind. When confirming a letter of credit, confirming banks may have to bear substantial non-payment risk and as a result, confirmation fees can sometimes climb to high values. In typical letter of credit transactions, other banks in addition to the issuing bank and confirming bank may be involved, such as an advising bank, a nominated bank, or a reimbursing bank. Every additional bank means additional fees and additional cost for either applicants or beneficiaries.

Typically, 3% of the contract value is a reasonable assumption for the cost of setting up and maintaining a letter of credit, however it is prudent to get a quote in order to ascertain the cost.

The exporter's customer may insist the exporter pays the bank cost, associated to setting up and maintaining the letter of credit, incurred by the buyer. In this instance, these costs should be agreed within a schedule of the contract.

UKEF can provide an estimate for setting up Letters of Credit and payment Insurance. Please see "UKEF" and "Payment Insurance" within this guide.

Figure 11: A typical Payment table within a contract featuring an off-contract payment mechanism.

Payment Date	Amount £GBP	Payment Terms	Type of Payment
Upon Contract Signature	£2,384,640 (30% of Contract Value)	Contract Signature	BACS
Month 12 from arrival of first Student into the United Kingdom	£2,384,640 (30% of Contract Value)	Completion of Month 11 Training (issue of acceptance certificate)*	CILOC
Month 18 from arrival of first Student into the United Kingdom	£2,384,640 (30% of Contract Value)	Completion of Month 17 Training (issue of acceptance certificate)*	CILOC
Month 26 from arrival of first Student into the United Kingdom	£794,880 (10% of Contract Value)	Completion of Month 25 Training(issue of acceptance certificate)*	CILOC

*Please refer to acceptance condition within the contract.

25. Offset

Offset contracting (also known as: industrial compensations, industrial cooperation, offsets, industrial and regional benefits - but not to be confused with “counter trade” contracting) is a form of contracting which is applied by some overseas governments to foreign aerospace and defence companies (or companies operating in a defence and security environment) who sell their goods and services into their country. Some countries are looking at widening the offset criteria to apply to other products and services outside of aerospace, defence and security.

“More than 120 countries around the world have some form of offset programs with unique requirements that suit their individual needs.”

In its simplest form: an offset agreement is an understanding between a foreign Government and an exporting company (exporter) which requires the exporter to purchase a certain amount of goods from that country in exchange for a contract. Offset agreements can be direct or indirect, depending on what raw materials the country may have. These agreements are often required in order to award a foreign contract to a large company producing valuable goods.

Direct offset

A direct offset agreement means that the supplier has agreed to either provide a service or transfer knowledge or buy something from the country awarding the contract that is directly related to the product the company providing. For example: if an aircraft manufacturer is awarded a contract from, say, France, the aircraft manufacturer may agree to use steel from France in order to produce the aircraft. The fact that the steel is being used to manufacture the product that is going back to the country makes the offset agreement a direct one.

Indirect offset

An indirect offset agreement is one where the company agrees to either provide a service or transfer knowledge or purchase a certain number of products from the foreign country that may not be directly related to the product being manufactured. Often, because companies have no need for certain products from the foreign nation, they may make deals with other companies. For example, an aircraft manufacturer may not need the type of steel produced in France, but a fast food company could use beef produced from France. The aircraft manufacturer could make a deal with that fast food company to purchase French beef. Often, to entice the fast food company into the contract, something else may be offered, such as exclusive rights to serve that company’s food in the aircraft company’s cafeteria.

In addition to helping the country get a return on its investment, offset agreements can be used to bolster developing economies. In some cases, an offset agreement, or a series of them, may help an industry within a developing country get the footing it needs to succeed. These companies can help improve the quality of life for the entire country by spreading the wealth around and creating spin-off industries. In such situations, an offset agreement can become a valuable tool for economic development – it is very typical for the transfer of intellectual property (including know how) to be an offset criterion.

Some countries, such as Brazil, India and the UAE, have well developed offset legislation and the offset contracting criteria of these countries form some of the most complex contracting practices likely ever to be encountered. One such publicly available example as described below.

A hypothetical case of Nation P (Purchaser) buying 300 tanks from defence company S (Exporter, of Nation S). The total sale contract is $400 million and Nation P (Purchaser) requests offset of 120%. Defence Company S (Exporter) is obliged to fulfil an offset equal to 120% of the sales contract, which is $480M. Nation P agrees on a list of specific offset deals and programs to fulfil the agreed total obligation with Company S (Exporter). The offset agreement includes both direct and indirect offsets.

Nation P also assigns a credit value for each typology of offsets offered by Company S. The credit value for the offset obligations is not the "actual value," but it is the "actual value" by a multiplier, that expresses the degree of interest of Nation P (Purchaser) in the proposed offsets. In other words, something deemed very valuable by nation P will have a high multiplier that expresses the importance and the value to Nation P of that type of offset. The multiplier (for instance 2, or 5, or 7) translates nation P's attached value into the credit value that eventually accounts for the fulfilment of the agreed sum of $480m (120% of offset); it is evident that with no multipliers, 120% offset would be nonsense. Most of the offset packages are divided into direct and indirect offsets. Here is a hypothetical, complex offset offer, divided into direct and indirect offsets in Nation P.

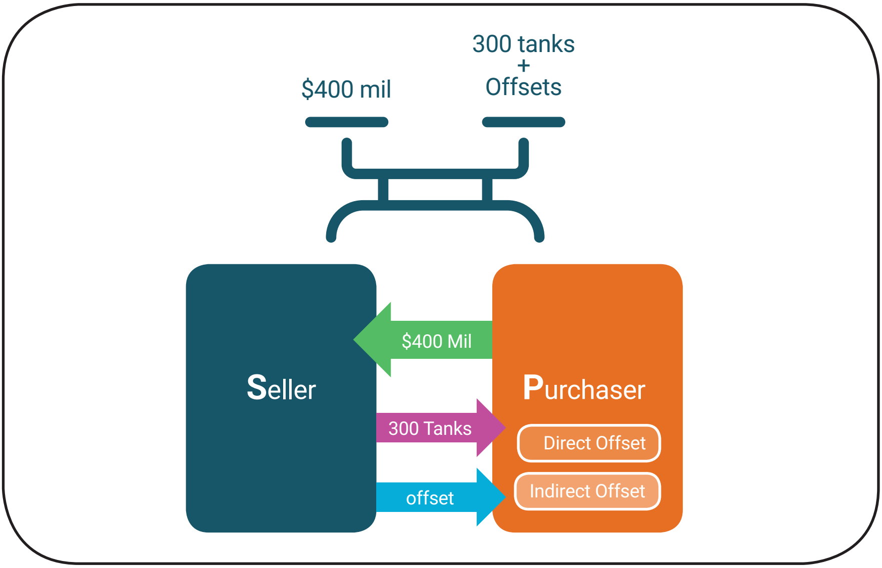

Figure 12: Offset example

Direct Offsets (military and related to the product of the Company S, i.e. the tanks in this example)

Co-production: Nation P chooses one or more local companies to manufacture some components of the tanks, such as turrets and some of the internal components. The actual value of the components is $70 million. Nation P assigns a multiplier of 3, since this develops capabilities of its military industrial base and creates jobs in Nation P. The total credit value for the fulfilment of the overall offset obligation is $70M x 3 = $210M.

	Actual Value	Multiplier	Credit Value
Co-production	70 mil	3	210 mil
Foreign Direct Investment (FDI)	14.5 mil	4	58 mil
Technology Transfer	20 mil	7	120 mil
Export Assistance / Marketing	3 mil year (x 8 years)	3	72 mil
	128.5 mil		480 mil

Figure 13: Offset example

Indirect Offsets (civilian and other agreements not related to the production of the weapons item, the tanks. They could be also military or security related, but not directly connected with the main acquisition, i.e., the tanks).

Foreign Direct Investments: Company S makes investments in 5 (defence or non-defence) companies in Nation P. The total value of the investments is $14.5M, and the multiplier is 4, a high multiplier, since Nation "P" suffers from a chronic lack of Foreign Direct Investments. This makes an additional credit value for Company S of $58M.

Technology Transfer: Company S provides water desalination technologies to one Nation P company. This technology is particularly appreciated by Nation "P". Its actual value is $20M, but the credit value is 7 times the actual value, that is, $140M.

Export Assistance and Marketing: Company S provides commercial assistance to market products and services of a Nation "P" company in a difficult market, such as, for instance, the Middle East. The assistance is offered for 8 years, at the value of $3M per year. Nation P considers this assistance to export as important to create new revenue streams and jobs for its company, and sets a multiplier of 3. Credit value: $72M. (Since company S is not an expert on marketing and export assistance, it may hire a specialist company to subcontract the job. Such a subcontractor is also known as an "offset fulfiller").

Nation P controls not only the supply of the military systems or services, but also the implementation of the offsets according to the offset agreement included or related to the main supply contract. This control is within the Minister of Defence and/or Ministry of Economy or Finance, or Ministry of Industry and Trade. Often arms importing nations establish special agencies for the supervision of the defence offsets.

Figure 14: The most common types of direct/indirect offsets.

Direct offset	Direct or Indirect offset	Indirect offset
Co-production	Technology Transfer	Export Assistance
Subcontracts	Training	Purchases
	Licenced Production	Offset Swapping (compensation of offsets' obligation through reciprocal abatement)
	Foreign Direct Investment, Credit Assistance and Financing	

Offset Contracting principles for the UAE:

1. Purchases Subject to Offset

Supply contracts of a cumulative value exceeding USD 10 million in any 5 year period are subject to Offset.

2. Contractual Requirements

The procurement & offset processes start in parallel. A defence/ aerospace contractor is informed of the requirement to enter into an Offset Agreement during the bidding process. The contract award process is linked to the signing of an Offset Agreement. This ensures that defence contractors are aware of the UAE offset requirements and have ample time to plan the identification and execution of an adequate project to fulfil potential obligations.

3. Level of Offset Obligations

Offset projects that are implemented by defence/ aerospace contractors to fulfil their obligations are required to add economic and commercial value to the UAE's economy equivalent to 60% of the supply contract value. The level of obligation does not directly correspond to investments made in an offset venture but to the value created by an offset venture in terms of contributions and profits generation over time.

4. Terms of Fulfilment

Typically, all defence / aerospace contractors are to fulfil their offset obligations over a period of seven years. At the offset committee's discretion, certain projects are granted an additional grace period depending on the level of complexity, sophistication and infrastructure requirements.

5. Milestones

A certain level of obligation is expected at the end of each year of a program. These levels have been carefully assessed and linked to the expected growth cycle of a project. Percentage achievements are calculated over a seven year period against the following: 5%, 10%, 10%, 15%, 15%, 20%, and 25% for each year respectively.

6. Credit Earning Activities

A hybrid program consisting of input and output based activities has been designed to allow the defence contractors the flexibility to maximize the structure of their obligation fulfilment contribution model. Input credit generating activities are up-to 30% of the total obligation of a specific program while output credit generating activities should not be less than 70% of obligation of that specific program. A list of approved input-credit activities can be obtained by contacting the offset committee.

7. Liquidated Damages

Liquidated damages of 8.5% will be assessed for non-performance. The liquidated damages are imposed on the unfulfilled portion of the obligation calculated at each milestone. Payment of liquidated damages fulfils 50% of the obligation due. The remaining portion is carried forward to a separate account to be achieved after the fulfilment of last milestone. At maturity of the program accumulated liquidated damages will be paid back upon satisfaction of the shortfalls.

8. Technology Transfer

When transferring technology as part of an offset deal it is important to understand the value attributable to the technology being transferred. Transferring Intellectual Property (often against a user licence) can be a good way of meeting offset obligations.

Countertrade Contracting

Countertrade is an umbrella term covering a wide range of commercial mechanisms for reciprocal trade. Countertrade can come in several forms but always involves payment being made, at least partially, in goods or services, instead of money. It often occurs when a multi-national company sells to a customer abroad and that customer pays by providing goods to the multi-national company. In some countries, countertrade is a condition of the buying organisation importing goods from elsewhere.

There are a number of key variations in countertrade including:

Barter - which is the simplest form of countertrade as no money changes hands and so the transaction is a straight exchange of goods.

Buyback - is usually associated with a turnkey type project in that it involves the provision of the means to deliver goods or a service in exchange for raw materials or some other product, usually to be supplied at a later date in the contractual arrangement. As the time scales can be quite lengthy, there are obvious risks which need to be managed to ensure that the contract is concluded satisfactorily. An example is a construction company which builds a plant or factory and once it is up and running and providing revenue, the construction company takes an agreed percentage of the output as payment over a defined period of time.

Counter-purchase - the exporter agrees to buy goods from the importer, the value of the goods is a percentage of the price of the goods exported, or the majority of the goods are paid for in cash.

26. Payment Insurance

Payment Insurance (sometimes called Export Insurance) provides protection against the risk of not being paid under an export contract or of not being able to recover the costs of performing that contract because of certain events which prevent its performance or lead to its termination.

In performing the contract, costs may be incurred before delivering goods and providing services to the buyer. For example, the exporter may need to buy equipment, pay sub-contractors or hire staff. The policy provides cover against not being able to recoup those costs because of the occurrence of an insured risk, which leads to the contract's termination or prevents its performance.

As goods and/ or services are delivered, the exporter may become entitled to payments under the terms of the contract. The policy provides cover to the exporter against non-payment of those amounts where the exporter has fulfilled its contractual obligations.

The benefits of an Export Insurance Policy are:

- up to 95% cover is provided
- The exporter is covered against loss suffered due to specified risks.

Events which might cause a contract to be frustrated or the buyer to not meet its obligations include:

- insolvency of the buyer
- the buyer's failure to pay any amount due under an export contract
- political, economic or administrative events outside the UK that prevent payments from the buyer under the export contract being converted into sterling or transferred to the UK
- hostilities or civil disturbances outside the UK that affect performance of the an export contract.

Cost

The premium payable for cover is determined on a case by case basis but typically in the region of 2%-3% of cover value (contract value).

In order to invoke the guarantee (of insurance,) the insurance policy may require the exporter to go through some form of arbitration, or at the very least have a dispute resolution condition within the supply contract. It is very important, therefore, that the insurance taken out by the exporter for non-payment is fully understood by the exporter prior to negotiating the supply contract.

The Payment insurance company will likely to insist that the buyer is not made aware that the contract has been insured.

Acknowledgements

Incoterms – Incoterms

UAE Offset Committee (OPT) - Offset

Brazil Ministry of Strategic Affairs – Offset

Le Sablier Ltd – David Robinson Pricing model / Advisor process (AST) / Business Success Criteria

UK Government Export Finance – EGCD (UKEF credit)

Transparency International UK – Due Diligence, ABAC

BBC – questions on ABAC

Pricing –David Robinson and Mike Marshall (NATS Services Limited)

Gathering Market Intelligence - Henri Leoni/ David Robinson (NATS Services Limited)

IP - Jonny White (Edited by David Robinson - Cut down version of Jonny's Guide)

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