

Association of Corporate Counsel Presentation

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Charlotte, North Carolina

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Managing Customer Risk:
Successful Contract Terms and Strategies
To Avoid Risk and Optimize Outcome

1. Contract Zen

a. Role of Sales Contracts – 2 Minute Drill

- Purpose of a Sales Contract

- Define Parties' Obligations

- Optimize Outcome When a Dispute Arises

- Disputes Erode or Eliminate Contract Profit
 - Margins May be Thin
- Materiality is a Driver
 - How Much is Invested in Contracts
 - How Much Invested in Resolving Disputes

b. Sales Contract Cosmos

- Making Your Terms and Conditions Stick
- Credit Applications – Highly Underrated
- Purchase Orders
- Order Acknowledgement
- Invoices
- Terms and Conditions
- Website Acceptance
- Sales or Supply Contract

- .com/termsandconditions

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2. Terms and Conditions of Sale (That Make a Difference)

- Attorneys' Fees – Altering Incentives to Litigate
- Interest Upon Default – Increasing the Cost of Non-Payment
- E.D.N.Y. Wrongful Contract Termination Case Example:
Interest/Attorneys' Fees Made the Difference

- Undelivered Inventory – Specially Manufactured Goods
 - Typical Customer's Wisdom
 - Unassailable Inventory Claim – Duty to Mitigate
 - Improves Value of A/R Claim
 - Contract Clause Opportunity – U.C.C. 2-708
- Setoff
- Delegation of Performance Clauses – Does P&G have any contracts?

- Multiple Buyers/Sellers Provisions – Joint and Several Liability
- Termination of Licenses Upon Default
- Limitation of Liability/Damages

Curb Your Counter-party's Enthusiasm

3. Contract Remedies

- Three “Damage Interests” of Recovery
 - Expectation (benefit of the bargain)
 - Reliance (out-of-pocket)
 - Restitution (value of the benefit conferred)

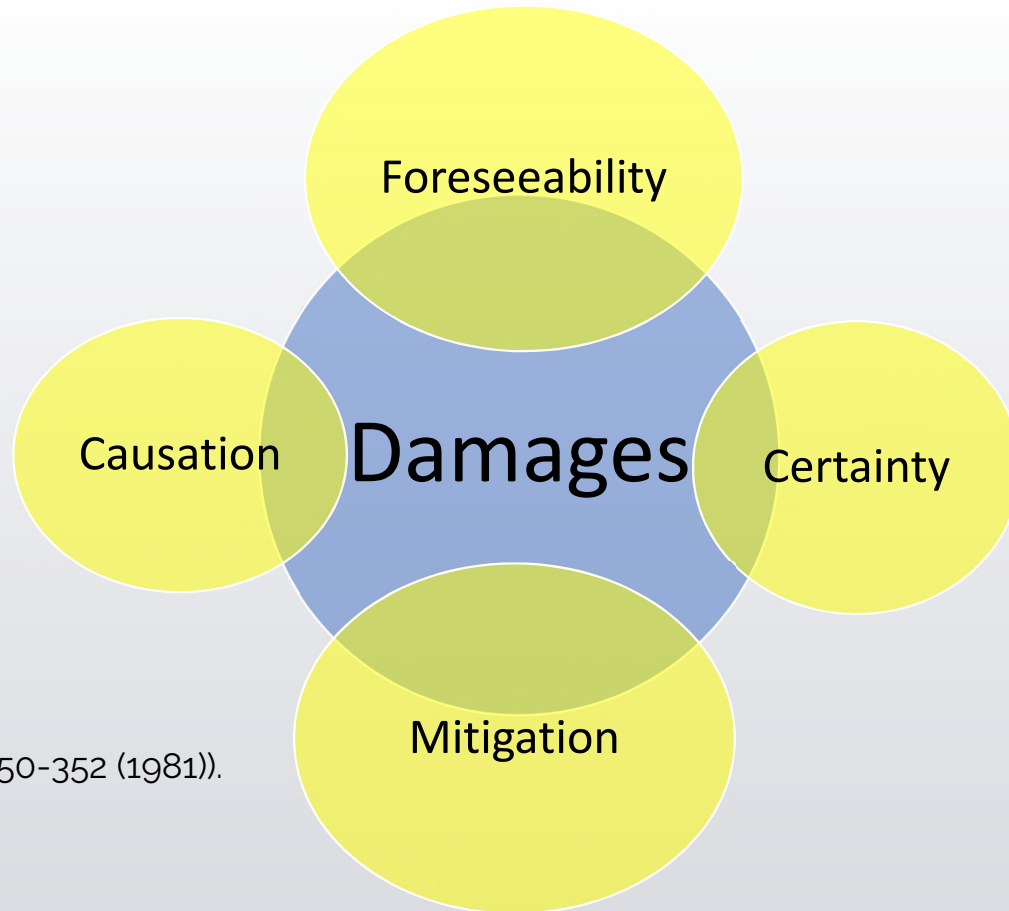
Types of Remedies:

- Legal (financial in nature)
 - Money damages
- Equitable (require or prohibit certain conduct)

a. Different Categories of Money Damages

- Compensatory Damages
- General (or Direct) Damages
- Incidental Damages
- Consequential (or Special) Damages

b. Limitations on Damages

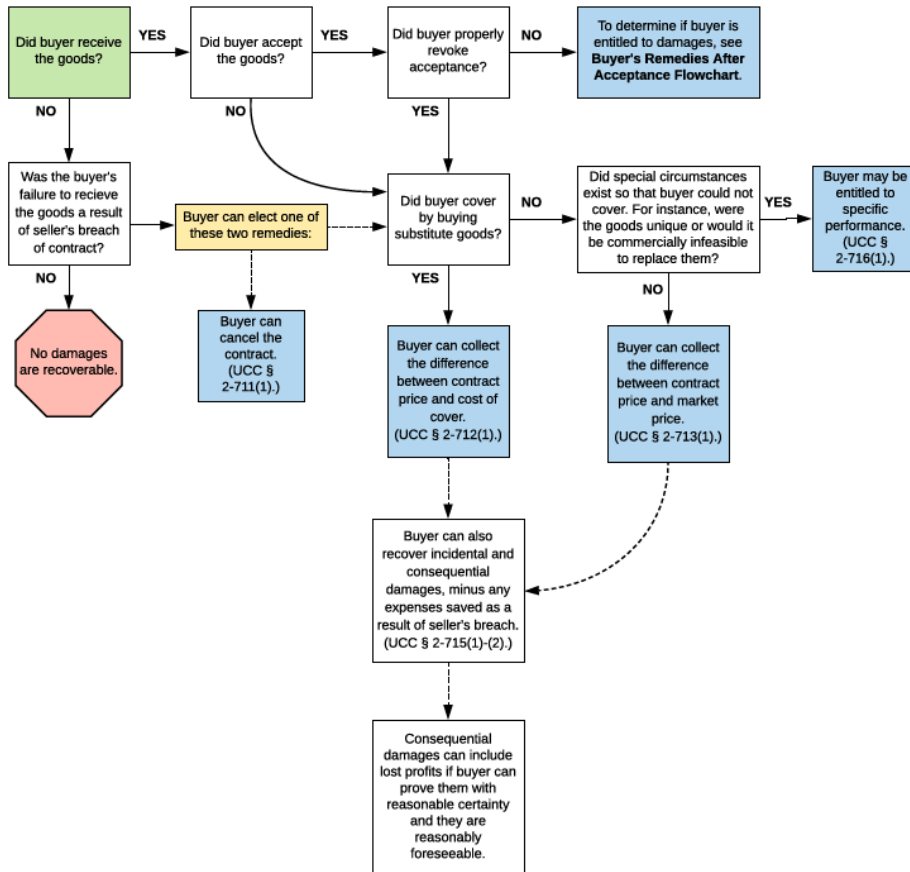


(Restatement (Second) of Contracts §§ 350-352 (1981)).

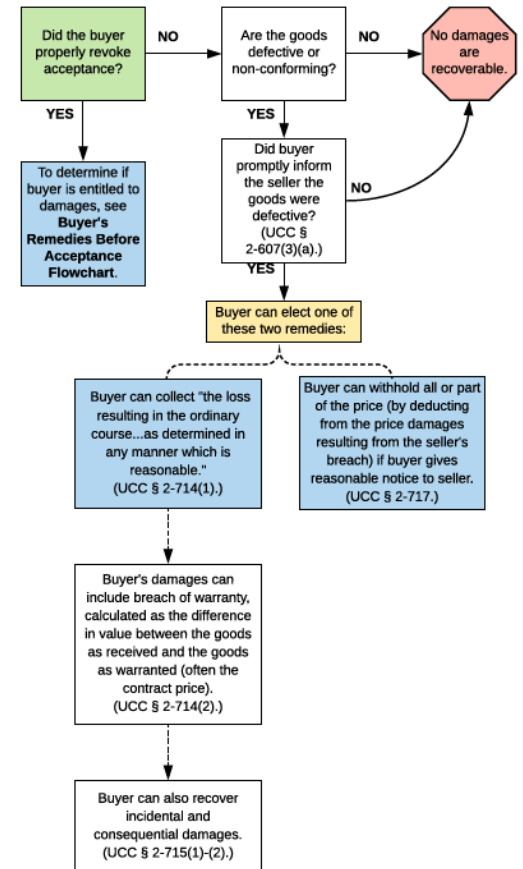
c. UCC's Default Remedies

- Damages Arising Before the Buyer Accepts Goods
- Damages Arising After the Buyer Accepts Goods
- Application of Damages Principles Under the UCC

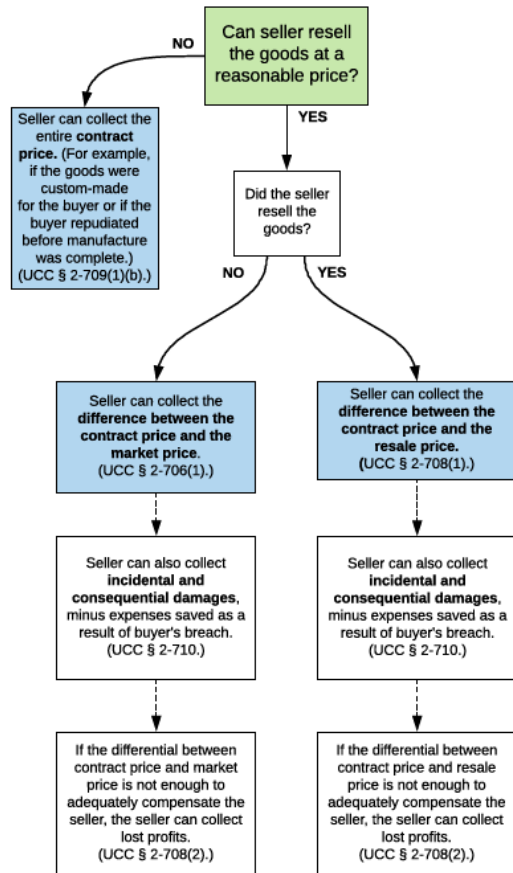
Buyer's UCC Article 2 Default Remedies Before Acceptance



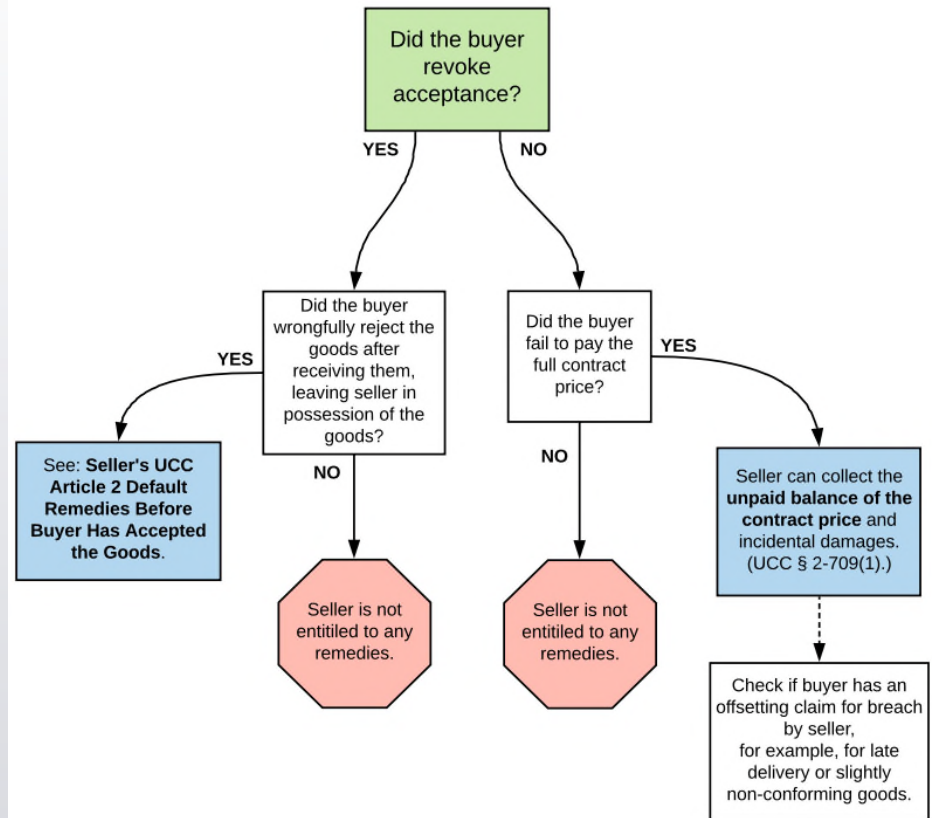
Buyer's UCC Article 2 Default Remedies After Acceptance



Seller's UCC Article 2 Default Remedies Before Buyer Has Accepted the Goods



Seller's UCC Article 2 Default Remedies After Buyer Has Accepted the Goods



4. Contract Shifting or Limiting Remedies or Damages

- Nearly every commercial contract includes limitation of liability clauses to circumscribe the scope and magnitude of the parties' contractual liabilities. These provisions typically set out the categories of damages that the non-breaching party cannot recover.
- The UCC recognizes, under certain circumstances, a contract may provide for remedies in addition to or in substitution for those provided in the UCC. Sec. 2-719
- EXCEPTIONS
 - 1) When remedy fails its essential purpose
 - 2) Unconscionable
 - 3) Injury to Person in the case of consumer goods

Waiver of Consequential Damages

- Attempts to exclude recovery for: indirect damages, consequential damages, incidental damages, special damages, punitive damages.
- One common formulation waives liability “for any consequential, lost profits, incidental, or indirect damages.”
- The safest course for contracting parties that want to exclude a discrete category of damages in a damage limitation provision is to specifically exclude that category of damages and not rely on an umbrella waiver of consequential damages.

Waiver of Consequential Damages (Continued)

- Example of Consequential Damages Waiver:

To the maximum extent allowed under Applicable Law, neither Party nor its Affiliates nor the employees, officers or agents of such Party or Affiliate shall be liable to the other Party whether in contract, tort (including negligence), warranty, strict liability, indemnity, or otherwise at law or in equity for any incidental damages, indirect damages, consequential damages, exemplary damages, special damages, or punitive damages, nor any loss of profits, lost revenues, financial losses, loss of business, reduction in value of Facility, depletion of goodwill and similar losses, or down time costs, costs of capital, debt expenses, cost of replacement materials and Equipment.

Liability Cap

- Also known as a maximum liability provision, a liability cap limits a party's maximum liability for all damages relating to the contract to either: (i) a specific dollar amount; (ii) fees paid or payable under the contract; or (iii) a percentage of fees paid or payable under the contract.
- Often the simplest way to limit damages, parties will negotiate liability caps to gain certainty about the risk of a transaction relative to the expected benefits.

Liquidated Damages

- Use a liquidated damages clause to limit the breaching party's liability to a pre-determined, fixed amount of money.
- Must reflect a compensatory rather than punitive intent. Both common law and the UCC require that liquidated damages bear a reasonable relation to anticipated or actual damages.
- UCC 2-718(1) provides that contract parties may agree to liquidate damages only in an amount which is reasonable in light of:
 - The anticipated or actual harm caused by the breach;
 - The difficulties of proving the amount of loss that may occur; and
 - The inconvenience or infeasibility of otherwise obtaining adequate remedy.
- PRACTICAL TIP: If you are including liquidated damages, do a calculation of what damages the business may suffer if there is a breach. Sign it, date it, and save to the file.

Liquidated Damages (Continued)

- Liquidated damages provisions are usually enforced in the following situations:
 - 1) unique or specifically manufactured goods
 - 2) situations involving delays in delivery
- Case examples:
 - *Dow Corning Corp. v. Capitol Aviation, Inc.*, 411 F.2d 622, 6 U.C.C. Rep. Serv. 589 (7th Cir. 1969) (liquidated damages enforced when seller breached promise to deliver new, specially-built airplane).
 - *Wahlcometroflex, Inc. v. Westar Energy, Inc.*, 773 F.3d 223, 85 U.C.C. Rep. Serv. 2d 312 (10th Cir. 2014) (upholding as valid liquidated damages weekly delay damages of 1.5% of \$6.2 million contract price).
 - *In re Exemplar Mfg. Co.*, 331 B.R. 704, 45 Bankr. Ct. Dec. (CRR) 139, 59 U.C.C. Rep. Serv. 2d 941 (Bankr. E.D. Mich. 2005) (liquidated damages of \$16,000 a day found not to be a reasonable approximation of either the anticipated or actual loss resulting from defendant's delay).

Liquidated Damages (Continued)

Example of a Liquidated Damages Clause:

The Parties acknowledge and agree that it is difficult or impossible to determine with precision the amount of damages that would or might be incurred by the [Purchaser] as a result of the [Seller's] failure to achieve the Guaranteed Date for Interim Acceptance. Therefore, it is understood and agreed by the Parties that any sums which would be payable under this Section are in the nature of liquidated damages, are not a penalty, and such payment represents a reasonable estimate of fair compensation for the losses that may reasonably be anticipated from such failure. Without limitation or qualification of the foregoing, each Party further acknowledges and agrees that (A) it expressly waives any right that it may have now or in the future under law to assert that the rates of any liquidated damages are a penalty, unfair, unreasonable, or not a reasonable estimate of fair compensation for the losses that may reasonably be anticipated from the failure of the Seller to meet its obligations and (B) the Contract Sum was established, in part, based upon the rates of the liquidated damages, and the level of risk assumed by the Seller in connection therewith.

Indemnification

- Use indemnification provisions to allocate risk and reduce uncertainty regarding exposure to certain categories of damages.
- They often include a duty to defend and hold the indemnified party harmless.
- Indemnity may be implied by state law, but many commercial agreements contain an express indemnification provision so that the parties can customize their indemnification rights and obligations.

Warranties

- Use warranties to apportion exposure to potential losses and shift risk from the recipient to the maker.
- A warranty is a promise that an assertion of fact given by one party to another party is true, supported by an implied promise of indemnity if the assertion is false.
 - For example, sellers may make warranties about the character and quality of the products being sold.
 - Buyers may make warranties about facts relating to their use of the purchased products or services.
- UCC Product Warranties:
 - Created by law and not contract, they are distinct from any transactional representations and warranties in the contract.
 - Express Warranties
 - Implied Warranties

Remedies Clauses

- Use a remedies clause to define the range of remedies available to the non-breaching party.
 - Cumulative remedies clause
 - Equitable remedies clause
 - Exclusive remedies clause

Insurance Coverage

- Allocate risk through covenants requiring one or both parties to maintain specific levels of insurance coverage. Insurance coverage helps to ensure that a party has the financial capacity to satisfy its liabilities under the contract by shifting the risk from the insured to its insurer.

5. Global Sales Contracts: Square Peg, Round Hole

a. Introduction

- Are you using domestic sales contract template?
- Uniform Commercial Code Article 2
- U.S. Article 2 Litigation Predictable
- Litigation Abroad: A Black Hole?
- Bespoke Global Contracts
 - International Template
 - Materiality Drives Tailored Contracts

b. Global Contract Considerations

- Applicable Law

Article 2 vs. CISG (Convention for the International Sales of Goods)

- 84 signatory countries

- Represent 80% world trade

- Role of Bargaining Power

- Comity and Reciprocity Issues

- Battle of the Forms: Article 2 or CISG
 - Whose documents control
 - Seller's Last Shot
- Where Will Disputes Be Resolved
 - Home Field Advantage
 - Enforcement of U.S. Judgments Abroad
 - No U.S. Enforcement of Judgment Treaty
 - Hague Choice of Court Convention (2005/2015)

- Where Are the Assets: Monetizing a U.S. Judgment
- Duplicative Legal Proceedings
- Arbitration of Foreign Disputes
 - New York Convention (1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards)
 - 156 Signatory Countries

Thank you for your attendance.

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