

Lectures on Defensive Management

Lecture #3: Common problems with contract & Problems and alternatives in financing the order

Objective:

- . Revision of the contract
- . Revision of financial methods
- . Demonstration of errors
- . Planning technique in error trapping and error avoidance.

Outcome:

- . Capable to minimize problem in contract related activities..
- . Capable to minimize problem in financial activities..

PART A

Introduction of contract

1. Revision of contract

1.1 What is Contract?

After a business deal is made verbally, the next step is to sign a contract, which legally bind both parties into an agreement. If any dispute happens, the judge of the court looks at the contract, and determine who has breached it.

1.2 Detail of contract

A contract consists of three sections:

1.2.1 Terms -

Terms are the items that both party agree on. Examples are:

- @1 price
- @2 delivery date
- @3 quantity

[Defensive Act] The settlement term (payment term) is the most important one in a contract.

1.2.2 Conditions

Conditions list out all the requirements that must be fulfilled before the terms can be valid. Examples are:

- #1 the delivery date can only be changed with the consent of both party
- #2 the colour fastness of the shipment must be 4 or better according to the test SABS 405
- #3 the dimensional allowance of the chest measurement is ± 0.5 "

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[Defensive Act] There must be a set of conditional clauses describing the acceptance and rejection of the shipment. These clauses should be written as precise as possible. Any grey area may lead to a dispute. Dispute may lead to lawsuit.

1.2.3 Default conditions

These are standard conditions on the contract. That means, unless overridden by the conditions in 1.2.2, all default conditions apply. Examples are:

- *1 the factory reserves the right not to delivery and all deposits will be refunded.
- *2 the buyer must present tangible proof if any claim of defective goods is concerned.

[Defensive Act] There are default conditions on the cancellation of order. Be ware!

1.3 General practice

In a business transaction, typically the buyer sign the contract provided by the seller. The default conditions are typically printed at the back of the contract, with small fonts. The content of these default conditions are protective to the seller in the case of lawsuit.

Since the language of legal documents are written in a very technical and logical way, most people cannot fully understand the meaning. In this case, a legal practitioner is needed to draft the default conditions.

[Defensive Act] To hire an attorney or a lawyer as a consultant on a yearly basis. Let the attorney to interprets and explain the terms and conditions to you.

1.4 What should we check in a contract?

Although the exact wording on the contract can vary, but the following point must be checked:

- #1 role assignment (who is buyer and seller)
- #2 date of contract
- #3 description of order
- #4 price
- #5 quantity
- #6 delivery date
- #7 format of order
- #8 method of settlement
- #9 condition of acceptance
- #10 condition of reject
- #11 condition of cancellation of order (include penalty)
- #12 other conditions
- #13 other default conditions

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2. Revision of legal action

2.1 What is legal action?

When two parties, who are bound with a contract, are having dispute and cannot settle themselves, one party can sue the other party. The process is typically carried out with the help of an attorney, or lawyer. The case is then considered in the court. After the attorney of both parties have completed their presentation and inquiry, the judge then arrives to a conclusion. [Sometimes juries are needed if criminal offense is involved!]

2.2 People involved in the legal action

Here are some definitions:

- @1 Plaintiff - complaining party in a lawsuit.
- @2 Defendant - party charged in a lawsuit.
- @3 Attorney/Lawyer - a legal practitioner representing one's client in a lawsuit.
- @4 Judge - public official authorized to decide questions brought before a court.
- @5 Jury - body of persons sworn to give a verdict on a matter.

2.2.1 The role

For the role of a plaintiff and a defendant, there are many combinations:

Plaintiff	Defendant	Example
Government (HKIR, Custom, Fire Dept, Labour Dept, etc)	Company	#1 unpaid tax #2 illegal entry of shipment #3 insufficient fire prevention device in a factory #4 illegal workers
Company	Government (Custom, etc) Staff, Workers.	#1 illegal seize of shipment #2 unauthorized transaction #3 damage
Staff/workers	Company	#1 Discrimination #2 Unpaid salary/pension #3 Unreasonable discharge

2.3 Special consideration before engaging into a lawsuit

Before engaging into a lawsuit, several factors must be considered thoroughly:

2.3.1 Chance of winning

When a dispute arises, who should bear the responsibility? How can you *prove* that it is someone else's fault? Unless the answers are "yes", don't bother to sue others.

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[Catch: the party who loses the case is responsible to the payment of the majority of the total expenses!]

[Defensive Act] Government is the party you should least sue. In most cases, if you can present sufficient documents, the dispute can be settled.]

2.3.2 Potential loss

Even if you have confidence to win the case, Murphy's law may strike and you may have to bear the cost! So, you better calculate the cost. Here are some basic components:

%1 Charge from attorney

%2 Time spent on the case, including attending the court

%3 Duration of the case. [sometimes, the waiting period of the first summon can be as long as 2 ~ 6 months!]

2.3.3 Amount of compensation

Suppose you win the case, how much is the compensation? Can it justify the lawsuit?

[Defensive Act] If the compensation does not worth the lawsuit, don't start.

[Defensive Act] Consult an attorney, and find out more and make sure you have the picture cleared before engaging into any lawsuit. Don't let your emotion overwrite your logic!

2.4 Procedure of lawsuit

- a. Consult an attorney and discuss the case.
- b. Try to settle down outside the court.
- c. If dispute cannot be settled, and a lawsuit is decided, let the attorney do the follow up.
- d. You appear in court.
- e. After the hearing is completed, the judge or the juries make a decision.

3. Common problem with contract

The biggest problem with the contract in the textiles and clothing industry is the precision of acceptance, or the quality level. There are the source of major problems.

3.1 Expressing precision of acceptance in dimension

The size chart on the contract indicates the anticipated measurement. There MUST be a tolerance together with this size chart. A typical one looks as follow:

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	S	M	L	Tolerance
Chest	34"	36"	38"	± 0.5"
Waist	22"	24"	26"	± 0.5"
Hip	34"	36"	38"	± 0.5"

It is very important to note that there are many factors affecting the tolerance:

@1 position of measurement

Example: tolerance at the chest and waist is higher than that length of cuff. It is because you need room to breathe and eat.

@2 "fit" requirement

Example: tolerance at the waist is equal to the basic allowance for eating, plus the requirement of fit. Therefore, a fitted shirt sometimes has less tolerance.

@3 types of garment

Example: an expensive evening wear typically has less tolerance than the casual wear.

@4 types of fabric

Example: knitted garment typically has a much larger tolerance than a woven garment, because of the stretchability of the fabric.

@5 types of finishing on the garment

Example: tolerance of garment washed clothes requires a very large tolerance because of the nature of the processing.

@6 selling price

Example: a very expensive gown usually requires more precise "fit"; consequently, the tolerance is smaller.

3.2 Expressing precision of acceptance in styling

As pointed out in lecture #2, terminology can be confusing. Therefore, a production sketch with engineering drawing can be used as part of the contract.

3.3 Expressing precision of acceptance in quality

Sometimes, the approved sample can be used as an agreement on the quality standard. However, in the court, since the judgement on difference between the production and the sample can be subjective, the judge commonly requires a third party opinion from an expert! [That's why ITC are hired to provide expert opinion on many occasions for a lawsuit! No kidding!]

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In terms of wording, usually the contract states that an inspection certificate from the buyer is a sufficient proof for the acceptance of the buyer. Depending on the practice of a firm, a third party may be employed to inspect the shipment, and provide a third party certificate. This third party is called the arbitrator!

In either case, there is a common practice of specifying the inspection level to be say “normal double sampling level I with AQL level 4.0! Yes, AQL 4.0 is a commonly accepted level for the apparel industry.

[Defensive Act] If there is a dispute on the quality, go for an arbitrator first, before considering a lawsuit!

PART B Alternatives in financing the order

4. Financial tools

There are many different methods of financing an order. Here are some popular ones:

\$1 L/C: letter of credit

That means the buyer issues a L/C through his bank to the seller. The seller brings this L/C to his bank and borrow money to finance the production. There are many documents required upon the completion of order, which must be submitted to the bank in order to clear the L/C and received the money.

4.\$1.1 Key documents to be submitted for L/C

Although there are many documents to be submitted for the collection of money from a L/C, the following two documents are usually the key documents, because they are issued by other party.

#1 Inspection certificate [from the buyer or the arbitrator to verify the acceptance of the shipment]

#2 Bills of lading [from the shipping company to verify that the shipment has been loaded on board]

[Catch: the seller does not need to trust the buyer, because the L/C is issued by a bank.]

[Defensive Act] Majority of international trade prefer this practice!

\$2 D/A: Document acceptance

This means the buyer is willing to pay for the shipment as long as the required documents are received!

[Catch: the D/A is not issued by a bank, so there is no service charge.]

[Defensive Act] Unless the seller has some way to secure the payment, this method is very dangerous.

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Example of safe practice of D/A: Both buyer and seller belong to the same business enterprise. The contract is nothing more than a formality.

5. Collection method

It should be clear that both L/C and D/A are also method of collecting payment.

There are other methods:

\$3 Factor House (credit agency)

A factor house plays the role of monitoring the credit of his members/clients. So, both buyers and sellers can join the factor house as a member. They have to sign a contract and a power of attorney for collection of payment. Here is the operation procedure:

%1 The seller submit the invoice to the factor house.

%2 Upon collection of shipment, the buyer pays to the factor house.

%3 The factor house collects the payment and pays to the seller on a periodic basis.

%4 If the buyer fails to pay to the factor house, the seller still gets the money from the factor house. [So, it is kind of insurance.]

The factor house is responsible to report the financial condition of the buyer to the seller, and vice versa. The factor house warns the seller not to ship to the buyer.

[Defensive Act] This is the most common method of payment in the wholesale business in countries like the USA.

\$4 Collection agent

There are companies which specialise in the collection of outstanding payment. They charge on the collection service.

5.\$4.1 How it works?

The client must present the case with clear indication and proof of right of collection. The agent typically write to collect on behalf of the client. The next step is to file a lawsuit. Since these companies have the time, the patience and the expertise, in many cases the collection can finally be achieved.

[Warning: Some collection agents may go for illegal method of collection. It is very careful to select the right agent.]
