

# Commercial Contract Risk Guide



Last Updated: 03 March 2026

## Purpose of This Guide

Commercial contracts form the foundation of most business relationships. Poorly drafted or poorly understood contracts can expose businesses to significant financial and legal risk.

This guide is designed to assist businesses in identifying and managing common contractual risks before entering into an agreement.

In particular, the guide aims to help businesses:

- Identify common contractual risks such as scope creep, unclear payment terms, and excessive liability exposure
- Use a structured checklist approach when reviewing contracts
- Improve internal contract governance and approval processes

This guide is particularly useful when:

- Negotiating new contracts
- Reviewing supplier agreements
- Renewing or amending existing agreements
- Entering into long-term commercial relationships

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## Governing Legal Framework

Commercial contracts in South Africa are primarily governed by the common law of contract, although several statutes may affect the enforceability and interpretation of agreements.

Understanding the legal framework can assist businesses in identifying potential risks before entering into contractual commitments.



## Common Law of Contract

South African contract law is largely based on common law principles.

These principles regulate matters such as:

- The formation of a valid contract
- The interpretation of contractual terms
- The consequences of breach of contract
- Remedies available to the aggrieved party
- Whether a contract is unlawful or contrary to public policy

For a contract to be valid and enforceable, several essential elements must generally be present, including consensus between the parties, lawful purpose, and contractual capacity.



## Companies Act 71 of 2008

The Companies Act 71 of 2008 introduces important governance considerations when companies enter into contracts.

Key risk areas include:

### Authority to Contract

Businesses must ensure that the person signing the contract has the necessary authority to bind the company.

This may involve verifying:

- Board approval for material transactions
- Internal delegation of authority
- Compliance with the company's memorandum of incorporation and internal policies

## Governance Compliance

Certain transactions may require formal corporate approvals such as board resolutions.

Failure to comply with internal governance requirements can create disputes regarding the validity of a contract.

## Execution Discipline

High-value or long-term contracts should follow structured internal approval procedures to ensure appropriate oversight and risk management.



## Consumer Protection Act 68 of 2008

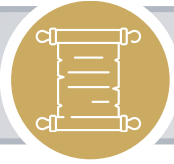
The Consumer Protection Act (CPA) may apply to certain business-to-business transactions.

However, the CPA generally does not apply where the consumer is a juristic person whose asset value or annual turnover exceeds the prescribed threshold (currently R2 million).

The CPA may become relevant where contracts involve:

- Standard form supplier agreements
- One-sided contractual terms
- Marketing representations
- Cancellation or return policies

Businesses should ensure that contractual terms are fair, reasonable, and transparent where the CPA applies.



## Electronic Communications and Transactions Act 25 of 2002

The Electronic Communications and Transactions Act (ECTA) regulates the use of electronic communications in commercial agreements.

Important considerations include:

- When electronic communications may constitute binding agreements
- The legal status of electronic signatures
- The evidentiary value of electronic communications and records

Businesses should ensure that their contracts clearly define how agreements may be concluded electronically.



## Protection of Personal Information Act 4 of 2013 (POPIA)

Where contracts involve the processing of personal information, the Protection of Personal Information Act (POPIA) may apply.

This is particularly relevant where agreements involve:

- Employee information
- Customer databases
- Marketing lists
- CRM systems
- Data processing services

Contracts involving personal information should clearly address:

- The lawful basis for processing personal information
- Security safeguards
- Data breach notification obligations
- The responsibilities of operators processing information on behalf of a responsible party



## Contract Formation (What Makes a Contract Valid)

Understanding how contracts are formed can help businesses avoid disputes regarding whether a binding agreement exists.

### Offer and Acceptance

A contract generally arises when one party makes an offer and the other party accepts that offer.

In modern commercial practice, contracts are often negotiated through email, messaging platforms, or electronic systems.

This can create uncertainty regarding when a binding agreement has been concluded.

To reduce this risk, businesses should:

- Include an entire agreement clause
- Clearly define what constitutes acceptance (for example, a signed agreement, purchase order, or written confirmation)
- Ensure that all material terms are clearly recorded in writing

### Identifying the Contracting Parties

One of the most common contractual risks arises when it is unclear who the contracting parties actually are.

Before signing a contract, businesses should verify:

- The full legal name of each party
- The company registration number
- The registered address

Where multiple companies within a group are involved, it is important to confirm which entity is actually assuming contractual obligations.

## Lawful Purpose and Public Policy

Contracts that involve unlawful conduct or that are contrary to public policy may be unenforceable.

Examples may include:

- Anti-competitive agreements
- Clauses attempting to exclude liability for fraud or intentional misconduct
- Penalty clauses that are disproportionate to the loss suffered

Businesses should ensure that contractual provisions comply with applicable law and regulatory requirements.



## Key Commercial Contract Clauses

Certain contractual provisions are particularly important in managing commercial risk.

Businesses should pay careful attention to the following clauses when negotiating or reviewing contracts.

### 1. Scope of Work

The scope of work clause should clearly define:

- The services or goods to be provided
- What is specifically included
- What is excluded unless agreed in writing
- The responsibilities of each party
- How changes to the scope will be handled

Poorly defined scope provisions frequently result in scope creep and fee disputes.

## 2. Payment Terms

Payment clauses should clearly address:

- The pricing structure
- Whether amounts are inclusive or exclusive of VAT
- When invoices may be issued
- Payment deadlines
- Interest on overdue payments
- The right to suspend services in the event of non-payment

Unclear payment provisions can lead to significant disputes regarding when payment becomes due.

## 3. Performance Timelines

Contracts should specify clear performance timelines, including:

- The commencement date
- Key milestones
- The expected completion date

Where delivery depends on actions by the client, these dependencies should also be recorded.

Unrealistic delivery dates can create unnecessary contractual risk.

## 4. Breach Provisions

Contracts should clearly define what constitutes a breach.

Examples may include:

- Failure to pay invoices
- Failure to deliver agreed services
- Breach of confidentiality obligations
- Intellectual property violations

Most contracts should also include a notice and remedy period, allowing the defaulting party an opportunity to correct the breach before termination.

## 5. Termination Provisions

Termination clauses provide important risk protection.

Contracts should generally address:

- Termination for material breach
- Termination in cases of insolvency or business rescue
- Termination where continued performance becomes unlawful
- Post-termination obligations such as return of confidential information

Termination provisions allow businesses to exit problematic commercial relationships in a structured manner.

## 6. Limitation of Liability

Limitation of liability clauses are designed to prevent disproportionate financial exposure.

These clauses typically:

- Limit liability to a specific monetary cap
- Exclude indirect or consequential losses
- Exclude certain categories of damages such as loss of profit

Without a limitation of liability clause, a business may face unlimited exposure for contractual damages.

## 7. Indemnity Clauses

Indemnity clauses allocate risk where third parties bring claims against one of the contracting parties.

Common indemnities relate to:

- Intellectual property infringement
- Personal injury claims
- Property damage
- Third-party legal claims

Indemnities should be carefully drafted and should generally align with the overall limitation of liability provisions.

## 8. Confidentiality Provisions

Confidentiality clauses protect commercially sensitive information.

These clauses should define:

- What information is confidential
- When disclosure is permitted
- How confidential information must be protected
- How long confidentiality obligations remain in effect

In many commercial agreements, confidentiality obligations continue after the termination of the contract.

## 9. Governance and Signatory Authority

Businesses should ensure that contracts are signed by individuals who have the authority to bind the relevant entity.

Before signing a contract, businesses should verify:

- Whether the signatory is a director or authorised representative
- Whether internal approvals are required
- Whether a board resolution or power of attorney is necessary

Proper governance procedures reduce the risk of disputes regarding the enforceability of agreements.

## Conclusion

Commercial contracts play a central role in managing business risk. However, poorly drafted or poorly understood contracts can expose businesses to significant legal and financial consequences.

By carefully reviewing contractual provisions, ensuring proper internal governance, and obtaining legal advice when necessary, businesses can significantly reduce contractual risk and strengthen their commercial relationships.

## Disclaimer

This guide is provided for general informational purposes only and does not constitute legal advice. While every effort has been made to ensure the accuracy of the information contained in this guide, the content is necessarily general in nature and may not apply to specific circumstances. Businesses should obtain professional legal advice before acting on any information contained in this guide. Jacobs & Potgieter Incorporated accepts no liability for any loss or damage arising from reliance on this guide without obtaining appropriate legal advice.