
Supply Chain Agreements: Consequential Damage Disclaimers, Indemnity, Force Majeure, Termination, Warranty Provisions

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Supply Chain Agreements: Selected Provisions

JUNE 19, 2019

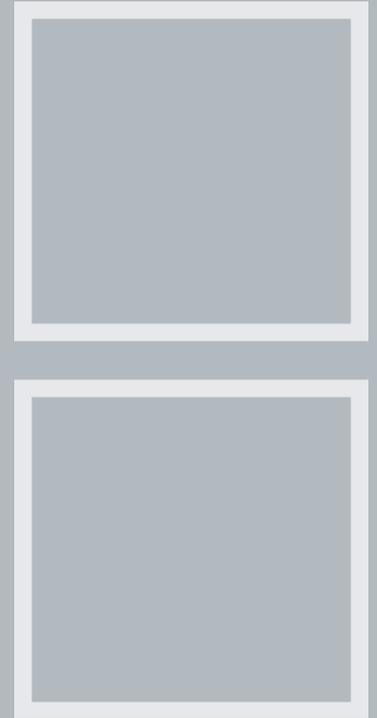
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What is meant by a “Supply Chain Agreement”?

- Agreements that set forth the terms of the various links in the supply chain.
- Examples:
 - Supply Agreement
 - Vendor Agreement
 - Consignment Agreement
 - Logistics Agreement

Indemnification



What is “Indemnification”?

- “A duty to make good any loss, damage or liability incurred by another.”

Indemnity, Black's Law Dictionary
(3rd Pocket Ed. 2006)

- Risk allocation tool
- Often limited to third-party claims

Common Indemnities

- Negligence and willful misconduct
- Breach
- IP infringement
- Failure to comply with law
- Personal injury and tangible property damage

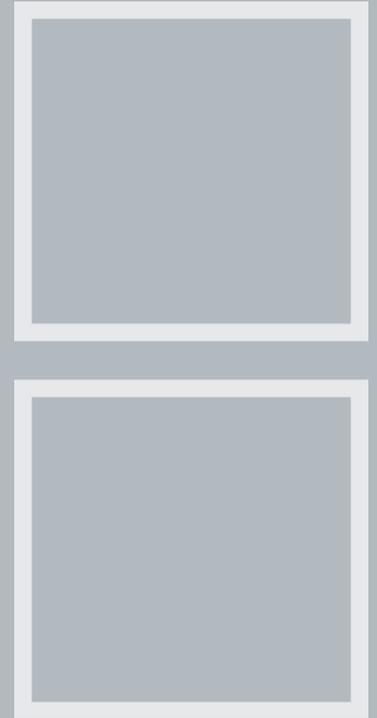
Indemnification vs. Warranty

- Requirement to defend
- Recovery of attorneys' fees
- Warranty remedies are typically limited

Other considerations

- Indemnification Procedures
 - Notice of claim
 - Control of defense
 - Requirement to cooperate
 - Settlement rights
- Consistency with limitation of liability provisions

Limitations on Liability



Types

- Exclusive warranty remedies
- Consequential damage disclaimers
- Overall damage caps



Exclusive Warranty Remedies

- Repair
- Replace
- Refund

What Are Consequential Damages?

- “losses that do not flow directly and immediately from an injurious act but that result indirectly from the act.”

Consequential Damages, Black's Law Dictionary
(10th Ed. 2014)

Classifying as Consequential

- Direct Damages are “utterly foreseeable, indeed certain.”

Rexnord Corp. v. DeWolff Boberg Assocs.,
286 F.3d 1001, 1004 (7th Cir.2002)

- Consequentials are reasonably foreseeable but not an invariable result of a breach.

- Example

Difficulty in Practice

- The distinction between damages as direct or consequential “is relative not absolute.”

IMI Norgren Inc. v. D&D Tooling & Mfg., Inc.,
247 F.Supp. 2d 966, 970–71 (N.D.Ill.2002).

Examples of Consequential Damages

- Loss of anticipated profits;
- Loss of business;
- Cost of unsuccessful attempts to repair defective goods;
- Loss of goodwill;
- Losses resulting from interruption of buyer's production process;
- Loss of reputation; and
- Loss of sales contracts because of delayed products.

Common Carve-outs

- Third party indemnification claims
- First party intellectual property infringement
- First party negligence and misconduct
- Product Recall
- Breach of Confidentiality

UCC – Personal Injury and Property Damage

- Personal injury or property damage proximately resulting from any breach of warranty is a consequential damage. U.C.C. § 2-715(2)(b).

Unconscionability

- “Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable...” UCC § 2-719(3)
- Typically not unconscionable between commercial parties, but see...

Unconscionability in a Commercial Setting

- “[T]he disclaimer is not adequately conspicuous. The paragraph is not titled, and the critical language limiting Exxon's liability is not capitalized or highlighted. Thus, there is no indication that this far-reaching disclaimer might be of greater importance than other provisions of the paragraph or the agreement.”

Carter v. Exxon Co. USA, 177 F.3d 197, 207-209 (3rd Cir. 1999) (concluding the application of the disclaimer to be unconscionable.)

Drafting Note: Clear and Conspicuous

- **SELLER SHALL NOT BE LIABLE FOR ANY CONSEQUENTIAL, INCIDENTAL, INDIRECT, SPECIAL OR CONTINGENT DAMAGES WHATSOEVER, WHETHER ARISING OUT OF BREACH OF CONTRACT, WARRANTY, TORT (INCLUDING NEGLIGENCE AND STRICT LIABILITY) OR OTHER THEORIES OF LAW, WITH RESPECT TO PRODUCTS SOLD HEREUNDER, OR ANY UNDERTAKINGS, ACTS OR OMISSIONS RELATING THERETO, AND SELLER HEREBY DISCLAIMS ALL SUCH DAMAGES.**

Drafting Note: List Most Concerning Ones

- Example language: “Without limiting the foregoing, Seller specifically disclaims and shall not be liable hereunder for any claims for loss of use or lost profits, lost income or damage to reputation.”

Overall Damage Cap

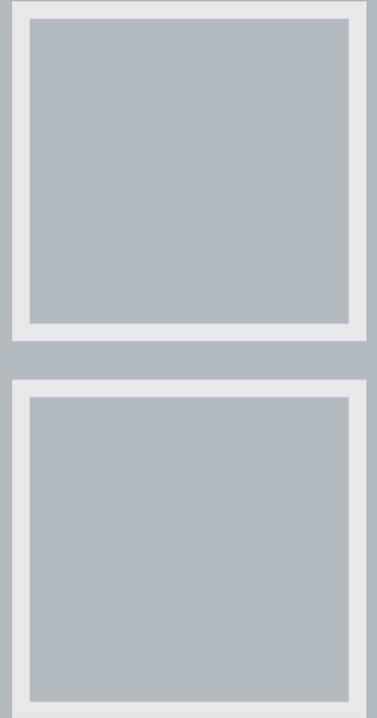
- Often limited to purchase price of order to which the claim relates.
- Paid vs. Payable
- Must provide a real remedy
 - “Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.” UCC § 2-719(2)
- Carve-outs



Example Language

- **THE TOTAL LIABILITY OF SELLER, WHETHER ARISING OUT OF BREACH OF CONTRACT, WARRANTY, TORT (INCLUDING NEGLIGENCE AND STRICT LIABILITY) OR OTHER THEORIES OF LAW, SHALL NOT EXCEED ONE HUNDRED PERCENT (100%) OF THE AMOUNTS RECEIVED BY SELLER FROM BUYER UNDER THIS AGREEMENT FOR THE PRODUCTS.**

Warranty



Warranties

- Express Warranties
- Implied Warranties
- Limited Warranties
 - Defects in material and workmanship
 - Disclaimers

§ 2-313. Express Warranties by Affirmation, Promise, Description, Sample.

- (1) Express warranties by the seller are created as follows:
 - (a) **Any affirmation of fact or promise** made by the seller to the buyer which relates to the goods and **becomes part of the basis of the bargain** creates an express warranty that the goods shall conform to the affirmation or promise.
 - (b) **Any description of the goods** which is **made part of the basis of the bargain** creates an express warranty that the goods shall conform to the description.
 - (c) **Any sample or model** which is **made part of the basis of the bargain** creates an express warranty that the whole of the goods shall conform to the sample or model.
- (2) **It is not necessary** to the creation of an express warranty **that the seller use formal words** such as "warrant" or "guarantee" **or that he have a specific intention to make a warranty, ...**

§ 2-314. Implied Warranty: Merchantability; Usage of Trade.

- (1) Unless excluded or modified..., a warranty that the goods **shall be merchantable is implied** in a contract for their sale if the seller is a merchant with respect to goods of that kind...
- (2) Goods **to be merchantable must be at least such as**
 - (a) pass without objection in the trade under the contract description; and
 - (b) in the case of fungible goods, are of fair average quality within the description; and
 - (c) are fit for the ordinary purposes for which such goods are used; and
 - (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
 - (e) are adequately contained, packaged, and labeled as the agreement may require; and
 - (f) conform to the promise or affirmations of fact made on the container or label if any.

§ 2-315. Implied Warranty: Fitness for Particular Purpose.

- Where the seller at the time of contracting has reason to know **any particular purpose for which the goods are required** and that the **buyer is relying on the seller's skill or judgment to select or furnish suitable goods**, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

§ 2-316. Exclusion or Modification of Warranties.

- (2) Subject to subsection (3), **to exclude or modify** the implied warranty of merchantability or any part of it **the language must mention** merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness **is sufficient if it states**, for example, that "There are no warranties which extend beyond the description on the face hereof."
- (3) Notwithstanding subsection (2)
 - (a) unless the circumstances indicate otherwise, **all implied warranties are excluded by expressions like "as is", "with all faults"** or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; ...

§ 2-718(1). Limitation of Remedies

- § 2-316(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (§§ 2-718; 2-719).
- § 2-718(1). Liquidation or Limitation of Damages; Deposits:
(1) Damages for breach by either party **may be liquidated** in the agreement **but only at an amount which is reasonable** in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. **A term fixing unreasonably large liquidated damages is void as a penalty.**
- Limited
 - Repair/replace
 - Disclaim consequential, special, etc.

§ 2-719. Contractual Modification or Limitation of Remedy.

- (1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,
 - (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, **as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts**; and
 - (b) resort to a remedy as provided is optional **unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.**
- (2) Where circumstances cause an exclusive or limited remedy to **fail of its essential purpose**, remedy may be had as provided in this Act.
- (3) Consequential damages...

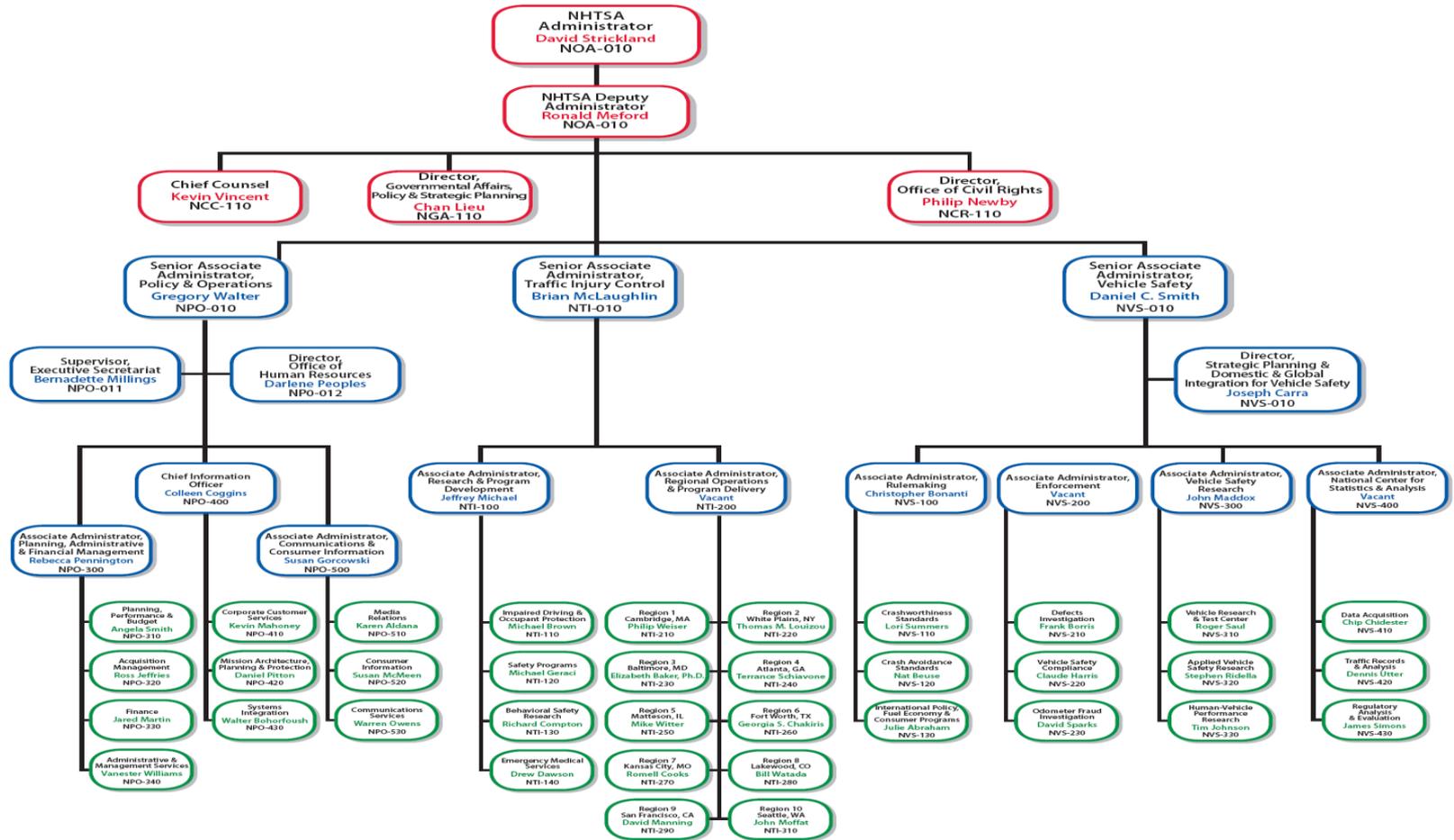
Product Recall



Product Recall

- Regulated depending on product
 - NHTSA
 - CPSC
 - Other?

NHTSA



Defect/Noncompliance Determinations

- Defect: in Performance, construction of a component, or material of a motor vehicle or motor vehicle equipment
- Motor Vehicle Safety: “Performance...in a way that protects the public against unreasonable risk of accidents...and against unreasonable risk of death or injury in an accident.”

Reporting

- Applies to all manufacturers of motor vehicles and motor vehicle equipment, including importers
- Reporting obligations:
 - Safety-Related Defects and Federal Motor Vehicle Safety Standards noncompliance
 - Early Warning Reporting
 - Foreign Recall Reporting
 - Submission of Service Bulletins and Customer Satisfaction Communications

CPSC – Consumer Product Safety Act

- “Consumer Product” is “any article, or component part thereof, produced or distributed
 - for sale to a consumer for use in or around a permanent or temporary household or residence, a school, in recreation, or otherwise, or
 - for the personal use, consumption or enjoyment of a consumer in or around a permanent or temporary household or residence, a school, in recreation, or otherwise.”

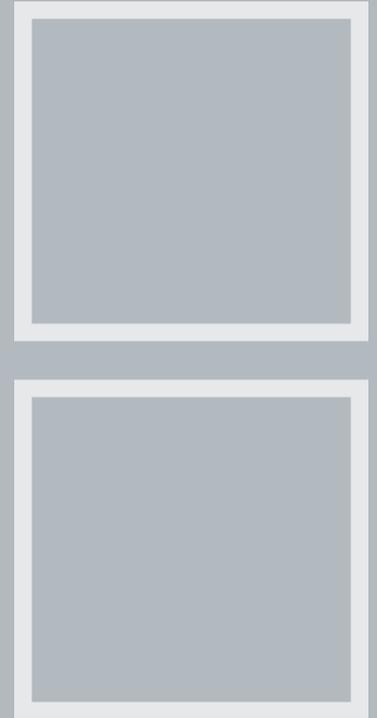
Substantial Product Hazard

- Depends on:
 - Pattern of defect
 - Number of defective products distributed in commerce
 - Severity of the potential injury
 - Likelihood of Injury
- Is there an unreasonable risk of serious injury or death
 - “Serious injury” includes
 - Hospitalization
 - Medical or surgical treatment

Reporting

- Obligation arises when:
 - Fails to comply with a voluntary standard upon which the CPSC has relied
 - Fails to comply with any other rule, regulation, standard, or ban under the Act or any other Act enforced by CPSC
 - Defect which could create a substantial product hazard
 - Creates an unreasonable risk of serious injury or death
- Must report immediately if company has information that reasonably supports the conclusion that a product creates a substantial product hazard

Force Majeure



What is “force majeure”?

- Force Majeure defined: circumstances that prevent a party from fulfilling a contract
- Excuses performance for the duration of the force majeure event

Force Majeure

- Specific events that the provision may cover include:
 - natural disasters or “acts of God,” such as lightening, tornadoes, hurricanes, tsunamis, floods and earthquakes
 - manmade disasters, such as plant fires or floods
 - war and civil issues, such as riots, civil unrest, acts of terrorism
 - labor disputes or strikes;
 - government embargos or other government actions affecting the supply chain
 - even power outages or transportation issues

Force Majeure

- Biggest hurdle to claiming force majeure: showing that this prevents performance
- No alternative means to fulfill the contract
- Increased costs alone are not enough
 - Ex. 2016 West Coast Labor Dispute (air freight still available even though more expensive)
 - Ex. Tariffs
 - What if the force majeure clause includes “acts of government”?

Force Majeure

- Different from the Doctrine of Commercial Impracticability, UCC § 2-615 (excuse by failure of presupposed condition)
 - A contract is commercially impracticable when, because of unforeseen events, it can be performed only at an excessive and unreasonable cost
 - Operates to excuse performance

Drafting Force Majeure Provisions

- Two key components:
 1. Define the events that constitute a force majeure
 2. Set forth the supplier's rights and obligations if a force majeure event occurs that impacts the supplier's ability to timely supply parts
- Specifics will depend upon the products at issue, the regions involved in the supply chain and risk allocation between the parties

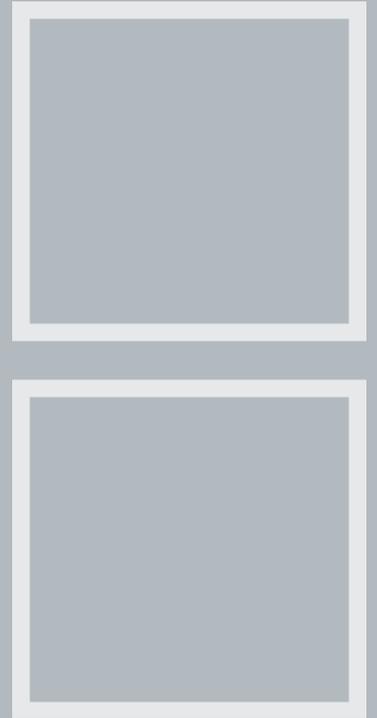
Force Majeure: Buyer's Strategies

- List specific events, as narrow as possible
- Exclude labor strikes
- Build-in prompt notice requirement and expected duration
- Shorten time to resume performance
- Need an “out” (escape hatch provision): right to terminate after certain time period

Force Majeure: Seller's Strategies

- Negotiate as broad of a list as possible
- Catchall: “. . . or any other unforeseeable circumstance beyond the control of the parties” (very broad)
- Suspend performance until the force majeure event is over

Termination



Termination

- Major point of dispute and litigation
- Termination rights often tied to:
 - Breach
 - Convenience
 - Insolvency, bankruptcy or receivership
 - Milestone failure (usually applicable to service contracts)
 - Specific date

Drafting Termination Provisions

- Termination for Breach:
 - Material breaches
 - Best practice is to define what constitutes a “material breach”
 - Under the law, there is always a right to terminate for breach
 - Written notice
 - Notice & opportunity to cure, but specify only “if curable”

Termination for Breach: Sample Clause

In the event of a material breach by the other Party, either Party may terminate this Agreement by written notice specifying the material breach. The breaching Party will have a right to cure any such breach, or breaches, if curable, within [X] days of receipt of such notice. In the event that such cure is not made within the [X]-day period and upon the expiration of the [X]-day cure period if such breach is curable but has not been cured on or before such expiration, this Agreement will terminate.

Drafting Termination Provisions

- Termination for Convenience:
 - The ability to terminate for no reason
 - Often a unilateral right of the Buyer
 - May impact value of the contract to the Seller
 - Require a longer notice period
 - Build-in protections for capital investments and obsolescence

Termination for Convenience: Sample Clause

Buyer may terminate this Agreement for convenience by providing [X] advance written notice to Supplier.

Post-Termination Considerations

- Best practice is to include list of provisions that still are applicable following termination
 - v. “other provisions that should by their nature survive termination, will survive in full force and effect.”
- Include a provision that spells out rights and obligations triggered by termination
 - Sellers should consider their supply chain
 - Tailor obsolescence provision
 - Other exit considerations

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