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Drafting Standard Forms for the Purchase of Goods From Suppliers: RFQs, Quotes, Purchase Orders, Long-Term Agreements

Minimizing Disputes Between Buyers and Suppliers With Carefully Drafted Terms and Conditions of Purchase

TUESDAY, JUNE 20, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Drafting Standard Forms for the Purchase of Goods

RFQs. Quotes, Purchase Orders, Long-Term Agreements



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Contract Language Samples

- In separate materials – They are not legal advice
- Each case requires careful consideration of client-specific objectives
 - Some companies prefer a “partnership” approach and will refuse strongest legal language
 - Some companies rely on market power instead of legal power
- Automotive Issues:
 - Just in time deliveries; loss of production is staggeringly expensive
 - Buyers dominate, but hogs get slaughtered

Applicable Law for Sales of Goods

- UCC Article 2 governs sales of goods, supplemented by:
 - United Nations Convention on International Sale of Goods (CISG) – can be disclaimed by agreement, but how achieve agreement in battle of forms? See, *Rosen Technologies, Inc. v. Carl Schreiber GmbH*, 2013 WL 4852314, 81 UCC Rep. Serv.2d 693 (W.D. Pa. 2013).
 - Incoterms (Int'l Chamber of Commerce Terms – generally governing shipping and delivery)
 - Common law – principles of equity

Basic Advice: What's at Stake

- Basic Article 2 advice:
 - *There is simply no substitute for reading the documents.*
 - *If you don't like what you see, keep on reading.*
 - Examples: revocation of acceptance, assurance of performance
- Goal = “our” terms, or fight Battle of Forms to a draw?
- Key Misconceptions
 - First communication controls
 - Being the [offeror/acceptor] is best
 - It's just boilerplate

Contracting: Minimum Requirements

- To be enforceable, agreements must:
 - Be *verifiable*
 - Usually a writing is required (Statute of Frauds)
 - Provide for *consideration* from each party to the other
 - Although a promise for a promise is adequate, and
 - Fairness is generally not an issue
 - *Identify and quantify* the subject goods
- That's it, as Article 2 will supplement the agreement to provide other relevant terms, including warranties – even price

Quantity: Output and Requirements Contracts

- Output and requirements contracts, that lack fixed quantities, are acceptable
 - As long as not “unreasonably disproportionate” to any estimate provided, if any, or to past activity: UCC 2-306
 - In addition, if the contract is exclusive, on either side, best efforts of seller to produce and best efforts of buyer to promote sales are required UCC 2-306
 - When is an output or requirements contract *not* exclusive?
 - What about percentage of requirements?

Contract Formation

- Classic Offer and Acceptance
 - Which communication is the offer? What is mere discussions?
 - Counteroffers
 - Conditional Acceptances
- Common law “mirror image” and resulting problems once performance is commenced
- Article 2 allows “mirror image” contracting, but rejects it as a requirement (more below), and takes other aspects of the parties relationship into account

UCC Favors Contracts - and Will Provide One, Even When Key Terms Are Disputed: UCC 2-207(3)

- Conduct creates contract even when writings do not
 - Accepted goods or payment will establish a contract of some sort
 - The terms are those on which the parties' writings agree, modified by Course of Performance, Course of Dealing and Usage of Trade (in that order), plus terms provided by the UCC
 - Implied terms even include price UCC 2-305
- So, how does this all work out where mirror image agreement is not obtained notwithstanding multiple communications but goods have been accepted?

The Battle of the Forms UCC 2-207

- Acceptance can occur even if different terms are proposed, unless acceptance is expressly made conditional on assent to the new terms
- New terms are treated as proposals, that become part of a contract between merchants unless:
 - Offer limits acceptance to the terms of the offer
 - The new terms materially alter the offer, or
 - The offeror has objects within a reasonable time
- A merchant offeree can impose immaterial changes in terms on a merchant offeror unless the offer has “my way or the highway” language

Case Law – What Proposed Changes are Material?

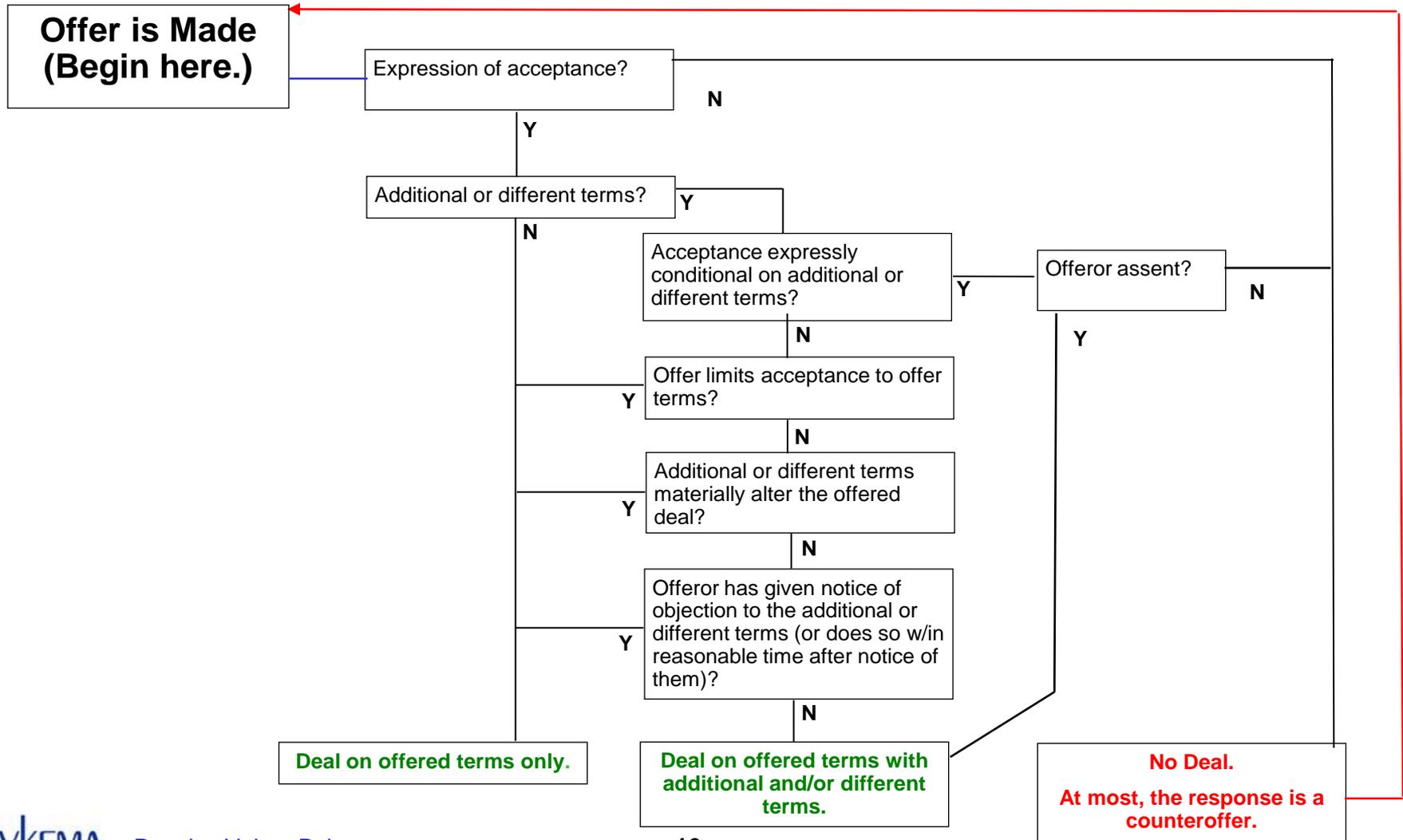
- When is an additional or changed term proposed by an offeree merchant so material that it does not become part of a contract between merchants (assuming the offer did not expressly limit acceptance to its terms)?
 - Arbitration clause? No, when arbitration was a common trade practice
 - Forum selection clause? Yes
 - Remedy limited to return of price? No (somewhat surprising as that is a specific example of an allowed limitation on remedies in UCC 2-719)

Battle of the Forms – Fully Engaged

- Obviously, “my way or the highway” language is important so everyone will be advised to include it. Given that, parties often end up with a contract, but with no agreement (indeed conflict) on various terms.
 - Note the effect of offer and acceptance analysis in determining where the parties agree – outcomes still depend in part on the court’s determination of who made the offer
- UCC 2-207(3): Contract will be on written agreed terms, plus Article 2 terms. “Knockout” Rule eliminates disputed terms

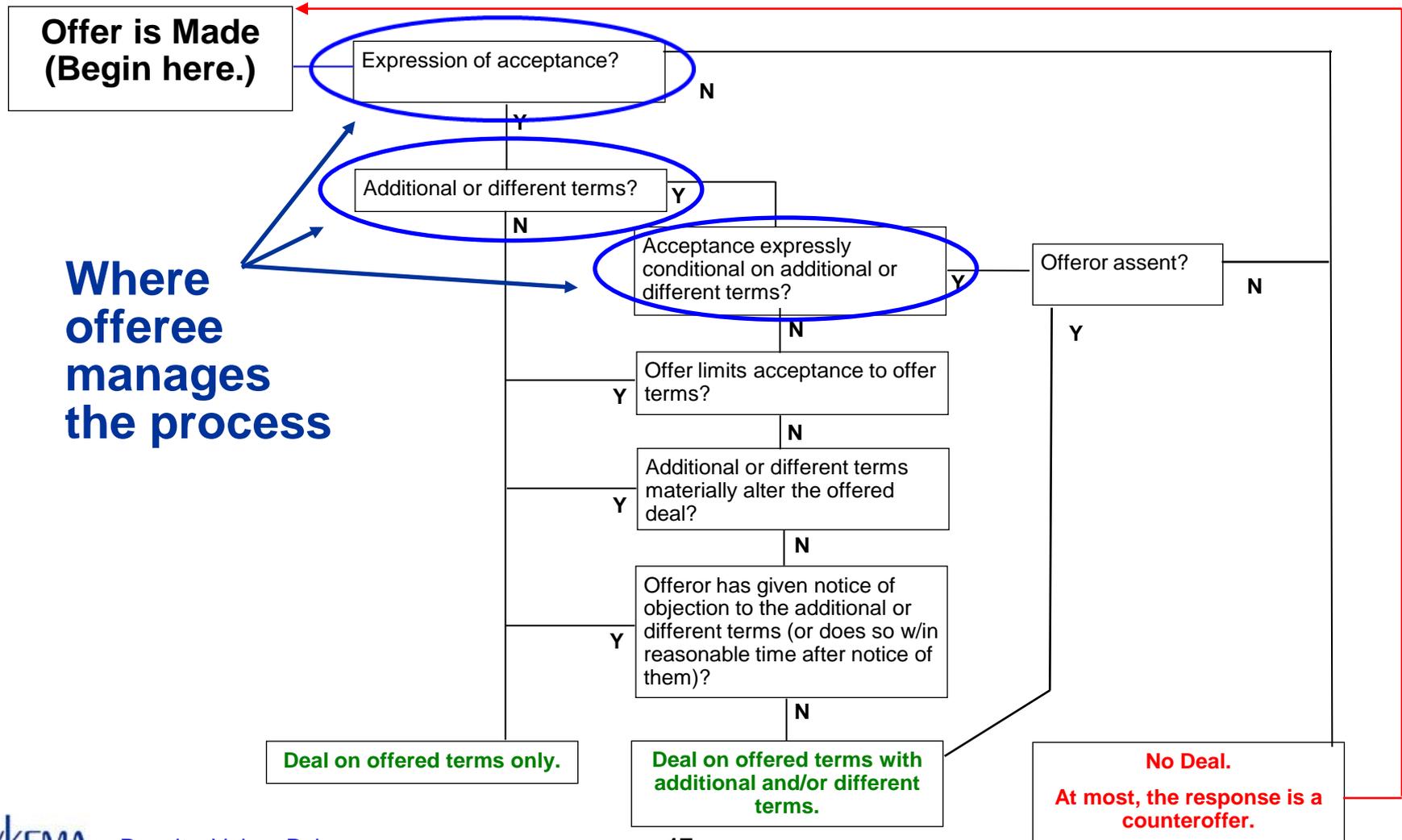
Deal or No Deal?

Assumes that the parties are merchants with respect to the goods involved.



Deal or No Deal?

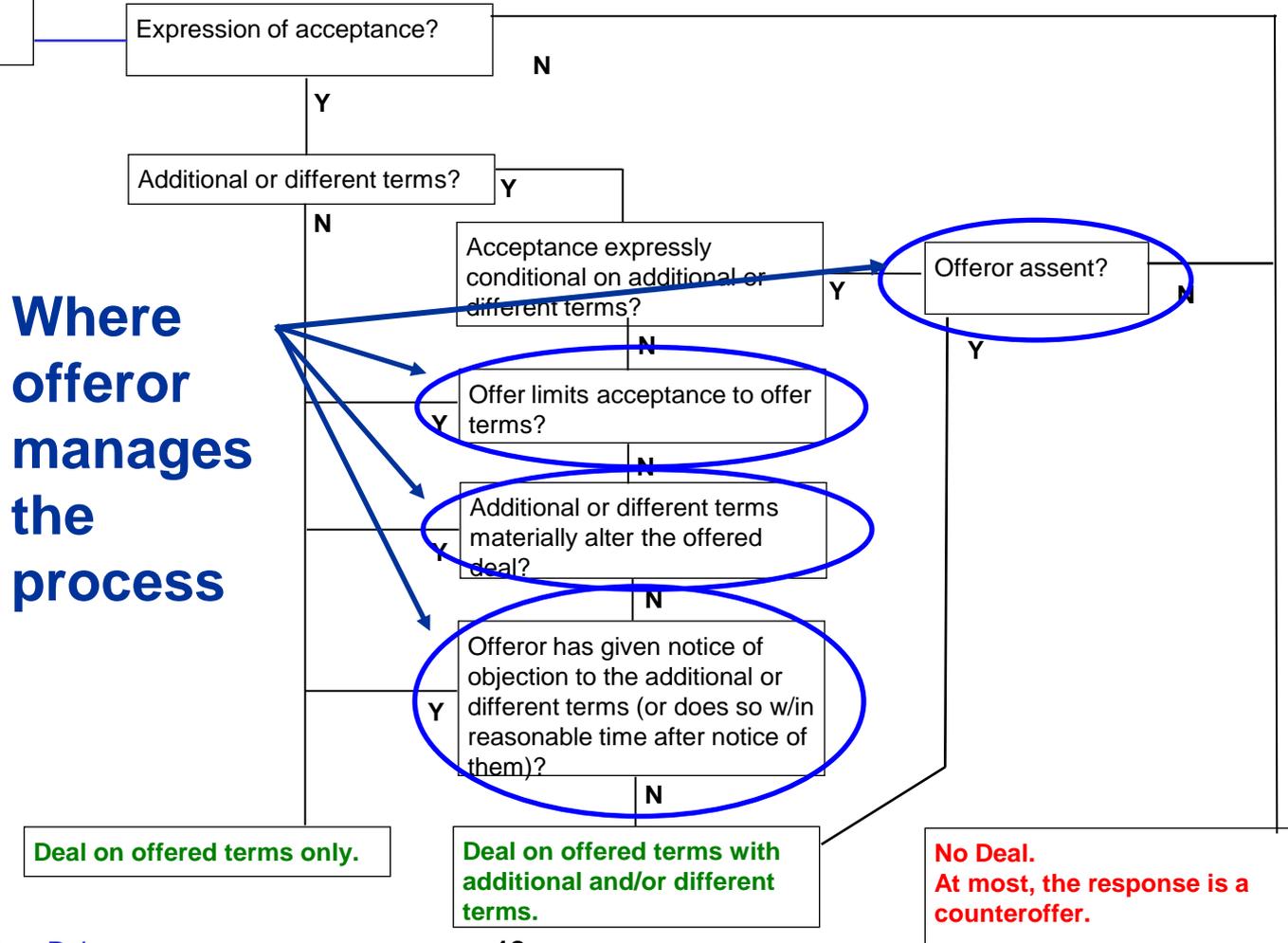
Assumes that the parties are merchants with respect to the goods involved.



Deal or No Deal?

Assumes that the parties are merchants with respect to the goods involved.

**Offer is Made
(Begin here.)**



Where offeror manages the process

Deal on offered terms only.

Deal on offered terms with additional and/or different terms.

**No Deal.
At most, the response is a counteroffer.**

After The Knockout Rule – What Implied Terms?

- Reasonable price UCC 2-305
- Delivery at Seller's place of business UCC 2-308
- Reasonable time to deliver and reasonable notice to terminate UCC 2-309
- Payment due on receipt unless Seller required or opts to extend credit UCC 2-310
- Risk of loss passes on delivery UCC 2-509
- Buyer's right to inspect UCC 2-513
- Terms concerning acceptance, revocation of acceptance, returned goods
- Remedies

Implied Warranties

- By far and away, the most important issue is whether UCC implied warranties will apply
 - Merchantability UCC 2-314
 - Pass in the trade without objection
 - Fair average quality for fungible goods
 - Fit for ordinary purposes
 - Run of even kind and quality
 - Adequate packaging and labeling
 - Conform to promises on container or label

Implied Warranties

- Other than Merchantability, there is :
 - Title and no infringement UCC 2-312
 - Title will pass free and clear and use will not infringe IP rights of others
 - Fitness for a particular purpose or use (if applicable, based on seller's expertise and knowledge of actual intended use) UCC 2-315

Disclaimers

- Disclaimers must be clear and conspicuous
- Merchantability must be specifically mentioned to be disclaimed
- Title must be specifically disclaimed
- However,
 - “as is” or “with all faults” works
 - Disclaimer can arise from CoD or UoT
 - All implied warranties are modified by pre-contract examination of samples (or what would have been revealed by one if buyer declines to perform one when samples are offered)

Knockout Rule Example

- First, identify areas of agreement and disagreement, then
- Keep agreed-upon terms (green) and eliminate others (red):

	<u>Buyer</u>
Payment:	Net 90
Warranties:	Merchantability Fitness for Purpose ANSI 2342.1
ADR:	Arbitration
Pricing:	Fixed through end of program

	<u>Seller</u>
Payment:	COD
Warranties:	No warranties. All disclaimed
ADR:	Arbitration
Pricing:	Subject to steel surcharges

Knockout Rule Example

- Then replace the eliminated terms with UCC gap fillers:

The Contract

Payment: COD (UCC 2-310)

Warranties: Merchantability UCC 2-314

Fitness for Purpose UCC 2-315

[No ANSI]

ADR: Arbitration

Pricing: Reasonable price at the time for
delivery (includes steel price effects)
UCC 2-305

Battle of the Forms Fought to a Draw

- Generally favors buyer
 - Merchantability
 - Fitness for purpose
 - No contractual limitations of liability
- Some elements favor sellers
 - Effectively FOB seller's dock
 - Payment due at the time of shipment
- Is this acceptable?
 - If not, discipline and management will be required to reach actual agreement

Real World: Importance of Determining the Offer

- *Compass Automotive Group, LLC v. Denso Manufacturing Tennessee, Inc.*, Case No. 12-10919 (E.D. Mich., Feb. 22, 2013).
- Buyer's RFQ expressly states it is not an offer, but includes buyer's standard T&C and "my way or the highway" language
- Seller sends "my way or the highway" quotation incorporating Seller's standard T&C
- Buyer sends "my way or the highway" purchase order based on quoted price, incorporating Buyer's standard T&C
 - Buyer expects that it controlled the process and seller is bound to buyer's characterization of purchase order as the offer

Real World: Importance of Determining the Offer

- Court holds:
 - RFQ was not an offer, but the quotation was
 - The purchase order was an acceptance proposing additional terms – a forum selection clause
 - Clause was material, so was not part of contract and seller could sue buyer in seller's state
- If court had held that purchase order was the offer, buyer would have prevailed
 - Performance would have constituted acceptance with no other response to purchase order

Practical Considerations/Recommendations

- The legal rules are deceptively easy, but incredibly difficult to apply
 - Great pressure to deal
- Avoid trap of assuming you control the offer
 - Tables can turn when other side tenders terms
- Therefore, ***all communications*** must include “my way or the highway” language
 - Consider “no deal until signed” language
- Use award letters to confirm agreement with standard terms and change procedure
- Understand and use two-edged sword of email.

Practical Considerations/Recommendations

- Lawyers, especially outside counsel, do not understand the details – specifications, handling and inspections procedures, usage of trade, etc.
 - So issues are ignored
- Invest in communication and solid forms
 - Use ready, shoot, re-aim approach; e.g., fix last year's 3 biggest issues each year
- Maintain discipline
 - Allow time for contacting process and enforce mileposts

Product Liability; Recall; Indemnification

- Automotive has extensive and detailed express warranties
 - Detailed specifications, engineering requirements and industry standards (e.g., Production Part Approval Processes)
 - In addition to UCC warranties
 - Apply notwithstanding inspection
 - Design pushed to suppliers
- Recall expenses can be extensive and much more than repair and replacement costs: typically, OEMs control
- Indemnification is broad and usually cover incidental and consequential damages without limitation

Thank you!

Any Questions?



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DELINEATING AREAS OF CONTROL AND FAULT

- Common types of losses subject to indemnification: breach of representation or warranty; breach of a covenant; losses incurred under specified conditions; and third-party claims against the indemnitee.
- If equal bargaining strength, parties should only warrant and indemnify for things under their control. In the indemnification provision, the types of fault that could reasonably occur should be defined and attributed to a certain party.
- Factors to consider:
 - Who would be at fault for the loss?
 - Who has the bargaining power?
 - Who is in the best position to insure against the risk?
 - Who is in the best position to control/mitigate the risk?
 - What is the customary industry practice?

OFTEN THE FACTS ARE MORE IMPORTANT THAN THE LAW

- Do you have the specific list of outsourced components in front of you when you draft the form MPA or Purchase Order T&Cs?
- Do you know how the outsourced component interacts with the parts and components manufactured in-house by your client?
- Do you know each failure mode of the outsourced component and the consequence to the final product?
- Do you know whether the failure mode creates an unsafe condition?

DESIGN RESPONSIBILITY AFFECTS RESPONSIBILITY FOR ACTUAL AND ALLEGED PRODUCT DEFECTS

- a. Purely manufacturer's design
- b. Purely Customer's design
- c. Design By A Third Party in the Supply Chain – usually ultimate seller (e.g., automotive; white goods)
- d. Jointly Designed – Custom negotiation of liability allocation
- e. “Industry” Design with modifications – more like “Purely Manufacturer's Design”

ALLOCATE LIABILITY FOR PRODUCT DEFECTS BASED ON DEFECTIVE WARNINGS

Warning/Instruction Defects

- a. Packaging/Instructions/Warnings by Seller
- b. Packaging/Instructions/Warnings by Buyer
- c. Effect of Industry standards

ALLOCATE LIABILITY FOR PRODUCT DEFECTS BASED ON MANUFACTURING DEFECTS

Manufacturing defects

- a. Normally all Seller's responsibility
- b. Where Buyer has incoming QC responsibilities
- c. Where nature of installation/product makes defect obvious before installation
- d. Defect not material to personal injury or property damage/limited to economic loss (repair)

THE VIEWPOINT OF THE BIG COMPANY GENERAL COUNSEL

- Risk Management
 - Unforseeable consequences
 - Getting many people to conform to process and procedure
- Use of standard agreements
- Restrict ability to deviate from standard agreement
- Psychology of the Purchasing Department

SUPPLIER'S VIEWPOINT

- A. Environment/Practical Considerations
- B. Key Commercial Points For Most Suppliers
- C. Order Acceptance Process
- D. Education/Training

A. ENVIRONMENT/PRACTICAL CONSIDERATIONS

1. Your VP of Sales/Salesman
2. Buyer's Purchasing Department
3. Some Buyers Will Not Bargain
4. Long Tern Relationships vs Isolated Transactions

B. KEY POINTS FOR MOST SUPPLIERS

1. Negotiating Master Purchase Agreements
 - What terms to focus on
2. Operating by way of “Simple” Exchange of Forms
 - What terms to focus on

KEY POINTS FOR MOST SUPPLIERS (ctd.)

1. Fitness for Specific purpose/Intended use
2. Relying on Supplier's expertise
3. Breach of warranty
4. Duty to mitigate
5. Recalls
6. Indemnification
7. Liability limits

C. ORDER ACCEPTANCE PROCESS

1. Understand the Seller's order acceptance process
2. Create documents that fit this process
3. Suggest changes to the process where necessary/desirable

PROCESS AND PROCEDURE

- Create a Checklist of what's most important
- Prioritize the items on the checklist
- Prepare specific description of the desired outcome
- Create your own Terms and Conditions of Sale
- Prepare specific description of acceptable outcome
- Prepare list of negotiating options
- Training of negotiators
- Understand what the customer needs vs printed terms of the form contract

D. EDUCATION/TRAINING

1. Sophisticated client

- Managers with Supply Chain Management degrees
- Experience in multiple industries and scenarios
- Use them as a resource

2. Unsophisticated client

- Education and training are the key

EXAMPLE: CREATING A PRIORITIZED CHECKLIST OF IMPORTANT ITEMS

Example assumes you will focus on specifications as key term

IMPORTANT ITEMS, STARTING WITH DETAILED SPECIFICATIONS

1. Warrant only that product will conform to specifications provided by Buyer and agreed upon by Seller.
2. Limitations of Liability to Buyer Notwithstanding Breach of Warranty within the 12 month warranty period
3. Indemnity/Defense by Seller
4. Quality Assurance obligations
5. Buyer's Indemnity/Defense of Seller
6. Government-mandated recalls
7. Elective recalls by customer/ultimate manufacturer
8. Order Process
9. Intellectual Property Rights/Indemnity

KEY POINTS REGARDING SPECIFICATIONS

- Manufacture to specifications provided by Buyer and agreed upon by Seller.
 - Recommendations of Seller have been independently approved and adopted by customer
 - Clear description of “specifications” without any ambiguity or vagueness
 - Exclude “intended use” or “purpose” clauses
 - Avoid incorporation of unknown or overbroad documents
 - Incorporated documents are overbroad if they include language that goes beyond merely building to customer’s specifications

COMPARE INDUSTRIES

1. Automotive
2. Industrial, Municipal and Household Pumps
3. Food additives

AUTOMOTIVE

- Highly sophisticated worldwide supply chain
- Trained purchasing departments supported by automotive engineers
- Safety, functionality and appearance all critical
- Long lead times for new models drive long-term partnerships
- Close cooperation between engineering departments
- OEM and supplier each contribute to design and warnings
- Significant regulation focused primarily on safety and environmental
- Complicated failure modes
- Warnings and operating instructions are material issues

PUMPS AND PUMP SYSTEMS

- Industrial, Municipal and Residential are all different businesses
- Large industrial customers often have own internal expertise, and products usually have some variation from a base design
- Sales to municipalities almost always through knowledgeable intermediaries, and pumping systems are sometimes nearly custom
- Governmental sourcing rules and regulations and RFQ process
- Residential sales are all off-the-shelf smaller products
- Safety rarely a significant issue

FOOD ADDITIVES

- Custom products designed for specific customers
- Standard proprietary products sold to customers, some of which are “tweaked”
- Private label products of seller’s creation, but packaged as required by customer
- Subdivide and repackage products purchased in large quantities and resold in small quantities.
- Very significant regulation focused on safety and disclosure – advertising representations and warnings are issues

COMPARISON

- Automotive should always be able to create exact specifications, though complexity is huge
- Pumping systems need to be integrated, and outside third party fits the pump to the more complex hydraulics of the system in an environment where all systems, even those used by the same municipality, are different
- Food taste and smell are always factors and are very hard to exactly quantify