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Commercial Contracting

CIPS L4M3

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QUESTION NO: 1

Which of the following is the reason why liquidated damage clauses are embedded into a contract?

- A. Because liquidated damages are the only remedy
- B. To penalise the supplier for their wrongdoing
- C. To avoid argument on correct measure of damage
- D. Because compensation will be awarded immediately

ANSWER: C**Explanation:**

Liquidated damages are an amount of money, agreed upon by the parties at the time of the contract signing, that establishes the damages that can be recovered in the event a party breaches the contract. The amount is supposed to reflect the best estimate of actual damages when the parties sign the contract. These usually apply to a specific type of breach, and in construction, it is frequently the failure to complete work on time.

Liquidated damages clauses are usually written as some sort of formula, for example:

Total Contract Price – [(X amount of \$ per day) x (number of days late)]

Including a liquidated damages clause can provide many benefits, the most important of which is predictability. When setting a predetermined amount of damages, it allows both parties a chance to negotiate and settle on a number they both feel is fair and reasonable.

From the owner's perspective, this acts like a cheap form of insurance against your contractors. In the event of a breach, the owner can immediately calculate the damages without going through the trouble of proving actual damages. Proving actual damages can be a complicated, lengthy, and costly process.

From a contractor perspective, this allows them to analyze the level of risk involved, and schedule appropriately. It also allows them the opportunity to limit the damage claims of the owner.

Reference:

- Construction Contract Clauses: What Is a Liquidated Damages Clause?

- CIPS study guide page 158-159

LO 3, AC 3.2

QUESTION NO: 2

Which of the following are reasons why a purchaser wants to embed a subcontracting clause into the main contract? Select TWO that apply:

- A. To induce the conflicts between the main contractor and subcontractors
- B. To improve supply chain transparency

- C. To reduce the main contract complexity
- D. To keep main contractor liable
- E. To condemn whole liabilities to subcontractors

ANSWER: B D

Explanation:

There are number of reasons why the purchaser will want to control the supplier's subcontracting:

- Supply chain transparency: Normally the purchaser has invested a lot of effort into selecting the right contractor. However, the main contractor's selection of subcontractor might not be in such careful manner, which may result in poor performance. Purchaser must know who subcontractors are. Controlling the subcontracting process can help the purchaser control the outcome.
- Contract terms: the purchaser's requirements must be reflected in the subcontracts. The subcontracting clauses may require the main contractor to do this.
- Liability: the main contractor may subcontract the whole or a part of its liabilities. Subcontracting clause may bind the contractor to be liable with the work, it cannot just blame the subcontractor for any faults.

Reference: CIPS study guide page 154-155

LO 3, AC 3.2

QUESTION NO: 3

Which of the following are NOT covered by CISG? Select TWO that apply:

- A. Transfer of risks
- B. Contract validity
- C. Remedies for breach of contracts
- D. Liability of the seller for death or personal injury
- E. Liability to pay damages

ANSWER: B D

Explanation:

United Nations Convention on Contracts for the International Sale of Goods (Vienna Convention or CISG)

Vienna Convention was prepared by by the United Nations Commission on International Trade Law (UNCITRAL) and adopted by a diplomatic conference on 11 April 1980. The Convention was welcomed by several countries from different geographic areas, with different legal and political systems. As of 20 August 2020, the Convention has 93 Contracting States. The Convention has proved the effectiveness of an uniform text on international trade law.

What CISG covers, and what it does not

In the 6 first articles of the Convention, the authors set up the boundaries of its application.

First is about where it applies. According to UNCITRAL, the Convention applies to contracts of sale of goods between parties whose places of business are in different States and either both of those States are Contracting States or the rules of private international law lead to the law of a Contracting State. A few States have availed themselves of the authorisation in article 95 to declare that they would apply the Convention only in the former and not in the latter of these two situations. As the Convention becomes more widely adopted, the practical significance of such a declaration will diminish. Finally, the Convention may also apply as the law applicable to the contract if so chosen by the parties. In that case, the operation of the Convention will be subject to any limits on contractual stipulations set by the otherwise applicable law.

Second, the Convention has a list of goods that are not subject to its application in Article 2. Article 3 clarifies the differences between manufacturing contracts and sale contract.

Third, Article 4 and 5 clearly states what CISG does not covers, including grounds for contract invalidity and liabilities to death or injury of person caused by the the goods

Finally, the Convention respects the contractual freedom of the trading parties. Trading parties may select this convention as governing law or select other instrument, such as UPICC or domestic laws.

Reference:

- Governing law in International Contracts - Would you choose CISG or UPICC (Part 1)

- CIPS study guide page 49-52

LO 1, AC 1.2

QUESTION NO: 4

Is the government only source of industrial standards within a country?

- A. No, the government can only adopt standards regarding security and defence
- B. Yes, while ISO make standards for international trade, the government standardises other facets of their country
- C. No, an organisation can also generate its own internal standards
- D. Yes, the standards must be made by legislative branch of the country

ANSWER: C

Explanation:

A standard is a document that sets out requirements for a specific item, material, component, system or service, or describes in detail a particular method or procedure. Standards are established by consensus and approved by recognized standardization bodies.

There are several different types of standards. Some of the most commonly-used standards set out the requirements that a particular kind of product, service or process must fulfil, in order to establish that it is 'fit for purpose'. Other types of standard relate to methods of testing, terminology and definitions, information requirements, or the compatibility of connections.

Standards provide individuals, businesses and all kinds of organizations with a common basis for mutual understanding. They are especially useful for communication, measurement, commerce and manufacturing.

Standards make trade easier by ensuring compatibility and interoperability of components, products and services. They bring benefits to businesses and consumers in terms of reducing costs, enhancing performance and improving safety.

Standards are voluntary, which means that businesses and other organizations are not legally obliged to apply them. However, in certain cases standards may facilitate compliance with legal requirements, such as those contained in European directives and regulations.

Standards can be made by a company, a standard organisation (such as ISO or BSI) or regulatory bodies.

Reference:

- CIPS study guide page 93-94
- Standards and your business

LO 2, AC 2.1

QUESTION NO: 5

A service contract is going to be expired, which data source is good to create specifications for ITT?

1. Incumbent supplier
2. Maintenance services
3. Alternative supplier
4. User's knowledge

- A. 1, 2 and 3
- B. 1, 3 and 4
- C. 1, 2 and 4
- D. 2, 3 and 4

ANSWER: B

Explanation:

There are a number of shortcuts that can be taken when drafting the specification. These include the following:

- The use of brand names
- The use of recognised standards
- The use of samples
- Information and knowledge from users/other buyers: Drafting a specification should naturally include those already used within the organisation itself, but also variants used by other companies in the same sector and other companies in different sectors
- Information from suppliers: suppliers will always be willing to assist in specification development, as this is one way in which they can seek to influence the design to favour their own products.

Reference: CIPS study guide page 81-85

LO 2, AC 2.1

QUESTION NO: 6

A procurement professional is preparing a sale & purchase contract of a machinery. Which of the following clauses should be added to the contract? Select TWO that apply

- A. Supplier selection mechanism
- B. Insurance requirements
- C. Period of hire
- D. Ratio decidendi
- E. Guarantees

ANSWER: B E**Explanation:**

The complexity of the contract will reflect the complexity of the purchase. For simple, low-value purchases, standard terms and conditions may be all that is required, but do not assume that just because the purchase is one-off, the contract will be simple. It may still need to cover the following areas:

- Warranties and guarantees if the one-off purchase has a considerable life-span and is business-critical (e.g., a back-up generator for the office which houses the national computer servers).
- Insurance requirements: including professional indemnity, public/products liability, employer's liability, and cover for any specific risks such as pollution or working at height.
- Specification requirements on quality, timing and delivery
- Minimum quality standards on the business operation (e.g., a catering provider might only be providing sandwiches for a team meeting lunch, but you still need to know its hygiene practices).
- Built-in change process for any goods or services that are beyond very simple (e.g., works contracts always have variations procedures because of the unpredictable nature of such projects).
- Ability to extend the scope of the contract should be minimal or none, and restrained to the single requirement.
- Ability to extend the duration of the contract should be limited to the ability to accommodate unexpected time overruns (which itself should be subject to a damages/penalty provision where they are attributable to the supplier, and an extension to overheads costs where they are attributable to the purchaser).
- Data security protocols need to be considered if personal data is being shared.

Reference: CIPS study guide page 57

LO 1, AC 1.3

QUESTION NO: 7

A supermarket purchases a new batch of house cleaner from new supplier. The supermarket is concerned about possible damage that the house cleaner may cause to consumers' floor. What type of insurance must they cover?

- A. Fire and explosion insurance

- B. Product liability insurance
- C. Professional indemnity insurance
- D. Public liability insurance

ANSWER: B

Explanation:

Product Liability Insurance is a form of general liability insurance meant to protect a business from financial and legal consequences as a result of bodily injury or property damage due to the use of the business's sold goods or products. Situations that are typically covered by Product Liability Insurance may include:

- A customer harms herself because of the faulty packaging on one of your products
- A drapery set that a customer purchased from your business was highly flammable and caught on fire, eventually damaging her entire kitchen
- A customer with a severe allergy finds trace amounts of tree nuts in your homemade gourmet muffins
- A homemade house cleaner that you sell damaged one of your customer's entire hardwood floor
- A customer becomes sick with food poisoning after eating old shellfish at your restaurant, goes to the hospital, and incurs medical costs caused by your contaminated food products
- A customer's pet becomes ill from ingesting some lining in a pet toy product that you sell

In the scenario above, the supermarket is purchasing and reselling house cleaner, which can be covered by product liability insurance.

Public liability insurance is a type of business insurance that covers the cost of claims made by the public that happen in connection with the business activities.

Professional indemnity (PI) insurance is a commercial policy designed to protect business owners, freelancers and the self-employed if clients claim a service is inadequate.

Reference: CIPS study guide page 150-153

LO 3, AC 3.2

QUESTION NO: 8

Which of the following should be specially noticed in market dialogue with suppliers in specification development?

- A. Both parties must respect confidentiality
- B. The buying organisation must avoid social media at all cost
- C. Market dialogue is banned in the public sector
- D. Market dialogue should only be conducted with well-known supplier

ANSWER: A

Explanation:

Being clear on your objectives helps you to design the best approach to the dialogue. There are some notices in developing dialogue with suppliers:

- All meetings should be documented

- Respect commercial confidentiality. Although insights gained from one conversation lead to questions in another, you must be very careful not to allow this to happen in a way that breaches the confidentiality of the first conversation.

Reference: CIPS study guide page 84-85

LO 2, AC 2.1

QUESTION NO: 9

Which of the following are most likely to be liabilities of suppliers under a guarantee clause? Select A. TWO that apply

B. Repair

C. Decommissioning

D. Upgrading

E. Replacement

F. Installation

Answer: B, E**Explanation:**

A guarantee is an agreement given by a trader to a consumer, without any extra charge, to repair, replace or refund goods that do not meet the specifications set out in the guarantee. A guarantee is usually issued by the manufacturer of goods or by a trader that provides goods as part of a service - replacement windows, for instance. Generally, a guarantee provider undertakes to carry out free repairs, for a set period of time, for problems that can be attributed to manufacturing defects.

Reference:

- Guarantees and warranties

- CIPS study guide page 157-159

LO 3, AC 3.2

A. Repair

B. Decommissioning

C. Upgrading

D. Replacement

E. Installation

ANSWER: A D**Explanation:**

A guarantee is an agreement given by a trader to a consumer, without any extra charge, to repair, replace or refund goods that do not meet the specifications set out in the guarantee. A guarantee is usually issued by the manufacturer of goods or by a trader that provides goods as part of a service - replacement windows, for instance. Generally, a guarantee provider undertakes to carry out free repairs, for a set period of time, for problems that can be attributed to manufacturing defects.

Reference:

- Guarantees and warranties
- CIPS study guide page 157-159

LO 3, AC 3.2

QUESTION NO: 10

Which of the following documents are likely to have legal standing? Select TWO that apply:

- A. Quotation
- B. Request for information
- C. Tender
- D. Requisition
- E. Estimate

ANSWER: A C**Explanation:**

A quotation and a tender are both firm offers which have legal standing to the offeror. Tenders are more detailed than quotations and will include quality aspects as well as prices.

LO 1, AC 1.1 & AC 1.2