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Manufacturing and Supply Agreements: Drafting High-Risk Provisions and Settling "Battle of the Forms" Issues

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Drafting Manufacturing/ Supply Agreements: Negotiating High-Risk Provisions & Navigating "Battle of the Forms" Issues

August 6, 2020

Topics

- Battle of the Forms
- Forecasting and Inventory Liability
- Warranty
  - Obligations, Remedies, Disclaimers
- Ownership of Intellectual Property
- Pricing
  - Adjustments, Changes, Early Pay discount, MFN
- Tooling
- Indemnity
- Limitations of Liability
- Boilerplate
  - Force Majeure, Amendments, Assignment, Integration, Choice of Law, Venue, Dispute Resolution, Construction, Advice of Counsel

IACCM SURVEY 2018

Most negotiated term	vs	Most important term
1. Limitation of Liability		Scope and Goals
2. Indemnification		Responsibilities of the parties
3. Price/ Price Changes		Price/ Price Changes
4. Termination		Delivery / Acceptance
5. Scope		Service Levels
6. Warranty		Performance Guarantees
7. Performance Guarantees		Service Levels
8. Payment		Payment
9. Data Protection/ Cybersecurity		Data Protection/ Cybersecurity
10. Liquidated Damages		Limitation of Liability

Battle of the Forms

Battle of the forms is **not** an issue:

- When Buyer / Seller sign an agreement, such as a Master Supply Agreement (MSA) which contains clear language regarding subsequent forms

Battle of forms **is** an issue when:

- The parties have **not** signed an MSA;
- Each party has provided its form to the other; and
- Neither party has signed the other's form

Battle of the Forms

When should the parties sign an agreement?

Ideally: All the time

Reality: Not always possible!

Best (alternative) practice:

- Master Supply Agreement (MSA) when parties intend to do business over a period of time
- Major sale/ acquisition

Battle of the Forms

When the parties don't sign an **MSA**

Common law: Mirror image rule

UCC: Battle of the Forms Section 2-207

Exchange of docs creates contract even if acceptance contains additional or different terms

Between merchants *additional terms* become part of contract unless:

- Offer expressly limits acceptance to offer
- Additional terms materially alter the offer
- Party has already given notice of objection to additional terms or gives it within reasonable time after receipt

Battle of the Forms

UCC "KNOCK-OUT" LANGUAGE

To increase likelihood that additional terms will be "knocked out":

The parties insert language in their document to comply with UCC 2-104 (1) stating:

- This is an offer which can only be accepted on its terms
- Any additional terms (proposed by other) are material alterations, and
- The doc represents advance **and** subsequent notice of objection to additional terms

Battle of the Forms

Example Buyer "Knock Out" Language

This Purchase Order is limited to the terms and conditions contained on the face and the reverse. Any additional or different terms proposed by Seller in any quotation, acknowledgement, or any other document are hereby deemed to be material alterations and notice of objection to them is hereby given. To the extent that a Purchase Order might be treated as an acceptance of Seller's prior offer, such acceptance is expressly made on condition of assent by Seller to the terms hereof and shipment of the Goods by Seller shall constitute such assent.**

** If terms on posted on website, the language should reflect this and reference the URL

Battle of the Forms

Example Seller "Knock Out" language

These terms and conditions constitute an offer to Buyer for the sale of all Products by Seller. Buyer's acceptance of this offer is expressly limited to and conditional upon these terms and conditions. Any different or additional terms proposed by Buyer, whether in Buyer's purchase order, confirmation or otherwise, are deemed to be material alterations, are expressly rejected by Seller, and will not become part of these terms and conditions.

Neither Seller's acknowledgment of a purchase order nor Seller's failure to object to different or additional terms and conditions in any document issued by Buyer shall be deemed an acceptance of such terms and conditions or a waiver of the provisions hereof.

Battle of the Forms

Basic Guidelines

Each party's forms should contain:

- A good set of terms and conditions
- Knock out language
- Reference on front of form to Ts & Cs on reverse, attached or posted on website

Battle of the Forms

Guidelines

When both parties exchange forms, and both forms contain Ts & Cs and "knock out" language …….

Under the UCC, the following guidelines GENERALLY apply:

1. Terms on both forms which agree will become part of the contract.

2. Different terms on each form will cancel each other out.

   With respect to those terms, the provisions of the UCC will apply. Course of Performance and Course of Dealing will be used to interpret the contract.

3. Additional terms may become part of the contract **unless the other party has included the "Knock out" language.**

Battle of the Forms

Unfortunate Prognosis for Sellers

Assuming both parties “engage” in the battle correctly and use the 2-207 “knockout” language:

Buyer will generally prevail on issues of:

- Warranties
- Liabilities
- Remedies
- Damages

Battle of the Forms

Practical Suggestions for Clients

1. Clear up discrepancies/ ambiguities on front of the forms before going forward

   E.g. Shipping point, Lead Time, Price, Payment Terms, Milestones, Part number, SOW/ Description

2. Don't sign the other party's form

3. Be careful when referring to the other party's doc in your form

   Watson Bowman Acme Corp. v. RGW Construction, Inc., No. F070067, slip op. at 18, 21-22 (Cal. App. Aug. 9, 2016)

4. Identify, address, agree to the major issues of most significance. Put those issues in a writing which both parties sign and attach to PO/ Acknowledgement. Reference that doc in PO/ Acknowledgment

Battle of the Forms

Cautionary Note regarding the MSA

Quotes and POs are often issued as "releases" under an MSA after the MSA has been signed

- These documents often contain the party's Ts and Cs
- To avoid inadvertent introduction of the other party's additional terms, include following type of language in MSA:

This Master Agreement shall apply to all quotations, purchase orders, sales acknowledgments, invoices and other documents issued by either Seller or Buyer in connection with the purchase and sale of Products. No inconsistent or additional terms on either party's form shall apply to any such transaction.

- Frequent Issue:
  - Whose MSA will the parties start with?

Forecasts & Inventory Liability

The Competing Interests

Buyer's Conundrum:

Buyer is unable to accurately forecast its product requirements

- Buyer is subject to vagaries of the market and its customers

Seller's Conundrum:

Product may be customized, contain long lead/ special items, or require special tooling or other upfront investment by Seller.

- Seller is subject to vagaries of the market and its customers

UNDERLYING QUESTION:

Who will bear economic liability for the unknown?

Forecasts & Inventory Liability

Buyer MSA often states:

Buyer's estimated twelve month annual usage ("EAU") for the Products is set forth in Exhibit A. Buyer makes no minimum commitment and does not guarantee that it will purchase such estimated EAU. Unless stated otherwise in writing, Buyer shall not be responsible for any material obtained or Product produced by Supplier in reliance on a Buyer forecast.

Forecasts & Inventory Liability

Buyer's Position

- Sellers should manage inventory: That's their business
- Sellers should not be over-committing to their suppliers
- We don't know either -- and our customers impose the same on us!

Inventory Control Risks

Seller's position

Who will be responsible for Long Lead/ Special Items or WIP if:

- Buyer does not issue firm orders which meet the forecast?
- Buyer terminates an order of the MSA?

Seller Example Clause:

Upon expiration or termination by either party of this Agreement, or upon the cancellation of any Buyer Purchase Order, Buyer shall purchase all:

i) Products in the Vendor Managed Inventory,

ii) items which have been ordered by Seller and

iii) work in process

pursuant to Buyer's MRP forecast and purchase orders.

Buyer's Perspective:

This clause is unacceptable because it has unbounded economic exposure.

Inventory Control Risks

CONTRACT LANGUAGE

- Among the most contentious issues in an MSA.
- MSA often does not address the issue or puts inventory onus on Seller
- Our clients are often reluctant to change the language we've provided them
- Our clients think all language (even language associated with issues such as forecasts and inventory liability) can't be changed without lawyer's approval
- Frequent Result: Parties negotiate outside of the contract
- Buyer's responsibilities regarding forecasts should be clearly stated:
  - Frequency of the forecasts, non-binding/ binding nature, and length
- Contract should be clear regarding Buyer's obligations to reimburse, when, and under what circumstances.

Forecasts & Inventory Liability

Issues our clients should discuss with their counterpart

ROLLING FORECASTS WITH BINDING PORTIONS:

On a *(monthly/ quarterly)* basis, Buyer shall provide Seller with a rolling twelve month estimate of its *(monthly/ quarterly)* supply requirements for each Product.

(i) The first ___(*weeks/ months*) of each forecast shall be considered firm;

(ii) The ___ through the ___ (*weeks/ months*) authorize Seller to make material purchases of the components listed in Exhibit A in an amount not to exceed the amount necessary to support such period; and

(iii) The ___ through the ___ (*weeks/ months*) forecast quantities which are not firm orders, are to be used by Seller for planning purposes only and shall not give rise to any liability to Buyer.

Product Warranties

- Distinguished from representations and warranties
- Timing
- Express vs. Implied
- Limiting the scope of warranties
- Disclaiming warranties

Timing of Product Warranty Issues

- Even if Buyer isn't getting any formal warranties, it will usually insist on an inspection right upon delivery.
- Buyer's payment obligation is often tied to its satisfaction with this inspection.
- Issues arise over timing to do this inspection, what buyer has to find to reject the goods and which goods may be rejected, in the case of large orders of relatively small value goods.
- Ideally, the length of the warranty on goods incorporated into the Buyer's product should be concurrent with the length of the warranty to Buyer's customers.
- Bigger issue may be latent defects in goods: how long the warranty for the goods should be (statute of limitations or something shorter) and what limitations, if any should be placed on these warranties.
  - Consider Revocation of Acceptance (UCC Section 2-608)

Express Vs. Implied Warranties

- The UCC provides for both of these types of warranties

- Warranty framework, including disclaimers thereof, strongly favors buyers

Express Warranties

- Express warranties are an affirmation of fact or promise by a seller to a buyer regarding the specific qualities of the goods sold. Some examples: that a standard automobile would be suitable for racing, that a normal washing machine could clean a 4' x 6' rug, that a dining room chair could bear the weight of a 350 lb. person, etc. (See, e.g., California Commercial Code Section 2-313)

- Express warranties may be oral as well as written, do not need to contain the words "warranty" or "guaranty" to create a potential liability for a seller, and seller does not need to have an intent to create a liability on its part.

- Once the express warranty is created, the only requirement is the buyer relied on it in making its purchase decision.

Implied Warranties

- Implied warranties, unlike express warranties, do not need to be stated. Absent a seller taking direct steps to the contrary, discussed below, these will be included in a purchase and sale of goods transaction.
- There are 4 implied warranties:

1. **The warranty of merchantability** (as codified in Uniform Commercial Code (UCC) Section 2-314) provides that for goods to be merchantable, they must, at least:

– (a) Pass without objection in the trade under the contract description; (b) in the case of fungible goods, are of fair average quality within the description; (c) are fit for the ordinary purposes for which such goods are used; (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; (e) are adequately contained, packaged, and labeled as the agreement may require; and (f) conform to the promises or affirmations of fact made on the container or label if any.

2. **The warranty is fitness for a particular purpose** (UCC Section 2-315)

   For example, to go back to our car buyer hypothetical, if a car salesman knows that a buyer needs her vehicle primarily for driving in the snow, the buyer may have a claim against the seller if the car is unable to perform that function.

3. **The warranty of title** (UCC Section 2-312)

4. **The warranty of non-infringement** (UCC Section 2-312)

Limitation of Warranties—some examples:

This warranty only applies to the original purchaser of the goods.

Seller has no duty to inspect, advise, warn, install or observe.

If Buyer has supplied specifications or information about operating conditions and actual conditions vary from what has been provided, to the extent any loss or damage is

- related to such variance, the warranty is void.
- failure to provide notice in the manner and within the time limits set forth in the Agreement shall void the warranty.

Disclaimer of Warranties

Warranties are often treated as an all or nothing proposition: they are either in place or they are disclaimed, as discussed below.

But limitations on warranties can be almost as beneficial to a seller as a disclaimer of warranties. Some examples:

- No warranty for misuse, negligence, normal wear and tear, failure to follow directions, unauthorized modification or alteration, incorrect installation, etc.

- Warranties may be disclaimed in whole or in part. UCC guidance on disclaiming warranties is fairly general (see, e.g., California Commercial Code Section 2316) and may be more subject to laws of individual states than other UCC provisions.
  - In general, disclaimers must be in writing, clear and conspicuous. Although the means for doing this aren't specifically mandated, common practice is to use all capitals, bold type and sometimes to have both parties initial it. Disclaimers of the warranty of merchantability must specifically mention merchantability.

Here is an example of a disclaimer of warranties:

- **EXCEPT AS OTHERWISE EXPRESSLY PROVIDED HEREIN, SELLER HEREBY EXPRESSLY DISCLAIMS ALL REPRESENTATIONS AND WARRANTIES, EXPRESS OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY, SUITABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE, NON-INFRINGEMENT AND OTHERWISE, WITH RESPECT TO ANY SERVICE OR DELIVERABLE PROVIDED UNDER THIS AGREEMENT.**

Intellectual Property

Ownership

Customers often expect IP ownership of the deliverables if they pay for any development/ customization. We paid for it, we own it!

Supplier shall assign all right, title and interest in and to the Intellectual Property contained in the Work Product delivered by Supplier to Customer under this Agreement.

Intellectual Property Ownership

Buyer Perspective

- Each party retains exclusive ownership of all Background IP rights.
- Buyer owns all IP Foreground rights developed during Agreement -- but not Background IP rights -- if IP developed:
  - solely by Buyer;
  - jointly by Buyer and Seller; or
  - solely by the Seller as requested by Buyer in connection with agreement.
- Require Seller to assign any Foreground IP rights to Buyer.
- Restrict Seller's use of Foreground IP rights to the production/ supply of goods for Buyer.
- Requirement that Seller grant Buyer a broad license to use Seller’s Background IP

Intellectual Property

Buyer Reasons for Ownership Request

We paid for it, we should own it!

Why does Buyer need the IP?

- Preclude Seller from providing same/ similar IP to competitor
- Preclude Seller from selling product for which Buyer co-funded development
- Ongoing product use, support

Potential anti-trust issues if including restrictive covenant:

- Rationale: Tie to Buyer disclosure of confidential info

Intellectual Property Ownership

Seller Perspective/ Considerations

- Seller will retain all IP rights used to create/ or embodied in the Goods
- Preferred approach: Buyer does not acquire any ownership interest in Seller's IP Rights
    - Secondary approach: Buyer will acquire IP Rights only to Foreground IP specifically created by Seller for Buyer
- Buyer shall use Seller's IP Rights only in accordance with Agreement
- **CONSIDERATION:**
    - Seller should consider the value of the IP involved and whether it's likely to use it again in its business

Intellectual Property

License: Alternative Approach to Ownership

Background IP: Buyer often requests a broad license

Supplier hereby grants to Buyer a worldwide, royalty-free, non-exclusive license to copy, modify, distribute, publish, and use the Background Technology in connection with Buyer's use, sale and support of the Products.

Alternative Approach

Supplier hereby grants to Buyer a worldwide, royalty-free, non-exclusive license to use such Background Technology for incorporation into any end-product which is an upgrade to, new generation of, or from the same product family as the end-product for which the Background Technology contained in the Work Product is incorporated.

Supplier Preferential Approach

Supplier hereby grants to Buyer a worldwide, royalty-free, non-exclusive license to copy, modify, distribute, publish, and use the Background Technology in connection with Buyer's support and maintenance of the PRODUCT should Supplier breach its obligation of maintenance after notice of breach and the failure of Seller to cure within the period of time noted in the Termination section of this Agreement.

PRICING

Buyer perspective: Price **firm** for entire Term, including renewal period(s)

Vs

Seller perspective: Price **adjusted** periodically as needed

REALITIES

- Costs of components, raw material and labor increase over time
  - However, a 5% component increase should not result in a total product price increase of 5%
- If delivery/performance is scheduled for months/years out, Seller will want to include a price escalation clause to accommodate for Seller floating Customer's cash.

CONUNDRUM

Creating a price adjustment (+/-) formula equitable for both parties

APPROACHES

- Identify price sensitive components/ raw material
- Tie adjustments (+ / -) to an index for such materials and reviewed periodically
- Identify the % material/ labor of product subject to the adjustment

NOTE: Buyers will want to cap long term pricing increases

PRICING

QUANTITY ISSUES

What if Buyer orders significantly less quantities than forecasted?

- Should price be adjusted?

Assume Seller has amortized the cost of tooling, molds, equipment over unit price:

- How will differential be addressed?

PAYMENT TERMS

OPTIMUM

- Buyer: Net 30, 45, 60 even 90 day terms; Early discount payment: 2%/10; Net 30
- Seller: Interest charged for late payment

OPPOSING INTERESTS

- Buyer wants extended payment
  - Increases Buyer's opportunity to use available cash for other business activities.
  - Gives Buyer additional time before payment to inspect the goods to confirm they are satisfactory. This can allow Buyer to avoid paying for defective or non-conforming goods.
- Seller wants to reduce time of payment
  - Minimize risk of nonpayment
  - Seller can use funds to pay its own expenses; R&D

REALITY

- Buyer does not always pay on time but may take discount payment
- If Seller charges late payment fees, Buyer rarely pays. Seller can consider termination for repeated late payment if deal no longer makes economic sense

NEGOTIATION CONSIDERATION

- Buyer will hold Seller's feet to the fire for on-time delivery
- Seller should discuss quid quo pro for on-time payment

CHANGE ORDERS

Contract Language vs Reality

Changes Clause

- Often requires that before any change is implemented the parties must follow certain procedures.
- Failure to do so entitles customer to withhold price adjustments.
- Procedure often contains unrealistic time periods/procedures.

Example language

Any change to a Project Parameter (a "Change") may only be authorized by a Change Order. …..Any work outside the Scope of Work performed by Contractor without it having received a Change Order shall be at Contractor's sole risk and expense. ……

If Company wants to make a Change, it shall submit a written proposal requesting and specifying the scope of such Change (a "Company Change Request"). Contractor shall review the Company Change Request and issue Company a written notice setting out the impact on the Project Parameters of the Company Change Request within ten (10) Business Days of its receipt of any Company Change Request, in which case within thirty (30) days of receipt of the Company Change Request, Company shall, if it wishes to proceed with the Change, issue a Change Order directing Contractor to perform the Change.

Result

- The parties often don't follow the contract procedure which leads to disputes

CHANGE ORDERS

Drafting Issues

- Is the change order procedure – the form and timing – practical?
- Will the individual who must sign off the change order be readily available?
- Negotiate several customer reps who can sign change order to avoid delays
- Distinguish between major and minor changes:
  Example: Changes under a $xx can proceed with approval of customer's on site project manager
- Address what will happen if procedure is not followed:
  Supplier will proceed with the change, but if no written approval by the customer is given within XX days, or if no resolution to the price adjustment has been agreed upon, Supplier has the right to stop work.
- Bottom Line: Contract Administration is an important element in the contract.

MOST FAVORED CUSTOMER/ NATION CLAUSE

- Originated in government contracting
  - Doing business with the Gov't requires maintenance of financial records in a prescribed way for audit to ensure lowest price
- Concept migrated to commercial contracting
  - Concept appears valid but:
    - Customer MFC clauses don't compare "apples" to "apples"
      - i.e. identical quantities, products, time frames, terms
    - Most suppliers won't permit customer audits and therefore, no viable way to monitor
- Sellers will generally resist
  - Consider tying MFN to Forecasting liability
- Potential anti-trust issues
  - Depends on size of the customer, market-share

Tooling
Ownership

- Buyer perspective:

  If Seller charges for tooling, Buyer should own it.
- Supplier perspective:

  Many times the tooling is not fully charged to the Buyer. Tooling will remain the Seller's unless there is a separate line item charge or Buyer supplied

Two approaches:

- Insert clauses in your Contract dealing with payment, ownership, and maintenance of Tooling; or
- Issue a Purchase Order for the Tooling and have Supplier sign a separate Bailment (Loan) Agreement.

Price

- If amortized over unit price and quantity not met, how will the differential be addressed?

Tooling

Bailment agreement

- Risk of loss and insurance
- Identifying tag
- Maintenance and repair vs major repairs
- Authorized use
- Protection in event of supplier bankruptcy
- Security agreement
  - NOTE: Security interest not valid unless UCC-1 is filed

Indemnity

- Indemnity touches on numerous other areas--warranties, limitation of liabilities, insurance and *force* majeure—and should be considered in conjunction with them.

- The broad goal of indemnity provisions is to return a party injured because of a breach by the other party of the underlying agreement to the *status quo ante*.

- The aim of the parties in working through these provisions should be to identify and allocate risks:
  - What can go wrong under the contract?
  - What are the consequences if this occurs?
  - What is the likelihood of this occurring?
  - As between the parties, who is in the best position to prevent this from happening/mitigate it if it does?

Indemnity (continued)

Risks will, of course vary from contract to contract, but to generalize broadly, damages are most likely to arise from:

- Product delays;
- Product defects (product liability);
- Property damage/damage to the property of others;
- Bodily injury/injury to others; and
- Infringement.

- Seller's possible obligations in the event of the above:
  - Compensate, in whole or in part, buyer for any losses it suffers, either directly or through its own obligations to third parties.
  - Replace or fix any defective and/or infringing product.

Indemnity (continued)

- What are buyer's obligations in the event it may have a claim under the Agreement's indemnification provisions?
  - Promptly notify seller of the claim. Seller should have an opportunity to defend, and if its rights are prejudiced, its obligations should be reduced (or eliminated).
  - Duty to mitigate?

Indemnity (continued)

- What about buyer's duty to indemnify the seller?
  - Rarely arises, since the buyer's primary obligation under typical supply agreements is to pay the seller for goods it provides and/or services it performs.
  - But if seller is working from buyer's designs, for example, and liability ensues, buyer disseminates seller's confidential information, etc., a buyer indemnification duty could arise.

Indemnity (continued)
Some Additional Considerations

- Does the duty to indemnify cover first party claims or only claims by third parties?
- Does the duty to indemnify include the duty to defend? (Note that being silent on this makes this a matter of state law, and some states automatically include this while others do not).
- How does the duty to indemnify interact with the indemnifying party's insurance coverage?
- Is the indemnifying party's duty to indemnify cumulative with or in lieu of statutory rights the indemnified party may have such as suit for breach of contract or rescission?
- Are there state law limitations on the duty to indemnify, particularly limiting a party's right to be indemnified for its own negligence?

Limitation of Liability Provisions

- Section 2-719 of the UCC allows parties to a contract to limit available remedies, which expressly includes consequential damages.

- In addition to the disclaimer of warranties provisions discussed above, limitation of liability provisions generally have 2 parts:

  – Limitations on **types** of damages which may be recoverable, and limitations on the **amount** of damages which may be recoverable.

  – Note that state law (per the discussion of choice of law at the end of our presentation) varies widely, and perhaps wildly, on these issues, and it is critical that the practitioner familiarize him or herself with the law of the state applicable to the contract.

- There is no one definition of direct damages, but in general, they are the difference in what is received by way of performance under a contract and what was promised, as measured by market value.

  – Likewise, special, indirect and consequential damages are not precisely defined but generally include items which may relate to the special circumstances of the party claiming the loss and/or those which may not have been foreseeable to the parties at the time the contract was signed.

Limitation of Liability Provisions

- Punitive damages are not really "damages" in the sense that they may have only a faint relation to the actual loss suffered by the injured party but are awarded expressly to punish, deter or reform the defendant.

- Limitations on the ability to waive some or all of these classes of damages may exist depending on:
  - The particular **type** of damages,
  - The standard of the **defendant's conduct** (much more likely to be enforced, e.g., for defendant's negligent than reckless conduct),
  - The **remedy actually offered** to the injured party (e.g., if a waiver of damages were to be enforced, the injured party would likely to have to be offered, at a minimum, a replacement of the defective good and/or his or her money back) and perhaps the subject of the agreement (for example, professionals may not be able to so limit their liabilities, but it's not clear that this would affect manufacturing or supply agreements).

- IMPORTANT: The Buyer should consider certain carve outs to the Limitations of Liability provision such as:
  - Indemnity;
  - Intellectual Property Infringement Indemnity;
  - Breach of Confidentiality;
  - Claims of Product Liability.

Limitation of Liability Provisions

The following is an example of a limitation of liability provision:

- Limitation of Liability. This provision allocates the risks under this Agreement between Seller and Customer. Seller's pricing reflects this allocation of risk and limitation of liability specified below.

  - **SELLER SHALL NOT BE LIABLE TO CUSTOMER, OR ANY OF CUSTOMER'S USERS OR ANY THIRD PARTY, FOR CUSTOMER'S LOST PROFITS, OR SPECIAL, INCIDENTAL, CONSEQUENTIAL, PUNITIVE OR EXEMPLARY DAMAGES, WHETHER IN AN ACTION OR A PROCEEDING IN CONTRACT OR TORT, EVEN IF SELLER HAS BEEN ADVISED BY CUSTOMER OF THE POSSIBILITY OF SUCH DAMAGES.**

  - **SELLER's sole liability, and Customer's and Customer's User's sole remedy, for any claims arising from or relating to this Agreement, including without limitation any claims arising from or relating to the failure of any Product to perform in accordance with, or otherwise conform to, agreed upon specifications, such as, for example, any breach of representation or warranty related thereto, regardless of whether SELLER's conduct has been negligent or grossly negligent, shall be as follows: SELLER shall make necessary corrections to the Product within a reasonable time of receiving written notice of the breach from Customer, or, if it is unable to do so, terminate Customer's right to use the Product and refund to Customer the unearned portion of the fees paid by Customer, based on a straight-line amortization of the price based on the period during which the Customer used the Product.**

- Parties should carefully consider what they wish to compensate in the context of the size of the contract, overall risk allocation and applicable state law. Parties may also wish to consider whether available insurance should be considered in determining what limits should be applied.

Boilerplate Provisions

- These provisions usually appear at the end of the contract under "Miscellaneous".
  - It's easy to have "document fatigue" by the time you get to the end of a long document with vigorously negotiated provisions on pricing, warranty obligations, delivery, intellectual property ownership and limitation of liabilities, but don't let it deter you from paying close attention to these provisions! They could be the subject of an entire seminar.

- Probably most important and most negotiated are the sections which relate to what law and venue will apply if a dispute arises and the forum and conditions for its resolution.

- Although 49 of the 50 states have adopted some version of Article Two of the UCC, important provisions such as what constitutes direct damages and whether and how liabilities can be limited diverge significantly.
  - Also, some states do not have extensive bodies of commercial law, and if you accept a choice of law from such a state, you could find your client subject to outlying and highly disadvantageous case law. Consider choice of law carefully.

- **Venue** is a more straightforward consideration.
  - But it can be critical, particularly in a non-US context, of deciding the economics of whether to bring a claim (or settle a claim) if your client will have to incur expense to travel to prosecute or defend the claim. Particularly in smaller states, there is a perception that out of state defendants may not always get a fair shake, especially from juries. If this issue becomes deadlocked, consider whether the parties should stipulate to a place in which neither is headquartered, or agree to a hybrid venue, such that each party agrees to only bring actions in the other party's home state.

- The last of these provisions concerns where and how a dispute will be resolved.
  - Possibilities are generally arbitration or the courts, in either instance with potentially mandatory mediation as a precursor. Perhaps more important than the foregoing choices is the waiver of the right to a jury trial. This waiver will be more likely to benefit the seller than the customer.

Boilerplate Provisions

- **FORCE MAJEURE**
  - Force Majeure (literally, "Act of God") excuses or tolls non-performance by one party while the specified event is ongoing, and depending on the provision, for some time thereafter.

    For the event to qualify as Force Majeure, it should be both unanticipated and out of the control of the party attempting to invoke (e.g., not including a snowstorm in the Upper Midwest in January nor a labor strike incurred the invoking party).

    Force Majeure in the time of Covid 19: what does the inclusion of pandemics mean for contracts entered into prior to the onset of the virus? What does it mean to include it in a contract in the midst of the pandemic?
- **Assignment** provisions determine the parties' rights to transfer their rights and obligations to third parties.
  - This is another area in which state law must be carefully considered, as what constitutes an "assignment" varies considerably (for example, a merger would not be considered an assignment in California without the parties so providing; it would be considered a "transfer by operation of law", nor would a stock purchase). The non-assigning party could end up in a situation in which it was forced to perform for a competitor or a company which was in a more financially precarious condition than the party with which it originally contracted.
- **Amendment** provisions should be considered carefully in the context of the battle of the forms issues we began our presentation by discussing. Do the parties see the likelihood of needing to revise their relationship as they move forward? What should be the consequences if they cannot agree at such time?
- **Entire agreement/ Integration** provisions should alert the parties to the importance of including into the final contract all discussed/ agreed upon deal points and understandings
- **Notice** provisions should be reviewed and considered in light of the parties' anticipated course of their future interactions.
  - Notices must often be given a certain way or the underlying claim may be lost. Parties often communicate by e-mail or even text, but many companies use old forms which include telecopy or fax but not e-mails as an acceptable form of notice.
- **Construction and advice of counsel** provisions can be thought of together and are especially important when companies of differing sizes contract with each other.
  - The smaller company may not even engage a lawyer, but it can be important that it acknowledge that it has at least had the opportunity to for the larger company to avoid arguments of adhesion, coercion, etc.
  - Likewise, by stating both parties have had a role in the contract preparation, the contract preparer may be able to avoid the presumption in many states that any ambiguity, such as what types of damages are covered under "direct" damages, should be construed against the drafter.

Boilerplate Provisions

Whenever possible:

- More discussion is better than less

- Providing for greater specificity of the circumstances the parties anticipate arising during their contractual relationship is highly desirable

- However, there may be situations in which silence on certain points may be the best your client can hope for
  - In those cases, it's especially important to understand what the law of the applicable state will be on those topics.

AND FINALLY

Professors Hart and Holmstrom won the 2016 Nobel Economics prize on their work regarding Contracts

"Contracts are incomplete instruction manuals. They cannot specify what should be done in every case. Instead, they must stipulate how decisions should be made."

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