Monday, October 1, 2012
2:30 PM - 4:00 PM

302 – Contract Drafting, Part 1 - Addressing Liability Issues: Warranties, Epidemic Failures and Liability Limitations

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Prior to WEG Electric Corp. he was a corporate governance and regulatory compliance attorney for Southern Company. Between Southern Company and WEG, Mr. Ginn served as manager of legal operations for Mirant Corporation in Atlanta, GA. Earlier, he practiced law in Georgia before his first in-house assignment in landowner relations with Exxon in Houston, TX.

He is treasurer of the ACC's Georgia Chapter, a past chair of ACC's Corporate and Securities Law Committee, past vice chair of ACC's Energy Law Committee and co-chair of the 2009 ACC GA charity golf and tennis tournament. He is a member of the advisory board of the southeast chapter of the Society of Corporate Secretaries and Governance Professionals, a volunteer attorney for Truancy Intervention Project Georgia, Inc. and serves as an industry guide for the Roswell UMC Job Networking program.

Mr. Ginn received his JD and LLM from Atlanta Law School.

Steven Jackman

Steven H. Jackman is the vice president and deputy general counsel of Flextronics' integrated network solutions and high velocity solutions segments.

Previously, Mr. Jackman was the vice president and corporate counsel of Sanmina-SCI Corporation and the assistant general counsel at Benchmark Electronics. Mr. Jackman counsels the organization in several practice areas -- including contracts, compliance, litigation, M&A, intellectual property and human resources -- and manages other attorneys and outside counsel. Prior to going in-house, Mr. Jackman was an associate in

the Atlanta offices of Kilpatrick Stockton, Booth, Wade & Campbell, and Holland & Knight, and served as a law clerk for the Honorable William H. Stafford, Jr., Chief Judge for the United States District Court for the Northern District of Florida.

Mr. Jackman received a BA from the University of California, Berkeley, cum laude, and is a graduate of the University of California, Hastings College of the Law.

Jeff Lewin

Jeffrey D. Lewin is a founder, shareholder and trial attorney at Sullivan Hill Lewin Rez & Engel, a business law firm, based in San Diego, CA.

With more than 30 years of experience in business-related civil litigation, Mr. Lewin has tried dozens of lawsuits, including antitrust, RICO, Lanham Act, fraud, breach of trust, products liability, breach of contract, breach of warranty, employment, negligence, product defamation and punitive damages cases, in state and federal courts throughout the country. Mr. Lewin represents a variety of national and international corporations as well as individuals. He focuses on fraud, products liability and employment cases.

Mr. Lewin is a member of the American Bar Association and the San Diego County Bar Association. He is also an active member of the Federal Bar Association, the Association of Business Trial Lawyers and Meritas' Finance Committee and Litigation Section Steering Committee. Mr. Lewin has lectured and published articles on various legal topics, and currently serves as a trustee, member of the Executive Committee and chairman of the Finance/Investment and Retirement Committees of California Western School of Law. He also serves on the Steering Committee for the University of California San Diego (UCSD) economics roundtable and is a member of the City Club of San Diego.

Mr. Lewin received his BA from Stanford University with honors, attended Harvard University for post-graduate studies and graduated cum laude from California Western School of Law.

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Session 302
Contract Drafting, Part 1 - Addressing Liability Issues: Warranties, Epidemic Failures and Liability Limitations

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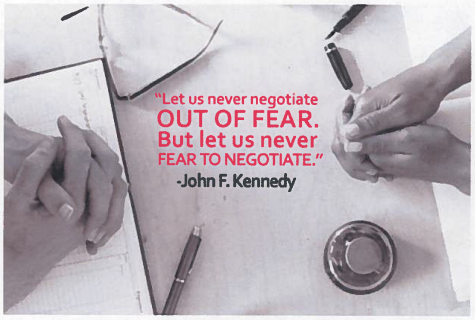
Key Issues in Warranty Negotiations

- Scope
- Duration
- Remedy
- Exclusions/Disclaimers



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Key Issues in Warranty Negotiations

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Key Issues in Warranty Negotiations
Scope

- Is the scope of the warranty clearly defined?
- Items to consider:
  - Workmanship
  - Design/Specifications
  - Product
  - Items Provided by Third Parties (Material and Software)
  - Non-Infringement
  - Compliance With Laws

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Key Issues in Warranty Negotiations
Scope

Seller warrants to Buyer that all Products will: (a) be free from any defects in workmanship, material and design; (b) conform to applicable specifications, drawings, designs, samples and other requirements specified by Buyer; (c) be fit for their intended purpose and operate as intended; (d) be merchantable; (e) be free and clear of all liens, security interests or other encumbrances; and (f) not infringe or misappropriate any third party's patent or other intellectual property rights.

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Key Issues in Warranty Negotiations
Duration

- Specific Term
- Clear Starting Date
  - Shipment
  - Delivery
  - First Use
  - Acceptance
  - Commercial Operations
- "Not to Exceed" Start Date

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Key Issues in Warranty Negotiations
Duration Example

POOR DRAFTING:

Seller warrants the Products against defects in workmanship, material and design for 12 months following installation at the end user's place of business or 18 months following the date of shipment, whichever is later.

BETTER DRAFTING:

Seller warrants the Products against defects in workmanship, material and design for a period expiring on the earlier of 12 months following installation at the end user's place of business or 18 months following the date of shipment.

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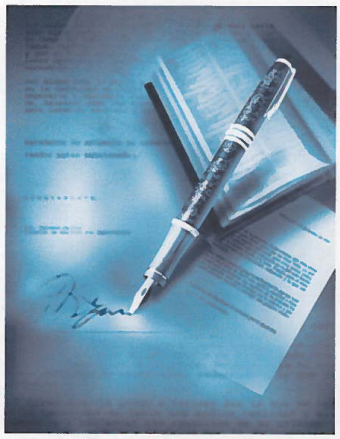
Key Issues in Warranty Negotiations
Remedy

- Remedy should be specifically defined
  - Repair or replacement
  - Credit or refund
  - Termination of Agreement
- Parties should consider whether the remedy provided is the "sole and exclusive" remedy or whether remedies are cumulative.
- Consider effect of insurance



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Key Issues in Warranty Negotiations
Exclusive or Non-Exclusive Remedies

Exclusive Remedy. In the event of a breach of warranty, Seller shall, at its option and at its expense (and as Buyer's sole and exclusive remedy for breach of any warranty), repair, replace or (if the Product cannot be repaired or replaced) issue a credit for Product found defective during the warranty period. In addition, Seller will pass on to Buyer all manufacturers' Materials warranties to the extent that they are transferable, but will not independently warrant any Materials. THE SOLE REMEDY UNDER THIS WARRANTY SHALL BE THE REPAIR, REPLACEMENT OR CREDIT FOR DEFECTIVE PRODUCTS AS STATED ABOVE.

Remedies Not Exclusive. No remedy conferred by any of the specific provisions of this Agreement is intended to be exclusive of any other remedy, and each and every remedy will be cumulative and will be in addition to every other remedy given hereunder or now or hereafter existing at law or in equity or by statute or otherwise. The election of any one or more remedies will not constitute a waiver of the right to pursue other available remedies.

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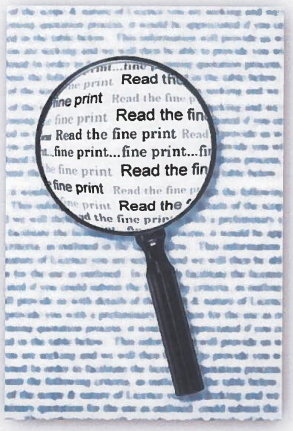
Key Issues in Warranty Negotiations
Exclusions/Disclaimers

- Did the seller expressly disclaim all express warranties on which buyer could rely?
- Did the seller expressly and adequately disclaim all implied warranties?



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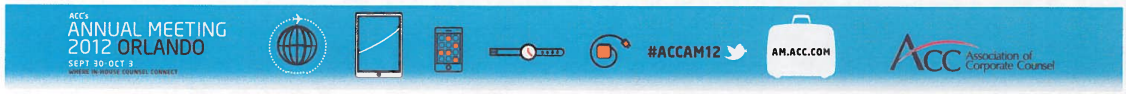

Key Issues in Warranty Negotiations
Disclaimer Example

THIS WARRANTY IS THE SOLE WARRANTY GIVEN BY SELLER AND IS IN LIEU OF ANY OTHER WARRANTIES EITHER EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO WARRANTIES OF MERCHANTABILITY, NONINFRINGEMENT, TITLE, COMPLIANCE WITH ROHS, WEEE AND REACH (AND OTHER SIMILAR APPLICABLE LEGISLATION), AND FITNESS FOR A PARTICULAR PURPOSE, EACH OF WHICH IS SPECIFICALLY DISCLAIMED.

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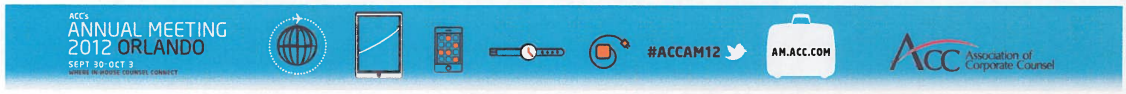

Key Issues in Warranty Negotiations
Exclusions

Seller makes no warranty with respect to (i) the third party materials and software included in the Product, (ii) the specifications and/or the Product design; (iii) Product that has been abused, damaged, altered, handled/repaired by a third party, or misused or mishandled (including any use contrary to Seller's instructions); (iv) prototypes and pre-production units; (v) defects resulting from tooling, designs or instructions produced or supplied by Buyer; or (vi) defects resulting from normal wear and tear. Buyer shall be liable for expenses incurred by Seller arising out of or related to the foregoing exclusions.

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Key Issues in Warranty Negotiations
Disclaimer Example (Software Agreement)

EXCEPT AS SPECIFICALLY SET FORTH IN THIS AGREEMENT, THE SERVICES, SUPPORT, TRAINING, AND ANY OTHER SERVICES ARE PROVIDED "AS IS" AND "AS-AVAILABLE," WITH ALL FAULTS, AND WITHOUT WARRANTIES OF ANY KIND.

THE SERVICES MAY BE USED TO ACCESS AND TRANSFER INFORMATION, INCLUDING CONFIDENTIAL INFORMATION, OVER THE INTERNET. BUYER ACKNOWLEDGES AND AGREES THAT SELLER AND ITS VENDORS AND LICENSORS DO NOT OPERATE OR CONTROL THE INTERNET AND THAT (A) VIRUSES, WORMS, TROJAN HORSES, OR OTHER UNDESIRABLE DATA OR SOFTWARE; OR (B) UNAUTHORIZED THIRD PARTIES (e.g., HACKERS) MAY ATTEMPT TO OBTAIN ACCESS TO AND DAMAGE BUYER'S DATA, WEBSITES, COMPUTERS, OR NETWORKS. SELLER WILL NOT BE LIABLE FOR ANY SUCH ACTIVITIES NOR WILL SUCH ACTIVITIES CONSTITUTE A BREACH BY SELLER OF ITS OBLIGATIONS UNDER THIS AGREEMENT.

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Other Considerations In Drafting a Warranty Clause

- Is the warranty clause the only clause in the agreement addressing product defects?
  - Quality clauses
  - Epidemic Failure
  - Compliance with laws
- Is the limitation of liability clause intended to affect the warranty?

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Do We Need an Epidemic Failure Clause?

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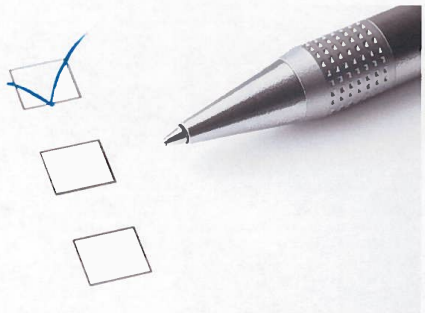
Five Things to Consider When Drafting a Limitation of Liability Clause

1. Should there be a LOL and, if so, should anything be excluded from the LOL?
2. Do we need to define "consequential damages" and "direct damages"
3. If I can't get the cap I would like to get, would subcaps be a good alternative?
4. Are liquidated damages a good idea?
5. How can I make sure that the cap is enforceable?



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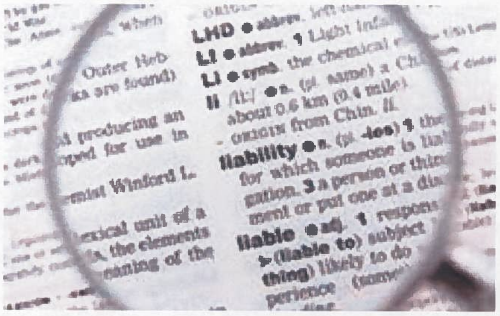
Limitations of Liability

#1

Should there be a limitation of liability in the first place, and if so, should anything be excluded from the limitation of liability?



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Sample Limitation of Liability Clause

THE TOTAL LIABILITY OF SELLER TO BUYER OR ANY THIRD PARTY ARISING OUT OF THIS AGREEMENT AND ANY SERVICES RENDERED UNDER THIS AGREEMENT FOR ANY AND ALL CLAIMS OR TYPES OF DAMAGES WILL NOT EXCEED 25% OF THE TOTAL FEES PAID HEREUNDER BY BUYER DURING THE PRIOR 12 MONTHS.

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Sample Limitation of Liability Clause (Negotiated)

EXCEPT AS TO LIABILITIES ARISING FROM (I) BREACH OF THE EXPRESS WARRANTY SET FORTH IN SECTION X; (II) BREACH OF THE CONFIDENTIALITY OBLIGATIONS SET FORTH IN SECTION Y; OR A CLAIM FOR INDEMNITY UNDER SECTION Z (AND EXCEPT FOR AMOUNTS DUE FROM BUYER FOR PRODUCT DELIVERED TO BUYER), THE TOTAL LIABILITY **OF EITHER PARTY TO THE OTHER** ~~**SELLER TO BUYER OR ANY THIRD PARTY**~~ ARISING OUT OF THIS AGREEMENT AND ANY SERVICES RENDERED UNDER THIS AGREEMENT FOR ANY AND ALL CLAIMS OR TYPES OF DAMAGES WILL NOT EXCEED ~~**25% OF**~~ **THREE TIMES** THE TOTAL FEES ~~**PAID**~~ **INCURRED** HEREUNDER BY BUYER DURING THE PRIOR 12 MONTHS.

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Limitations of Liability

#2

Do we need to define "consequential damages" or "direct damages" (or any other types of damages to be included or excluded)?

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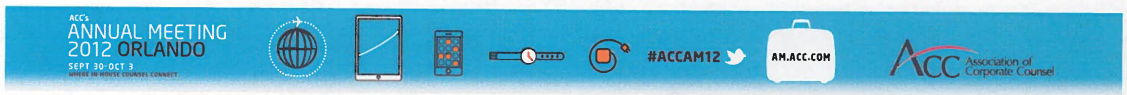

Limitation of Liability
Reviewing Types of Damages

Direct (General): Losses that flow directly and necessarily from a breach of contract, or that are a natural result of a breach and that are equivalent to the benefit of the plaintiff's contractual bargain.

Indirect (Consequential, Special or Incidental): Losses which do not arise directly and inevitably from any similar breach of any similar agreement, but are instead "secondary" or "derivative" losses arising from the particular consequences.

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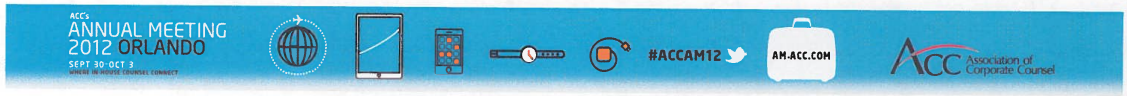

Sample Limitation of Damages Clause

IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER FOR

(a) ANY INDIRECT, CONSEQUENTIAL, INCIDENTAL, PUNITIVE OR SPECIAL DAMAGES, OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS;
(b) LOST PROFITS, LOST REVENUE OR DAMAGES RESULTING FROM VALUE ADDED TO THE PRODUCT BY CUSTOMER;
(c) COSTS OF PROCUREMENT OF SUBSTITUTE PRODUCT BY CUSTOMER; OR
(d) THE VALUE OF THE INTERNAL TIME OF CUSTOMER'S EMPLOYEES TO REMEDY A BREACH

ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE SALE OF PRODUCTS, WHETHER SUCH LIABILITY IS ASSERTED ON THE BASIS OF CONTRACT, TORT (INCLUDING THE POSSIBILITY OF NEGLIGENCE OR STRICT LIABILITY), OR OTHERWISE, EVEN IF THE PARTY HAS BEEN WARNED OF THE POSSIBILITY OF ANY SUCH LOSS OR DAMAGE, AND EVEN IF ANY OF THE LIMITED REMEDIES IN THIS AGREEMENT FAIL OF THEIR ESSENTIAL PURPOSE.

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Limitation of Liability

#3

If I can't get a meaningful cap, could I effectively limit my liability through subcaps?

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Sample Limitation of Liability Clause Subcaps

NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN CONTAINED:

- IN NO EVENT SHALL SELLER'S LIABILITY FOR ANY CLAIM ARISING OUT OF OR RELATING TO ANY ALLEGED FAILURE TO TIMELY DELIVER PRODUCT EXCEED $1,000,000 PER OCCURRENCE;
- IN NO EVENT SHALL SELLER'S LIABILITY FOR ANY CLAIM ARISING OUT OF OR RELATING TO ANY EPIDEMIC FAILURE (INCLUDING ANY REMEDY PROVIDED IN SECTION W) EXCEED $2,500,000;
- IN NO EVENT SHALL SELLER'S LIABILITY FOR ANY CLAIM ARISING OUT OF OR RELATING TO ANY ALLEGED BREACH OF ITS QUALITY OR COMPLIANCE OBLIGATIONS IN SECTIONS X, Y, AND Z EXCEED $2,000,000 PER OCCURRENCE OR $3,000,000 IN ANY TWELVE-MONTH PERIOD; AND
- IN NO EVENT SHALL A PARTY'S LIABILITY FOR ANY CLAIM FOR INDEMNIFICATION FOR INTELLECTUAL PROPERTY INFRINGEMENT UNDER SECTION A EXCEED $10,000,000 UNLESS SUCH INFRINGEMENT WAS WILLFUL, IN WHICH CASE A PARTY'S LIABILITY SHALL NOT EXCEED $30,000,000.

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Limitation of Liability

#4

Are liquidated damages a good idea?

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Sample Limitation of Liability Clause Liquidated Damages

On-time delivery is critical under this Frame Agreement. The parties acknowledge that Seller's delay will cause damages to Buyer which damages would be difficult to prove. Accordingly, should Seller fail to deliver product on the mutually agreed written delivery date (and the delivery is not excused as a Force Majeure or otherwise hereunder), and as Buyer's sole and exclusive remedy for any such failure to timely deliver Products, Seller shall be required to pay liquidated damages equal to one percent (1%) of the price of the delayed Product for each calendar day of delay up to a maximum of fifteen percent (15%) of the price of the delayed Product.

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Limitation of Liability

#5

How can I make sure that the cap is enforceable?

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WARRANTY, EPIDEMIC FAILURE AND LIMITATION OF LIABILITY

I. Differences Between Warranty and Acceptance

A. In General.

1. Acceptance: Trigger of the customer's payment obligation (until the product is accepted, the customer can reject the product and refuse to pay for the product). It is important to limit the reasons for which the customer can reject the product to defects which are covered by the warranty.

2. Warranty: Promise that the product will continue to satisfy certain criteria after acceptance.

3. Epidemic Failure: Generally a method for the customer, under certain circumstances, to obtain (i) a longer warranty or (ii) warranty remedies in addition to "repair, replacement or credit."

B. Acceptance.

1. Definition. "Acceptance" is an important legal concept, since the buyer's obligation to pay for product arises upon acceptance**.** The acceptance period should be limited to a certain number of days following receipt of the product; if the product has not been rejected during this time frame, it should be deemed accepted. The range of acceptance periods is 20-90 days, with the majority of contracts having a 30-day period. The acceptance period may also affect revenue recognition. For contracts governed under the Uniform Commercial Code, Section 2-606 provides that (absent an agreement to the contrary) acceptance is deemed to occur when the buyer fails to reject the goods within a "reasonable time" (which might reach 90 days). It is critical to separate the acceptance period from the payment terms clause. The payment terms clause should always follow the shipment date (which is in the control of the seller) rather than the acceptance date (which may not be).

2. Examples.

a. Seller ships product to the Buyer on March 1, 2012. On March 20, the Buyer returns the product to Seller, stating that the product is defective. This constitutes a rejection of the product and (assuming that the defect is covered by the Seller's warranty), Seller must correct the defect. The Buyer has no obligation to pay the invoice associated with the product because acceptance has not yet occurred. The Seller should probably issue a RMA (return materials authorization, the typical way product sellers handle defective product claims) for the full value of the product, repair or replace the product (assuming that the defect is covered by the Seller's warranty), and re-invoice the Buyer upon shipment of the repaired or replaced product.

b. Seller ships product to the Buyer on March 1, 2012. On August 15, Buyer returns the product to Seller, stating that the product is defective. Because the acceptance period has passed, the Buyer's remedies are governed by the warranty clause. Unlike the prior example, the Buyer has an obligation to pay the invoice associated with the product. Rather than permit the Buyer to delay payment of the invoice by crediting the Buyer with the purchase price of the product, fixing the product, and then

re-invoicing the Buyer for the product, Seller should probably issue a RMA at "zero value" (which shows that the product left the facility, but at a value of "zero" so that it does not create an credit in the Buyer's favor), repair or replace the product (assuming that the defect is covered by the Seller's warranty), and ship the product back to the customer at "zero value."

c. The difference between acceptance and warranty is most easily illustrated by the use of an electronics example. When one buys a tablet and the tablet breaks down within a couple of days thereafter, the buyer can usually return the tablet to the store and get a replacement tablet or refund. This is because the tablet has not yet been "accepted." However, after a period of time (the acceptance period) has passed, the electronic supplier will not generally replace the tablet or provide an immediate refund. Rather, the electronic supplier will ask the customer to leave the tablet with them so that they can repair it (or have it repaired by a third party). The buyer is still responsible for making payments towards the product in the event he financed the products.

3. Comment. While the foregoing principles apply in theory, they are often difficult to enforce in practice. Buyers do not typically want to pay for a non-working product. Many buyers confuse "acceptance" with "warranty" and will attempt to offset against a receivable the value of any product it returned to the seller, regardless of whether the return legally constitutes a "rejection" of the product (in which case the offset is legitimate) or a warranty claim (in which case the offset is not legitimate). In general, this raises only a timing issue. However, when the buyer is financially unstable (e.g., on the verge of bankruptcy), the seller will probably want to strictly distinguish between acceptance and warranty. First, the seller will not want to invest time and resources repairing a product under warranty for which it has not been paid. For example, assume the product was shipped on March 1 and the agreed acceptance period was 30 days. On June 15, the buyer returns the product to the seller and offsets the invoice for the product against its receivable balance. The seller would not want to repair the product unless it could be assured that it would be paid for the product. Second, the seller might want to maintain its right to commence a legal action against the customer immediately following the breach - before the customer becomes insolvent.

4. In the event the seller chooses not to enforce the concept of "acceptance" (e.g., the seller takes product back at full value and reinvoices upon reshipment), the seller should take steps to ensure that it is not waiving its right to later require full compliance with the acceptance clause. For example, the seller should consider sending the buyer a notice advising the buyer that it is permitting an offset in this particular case, but that in future instances of product warranty claims should be handled in accordance with the warranty section and are not subject to an offset or waiver.

C. Warranty and Epidemic Failure. These are discussed below.

II. Differences Between Warranty and Indemnity

A. In general

1. Indemnity generally applies only to third party claims (and is often limited to third party claims for personal injury, property damage, death or infringement).

However, some buyers attempt to craft an indemnity clause to provide for additional remedies for first party claims.

2. Warranty applies to first party claims.

B. Exclusion from Limitations of Liability

1. Indemnities are generally excepted from contractual limitations of liability, which makes it critical that they be carefully drafted and contain specific remedies and/or limitations;

2. Warranties are typically subject to the limitations of liability in an agreement (including both the limitations on the types of damages recoverable and any liability cap); if they are subject to a liability cap, however, there is the potential for a claim that the warranty failed of its essential purpose. For example, assume that Seller shipped $10 million worth of products to Buyer which do not meet the applicable specifications. In the event any product did not meet the warranty, Seller agreed to repair, replace or refund the purchase price of such product. Assume further that the cost to repair the products is $3.5 million and that the contract has a $1 million limitation of liability cap. Because the cost to repair the products exceeds the limitation of liability cap, Seller might refuse to repair the products and pay the $1 million. However, by doing so, Buyer has a good claim to void the limitation of liability clause on the grounds that the warranty failed of its essential purpose.

C. Duration

1. Warranties generally terminate after a specified certain period of time;

2. Indemnities often survive expiration of the warranty period and even expiration of the contract.

III. Anatomy of a Standard Warranty

A. Overview.

1. In general, a warranty creates an affirmative obligation for a seller or service provider for a period of time following the delivery of the product, design or software to the customer to correct a defect and/or reimburse the purchaser for damages resulting from the defect. Often, warranties exclude certain types of defects and limit the purchaser's remedies. In addition, parties often tailor the warranty and the warranty remedy based on the particulars of their industry.

2. Warranties can be express or implied.

a. Express warranties are formed when the seller makes a representation about a product which induces the buyer to purchase the product. Advertisements, pictures, proposals, catalogs, sample products, and even oral representations may constitute express warranties. Under the UCC, oral statements must be a part of the buyer's decision making process in order to be considered a "warranty." In addition, oral statements (e.g., by an aggressive salesperson) can often be countered by strong language in the contract that the buyer is not relying on any other representations/statements other than those specifically set forth in the warranty section. Courts will scrutinize the facts of the case to determine whether the statement was a "representation" or "puffery" and

whether the buyer relied on the statement. See, e.g., Johnson v. Mitsubishi Digital Electronics Am., Inc., 578 F. Supp. 2d 1229 (C.D. Cal. 2008) (neither manufacturer's promotional materials nor salespersons statements were actionable).

b. Consider the following disclaimer language from a manufacturing agreement:

> This agreement contains the entire and only agreement between the parties, and it supersedes all pre-existing agreements between such parties, respecting the subject matter hereof; and any representation, promise or condition in connection therewith not incorporated herein shall not be binding upon either Party. No modification or termination of this Agreement or any of the provisions herein contained shall be binding upon the party against whom enforcement of such modification or termination is sought, unless it is made in writing and signed on behalf of Seller and Purchaser by duly authorized executives.

c. The Uniform Commercial Code provides for four implied warranties which are incorporated into every sales contract unless they are expressly disclaimed. These include (i) the implied warranty of merchantability; (ii) the implied warranty of fitness for a particular purpose; (iii) the implied warranty against infringement and (iv) the implied warranty of title.

d. The Uniform Commercial Code and the common law generally permit sellers to draft limited warranties and disclaim all other express and/or implied warranties provided that they do so unambiguously and in accordance with certain guidelines. An example of such a disclaimer is provided in the following section.

B. "Standard" Warranties

1. Most sellers offer only limited warranties and disclaim all other warranties, express and implied.

2. When drafting a warranty, one should consider the following:

a. Scope of warranty

b. Duration of warranty

c. Remedy

d. Exclusions/Disclaimers

3. Sample warranty clauses are set forth in Appendix B.

C. Warranties in Manufacturing Agreements.

1. Scope of Warranty

a. Generally, manufacturers (who do not design the product) will warrant only their workmanship (that the product is manufactured and tested in accordance with certain manufacturing standards and/or the customer specifications for manufacture and test). Manufacturers might also warrant the production materials (e.g., solder, epoxy, glue, labels).

b. Manufacturers may also warrant that the manufacturing process does not infringe any third party intellectual property rights, but will not extend that warranty to the product (because to do so would include the unintended warranties that the components and the design – neither of which are generally selected by the manufacturer – do not infringe a third party's intellectual property rights)

c. Manufacturers do not want to warrant components they purchase from third parties.

1. It is often difficult to match the durations. For example, in order to deliver the product on December 15, Manufacturer must ensure that all components have been delivered no later than December 15 (in order to allow time to manufacture and test the product). If the customer then pushes delivery out to March 1, the component vendor's one year warranty would likely expire the following December 15 (on the date the components were delivered to Manufacturer), but the warranty from Manufacturer to the customer would not expire until March 1 (assuming that the warranty period commences on delivery of the product).

2. It is often difficult to match the remedy. Most component suppliers will limit the remedy to "repair, replacement or credit," and will not cover any incidental, special, indirect or consequential damages. A defective resistor or capacitor might cost less than a penny (the value of the replacement part/amount of the credit), but could cause thousands of dollars in damages if the product must be scrapped, or hundreds of dollars in damages if the product must be shipped to the Manufacturer to be reworked and then shipped to the customer once rework is complete.

3. If the components are specified by the customer, the Manufacturer has no leverage/relationship with the Component vendor. This is generally the case for high dollar and other critical components.

4. While the Manufacturer may not independently warrant third party components, it may offer to enforce any warranty it does obtain from the component supplier provided that the customer pays Manufacturer's costs for enforcing such warranty. (Because the warranty might not be assignable, it is possible that only the Manufacturer will have privity of contract and be entitled to enforce the warranty; however, lawsuits are costly, and the Manufacturer might not want to be forced to absorb the cost of a lawsuit)

(c) Often customers will ask manufacturers to increase the scope of their warranties to include

1. Compliance with laws (or at least the laws applicable to the manufacture of the product)

2. Compliance with certain environmental regulations (including RoHS, WEEE and REACH)

3. Compliance with certain quality obligations.

(d) Examples:

1. Workmanship v. Product. Assume that Manufacturer ships a product to Customer ABC. One of the Components in the product is a cable manufactured by Company X. European law requires that the cadmium level of the cable be under 0.01%. Unbeknownst to Manufacturer, the cadmium level of some of the cables exceeded this amount. The Customer's shipments were seized by customs, and the customer lost the sale because the end-user cancelled its agreement with the customer. The customer claimed that the product didn't meet the specifications, and has offset its payables to Manufacturer by the damages it claims that Manufacturer owes it. If Manufacturer limited its warranty to workmanship only, it would have no responsibility for the cables. However, if Manufacturer independently warranted the components, it would be responsible for the defect (the excessive cadmium level of the component) and any related liability and damages, to the extent not otherwise limited in the agreement.

2. Exclude Specified Components.

a. Assume that the customer's approved vendor list requires that Manufacturer purchase connectors from XYZ. Manufacturer received 100 connectors from XYZ, incorporated them into products, tested the products, and when the products passed the test, shipped the products to the customer. Six months later, a latent defect appears in the connector. Consistent with the warranty Manufacturer received from XYZ, XYZ offers to repair or replace the connector, but refuses to reimburse Manufacturer for its cost to repair the product (or, worse yet, the product cannot be repaired and must be scrapped!). The cost of 100 connectors is less than $1, but the cost to retrieve the products from the field, repair or replace them, and ship the product back to the customer exceeds $75,000. If Manufacturer warranted the connector, it will have to absorb the $75,000 cost.

b. Assume the same fact pattern as in (a), except that the latent defect appears 11 months after shipment and that Manufacturer was able to negotiate a vendor warranty whereby the vendor (XYZ) was required to pay for any consequential and incidental damages caused by the connector (e.g., repair and replacement costs). Assume further that, by the time the latent defect appears, XYZ filed for bankruptcy. Under Manufacturer's standard warranty, the cost of a replacement part and the cost to repair or scrap the product are chargeable to the customer; had Manufacturer warranted the components, Manufacturer would have to bear these costs itself. Lesson learned: even if Manufacturer negotiates a satisfactory warranty with the vendor, it may still not

warrant the component to the customer to avoid being "guarantor" of the vendor's obligations in the event the vendor fails to/cannot honor the warranty.

3. Ensure Concurrent Warranty Periods. Assume that Manufacturer buys printed circuit boards ("PCB's) from ABC for use in customer's set-top video boxes. ABC warrants the PCB's for twelve months. Manufacturer warrants the boxes (to the customer) for eighteen months. Thirteen months into the warranty period, the customer returns 100 boxes to Manufacturer. Manufacturer determines that the boxes failed as a result of a defective PCB. In the event Manufacturer warranted the PCB, Manufacturer would be obligated (under its warranty to the customer) to replace them, but would have no recourse from the vendor because the PCB's are outside of the vendor's 12-month warranty.

2. Duration of Warranty

(a) A manufacturer often wants the warranty to commence upon shipment because that is the date which tit tracks in its IT systems. Customers often prefer that the warranty commences upon delivery of the product to the customer, or occasionally, upon delivery of the product to the customer's customer (the end user).

(b) Consider what happens if the product has been manufactured, but the customer continues to delay delivery of the product? If the warranty runs from shipment, then every day the product sits on the shelf serves to extend the manufacturer's warranty. If the manufacturer warrants components, the component warranty might expire, but the manufacturer might still be liable to customer in the event the components are defective.

(c) The duration of the warranty is often negotiated and reflected in the product cost. The duration of a warranty is often an "industry standard" metric. Longer warranties can be negotiated and priced into the agreement.

3. Warranty Exclusions and Disclaimers

(a) When negotiating warranties, consider whether the following should be excluded:

1. the customer's design of products (including, but not limited to, design functionality failures, specification inadequacies, failures relating to the functioning of products in the manner for the intended purpose or in the specific customer's environment);

2. accident, disaster, neglect, abuse, misuse, improper handling, testing, storage or installation including improper handling in accordance with static sensitive electronic device handling requirements;

3. alterations, modifications or repairs by the customer or third parties (without appropriate certification or training);

4. defective customer-provided test equipment or test software; or

5. the failure of the customer-approved test plan to detect such a defect.

6. sample products (prototypes, first articles, and preproduction units) are sometimes sold without a warranty, with the understanding that they will not be placed into commerce).

(b) In addition, consider whether any of the following warranties (implied under law and/or the Uniform Commercial Code) should be disclaimed:

1. Implied warranty of merchantability. Section 2-314 of the UCC states that the goods will (i) pass without objection in the trade; (ii) be fit for the general purpose for which the goods are normally used; and (iii) be of "fair average quality."

2. Implied warranty of fitness for a particular purpose. Section 2-315 of the UCC states that if (i) the seller knows of the particular purpose for which the goods are required and (ii) the buyer relies on the seller's skill or judgment to select suitable goods then (absent a disclaimer of the warranty) the seller warrants that the goods are fit for the particular purpose specified by the buyer.

3. Implied warranty of title. Section 2-312 of the UCC provides that a seller (who is a merchant) warrants that the goods are not stolen or subject to any liens or other security interests.

4. Implied warranty against infringement. In general, under Section 2-312 of the UCC, a seller warrants that the items it is selling do not infringe anyone else's patent. There is an exception, however, for products not of the seller's own design. In fact, if the buyer provides the seller with the design specifications, the seller does not warrant that the products do not infringe any patent; rather, the buyer may be liable to the seller for any patent infringement.

The Uniform Commercial Code permits such disclaimers, and the failure to include such a disclaimer may result in the manufacturer having been deemed to make these warranties. It is unusual for a manufacturer to disclaim the warranty of title. Any disclaimer should be conspicuous.

(c) Consider the following disclaimer language:

MANUFACTURER MAKES NO REPRESENTATIONS AND NO OTHER WARRANTIES OR CONDITIONS ON THE PERFORMANCE OF THE WORK, OR THE PRODUCTS, EXPRESS, IMPLIED, STATUTORY, OR IN ANY OTHER PROVISION OF THIS AGREEMENT OR COMMUNICATION WITH CUSTOMER, AND MANUFACTURER SPECIFICALLY DISCLAIMS ANY IMPLIED WARRANTY OR CONDITION OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR NON-INFRINGEMENT.

4. Remedies for Breach of Warranty

(a) Repair, Replacement or Refund/Credit. Manufacturers generally seek to limit the customer's remedy for a breach of warranty to the repair of the product at a manufacturer-designated facility, the replacement of the product, or (if the manufacturer determines that the product cannot be repaired or replaced), the credit of the purchase price of the product. The manufacturer often seeks to make this the sole and exclusive remedy for breach of warranty.

(b) Additional Costs. Many customers are not keen to limit their remedies in this manner. They might want the manufacturer to reimburse them for (i) amounts they pay to the end user (their customers) as liquidated damages or other damages as a result of the defective product; (ii) the value of the internal time they spend dealing with the problem (testing, evaluating the root cause, etc); and (iii) expedited inbound and outbound freight costs. Customers often seek additional remedies, such as a product recall, for epidemic conditions.

(c) Specific Turn Around Times. The customer often seeks assurances that warranty repairs will be made within a particular amount of time. The manufacturer may try to soften the commitment to a specific turn-around time to make the repairs. (What if components are not available? What if the product hasn't been manufactured for a while, but is still under warranty?)

D. Warranties in Product Agreements

1. Scope

(a) Generally, sellers of products (who both design and manufacture the products) will warrant that the product conforms to the published specifications. Regardless of whether the defect arose from the design of the product, the components included in the product or the manufacturing of the product, the seller agrees to be responsible for the defect.

(b) Customers often ask that the product seller warrant third party software contained in the product. To the extent that the software is "off the shelf" rather than custom, this request is probably not unreasonable.

d. Given that the seller designed the product and presumably has an understanding of the intellectual property landscape in the field, it is not unreasonable (and likely expected) that the seller will provide an IP warranty (or, if not, at least an IP indemnity).

e. The seller will often warrant that the product complies with applicable laws.

2. Duration

(a) To the extent the product is intended for consumers, the buyer often requires that the warranty commence when the end user purchases the product. If this is the case, the seller might want to include a clause setting forth a maximum warranty period (e.g., the later of one year from the date on which the end user purchases the product or eighteen months from delivery of the product).

(b) To the extent the product is not intended for consumers, principles set forth in Section C [Warranties in Manufacturing Agreements] apply.

3. Exclusions and Disclaimers

(a) Many of the exclusions set forth in Section C [Warranties in Manufacturing Agreements] above apply equally to product warranties. The exclusions regarding defective customer-provided test equipment/software and the failure of the test plan to detect a defect likely do not apply to product warranties because the manufacturer also designed the product. .

(b) The implied warranties should be explicitly disclaimed.

4. Remedies for Breach of Warranty

(a) Product sellers generally seek to limit the customer's remedy for a breach of warranty to repair, replacement or credit (at the seller's option), and seeks to make this the sole and exclusive remedy for breach of warranty. Customers often raise the same objections to this limitation as they do to the manufacturing warranty limitations.

(b) For products with a well-defined useful life (e.g., certain electronics), the seller should consider whether it should limit the remedy to a depreciated value of the product in the event the product cannot be repaired or replaced (e.g., if the seller sells a product with a three year useful life and it fails after two years, should the buyer get 100% of its money back or should its recovery (in the event repair/replacement are not feasible) be limited to 33% of the purchase price)? Providing a right to a refund might impact revenue recognition, so one should be careful about including such clause.

E. Warranties in Design Agreements

1. Overview/Scope

a. Design agreements pertain to providing services instead of products or goods. Because the UCC does not apply to service agreements, the common law controls. Thus, warranty provisions in design agreements should be explicit.

b. Designers are more liberal with their warranties regarding fitness for a specified purpose non-infringement. Because they design the product, they are more familiar with the uses of the product and the intellectual property landscape surrounding the product.

c. Because design engagements run the gamut from designing a small part of a product to an entire system, it is important that the scope of the warranty reflect the actual work being performed. For example, if the buyer already has a product (and detailed specifications for the product) and the designer's role is to redesign a portion of the product, it is unfair for the buyer to require the designer to warrant that the product does not infringe a third party's intellectual property rights; rather, the designer should only be required to warrant that the work it is performing (the limited redesign) does not infringe any third party's intellectual property rights.

d. For companies which both design and build, it is important to consider separating the design warranties (and limitations) from the manufacturing warranties.

2. Duration

a. A design should be warranted until acceptance, but limited to a specific reasonable period (i.e. 90 days) in which to discover any defects

3. Exclusions

a. The designer should exclude from its warranty any design provided by the buyer which may be incorporated into the design;

b. The designer should exclude from its warranty alterations, modifications or changes by the customer or third parties; and

c. The designer should exclude from its warranty latent defects which could have been detected before the design was accepted.

4. Remedies

a. The designer will want to impose a limited remedy (e.g., redesign) for any breach of the design warranty; and

b. In addition, the designer will want to include a clause limiting its liability to a reasonable amount (e.g., the amount paid for the design, a multiple of that amount or some other dollar cap).

c. The customer will want significantly broader remedies.

5. Design and Build Agreements

a. Occasionally, a party will design and build a product. From a manufacturers' liability perspective, it is often better to have two separate agreements – one covering the design and the other covering the manufacture of the product so that the warranty regarding the design scope of the work can be limited independently of the manufacturing portion of the work..

b. Once the product (designed by the manufacturer) goes into production, the question of warranty surfaces. Does the manufacturer (who designed the product) warrant the design? Does the manufacturer warrant the materials that it selected for the product? Does the manufacturer provide any warranties (or indemnities) in the event the product infringes a third party's intellectual property? Or, does the manufacturer warrant only its workmanship.

c. The more the design relationship approaches a "contract design engagement" (where the customer owns all of the intellectual property created during the design, other than any background intellectual property of the manufacturer, for which it retains only a license), the more reasonable it is for the manufacturer to seek to limit is liability for the design. In such cases, it is critical that the design warranty and the limitation of liability set

forth in the design agreement limit the manufacturer's liability for design once the manufacturer has begun production of the product.

d. For example, assume that customer paid Manufacturer $1.5 million to design a portion of the layout of customer's product. The customer accepts the design, and the Manufacturer commences production. Assume that ten months later, the parties discover a latent defect in the design (or a third party sues customer for infringement alleging that the design Manufacturer created infringed its intellectual property). Manufacturer's liability could be significantly limited if the cap set forth in the design agreement is effective; if Manufacturer warrants the design against latent defects and/or infringement in each of products it manufacturers, its liability could be significant.

F. Warranties in Technology Agreements

1. Scope

(a) Providers of technology generally will include limited warranties regarding the performance of their product and services in the agreement covering the acquisition of product or service, and include broader protections in the maintenance agreements that are usually signed in connection with the technology.

(i) Warranties will generally provide that products and services will perform in a manner which is materially error-free and in accordance with specified documentation. Errors of an immaterial nature will be excluded from the warranty.

(ii) Warranties may be limited to use in a certain environment. For instance, warranties for software may only apply if the software is used on hardware approved by the software provider.

(b) Providers will include some warranties on the intellectual property rights used in technology.

(i) Since much technology is derived from prior works, it is important to consider the use of "Background Technology." This relates to all technology which provider intends to use in performing work under the agreement. A purchaser should seek a warranty that it is either owned solely by provider or licensed to the provider with a right to sublicense it to the purchaser.

(ii) Often times the technology provider will seek to limit the remedy for IP infringement to causing the provider to: (x) secure the applicable right, (y) replace or modify the technology so that there is no such infringement, or (z) terminate the agreement.

(iii) Warranties may not apply if technology is used in an unapproved manner. For instance, warranty may not apply if software is used in combination with other, unapproved software.

(iv) Warranties may be voided if the technology has been altered in any manner.

(c) Technology buyers may want to include a warranty that the products and services will be supported by the provider, and not be allowed to become obsolete, for a given period of time.

(d) Buyers of Software as a Service (SaaS) should seek warranties regarding the existence of adequate continuity plans in the event of a disaster or other casualty loss.

(e) Buyers of software might want to seek an upgrade protection warranty so that if the vendor comes out with a new version of the product within some length of time after the purchase, the buyer can receive the enhanced version

(f) Buyers of software might want to seek warranties that the product will be compatible with its existing products and/or a configuration warranty that the computer system will operate as a whole.

2. Duration

(a) Warranties are generally limited to the date the technology is delivered, unless a maintenance agreement is entered into by the parties.

(b) Agreements for SaaS and other applicable technology agreements include Service Level Agreements (SLAs) which seek to ensure appropriate levels of "up time." For example, SLAs can be used to warrant:

i. That customer support will be available during certain hours;

ii. That the service will be operational during a certain percentage (e.g., 99.7%) of the day, week, month or year;

iii. That data will be a certain percentage error-free; or

iv. That data will be processed within a certain time period (e.g., 0.25 seconds).

3. Exclusions/Disclaimers

(a) As with other agreements, it is important to effectively disclaim the implied warranties as well as any statements made by the seller to the buyer prior to the purchase, and limit the warranties to those express warranties set forth in the agreement. West Liberty Telephone Co. v. CopperCom, Inc., 805 F. Supp. 2d 669 (S.D. Iowa 2009) (under Iowa law, sales representative statements to buyers can cross over into express warranty when it induces representation or affirmation of facts given in such terms as to attain status of warranty); Irwin Seating Co. v. International Business Machines Corp., 2009 WL 32711 (6th Cir. 2009) (upholding the disclaimer in connection with the purchase of a computer system); Leson Chevrolet Co., Inc. v. Oakleaf & Assocs., Inc., 796 F.2d 76 (5th Cir. 1986) (seller disclaimed in obvious manner any implied warranties and was not liable for breach of implied warranty given sales contracts which displayed in conspicuous way limitation on remedies that precluded liability for breach of any implied warranty of merchantability).

4. Remedies

(a) Typically, the technology provider limits its remedy to a refund of the purchase price of the software.

(b) Courts have upheld limitations on remedies in a software license. See, e.g., M.A. Mortenson Co., Inc. v. Timberline Software Corp., 140 Wash. 2d 568, 998 P.2d 305, 41 U.C.C. Rep. Serv. 2d 357 (2000). In general, warranty limitation clauses in software license will be upheld if they meet the requirements of the UCC. See, e.g., Harper Tax Servs., Inc. v. Quick Tax Ltd., 686 F. Supp. 109, 6 U.C.C. Rep. Serv. 2d 408 (D. Md. 1988) (applying New York law; holding that provisions in a software license that precluded recovery of damages for any lost profits, or for any claims or demand against the customer by any other party, except a claim for patent or copyright infringement, and also precluded recovery of consequential damages, were valid); Hi Neighbor Enterprises, Inc. v. Burroughs Corp., 492 F. Supp. 823, 29 U.C.C. Rep. Serv. 1256 (N.D. Fla. 1980) (applying Florida law to uphold the validity of a clause in a software license limiting recoverable damages to "charges" and excluding damages for lost profits, incidental, special, and consequential damages, as well as damages for delay in installation or delivery of the software); Colonial Life Ins. Co. of Am. v. Electronic Data Systs. Corp., 817 F. Supp. 235, 20 U.C.C. Rep. Serv. 2d 753 (D.N.H. 1993) (applying New Hampshire law to hold that a provision in a software license, which limited damages to the compensation payable for the two months preceding the event giving rise to the liability, and precluded incidental and consequential damages, was not unconscionable as a matter of law).

(c) However, the “failure of the essential purpose” doctrine also applies to technology contracts. In the event the seller offers an exclusive remedy (e.g., repair service for documented program errors) and the seller cannot make such repairs, the limitation of liability in the contract may be held unenforceable. See, e.g., Baney Corp. v. Agilysys NV, LLC, 773 F. Supp. 2d 593 (S.D. Md. 2011). Note that in states which adopted the Uniform Computer Information Transactions Act, unless there is clear language in the contract that the contractual limitation of liability shall be effective even in the event of the failure of an exclusive remedy (e.g., that the two clauses are expressly independent), the limitation of liability will not be enforced. Id. at 606 (under MUCITA Section 22-803(c), the failure of an “exclusive ... remedy makes a term disclaiming or limiting consequential or incidental damages unenforceable unless the agreement expressly makes the disclaimer or limitation independent of the agreed remedy”); Caudill Seed and Warehouse Co., Inc. v. Prophet 21, Inc., 123 F. Supp. 2d 826 (E.D. Pa. 2000) (under Pennsylvania law, damages disclaimer in limitation on liability clause in computer software licensing agreement was not enforceable against buyer, and thus buyer could invoke full range of remedies available under UCC including consequential and incidental damages, where agreement restricted buyer to exclusive remedy of repair or replacement, and seller refused to repair or replace).

G. Exception to the Enforceability of Disclaimers and Limitations

1. Fraud, Willful Misconduct, Gross Negligence or Reckless Indifference. Evidence of fraud in the inducement, willful misconduct, gross negligence or reckless indifference will likely vitiate any disclaimer of warranty, limitation of liability or limitation of damages. The degree of evidence required is limited: anything that "smacks" or that has "a trace, vestige, or suggestion" of wrongdoing may be sufficient. For two recent cases which apply this principle and reach different results, see MyPlayCity, Inc. v. Conduit Ltd., 2011 WL 3273487 (S.D.N.Y. 2011) and Smithkline Beecham Corp. v. Abbott Laboratories, 2011 WL 3903190 (N.D. Cal. 2011).

2. Disclaimers Not Conspicuous. Because disclaimers and limitations are disfavored, they must be brought to the attention of the purchaser and not hidden. Disclaimers can be made conspicuous by placing them at the beginning or end of the contract, putting them in a box or frame, labeling them with a clear and descriptive caption, using a font that is larger or a different color than the font used in the rest of the contract, using bold font or upper case letters or requiring the purchaser to initial the clause on a line or in a box near the clauses.

3. Unconscionability. Limitations on consequential damages may be unconscionable. In some states substantive unconscionability occurs if the terms of the contract are one-sided or oppressive. Procedural unconscionability occurs if the seller employed overreaching or sharp practices and the buyer was ignorant or inexperienced. In determining whether a limitation on damages is unconscionable, a court may look to the circumstances surrounding the agreement; the alternatives, if any, that were available to the parties at the time of making the contract; the inability of one party to bargain freely; whether the contract is illegal or against public policy; and whether the contract is oppressive. Courts are especially likely to uphold liability limits for consequential damages in commercial transactions with sophisticated parties. Courts may also uphold the exclusion of damages for consequential economic loss, such as lost profits, downtime, and claims of third parties where there is evidence that the buyer was on notice of the limitation. See, e.g., Berge Helene Ltd. v. GE Oil & Gas, Inc., 830 F. Supp. 2d 235 (S.D. Tex. 2011)

4. Failure of Essential Purpose. If a buyer can establish that a limited or exclusive remedy provided in the contract "fails of its essential purpose," then the buyer may disregard that term of the contract and pursue remedies to which the buyer otherwise might not have recourse. The "failure of essential purpose" exception to the general right of sellers to limit liability under the U.C.C. "applies most obviously to situations where the limitation of remedy involves repair or replacement that cannot return the goods to their warranted condition. In such cases, a limited or exclusive remedy fails its essential purpose if the seller is unwilling or unable to repair the defective goods within a reasonable period of time. Limited remedies have also been found to fail their essential purpose where the limited remedy would cause plaintiff to lose the "substantial value of their bargain." For two recent cases which discuss this concept and reach different results, see Beausoleil v. Peterbilt Motors Co., 2010 WL 2365567 (E.D. Va. 2010) and Viking Yacht Co., Inc. v. Composite One LLC, 385 Fed. Appx.195 (3rd Cir. 2010).

5. Inconsistent Language. If the contract or a related document, such as a transmittal letter or brochure, contains language that is inconsistent with the disclaimer or limitation, it is likely not to be enforced, especially if the contract does not contain an integration clause.

H. Quality-Related Provisions.

1. Many agreements contain a separate quality section setting forth certain metrics (e.g., minimum yields or minimum levels of scrap) and other requirements. While some of these may be fairly innocuous, others have far-reaching consequences. A breach of any of the quality requirements can subject the seller to damages and, unless the quality section is somehow tied to the warranty limitations, the seller's liability might remain uncapped.

2. Most manufacturing agreements provide that the "sole and exclusive" remedy for a warranty defect is the repair or replacement of the product or a credit in the amount of the purchase price of the product in the event the product cannot be repaired or replaced. It is critical that any separate quality clause in the Agreement be subject to these exclusive remedies.

I. Non-Product Warranties. Often, customers will request "warranties" for non-product matters. For example, a customer might request that the manufacturer "warrant" that it complies with laws. (See discussion about "compliance with laws" below). While in the US, there is not a significant difference between a warranty and a covenant, this is not the case in other jurisdictions. It is probably best to include these as covenants rather than warranties in order to limit liability.

IV. Epidemic Failure

1. Many times, the customer will ask for an epidemic failure ("EF") clause; often, the customer will not know why they need it. Most of the time, the customer's concern is covered by the warranty clause: if the product is defective within the warranty period, the warranty gives the customer the right to send the product back for repair or replacement (or, in certain cases, credit). In general, an EF clause contains two concepts not offered under the warranty clause: (i) an extension of the warranty under certain circumstances or (ii) an extension of the remedy provided in the warranty clause.

(a) In order for a product to be covered under the warranty clause, it must exhibit a defect during the warranty period. A customer might be concerned that a latent defect might appear towards the end of the warranty period and, in the event it does not return the product during the warranty period, it might be left without a remedy. For example, assume that Manufacturer shipped 1000 units on June 1, 2011. Between April 20, 2012 and May 15, 2012, forty of the units failed, and the failure was attributable to the same root cause. The fact that the forty units' failure was attributable to the same root cause makes it more likely that the remaining 960 units might have the same defect. However, unless the 960 units fail before May 31, 2012 (the expiration of the one year warranty), the customer will be left without a remedy. Providing the customer with a longer warranty period in the event of an epidemic failure is an easy solution to this problem.

(b) The standard warranty limits the customer's remedy to "repair, replacement or, if the product cannot be repaired or replaced, credit." Often, customers will argue that the remedy is insufficient to compensate them for (i) any costs of a product recall should one need to occur and (ii) the internal time customer spends handling the epidemic failure. Remember that a key difference between the "warranty" clause and the EF clause is that, while the warranty applies to and provides a remedy

for products known to be defective, the EF clause applies to products suspected of being defective, In the example set forth above (where 40 units out of 1000 exhibited the same root cause), the customer might choose to inspect (or recall and inspect) the remaining 960 units to ensure that they are not defective (or, if they are defective, to repair or replace them). In fact, the law or customer's policy might require such a recall. What happens if none of the 960 recalled units is defective? Because they are not covered by the warranty (because they are not defective), the customer ordinarily would bear this cost…absent an epidemic failure clause which shifts this burden to the manufacturer.

(c) Giving the customer an epidemic failure remedy is not only costly but might also be misused. In the example above, assume that the 40 (of the 1000) units that were defective were manufactured during one shift in the week of August 20, 2011, and the manufacturer has isolated the cause of the defect to a particular individual working that particular shift. manufacturer would want to limit any recall to the units produced during that shift. The customer might require that all units be recalled. The difference between the costs of these two remedies is significant.

2. It is difficult to define the appropriate triggers for an EF. At a minimum, the triggers should include

(a) A certain percentage of defects found during a particular 90-day period. Obviously the higher the threshold, the less likely the EF clause would be triggered.

(b) A minimum number of units found to be defective. This is to make sure that there is truly an EF. For example, if the trigger is 4%, but only 50 units were produced, then two defective units whose defect is attributable to the same root cause would constitute an EF because 4% of 50 is two. At a minimum, there should be some minimum number (e.g., a minimum of 20 units) in order to trigger the EF obligations.

3. Query whether product recall insurance is available and, if so, whether it provides appropriate coverage. First and second party coverage is generally available, but covering the cost of the customer's (second party) damages can be very expensive as their products may be many multiples of the value of the manufacturer's products. First party coverage will normally not cover all of the manufacturer's (first party) costs, but will cover a portion of them once the deductible has been reached.

4. Sample epidemic failure clauses are attached as Appendix A.

IV. Limitation of Liability/Liquidated Damages

A. General.

1. It is common practice for agreements to include limitation of liability ("LOL") clauses. Absent an agreement explicitly limiting a party's liability, a party is liable for incidental damages (e.g., charges, expenses or commissions incurred in connection with effecting cover and other reasonable expenses incident to the delay or other breach) and consequential damages (e.g., loss of profits, value add damages, line down charges, and other damages which are reasonably foreseeable). Thus, the limitation of liability is arguably the most important clause in an agreement. A party cannot rely on the limitation of liability clause in the

battle of the forms to protect it. Rather, because the UCC favors the buyer, unless the limitation of liability clause appears in the buyer's form also (which it rarely does), the seller will not have any such protection. In addition, under both common law and the UCC, the buyer is entitled to recover all damages which are "reasonably foreseeable" absent any restriction limiting such a remedy.

2. Some courts draw a clear distinction between limitations on liability and limitations on remedies and damages. Different jurisdictions have different laws regarding the enforcement of exculpatory clauses, so attention should be paid to forum selection, choice of law and arbitration clauses.

B. Items to Include in a LOL Clause. Typically, "limitation of liability" clauses contain the following items:

1. Exclusion of certain damages.

(a) LOL clauses typically exclude incidental, special, indirect, consequential (and occasionally, punitive, although this restriction is likely not enforceable) damages, and limit the damages recoverable by a buyer to "actual direct damages." While "lost profits, loss of use and lost revenue" are the quintessential consequential damages, in the manufacturing area, "value add" damages might be equally important, and the manufacturer might want to specifically disclaim those damages. For example, a chip manufacturer knows that its $100 chip might be incorporated into a motherboard and, ultimately, a computer, which wholesales for $800. If the chip is defective and the computer must be scrapped, does the chip manufacturer want to be exposed to $800 worth of damages?

(b) Because courts have not been uniform in their approach to determining whether an element of damages is "direct" or "consequential," one should consider listing typical damages which would be considered consequential. These damages might include loss of earnings, profits or revenue from the transaction that is the subject of the agreement, which a court might otherwise consider as a "direct damage." Other damages which one might attempt to define as "consequential" include loss of use of an asset; loss of business, reputation or goodwill; loss of business opportunity, lost sales or lost contracts; loss of management or employee productivity; wage or salary increases or other inflationary costs of labor; increase in financing costs, cost of capital, administrative fees, legal fees or overhead or failure to realize expected savings; business interruption; shutdowns or service interruptions; inventory charges; lost data or information; and loss of product.

(c) A party should also consider limiting the other party's rights to recover their "costs of cover". For example, if Party A sells its computer for $800, but the competitor sells its computer for $1,200, then Party A's breach of contract (e.g., late delivery, defective product which has not been repaired) might permit the other party to purchase the $1,200 computer and charge Party A $400 (the difference between the $800 and $1,200).

(d) A key element of damages is the non-breaching party's claim for "internal time" spent remedying a breach. One might consider whether this should be excluded as a "direct damage" or otherwise cap this portion of the claim.

(e) One might also consider whether to exclude “line down charges” if the product being manufactured will be used in customer’s product (and the failure to timely deliver the product would cause the customer’s line to be down situation where the customer has to pay for idle labor and machine time without being able to manufacture its product)

(f) One might also want to consider whether “penalties” or “liquidated damages” payable to a third party constitute direct damages under a contract and, if so, whether they should be separately capped.

(g) By definition, a party is not responsible for damages in the event of a force majeure. By creatively expanding the definition of “force majeure,” a party might be able to indirectly foreclose the other party from recovering any damages. Most parties will agree that a “force majeure” should include acts of God such as hurricanes, earthquakes, flooding and fires, but one should also consider items as “strikes” (the buyer might argue that the seller has some control over its labor force and if the strike is particular to its business or facility, this should not be considered a force majeure item) and third party actions (e.g., the inability of a third party supplier to timely deliver materials to the seller)

(h) Consider whether a customer must reduce its damages by the amount of any insurance recovery, third party recovery or tax benefit (e.g., and recover from the manufacturer only its “net damages.”

(i) Consider whether to include clause requiring a party to affirmatively mitigate its damages.

(j) Consider whether to agree to a shortened “contractual” statute of limitations for a party to present a claim for damages. This would likely foreclose a party from raising (in response to a proceeding initiated by the other party) claims which it failed to timely raise in accordance with the agreed-upon limitations period.

2. Cap on liability.

(a) Sellers will want to ensure that their contracts include an “overall cap on liability” expressed as (i) a fixed dollar amount or (ii) a percentage or multiplier of the amounts paid by the customer during the preceding (12-month) period. (“Amounts paid” is often better than “trailing 12 month revenue” because it excluded disputed invoices). Often, it is necessary to craft a limitation that works in the beginning of the period (where there is no revenue) as well as years later. One can accomplish this in several ways, including by giving the customer a “greater/lesser” option of a fixed dollar amount or an “amount paid”.

(b) Sometimes, the buyer will seek a cap which is out of proportion for the level of business. Sometimes this is prompted by “corporate policy” or the negotiator’s desire to “look good” by getting a high cap in the agreement. In order to close the deal, one should consider using subcaps. It is easier to agree to a $25 or $50 million cap (rather than a $5 million cap) if the seller is relatively sure we will never hit the cap. For a manufacturer, for example, the two most common breaches of the agreement are (i) delivering defective product and (ii) late delivery. In a design contract, the most likely breach is probably that the design is not

completed on time. In the event the parties cannot agree to an overall limitation of liability, a seller might be able to accomplish its goal by accepting a high limitation of liability, but using subcaps to mitigate the risk.

(c) Subcaps can also be useful to limit a party's risk for accepting additional liability under an agreement (including liability resulting from overbroad clauses). For example, many buyers include broad "compliance with laws" clauses in their agreements. It is difficult to argue that the clause should be removed (of course one has to comply with the laws), but it is also difficult for a party to create a cause of action for the other party for each and every failure to comply with the law.

(d) Similarly, quality clauses might create additional hidden liability for a seller. For example, a seemingly innocuous statement in the quality section that "The Products will comply with the Workmanship Specifications" could be problematic because (unlike the warranty section where breaches might be limited to the explicit "repair, replacement or credit" remedies provided), the remedy for breach of the quality section is not so limited (but would be subject to the broad contractual remedies/limitation of liability). If one cannot tie the breach of the quality clause to the warranty remedies, then a cap might be an effective solution to alleviate the additional risk.

(e) Subcaps can also be an effective way to limit certain types of damages. Assume that the parties agreed on an overall cap of the "greater of $2.5 million or five percent of the trailing twelve months revenue." The parties anticipate that during the first year, the revenue would be approximately $50 million, but that it would increase to $100 million in the second year and $150 million in the third year. Therefore, the effective cap during the first year would be $2.5 million, but this cap would rise to $7.5 million in the third year. The seller might be willing to reimburse the customer for a certain amount of cover damages (e.g. $500 per unit, up to a maximum of $1,000,000), but does not want to expose itself to the full limitation of liability cap ($2.5 - $7.5 million). Similarly, a seller might be willing to reimburse its customer for a portion of any liquidated damages which the customer might have to pay its customer or a certain amount of product recall expenses. Subcaps can be particularly effective in these cases.

3. Exclusions from the Limitation of Liability Clause.

(a) It is fairly typical to exclude (i) indemnification obligations; (ii) breaches of confidentiality obligations; (iii) misappropriation of the other's intellectual property; (iv) payment obligations for product delivered and (v) in manufacturing agreements, liability for excess materials (see below) from the limitation of liability clause. Because they are typically excluded, it is critical that these clauses – and in particular the indemnification clause – be drafted precisely and narrowly.

(b) Consider whether an event should be excluded from the liability cap or the damage limitations. For example, it is possible that the parties will agree that only actual damages are recoverable for a specific breach of the agreement, but would not agree to cap the level of actual damages recoverable in the event of breach. Or, it is possible that the parties might be willing to cap the amount of recoverable damages resulting

from a breach, but may not be willing to limit the recovery to actual damages.

(c) Some agreements may preclude application of the LOL clause to the extent damages may be claimed against insurance policies covering the transaction or the parties. Not all jurisdictions will enforce such a provision, so parties should take steps to ensure applicable law will permit such a formulation.

4. Enforcement of Limitations of Liability Clauses.

(a) Limitations of liability clauses may not be enforceable in situations where

(1) the action or inaction sought to be limited is against public policy
(2) the action or inaction constitutes intentional, reckless or grossly negligent conduct. Wartsila NSD N. Am., Inc. v. Hill Int'l, Inc., 530 F.3d 269 (3rd Cir. 2008); MDT Tek, LLC v. StaffChex, Inc., 2012 WL 2523941 (C.D. Cal. 2012).
(3) the limitation was procured by fraud
(4) the limitation is not conspicuous
(5) the limitation is unconscionable
(6) the limitation would cause the contract remedy to fail in its essential purpose. Northern States Power Co. v. ITT Meyer Indus. Div. of ITT Grinnell Corp., 777 F.2d 405 (8th Cir. 1985); Phillips Petroleum Co. v. Budyrus-Erie Co., 131 Wis. 2d 21, 388 N.W.2d 584 (1986); Ricwil, Inc. v. S.L. Pappas and Co., Inc., 599 So. 2d 1126 (Ala. 1992).

(b) Limitations on remedies are more likely to be enforceable than limitations of liability.

C. Value Add Liability. Occasionally, a manufacturer must accept some level of "value add" liability. It is critical to limit one's exposure to a reasonable level. The manufacturer should consider limiting its liability:

(a) to a percentage of the revenue generated by the customer during the previous year/quarter;

(b) to the cost of the components damaged as a result of the breach of warranty, exclusive of markup (and exclusive of labor charges, lost profits, etc);

(c) to a certain lot size/number of units (the manufacturer wants to encourage its customers to halt manufacturing once they suspect a defect rather than continue to populate potentially defective units in order to meet their customer's demands);

(d) to a certain dollar value of components per unit;

(e) to taking a credit on future orders rather than receiving a credit on prior orders (so that the manufacturer can mitigate the impact through future product sales).

D. Liquidated Damages (For Late Delivery). There are two schools of thoughts concerning the use of liquidated damages in the case of late delivery. The "business people" generally dislike liquidated damages because they provide an easy and obvious remedy for the customer for late deliveries which might not cause the customer any actual

damage (and, accordingly, claims which the customer might not choose to otherwise pursue if it had to prove its damages). Business people may also think that a liquidated damages remedy might cause the parties to dwell on "pointing fingers" as to the cause of the late delivery in order to provide for/defend against the applicability of the liquidated damages clause which tends to distract the parties from their long-term relationship. Attorneys, however, often prefer the inclusion of a pre-negotiated measure of damages to the uncertainty of having a third party determine a party's damages. Where liquidated damages are the "sole remedy" for a delayed delivery, liquidated damages can be a very effective limitation of liability. This is generally the case in the United States where one cannot recover both liquidated damages and actual damages. However, in other jurisdictions (e.g., some European countries), the non-breaching party may recover both liquidated damages/penalties and actual damages in the event of breach. The parties should consider the following when drafting a late-delivery damages clause:

(a) Consider limiting damages to cases where the customer has specifically advised the manufacturer that the order is subject to liquidated damages;

(b) Consider limiting damages to the lesser of the liquidated damages or the amounts actually paid to the customer's customers;

(c) Consider limiting damages to circumstances where the event triggering the breach is caused solely by the breaching party (e.g., in late delivery cases, the delay is caused solely by the manufacturer and not where the delay is attributable to the vendor's failure to timely deliver components to the manufacturer);

(d) Damages should be limited to a certain percentage of the sales price (e.g., 1% for delays between 7-15 days, 2% for delays between 15-25 days and 3% for delays greater than 25 days)

(e) If the business is new to the manufacturer (e.g., customer had a prior supplier) determine what the current on time delivery ("OTD") rate is first, and use that as a benchmark (e.g., if the current OTD rate is 98%, the manufacturer should not be penalized if its OTD rate is 98.5%, even if it is not at 100%).

Liquidated damages clauses are typically enforced if they are not a "penalty" and if the damage amount represents a reasonable attempt by the parties to estimate the impact of a loss which might be sustained in the event of a breach. If, however, the stated liquidated damages are disproportionate to the actual damages incurred, a court might invalidate the liquidated damages clause on the grounds that it is, essentially, a penalty.

It is probably best to avoid using fixed dollar liquidated damages clauses, but rather attempt to construct liquidated damages clauses based on a formula (e.g., a percentage/multiple of the dollar value of the contract).

(7) Sample liquidated damages clauses are attached as Appendix C.

APPENDIX A
SAMPLE EPIDEMIC FAILURE CLAUSES

EXAMPLE 1 – Benign/Favorable to Seller

EPIDEMIC FAILURE. DURING THE TERM OF THIS AGREEMENT, SELLER SHALL REPAIR OR REPLACE ANY AFFECTED PRODUCTS FOR ANY EPIDEMIC FAILURE DUE TO ANY DEFECT COVERED UNDER THE WARRANTY. AN EPIDEMIC FAILURE WILL BE CONSIDERED TO EXIST WHEN RETURN RATE DATA INDICATES THAT X PERCENT (X%) OF PRODUCT SHIPPED DURING ANY TWELVE (12) CONSECUTIVE MONTHS HAS BEEN PROVEN TO EXHIBIT THE SUBSTANTIALLY SAME MAJOR FUNCTIONAL, MECHANICAL, OR APPEARANCE DEFECT ATTRIBUTABLE TO THE SAME ROOT CAUSE. SELLER AND BUYER WILL AGREE TO A REASONABLE PLAN AND ALLOCATION OF COSTS TO CARRY OUT THE REPAIR OR REPLACEMENT OF AFFECTED PRODUCT SHIPPED DURING SAID TWELVE-MONTH PERIOD AND THE COSTS OF EXPEDITED SHIPPING FOR SUCH ITEMS. UPON AGREEMENT, SELLER WILL PAY ANY CLAIMS FOR SUCH COSTS BY BUYER IF THE PROBLEM IS A RESULT OF A BREACH BY SELLER OF ITS EXPRESS LIMITED WARRANTY SET FORTH IN SECTION XX. NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN CONTAINED, THE REMEDIES PROVIDED IN SECTION YY (WARRANTY) AND THIS SECTION SHALL BE THE SOLE AND EXCLUSIVE REMEDIES FOR ANY CLAIM THAT (A) SELLER BREACHED ITS WARRANTY OR (B) THE PRODUCT IS DEFECTIVE AND/OR OTHERWISE FAILS TO CONFORM TO THE SPECIFICATIONS.

Comments:

- Under this clause, Seller makes no commitments to do anything (other than to agree on a reasonable plan).
- The epidemic failure is tied to a breach of warranty
- The trigger is high (over a 12-month period rather than a shorter period)
- The trigger is limited to the same "root cause."
- Nothing in this clause requires the Seller to conduct a recall.

EXAMPLE 2 – Benign/ Favorable to Seller

AN "EPIDEMIC CONDITION" EXISTS WHEN FAILURE REPORTS SHOW THAT FIVE PERCENT (5%) OR MORE OF THE SAME PRODUCT INSTALLED OR SHIPPED DURING ANY ONE-MONTH PERIOD (WITH A MINIMUM OF 50 UNITS) CONTAINS A DEFECT OF THE SAME ROOT CAUSE THAT IS COVERED BY THE WARRANTY SET FORTH IN [*REFERENCE THE WARRANTY SECTION*]. IN THE EVENT OF AN EPIDEMIC CONDITION, BUYER MAY, BY WRITTEN NOTICE, INSTRUCT SELLER TO POSTPONE ALL MANUFACTURING, ASSEMBLY AND SHIPMENTS OF THE PRODUCT THAT IS SUBJECT TO THE EPIDEMIC CONDITION, AND SELLER SHALL ABIDE BY THIS INSTRUCTION. SUCH POSTPONEMENT SHALL CONTINUE UNTIL THE EPIDEMIC CONDITION IS RESOLVED TO BUYER'S REASONABLE SATISFACTION, AND THE DEADLINES FOR EACH PARTY'S OBLIGATIONS REGARDING THE MANUFACTURING AND PURCAHSING OF SUCH PRODUCT SHALL BE EXTENDED BY THE LENGTH OF TIME EQUAL TO THE LENGTH OF SUCH POSTPONEMENT. SELLER SHALL USE COMMERCIALLY REASONABLE EFFORTS TO PROMPTLY REMEDY EACH EPIDEMIC CONDITION. IF IT IS DETERMINED THAT AN EPIDEMIC CONDITION EXISTS, SELLER SHALL PAY FREIGHT COSTS FOR BOTH INBOUND AND OUTBOUND SHIPMENTS OF UNITS AFFECTED BY THE DEFINED EPIDEMIC CONDITION TO BE REPAIRED. NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN CONTAINED, THE REMEDIES PROVIDED IN THE WARRANTY SECTION AND THIS SECTION SHALL BE THE SOLE AND EXCLUSIVE REMEDIES FOR ANY CLAIM FOR BREACH OF WARRANTY AND/OR FAILURE OF THE PRODUCT TO CONFORM TO THE SPECIFICATIONS. NOTWITHSTANDING ANYTHING TO THE CONTRARY HERIN CONTAINED, IN NO EVENT SHALL SELLER' LIABILITY FOR A BREACH OF THIS SECTION EXCEED THE AMOUNT IN [*THE SUBCAP SET FORTH IN THE LIMITATION OF LIABILITY SECTION*].

Comments:

- Note the relatively high percentage trigger and the required minimum (50) defective units required in order to trigger this clause.
- Note the relatively benign remedy – if there were an epidemic condition, the Buyer would likely instruct the Seller to halt production (and the Seller would not object because it would not want to unnecessarily increase its liability).
- Payment of freight expenses (outbound and return) is likely included in the warranty section as well (for defective products).
- It is always a good idea to consider a cap on the Epidemic Failure section.

EXAMPLE 3 – Negotiated

EPIDEMIC FAILURE.

(i) TRIGGER. AN "EPIDEMIC FAILURE" SHALL MEAN THE OCCURRENCE OF DEFECTS OR OTHER FAILURES (WHETHER OR NOT RESULTING IN BREACH OF THE WARRANTY OF SECTION 12.1) THAT: (A) ARE EXPERIENCED BY MORE THAN THREE PERCENT (3%) OF THE INSTALLED UNITS OF ANY GIVEN PRODUCT THAT ARE DELIVERED TO BUYER WITHIN ANY ROLLING TWELVE (12) MONTH PERIOD FROM THE SELLER DELIVERY DATE; (B) OCCUR IN SUCH UNITS OVER THREE (3) SEQUENTIAL MONTHS AND NOT LESS THAN AN INSTALLED BASE OF FIVE HUNDRED (500) UNITS; AND (C) ARE THE APPARENT RESULT OF THE SAME OR SIMILAR ROOT CAUSE ("FAILURE RATE MEASUREMENT").

(ii) PROCESS. IF A SUSPECTED EPIDEMIC FAILURE OCCURS, SELLER WILL PROMPTLY DETERMINE THE ROOT CAUSE OR CAUSES OF SUCH DEFECTS OR FAILURES. IF SUCH DEFECTS OR FAILURES HAVE THE SAME OR SIMILAR ROOT CAUSE, SELLER WILL PROMPTLY DEVELOP A PLAN TO ELIMINATE THE PROBLEM IN ALL CONTINUING PRODUCTION AND TO CORRECT THE PROBLEM IN ALL AFFECTED UNITS OF PRODUCT PREVIOUSLY SOLD AND DELIVERED TO BUYER DURING THE TWELVE (12) MONTH TIME PERIOD PRECEDING THE DATE OF BUYER'S NOTICE OF THE EPIDEMIC FAILURE. SELLER WILL SUBMIT SUCH PLAN TO BUYER FOR BUYER'S ACCEPTANCE ("PLAN"). UPON RECEIVING BUYER'S WRITTEN APPROVAL OF SUCH PLAN, SUCH APPROVAL NOT TO BE UNREASONABLY WITHHELD, SELLER WILL IMPLEMENT THE CORRECTIVE ACTION(S). IF SUCH PLAN REQUIRES THAT THE AFFECTED PRODUCT IS REPAIRED OR REPLACED, THEN BUYER AND SELLER SHALL MUTUALLY AGREE TO REPAIR, CREDIT, OR REPLACE THE AFFECTED PRODUCT AND SHALL JOINTLY DETERMINE THE LOGISTICS PROCESS FOR THE REPAIR OR REPLACEMENT OF PRODUCT WHICH MAY INCLUDE, BUT IS NOT LIMITED TO, CONDUCTING THE REPAIR AND/OR REPLACEMENT ACTIVITY AT OR NEARBY THE LOCATION OF THE AFFECTED PRODUCT. THE PARTIES AGREE TO USE COMMERCIALLY REASONABLE EFFORTS TO COMPLETE THE REPAIR OR REPLACEMENT OF THE AFFECTED PRODUCT WITHIN TWENTY (20) WORKING DAYS AFTER WRITTEN NOTICE OF SUCH EPIDEMIC FAILURE IS PROVIDED TO SELLER. FOR EPIDEMIC FAILURES THAT ARE AFFECTING CURRENT PRODUCTION, SELLER WILL IDENTIFY THE PROBLEM AND DEVELOP A PLAN TO SOLVE IT WITHIN SEVENTY-TWO (72) HOURS AFTER BUYER'S NOTICE. FOR THE AVOIDANCE OF DOUBT, SELLER WILL BE SOLELY RESPONSIBLE FOR ALL REPAIR, REPLACEMENT, OR CREDIT COSTS, AND ANY ASSOCIATED EXPENSES AGREED TO BY THE PARTIES IN THE PLAN FOR ANY EPIDEMIC FAILURE EVENT AS COVERED UNDER SELLER' WARRANTY IN SECTION 12.1. IN THE EVENT OF AN EPIDEMIC FAILURE DETERMINED BY THE PARTIES TO BE DIRECTLY ATTRIBUTABLE TO ANY CAUSE THAT IS NOT COVERED UNDER SELLER' WARRANTY IN SECTION 12.1, THEN ALL PRODUCT REPAIR, CREDIT, OR REPLACEMENT COSTS AND ASSOCIATED EXPENSES WILL BE BORNE BY BUYER AND, IN SUCH CASE, SELLER SHALL USE ITS BEST EFFORTS TO COLLABORATE WITH BUYER IN IMPLEMENTING THE NECESSARY RECOVERY PLAN.

(III) LIMITATION. IN NO EVENT SHALL SELLER'S LIABILITY FOR ANY EPIDEMIC FAILURE EXCEED $2,500,000. THE REMEDY PROVIDED FOR HEREIN (WHEN COMBINED WITH THE REMEDY PROVIDED IN [THE WARRANTY SECTION] SETS FORTH BUYER'S SOLE AND EXCLUSIVE REMEDY FOR ANY DEFECTIVE PRODUCT MANUFACTURED BY SELLER.

Comments:

- Because the term Epidemic Failure is defined in subsection (i) to include all defects – even those which are not covered by the warranty, Seller must clarify in subsection (ii) that it is only financially responsible for those Epidemic Failures caused by a defect covered by the warranty.

- Note the Buyer's concern about the Seller quickly responding to an epidemic failure.

EXAMPLE 4 – Detailed Highly Negotiated Clause

(A) IN THE EVENT THAT, AT ANY TIME DURING THE PERIOD FROM THE INITIAL SHIPMENT DATE UNTIL THREE YEARS THEREAFTER ("EPIDEMIC FAILURE PERIOD"), (I) MORE THAN TWO PERCENT (2%) OF ANY GIVEN PRODUCT SOLD AND DELIVERED TO BUYER WITHIN ANY ROLLING NINETY (90) DAY PERIOD (BUT AT LEAST TWENTY-FIVE (25) DEFECTIVE PRODUCTS) OR (II) A PRODUCT EXPERIENCES A SPECIFIC DEFECT MODE WHICH EXCEEDS 1500 FAILURE IN TIME ("FIT") RATE AFTER SIXTEEN MONTHS AFTER SHIPMENT OR DELIVERY; AND SUCH IN EITHER CASE OF "(I)" OR "(II)" ABOVE, FAILS TO OPERATE PROPERLY AS A RESULT OF THE SAME ROOT CAUSE, AND THE ROOT CAUSE IS ONE FOR WHICH SELLER IS RESPONSIBLE UNDER THE PRODUCT WARRANTY, THEN AN "EPIDEMIC FAILURE" SHALL BE DEEMED TO HAVE OCCURRED. UPON RECEIPT OF WRITTEN NOTICE BY BUYER THAT THERE HAS BEEN AN EPIDEMIC FAILURE, SELLER SHALL PROMPTLY REVIEW THE AFFECTED PRODUCTS AND DATA AND THE PARTIES SHALL DETERMINE WHETHER THE ALLEGED EPIDEMIC FAILURE RESULTED FROM A COMMON ROOT CAUSE WHICH IS COVERED BY THE SELLER'S PRODUCT WARRANTY (A "COVERED EPIDEMIC FAILURE").

(B) IN THE EVENT OF A COVERED EPIDEMIC FAILURE, THEN SELLER SHALL (WITHIN TWO BUSINESS DAYS) DEVELOP A PLAN TO ELIMINATE THE DEFECTS IN ALL CONTINUING PRODUCTION AND TO CORRECT THE PROBLEM IN ALL DEFECTIVE PRODUCTS DELIVERED TO BUYER DURING THE EPIDEMIC FAILURE PERIOD, AND SELLER SHALL SUBMIT THE PLAN TO BUYER FOR BUYER'S ACCEPTANCE. UPON RECEIVING BUYER'S APPROVAL OF SUCH PLAN, WHICH APPROVAL SHALL NOT BE UNREASONABLY WITHHELD OR DELAYED, SELLER SHALL IMPLEMENT THE CORRECTIVE ACTION AT ITS EXPENSE. IF SUCH PLAN IS NOT REASONABLY ACCEPTABLE TO BUYER, THEN BUYER CAN REQUIRE SELLER TO REPLACE, AT SELLER'S COST ALL DEFECTIVE PRODUCTS SUBJECT TO THE COVERED EPIDEMIC FAILURE AND, SUBJECT TO THE LIMITATION SET FORTH IN SUBSECTION (E), SHALL PAY BUYER'S DOCUMENTED COSTS OF REPLACING OR REPAIRING OTHER BUYER PRODUCTS WHICH INCORPORATE SUCH DEFECTIVE PRODUCTS. THE PARTIES AGREE TO USE COMMERCIALLY REASONABLE EFFORTS TO COMPLETE THE REPLACEMENT OF THE DEFECTIVE PRODUCT WITHIN A MUTUALLY-AGREED TIME FRAME.

(C) IN THE EVENT THE EPIDEMIC FAILURE DOES NOT RESULT FROM A DEFECT FOR WHICH SELLER IS RESPONSIBLE UNDER THE PRODUCT WARRANTY (E.G., IS NOT A COVERED EPIDEMIC FAILURE), THEN SELLER SHALL USE COMMERCIALLY REASONABLE EFFORTS TO ASSIST BUYER, AT BUYER'S EXPENSE TO IMPLEMENT THE CORRECTIVE ACTION REQUIRED TO REMEDY SUCH EPIDEMIC FAILURE. IN SUCH CASE BUYER SHALL BE RESPONSIBLE FOR ANY EXPENSES SET FORTH HEREIN, AND SELLER SHALL OBTAIN BUYER'S WRITTEN APPROVAL PRIOR TO INCURRING ANY SUCH EXPENSES.

(D) IF SELLER BECOMES AWARE OF ANY INFORMATION WHICH REASONABLY SUPPORTS A CONCLUSION THAT ANY PRODUCT SUBJECT TO A COVERED EPIDEMIC FAILURE MAY PRESENT ANY DANGER OF BODILY INJURY OR PROPERTY DAMAGE (A "COVERED HAZARD"), SELLER WILL PROMPTLY NOTIFY BUYER IN WRITING SETTING FORTH IN DETAIL THE INFORMATION KNOWN BY SELLER. UNLESS EXPRESSLY PROHIBITED BY LAW, SELLER WILL GIVE BUYER SUCH NOTICE PRIOR TO GIVING ANY NOTICE TO ANY GOVERNMENTAL AGENCY. SELLER WILL PROMPTLY PROVIDE BUYER WITH ALL RELEVANT DATA AND REVIEW AND DISCUSS WITH BUYER ALL INFORMATION, TESTS, AND CONCLUSIONS RELATING TO THE ALLEGED HAZARD AND THE BASIS FOR ANY CONTEMPLATED RECALL OR OTHER REMEDIAL ACTION. IN ADDITION TO ANY REMEDIES SET FORTH IN SUBSECTION "(B)" ABOVE, SUBJECT TO THE LIMITATION SET FORTH IN SECTION (E), SELLER WILL BE RESPONSIBLE FOR ALL COSTS OF ANY REMEDIAL ACTION INCLUDING, BUT NOT LIMITED TO, THE REASONABLE OUT-OF-POCKET COSTS TO BUYER AND SUBCONTRACTORS DIRECTLY RELATED THERETO

(E) IN NO EVENT SHALL SELLER'S LIABILITY UNDER THIS SECTION EXCEED FIVE HUNDRED THOUSAND DOLLARS ($500,000) PER INCIDENT, PROVIDED HOWEVER, THAT SELLER'S LIABILITY UNDER THIS SECTION SHALL BE DEEMED DIRECT DAMAGES AND NOT EXCLUDED UNDER [THE LIMITATION OF LIABILITY SECTION]. FOR THE PURPOSE OF THIS LIMITATION, THE COST OF PERFORMING THE REPAIR OR REPLACEMENT OF THE DEFECTIVE PRODUCT DELIVERED TO BUYER DURING THE EPIDEMIC FAILURE PERIOD AND SENT BACK TO SELLER FOR REPAIR, REPLACEMENT OR CREDIT DURING THE EPIDEMIC FAILURE PERIOD IS EXCLUDED FROM THE FOREGOING LIMITATION. NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN

CONTAINED, NOTHING HEREIN SHALL REQUIRE THE SELLER TO CONDUCT A PRODUCT RECALL AT ITS EXPENSE. IN ADDITION, IN NO EVENT SHALL EITHER PARTY HAVE TO REIMBURSE THE OTHER PARTY FOR ANY TIME OR EXPENSE INCURRED BY SUCH PARTY'S EMPLOYEES (E.G., INVESTIGATION TIME, SITE VISITS, TRAVEL TO THE BUYER) IN CONNECTION WITH ANY DETERMINATION AS TO WHETHER OR NOT AN EPIDEMIC FAILURE HAS OCCURRED, WHETHER OR NOT THE EPIDEMIC FAILURE IS A COVERED EPIDEMIC FAILURE, OR WHETHER OR NOT THE DEFECT IS A WARRANTY DEFECT. THE PARTIES INTEND FOR EACH OF THEM TO BEAR ITS OWN COSTS UNTIL THEY HAVE ENOUGH INFORMATION (OR REASONABLY SHOULD HAVE ENOUGH INFORMATION) TO DETERMINE WHICH PARTY IS RESPONSIBLE FOR THE COSTS. THE REMEDIES SET FORTH IN THIS SECTION (E), WHEN COMBINED WITH THE REMEDIES SET FORTH IN THE WARRANTY SECTION, SHALL BE BUYER'S SOLE REMEDY IN THE EVENT OF AN EPIDEMIC FAILURE.

Comments:

- In this example, the warranty period was only 1 year. However, the parties agreed that there would be a three-year period in the event of an Epidemic Failure. Essentially, this is similar to giving a three year warranty, and should be priced that way.
- Sections B and C set forth different paths depending on whether the Epidemic Failure was triggered by a warranty defect or whether it was triggered by an event which is not covered under the warranty.
- Section E resulted from a compromise – in exchange for a clarification that certain (potentially) consequential or indirect damages would be considered as recoverable direct damages, the Buyer accepted a reasonable cap.
- Section E explicitly forecloses a recall.

EXAMPLE 5 – Detailed Negotiated Clause (Similar to Example 4)

(A) IN THE EVENT THAT, AT ANY TIME DURING THE PERIOD BETWEEN THE DATE OF MANUFACTURE AND THREE YEARS FROM MANUFACTURE (THE "EPIDEMIC FAILURE PERIOD"), EITHER (I) THREE PERCENT OR MORE OF ANY GIVEN PRODUCT (BUT AT A MININMUM TWENTY PRODUCTS) SOLD AND DELIVERED TO BUYER WITHIN ANY ROLLING NINETY DAY PERIOD FAIL TO OPERATE PROPERLY AS A RESULT OF THE SAME ROOT CAUSE, AND THE ROOT CAUSE IS ONE FOR WHICH THE SELLER IS RESPONSIBLE FOR UNDER THE PRODUCT WARRANTY OR (II) A TOTAL OF TEN PERCENT OR MORE OF ANY GIVEN PRODUCT (BUT AT A MINIMUM SIXTY PRODUCTS) SOLD OR DELIVERED TO BUYER WITHIN ANY ROLLING NINETY DAY PERIOD FAIL TO OPERATE PROPERLY AS A RESULT OF DIFFERENT ROOT CAUSES, THEN AN "EPIDEMIC FAILURE" SHALL BE DEEMED TO HAVE OCCURRED. UPON RECEIPT OF A WRITTEN NOTICE BY BUYER THAT THERE HAS BEEN AN EPIDEMIC FAILURE, SELLER SHALL PROMPTLY REVIEW THE DEFECTIVE PRODUCT AND DATA TO DETERMINE WHETHER THE ALLEGED EPIDEMIC FAILURE RESULTED FROM A COMMON ROOT CAUSE OR CAUSES WHICH ARE COVERED BY THE SELLER'S WARRANTY (A "COVERED EPIDEMIC FAILURE"). AS AN ILLUSTRATION OF (II) ABOVE, IF SELLER SHIPPED 500 PRODUCTS DURING THE PERIOD BETWEEN JANUARY 1, 2011 AND MARCH 31, 2011 AND 15 OF THE PRODUCTS HAD ONE TYPE OF DEFECT, 15 PRODUCTS HAD ANOTHER TYPE OF DEFECT, 15 PRODUCTS HAD YET ANOTHER TYPE OF DEFECT AND 15 OF THE PRODUCTS HAD A FOURTH TYPE OF DEFECT, AN EPIDEMIC FAILURE WOULD BE DEEMED TO HAVE OCCURRED EVEN THOUGH THE DEFECTS ARE NOT ATTRIBUTABLE TO THE SAME ROOT CAUSE.

(B) IF IT IS MUTUALLY DETERMINED THAT A THERE IS A COVERED EPIDEMIC FAILURE, THEN SELLER SHALL (WITHIN TWO BUSINESS DAYS) DEVELOP A PLAN TO ELIMINATE THE DEFECTS IN ALL CONTINUING PRODUCTION AND TO CORRECT THE PROBLEM IN ALL AFFECTED UNITS (INCLUDING DEFECTIVE UNITS AND UNITS KNOWN TO BE SUBJECT TO OR CONTAINING THE SYSTEMIC ROOT CAUSE FAILRUE THAT HAS BEEN IDETNIFIED) OF PRODUCT PREVIOUSLY SOLD AND DELIVERED TO BUYER DURING THE EPIDEMIC FAILURE PERIOD, AND SELLER SHALL SUBMIT THE PLAN TO BUYER FOR BUYER'S ACCEPTACNCE. UPON RECEIVING BUYER'S APPROVAL OF SUCH PLAN, WHICH APPROVAL SHALL NOT BE UNREASONABLY WITHHELD OR DELAYED, SELLER SHALL IMPLEMENT THE CORRECTIVE ACTION AT ITS EXPENSE. IF SUCH PLAN IS NOT REASONABLY ACCEPTABLE TO BUYER, THEN (I) SELLER WILL EXTEND THE WARRANTY PERIOD BY AN ADDTIIONAL EIGHTEEN MONTHS; (II) BUYER CAN REQUIRE SELLER TO REPLACE, AT SELLER'S COST AND AS MUTUALLY AGREED TO BY BOTH PARTIES, ALL DEFECTIVE PRODUCT RESULTING FROM THE COVERED EPIDEMIC FAILURE, AND (III) SELLER WILL COMPENSATE BUYER FOR UP TO $_____ WORTH OF BUYER'S DOCUMENTED COSTS TO REMOVE THE DEFECTIVE PRODUCT FROM THE FIELD AND/OR PELANTLIES WHICH BUYER IS LEGALLY OBLGATED TO PAY AND HAS PAID TO A THIRD PARTY. THE PARTIES AGREE TO USE

COMMERCIALLY REASONABLE EFFORTS TO COMPLETE THE REPLACEMENT OF THE DFECTIVE PRODUCT WITHIN A MUTUALLY-AGREED TIME FRAME. IN NO EVENT SHALL SELLER BE REQUIRED TO CONDUCT A PRODUCT RECALL.

(C) THE REMEDY PROVIDED FOR IN THIS SECTION AND THE REMEDY PROVIDED FOR IN [THE WARRANTY SECTION] SHALL BE THE SOLE AND EXCLUSIVE REMEDIES FOR ANY CLAIM ARISING OUT OF OR RELATING TO A DEFECTIVE PRODUCT.

Comments:

- Note the example in (A) – examples are always worth 1,000 words.
- The inclusion of "mutually determined" gives the Seller an additional layer of protection
- The clause at the end of (B) provides a minimum (dollar) commitment in favor of the buyer in the event the parties cannot reach agreement on the remedy.

Example 6 - Negotiated Clause

32. CLASS FAILURE

32.1 IN THE EVENT OF A CLASS FAILURE, SELLER SHALL PROVIDE BUYER THE FOLLOWING ADDITIONAL REMEDIES:

32.1.1 WITHIN 24 HOURS OF BUYER NOTIFYING SELLER OF A CLASS FAILURE (SUCH NOTIFICATION BEING ORAL OR OTHERWISE), SELLER SHALL PROVIDE BUYER, WITH THE FOLLOWING INFORMATION:
32.1.1.1 A STATUS REPORT; AND
32.1.1.2 DETAILS OF THE INTERIM SOLUTION, IF ANY

32.1.2 NO LATER THAN FIVE BUSINESS DAYS FOLLOWING THE NOTIFICATION OF A CLASS FAILURE, SELLER SHALL PROVIDE BUYER WITH A ROOT CAUSE ANALYSIS AND CORRECTIVE ACTION PLAN. BUYER WILL MAKE AVAILABLE SUCH INFORMATION AND ASSISTANCE REASONABLY REQUIRED TO ALLOW SELLER TO CONDUCT ITS ROOT CAUSE ANALYSIS AND TO PROVIDE ITS CORRECTIVE ACTION PLAN.

32.1.3 IF, FOLLOWING REVIEW OF THE ROOT CAUSE ANALYSIS AND CORRECTIVE ACTION PLAN, BUYER REASONABLY DETERMINES THAT THE CLASS FAILURE NECESSITATES THE REMOVAL OF THE PRODUCTS FROM THE FIELD BY BUYER OR A BUYER-BASED RECALL OR RETROFIT, BUYER MAY ELECT, BY NOTICE TO SELLER, TO HAVE THE DEFECTIVE PRODUCTS:
32.1.3.1 RETURNED TO SELLER FOR REPAIR OR REPLACEMENT (AND THE PROVISIONS OF SECTION 31, WARRANTY SHALL APPLY TO ANY SUCH REPAIR); OR
32.1.3.2 REPAIRED OR REPLACED BY BUYER IN THE FIELD (IF BUYER REASONABLY CONSIDERS THIS NECESSARY) INCLUDING PRODUCTS IN THE SELLER INVENTORY, IN BUYERS' INVENTORY, IN BUYER' DISTRIBUTORS' INVENTORY AND IN BUYER' INSTALLED BASE. IF BUYER ELECTS TO PERFORM A FIELD REPAIR, SELLER WILL PROVIDE THE APPROPRIATE REPLACEMENT PRODUCTS OR PARTS TO BUYER. SUCH PRODUCTS OR PARTS WILL BE SHIPPED WITH THE HIGHEST SHIPPING PRIORITY UTILIZED BY SELLER.

32.1.4 IF THE ROOT CAUSE ANALYSIS SHOWS THAT THE RELEVANT DEFECT IS A MATERIAL DEFECT ARISING FROM A BREACH OF SELLER'S WARRANTIES UNDER SECTION 31, WARRANTY, SELLER SHALL BEAR ALL THE COSTS AND EXPENSES OF THE ABOVE PROCEDURES, SUBJECT TO AN ANNUAL CAP OF TWO MILLION DOLLARS ($2,000,000). IN THE EVENT THAT THE CAP IS OR COULD BE EXCEEDED THE PARTIES WILL DISCUSS APPROPRIATE ACTION AND ASSOCIATED COST. IN THE EVENT AGREEMENT IS NOT REACHED WITHIN TEN (10) BUSINESS DAYS, THE PARTIES WILL ESCALATE PURSUANT TO SECTION 42.4.3, DISPUTE RESOLUTION.

Example 7 – Buyer-Favorable Clause

"Epidemic Defects" shall mean Products and their associated Engineering Changes that experience one or more of the following: (a) a similar defect at a rate of one percent (1%) or more in any given thirty (30) day rolling period over the life of the Products, (b) a similar defect at a rate of one percent (1%) or more of total

purchases over the life of the Products, (c) recalls, or (d) safety defects. For Epidemic Defects, Supplier will, at Buyer's discretion: (i) refund or credit the Product Price, or replace or repair the defective Products at no charge in a timely manner, and (ii) reimburse Buyer for all actual and reasonable expenses incurred by Buyer related to Epidemic Defects, including, without limitation, costs associated with repair or replacement, field costs, customer related expenses, problem diagnosis, and field and finished goods inventory related costs. Supplier will commence such performance within five (5) calendar days of Buyer's notice to Supplier of an Epidemic Defect.

Comments:

- Note the very low trigger – 1% of products shipped during the past 30 days which exhibit a similar defect (even though it is not attributable to the same root cause). If only 100 products are shipped, one defective product will trigger this. (There is no minimum number of units required to be affected before the epidemic defect clause is triggered).
- The clause assumes that all epidemic defects are the supplier's fault – regardless of whether the defect is covered under the warranty. It is very dangerous for the supplier to accept an epidemic defect clause that is broader than its warranty.
- In this case, a "recall" or a "safety defect" can trigger the clause – and the buyer has the discretion to designate such a recall/safety defect (which must be remedied at seller's expense)
- Seller is liable for recall expenses, and these expenses are not capped.
- In addition, seller is liable for damages which might otherwise be deemed indirect or consequential (unless otherwise excluded in the agreement).
- Seller must immediately incur costs to remedy the problem which might not have been caused by it in the first place.

APPENDIX B
SAMPLE WARRANTY CLAUSES

Example 1 – Seller Favorable Manufacturing Warranty

4.1 MANUFACTURER Warranty. MANUFACTURER warrants that, for a period of one year from the date of manufacture of the Product, the Product will be free from defects in workmanship. Products shall be considered free from defects in workmanship (and CUSTOMER shall have no warranty claim) if they are manufactured in accordance with the latest version of IPC-A-600 or IPC-A-610 and successfully complete any mutually agreed product acceptance test. MANUFACTURER shall, at its option and at its expense (and as CUSTOMER's sole and exclusive remedy for breach of any warranty), repair, replace or issue a credit for Product found defective during the warranty period. In addition, MANUFACTURER will pass on to CUSTOMER all Vendor's (and manufacturers') Component warranties to the extent that they are transferable, but will not independently warrant any Components. All warranty obligations will cease upon the earlier of the expiration of the warranty period set forth above or the return (at CUSTOMER's request) of any test equipment or test fixtures. ALL CLAIMS FOR BREACH OF WARRANTY MUST BE RECEIVED BY MANUFACTURER NO LATER THAN THIRTY (30) DAYS AFTER THE EXPIRATION OF THE WARRANTY PERIOD.

4.2 RMA Procedure. MANUFACTURER shall concur in advance on all Product to be returned for repair or rework. CUSTOMER shall obtain a RMA number from MANUFACTURER prior to return shipment. All returns shall state the specific reason for such return, and will be processed in accordance with MANUFACTURER's RMA Procedure, a copy of which is available from MANUFACTURER upon request. MANUFACTURER shall pay all transportation costs for valid returns of the Products to MANUFACTURER and for the shipment of the repaired or replacement Products to CUSTOMER, and shall bear all risk of loss or damage to such Products while in transit; CUSTOMER shall pay these charges, plus a handling charge, for invalid or "no defect found" returns. Any repaired or replaced Product shall be warranted as set forth in this Article for a period equal to the greater of (i) the balance of the applicable warranty period relating to such Product or (ii) sixty (60) days after it is received by CUSTOMER.

4.3 Exclusions From Warranty. This warranty does not include Products that have defects or failures resulting from (a) CUSTOMER's design of Products including, but not limited to, design functionality failures, specification inadequacies, failures relating to the functioning of Products in the manner for the intended purpose or in the specific CUSTOMER's environment; (b) accident, disaster, neglect, abuse, misuse, improper handling, testing, storage or installation including improper handling in accordance with static sensitive electronic device handling requirements; (c) alterations, modifications or repairs by CUSTOMER or third parties or (d) defective CUSTOMER-provided test equipment or test software. CUSTOMER bears all design responsibility for the Product.

4.4 Remedy. THE SOLE AND EXCLUSIVE REMEDY UNDER THIS WARRANTY SHALL BE THE REPAIR, REPLACEMENT OR CREDIT FOR DEFECTIVE PARTS AS STATED ABOVE. THIS WARRANTY IS THE SOLE AND EXCLUSIVE WARRANTY GIVEN BY MANUFACTURER AND IS IN LIEU OF ANY OTHER WARRANTIES EITHER EXPRESS OR IMPLIED. MANUFACTURER DOES NOT MAKE ANY WARRANTIES REGARDING MERCHANTIBILITY, NONINFRINGEMENT, COMPLIANCE WITH ROHS, REACH AND WEEE (OR SIMILAR LEGISLATION), OR FITNESS FOR A PARTICULAR PURPOSE, AND SPECIFICALLY DISCLAIMS ANY SUCH WARRANTY, EXPRESS OR IMPLIED.

Comments:

- Section 4.1 clearly limits the warranty to workmanship defects and objectively defines how such defects are determined.
- Section 4.2 details the RMA process – a good "operational" item to include in the warranty.
- Section 4.3 sets forth the typical exclusions.
- Section 4.4 sets forth the remedy and clearly states that it is the sole and exclusive remedy for breach of warranty. In addition, Section 4 disclaims all implied warranties (other than title, which is intentional)

Example 2 – Negotiated Manufacturing Warranty [selected sections only]

14. Warranty

14.2(a) Products are warranted against defects in workmanship under normal use, handling and installation for a period of eighteen (18) months from the date of manufacture. Products shall be considered free from defects in workmanship if they are manufactured in accordance with the latest version of IPC-A-600 or IPC-A-610, and manufactured to Buyer specifications documented on engineering drawings and documentation provided by Buyer, and successfully complete any mutually agreed product acceptance test to demonstrate compliance with Buyer's Specifications**.** In addition, Seller Sourced Materials (meaning materials supplied by Vendors as selected by Seller, under pricing and terms and conditions as determined by Seller, and documented in a writing (including e-mail) as a Seller Sourced Material and approved by Buyer, shall be warranted by the Seller for a period of eighteen (18) months from the date of manufacture.

(b) Seller shall, at its option and at its expense (and as Buyer's sole and exclusive remedy for breach of the workmanship and Seller Sourced Materials warranty), repair, replace or issue a credit for Product found defective during the warranty period.

(c) In addition, Seller will pass on to Buyer all Vendors' (and manufacturers') Component warranties (for Components other than the Seller Sourced Materials), as received from the applicable Vendors and manufacturers in accordance with Section 14.2(a) above to the extent that they are transferable, as well as manage such warranties as described below, but will not independently warrant any such Components. In the event that such a Component is deemed to be the cause of a Product defect, Seller shall submit the warranty claim to the manufacturer/Vendor and, using commercially reasonable efforts, coordinate with the manufacturer/Vendor to address the Component defect in accordance with Vendor/manufacturer's warranty terms. In the event that such Seller claim management efforts are not successful in resolving the Component defect with the manufacturer/Vendor, Seller will notify Buyer in writing and the parties will discuss and mutually agree in writing on any additional process (including the responsibility for the costs thereof) that Buyer wants to pursue to enforce the manufacturer/Vendor warranties. At Buyer's request and at Buyer's expense, Seller shall take such legal action, including commencing and pursuing litigation or arbitration, if required in the underlying agreement, against any supplier/Vendor in order to enforce Seller's/Buyer's warranty and/or other rights of recovery against any such supplier/Vendor, it being the intention of the parties that Buyer shall be entitled to any and all sums or amounts recovered in such action. In pursuing such recovery, Seller shall at all times cooperate with and assist Buyer in such matter, shall use counsel that has been approved in writing by Buyer and shall permit Buyer to control the prosecution of any such action. Buyer shall be responsible for all legal fees and pre-approved out of pocket expenses incurred by Seller in reasonably pursuing such litigation, including mutually agreed and reasonable internal or administrative costs or time expended by Seller in managing pursuit of such recovery or in cooperating with and assisting Buyer in such litigation.

(d) If Buyer removes any test equipment or test fixtures, Seller' Warranty obligations shall be limited to payment of a sum for necessary Warranty repairs which shall not exceed Seller's internal repair cost, unless the parties mutually agree that repair is not feasible and the defective Product must be replaced, in which case Seller's obligation shall not exceed the Seller's sell price of the Product. In all such instances Seller may at its election be present at the time that such repairs are made.

(e) ALL CLAIMS FOR BREACH OF WARRANTY MUST BE RECEIVED BY SELLER NO LATER THAN THIRTY (30) DAYS AFTER THE EXPIRATION OF THE WARRANTY PERIOD

[14.3 – 14.6 omitted]

14.7 Seller represents and warrants that (with respect to the RoHS Directive, REACH Directive and the WEEE Directive, as well as any and all directives or regulations that are equivalent or similar to the RoHS Directive, REACH Directive and WEEE Directive) (i) its manufacturing processes are RoHS compliant, (ii) it will request RoHS and REACH Certificates from all suppliers, will review all such supplier-provided Certificates for accuracy, will match the Certificates to the supplier RoHS/REACH compliant part numbers, and will maintain (in accordance with Seller's internal procedures), for a mutually agreed time period, a file of all such Certificates for potential review by Buyer upon reasonable prior written notice.

14.8 THE SOLE REMEDY UNDER THIS WARRANTY SHALL BE THE REPAIR, REPLACEMENT OR CREDIT FOR DEFECTS AS STATED ABOVE. THIS WARRANTY IS THE SOLE WARRANTY GIVEN BY SELLER AND IS IN LIEU OF ANY OTHER WARRANTIES EITHER EXPRESS OR IMPLIED. SELLER DOES NOT MAKE ANY WARRANTIES REGARDING MERCHANTIBILITY, NONIN-FRINGEMENT, COMPLIANCE WITH RESTRICTION ON THE USE OF CERTAIN HAZARDOUS SUBSTANCES ("ROHS") OR SIMILAR LEGISLATION (E.G. REACH)) OR FITNESS FOR A PARTICULAR PURPOSE, AND SPECIFICALLY DISCLAIMS ANY SUCH WARRANTY, EXPRESS OR IMPLIED. WITH RESPECT TO COMPLIANCE WITH THE ROHS DIRECTIVE, REACH DIRECTIVE AND THE WEEE DIRECTIVE (OR SIMILAR LEGISLATION), SELLER'S OBLIGATIONS SHALL BE LIMITED AS EXPRESSLY SET FORTH IN SECTION 14.8(b) BELOW.

Comments:

- Section 14.2(a) provides a limited warranty for components sourced by the Seller (rather than the buyer) in addition to the workmanship warranty
- Section 14.2(d) provides assurance to Buyer that even if a component is not covered under the warranty, the Seller will use its reasonable efforts to obtain for the Buyer the appropriate compensation from the component manufacturer
- Section 14.2(e) provides for a shortened limitations period for bringing a claim.
- Section 14.7 limits Seller's RoHS, WEEE and REACH warranties

Example 3 –Negotiated Manufacturing and Product Warranty

(a) Warranty.

1. For ODM Products. Except as explicitly set forth herein, Supplier warrants that, during the Warranty Period, the ODM Products will conform to their corresponding Specifications and will be free from defects in material and workmanship. The "**Warranty Period**" shall be defined in each individual Product Addendum. This warranty applies only when the Product is used with previously validated Components, and does not apply to issues or defects arising from the use of Components not previously validated by Supplier for that Product. Notwithstanding the foregoing, the material portion of the warranty for hard disk drives, microprocessors, and power supplies is limited to a pass-through of the warranty received by the Component manufacturer; provided, however, that Supplier shall (i) notify Customer of such third party warranty terms, and any changes thereto, and (ii) administer such Component warranties on Customer's behalf.

2. All Other Products. All Products other than ODM Products are "CM Products." Supplier warrants that, during the Warranty Period, the CM Products will manufactured in accordance with their corresponding workmanship Specifications and will be free from defects in workmanship. The "**Warranty Period**" shall be defined in each individual Product Addendum. Supplier does not warrant any Components incorporated in the CM Products, but will use commercially reasonable efforts to enforce any manufacturer's warranty on Customer's behalf.

(b) Remedy. As Customer's sole and exclusive remedy for breach of this warranty, Supplier shall, at its sole option and at its sole expense, and in accordance with the timelines set forth in the Quality Plan attached hereto as Exhibit B:

(1) repair the Product by means of hardware and/or software, or for CM Products through other means of repair;
(2) replace the Product with another Product, or
(3) if Supplier is unable to repair the Product as set forth in (1) or replace the Product with another Product, refund the purchase price of the Product.

In no event will Supplier be liable for any other costs associated with the replacement or repair of Products, including labor, installation, or other costs incurred by Customer.

(c) Exclusions.

(1) Except as otherwise provided in this Agreement (including but not limited to Section 12(a) above and Section 13 below), Supplier does not warrant that Products to be delivered hereunder, whether delivered stand-alone or integrated with other products or other hardware or software, including without limitation semi-conductor Components, will operate uninterrupted or be free from design defects or errors, known as errata.

(2) The warranty in Section 12(a) above does not include defects or failures in Products resulting from the following after delivery to Customer: (a) Customer's or any third party-caused accident, disaster, neglect, abuse, misuse, improper handling, testing, storage or installation, including improper handling in accordance with static sensitive electronic device handling requirements (outside of any Product Specifications); (b) alterations, modifications or repairs by Customer or any third parties or (c) for CM Products, defective Customer provided test equipment or test software.

(3) The warranty in Section 12(a) above does not include prototype, evaluation, sample, manufacturing verification build ("**MVB**"), test development or any other non-production models sold to Customer. ALL PROTOTYPE, EVALUATION, SAMPLE, MVB, TEST DEVELOPMENT OR ANY OTHER NON-PRODUCTION MODELS SOLD OR DELIVERED TO CUSTOMER ARE STRICTLY "AS-IS" AND CUSTOMER ACCEPTS NO RESPONSIBILITY FOR THEIR OPERATION, FITNESS FOR A PARTICULAR USE, OR ANY ACTIONS OR CONSEQUENCES ARISING FROM THEIR USE OR OPERATION.

(4) For purpose of clarity, Supplier's warranty for CM Products does not include any Components incorporated therein, or any design or performance Specifications.

(5) TO THE EXTENT PERMITTED BY APPLICABLE LAW, IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE ARE HEREBY DISCLAIMED.

(d) Exclusive Remedies. Supplier's responsibility under this warranty is limited to repair, replacement or refund, as set forth in this Section 12. These remedies are the sole and exclusive remedies to Customer, and constitute Supplier's sole obligation for any breach of this warranty.

(e) Warranty Cap. Notwithstanding anything to the contrary herein contained, in no event shall Supplier's liability for a breach of this Section 12 exceed the amount set forth in Section 19.

Comments:

- This agreement contemplated the manufacture of two separate products. For the ODM Product, the Supplier had more control over the subcomponent manufacturers than for the CM Product, and the warranty reflected the differences in control.
- The parties heavily negotiated the exclusions based on the particular products manufactured under the Agreement.
- The Supplier attempted to limit is liability under the Warranty to a specified dollar amount. Query whether this would cause the warranty to fail of its essential purpose if the Supplier walked away from its warranty obligations in the event they exceeded the cap.

Example 4 – Negotiated Product Warranty

12. Limited Warranty.

(a) Warranty. Except as explicitly set forth herein, Seller warrants that, during the Warranty Period, the Products will conform to their corresponding Specifications and will be free from defects in material and workmanship. The "**Warranty Period**" shall be defined in each individual Product Addendum. This warranty applies only when the Product is used with previously validated Components, and does not apply to issues or defects arising from the use of Components not previously validated by Seller for that Product. Material warranties on hard disk drives, microprocessors, and power supplies are limited to the warranties offered by the Component manufacturer. Seller shall (i) notify Buyer of such third party warranty terms, and any changes thereto, promptly following Seller's receipt of such information, and (ii) administer such Component warranties on Buyer's behalf.

(b) Remedy. As Buyer's sole and exclusive remedy for breach of this warranty, Seller shall, at its sole option and at its sole expense, and in accordance with the timelines set forth in the Quality Plan attached hereto as Exhibit B:

(1) repair the Product by means of hardware and/or software, or
(2) replace the Product with another Product, or
(3) if Seller is unable to repair the Product by means of hardware and/or software or replace the Product with another Product, refund the purchase price of the Product,
(4) provide that, if the Product has been purchased by a US Government agency, and used for Classified Information, Seller's remedies shall be limited to (2) & (3) above, providing Buyer provides, upon request by Seller, proof of such application and a Certificate of Destruction by the government entity.

In no event will Seller be liable for any other costs associated with the replacement or repair of Products, including labor, installation, or other costs incurred by Buyer.

(c) Exclusions.

(1) Except as otherwise provided in this Agreement (including but not limited to Section 12(a) above and Section 13 below), Seller does not warrant that Products to be delivered hereunder, whether delivered stand-alone or integrated with other products or other hardware or software, including without limitation semi-conductor Components, will operate uninterrupted or be free from design defects or errors, known as errata.

(2) The warranty in Section 12(a) above does not include defects or failures in Products resulting from the following after shipment pursuant to Section 5(c) above: (a) Buyer's or any third party-caused accident, disaster, neglect, abuse, misuse, improper handling, testing, storage or installation, including improper handling in accordance with static sensitive electronic device handling requirements (outside of any Product Specifications); or (d) alterations, modifications or repairs by Buyer or any third parties.

(3) The warranty in Section 12(a) above does not include prototype, evaluation, sample, manufacturing verification build ("**MVB**"), test development or any other non-production models sold to Buyer. ALL PROTOTYPE, EVALUATION, SAMPLE, MVB, TEST DEVELOPMENT OR ANY OTHER NON-PRODUCTION MODELS SOLD OR DELIVERED TO BUYER ARE STRICTLY "AS-IS", AND SELLER-SCI ACCEPTS NO RESPONSIBILITY FOR THEIR OPERATION, FITNESS FOR A PARTICULAR USE, OR ANY ACTIONS OR CONSEQUENCES ARISING FROM THEIR USE OR OPERATION.

(4) TO THE EXTENT PERMITTED BY APPLICABLE LAW, IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE ARE HEREBY DISCLAIMED.

(d) Exclusive Remedies. Seller's responsibility under this warranty is limited to repair, replacement or refund, as set forth in this Section 12. These remedies are the sole and exclusive remedies to Buyer, and constitute Seller's sole obligation for any breach of this warranty.

Example 5 – Buyer-Favorable Warranty

Seller warrants that the Goods will perform in accordance with and conform to the agreed specification for the Goods, will meet what otherwise has been agreed upon, and will be free from defects in design, materials and workmanship provided:

(a) that the Goods have not been subject to misuse or neglect by Buyer or its customer; and
(b) that the Goods have not been altered or repaired otherwise than by Seller or with its approval or instructions; and
(c) that the defect is not caused solely by a Buyer Design and that such defect in the Buyer Design could not reasonably have been detected by Seller prior to commencement of the manufacturing or delivery of the Goods in question.

Comments:

- This warranty is very broad. The Seller is warranting the performance of the goods and the conformance of the goods to the Specifications
- There are few exclusions.
- There is no disclaimer of the implied warranties
- There is no limit to Buyer's remedies (in addition to repair or replacement, Seller is liable for damages)

Example 6 – Buyer-Favorable (Comprehensive) Warranty

1.0 Supplier makes the following ongoing representations and warranties:

A. It has the right to enter into this Agreement and its performance of this Agreement will comply, at its own expense, with the terms of any contract, obligation, law, regulation or ordinance to which it is or becomes subject;

B No claim, lien, or action exists or is threatened against Supplier that would interfere with Buyer's use or sale of the Products;

C. Products and Services do not infringe any intellectual property right of a third party except that this warranty does not extend to IP infringement that may occur as a result of:

1) Buyer's combination of Supplier's Products or Services with other products or services, except where: i) Supplier's Products or Services , by themselves, constitute direct infringement of the allegedly infringed third party intellectual property rights; or ii) Supplier's Products and Services constitute a material part of the allegedly infringed third party intellectual property rights and Supplier's Products and Services are not suitable for substantial non-infringing use;

2) Supplier's implementation of a Buyer originated Specifications (including but not limited to component selection and design) and such infringement or claim would have been avoided in the absence of such implementation; and/or

3) Buyer's modification of the Products except for intended modifications required for use of the Products and such infringement or claim would have been avoided in the absence of such modification;

E. It has disclosed to Buyer in writing the existence of any third party code, including without limitation open source code, that is included in or is provided in connection with the Product(s) and that Supplier and the Product(s) are in compliance with all licensing agreements applicable to such third party code;

F. All authors have agreed not to assert their moral rights (personal rights associated with authorship of a work under applicable law) in the Products, to the extent permitted by law;

G. Products are free from defects in material and workmanship for a period of the longer of (i) three years from the delivery date or (ii) 30 months from the date on which Buyer delivers the product containing Supplier's Products to its end customer;

H. Products will conform to the warranties, specifications and requirements, including but not limited to quality requirements in this Agreement;

I. Products are free of defects in design (except for written designs provided by Buyer unless the defects in Buyer's designs are based on Supplier's specifications);

J. Products are safe for use consistent with and will comply with the warranties, specifications and requirements in this Agreement;

K. Products and Services which interact in any capacity with monetary data are euro ready such that when used in accordance with their associated documentation they are capable of correctly processing monetary data in the euro denomination and respecting the euro currency formatting conventions (including the euro sign);

L. None of the Products contain nor are any of the Products manufactured using ozone depleting substances such as halons, chlorofluorocarbons, hydrochlorofluorocarbons, methyl chloroform and carbon tetrachloride as defined by the Montreal Protocol;

M. Products are new and do not contain used or reconditioned parts;

N. To the extent Products include software code (including without limitation firmware, BIOS, and device drivers), Products contain no harmful code;

O. All Products and all parts of Products, including, but not limited to parts that may be identified as field replacement units, customer replacement units, spare parts, and/or parts that have any floppy disk controller functions and other storage devices shall not experience data integrity, undetected data loss, or related issues;

P. All Products will process date data correctly (including, without limitation, correctly processing, providing, receiving, and displaying date data within and between the twentieth and twenty-first centuries), and are designed to exchange date data accurately and correctly with other products (including, without limitation, hardware, code, other software, and firmware) when used with products which are designed to exchange date data accurately and correctly;

Q. It is knowledgeable with, and is and will remain in full compliance with all applicable export and import laws, regulations, orders, and policies (including, but not limited to, securing all necessary clearance requirements, export and import licenses and exemptions from, and making all proper filings with appropriate governmental bodies and/or disclosures relating to the release or transfer of technology and software to non U.S. nationals in the U.S., or outside the U.S., release or transfer of technology and software having U.S. content or derived from U.S.-origin software or technology); it is knowledgeable with applicable supply chain security recommendations issued by applicable governments and industry standards organizations and will make best efforts to comply with such recommendations;

R. Upon Buyer request, it will promptly provide all information necessary to export and import Deliverables under this Agreement, including, as applicable, the Export Control Classification Numbers (ECCN) and subheadings or munitions list category number, and will notify Buyer in writing of any changes to the information provided by Supplier to export and import Deliverables under this Agreement;

S. Unless authorized by applicable government license or regulation, including but not limited to any U.S. authorization, Supplier will not directly or indirectly export or reexport, at any time, any technical information, technology, software, or other commodity furnished or developed under this, or any other, agreement between the parties, or any other product that is developed or produced from or using Buyer's technical information, technology, software, or other commodity provided under this Agreement to any prohibited country (including release of such technical information, technology, software, or other commodity to nationals, wherever they may be located, of any prohibited country) as specified in applicable export, embargo, and sanctions regulations;

T. It will not use, disclose, or transfer across borders any Personal Data that is processed for Buyer, except to the extent necessary to perform under this Agreement; and

U. It will comply with all applicable data privacy laws and regulations, will implement and maintain appropriate technical and organizational measures and other protections for the Personal Data, (including, without limitation, not loading any Personal Data provided to Supplier on (a) any laptop computers or (b) any portable storage media that can be removed from Supplier's premises unless, in each case, (i) such data has been encrypted and (ii) such data is loaded onto portable storage media solely for the purpose of moving such data to off-site storage). Further, it will report to Buyer any breaches of security of Personal Data immediately after discovery thereof if the Personal Data was, or could be, accessed, used or acquired by an unauthorized person or compromised in any way and will cooperate fully with Buyer in investigating any such breaches or compromises, will cooperate fully with Buyer's requests for access to, correction of, and destruction of Personal Data in Supplier's possession, and will comply with all instructions or other requirements provided or issued by Buyer from time to time relating to Personal Data.

1.2 If Products or Services do not comply with the warranties in this Agreement, in addition to other remedies available at law, equity, and/or in this Agreement, Supplier will repair or replace Products (at the latest revision level) or re-perform Services, or credit or refund the Price of Products or Services, such remedy at Buyer's discretion. For such Products, Supplier will issue to Buyer a Return Material Authorization ("RMA") within twenty-four (24) hours of Buyer's notice. If Supplier fails to repair or replace Products or re-perform Services in a timely manner, Buyer may do so and Supplier will reimburse Buyer for actual and reasonable expenses. Buyer may return Products which do not conform to the warranties in this Agreement from any Buyer location to the nearest authorized Supplier location at cost of Supplier and Supplier will, at cost of Supplier, return any repaired or replaced Product in a timely manner.

Example 7 – Seller-Favorable Design Services Warranty

Developer will perform the Design Services using careful, efficient, and qualified workers, and in a professional and workmanlike manner in accordance with the Design Statement of Work. The Deliverables will conform in all material respects to the Design Specifications. Except as otherwise expressly provided herein, the Deliverables (including any prototype or trial units of the Product) shall be provided on an "as-is" basis. Developer makes no warranty whatsoever with respect to commercial products manufactured by third parties based on or incorporating all or any part of the Deliverables.

In the event the Design Specifications require that the Product be compliant with Environmental Regulations, Customer agrees that Developer is only responsible for ensuring that, for the Materials that Developer includes in the Deliverables, Developer has received from suppliers of such Materials a certificate of compliance with such Environmental Regulations. Customer agrees that Developer has no responsibility whatsoever in the event the Materials are determined to be not in compliance with such Environmental Regulations. Customer agrees that Developer has no responsibility whatsoever for Customer Controlled Materials that Customer has specified to be included in the Deliverables and/or Product.

The foregoing warranties are the sole and exclusive warranties provided by Developer. Customer's sole and exclusive remedy in the event of breach of the foregoing warranties is (i) require that Developer redesign the Product to comply with the warranties or, (ii) if Developer is unable to comply with (i), to require Developer to refund to Customer the amount paid to the Developer for the Deliverables.

Comments:

- The warranty for the Deliverables is weakened by the use of "in all material respects".
- The warranty does not extend to products manufactured using the design created by the Deliverables
- The warranty limits the developer's obligation to comply with Environmental Regulations.
- The remedy is limited to redesign or refund.

Example 8 – Seller-Favorable Design Services Warranty

Warranty

(a) DEVELOPER represents and warrants that the Services under this Agreement: (1) will be performed by qualified employees, (2) will be of a quality conforming to industry standards, and (3) will conform to the applicable COMPANY's Specifications provided to DEVELOPER with the exception of any items identified in Exhibit __ (Compliance Matrix). DEVELOPER provides no warranty for items, materials, or components provided by COMPANY (including COMPANY Background IP or Newly Developed COMPANY Specific IP).

(b) EXCEPT AS EXPRESSLY PROVIDED IN THIS AGREEMENT, DEVELOPER MAKES NO WARRANTIES, EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR AS TO NON-INFRINGEMENT OR ARISING FROM COURSE OF DEALING OR USAGE OF TRADE.

(c) Developer makes no warranties regarding the availability or continued availability of any parts and/or components used in any design developed under this Agreement, or that the design will comply with the Specifications when used with parts and/or components not specified by DEVELOPER. Developer shall use its best efforts to develop the design using readily available parts, however, COMPANY acknowledges and understands that parts and/or components may rapidly go end-of-life or become unavailable through no control of Developer. Should a part and/or component go end of life, Developer and THE COMPANY shall negotiate in good faith either a new Design Agreement or an Amendment to this Agreement in order to qualify a new part and/or make any design changes if necessary.

(d) Warranty Period. All Warranties expressed in this Agreement shall terminate six (6) months from the date of Acceptance of the final deliverable by the COMPANY.

(e) Exclusive Remedy. COMPANY's sole and exclusive remedy under the warranty clause of this Section 6 shall be a redesign of the portions of the design in question at DEVELOPER's expense to bring the design in compliance with the Specifications. In the event that a redesign to the COMPANY's Specifications is not possible and/or practical, then COMPANY's sole remedy will be for DEVELOPER to return all payments made by COMPANY to DEVELOPER under this Agreement to date.

APPENDIX C
SAMPLE LIMITATION OF LIABILITY AND LIQUIDATED DAMAGES CLAUSES

Example 1 – Limitation of Liability

IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER PARTY FOR ANY CONSEQUENTIAL, INCIDENTIAL, INDIRECT, PUNITIVE OR SPECIAL DAMAGES, EVEN IF SUCH OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. THE LIMITATION SET FORTH IN THIS SECTION SHALL APPLY WHETHER THE DAMAGES ARISE OUT OF OR RELATE TO THIS AGREEMENT AND WHETHER THE CLAIM IS BASED ON CONTRACT, TORT OR OTHER THEORY. THE LIMITATIONS OF LIABILITY SET FORTH IN THE PRECEDING SENTENCE APPLY TO EVERYTHING HEREIN CONTAINED. THE LIMITATIONS OF LIABILITY CONTAINED IN THE FOLLOWING SENTENCE DO NOT APPLY TO (I) ANY INDEMNIFICATION OBLIGATIONS UNDER THIS ARTICLE 9 OR (II) ANY BREACHES BY EITHER PARTY OF ARTICLE 13 (CONFIDENTIALITY). IN NO EVENT SHALL A PARTY'S LIABILITY (WHETHER ASSERTED AS A TORT CLAIM OR CONTRACT CLAIM) EXCEED (A) $4,000,000 IN THE EVENT OF A MATERIAL BREACH OTHER THAN A MATERIAL BREACH OF SUPPLIER'S OBLIGATION TO CONTINUALLY SUPPLY CUSTOMER WITH PRODUCT AS A RESULT OF CIRCUMSTANCES WITHIN THE COMPLETE CONTROL OF SUPPLIER (WHICH SHALL BE SUBJECT TO THE CAP IN (B))AND (B) THE AMOUNTS PAID TO SUPPLIER FOR PRODUCT DURING THE TWELVE-MONTH PERIOD IMMEDIATELY PRECEDING THE MATERIAL BREACH FOR ANY MATERIAL BREACH OF CUSTOMER'S OBLIGATION TO CONTINUALLY SUPPLY CUSTOMER WITH PRODUCT WHICH BREACH RESULTS FROM CIRCUMSTANCES WITHIN THE COMPLETE CONTROL OF SUPPLIER'. NOTWITHSTANDING THE FOREGOING, (I) NEITHER PARTY SHALL BE LIABLE FOR ANY DAMAGES RESULTING FROM A FORCE MAJEURE AND (II) CUSTOMER SHALL NOT BE ENTITLED TO RECOVER LOST PROFITS FOR ANY BREACH DESCRIBED IN CLAUSE (A) ABOVEFOR THE PURPOSE OF CLAUSE (A) ABOVE, THE PARTIES AGREE THAT CUSTOMER'S INABILITY TO SUPPLY A CONTINUAL (AS OPPOSED TO A "ONE-TIME") FLEXIBILITY INCREASE SET FORTH IN SECTION 4.2(d) SHALL NOT CONSTITUTE A MATERIAL BREACH OF SUPPLIER'S OBLIGATION TO CONTINUALLY SUPPLY CUSTOMER WITH PRODUCT. THESE LIMITATIONS SHALL APPLY NOTWITHSTANDING ANY FAILURE OF ESSENTIAL PURPOSE OF ANY LIMITED REMEDY. Notwithstanding the foregoing, this Section shall not (i) affect CUSTOMER's obligation for termination payments in accordance with Section 10 or (ii) prevent the Indemnitor from indemnifying the Indemnitee from and against any license fees and/or royalties the Indemnitee is required to pay to a third party.

Example 2 – Limitation of Liability

IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER FOR ANY INDIRECT, CONSEQUENTIAL, INCIDENTIAL, PUNITIVE OR SPECIAL DAMAGES, OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS, EVEN IF SUCH OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. THE LIMITATION SET FORTH IN THIS SECTION SHALL APPLY WHERE THE DAMAGES ARISE OUT OF OR RELATE TO THIS AGREEMENT. FOR THE PURPOSE OF THIS SECTION, BOTH LOST PROFITS AND DAMAGES RESULTING FROM VALUE ADDED TO THE PRODUCT BY CUSTOMER SHALL BE CONSIDERED CONSEQUENTIAL DAMAGES. IN NO EVENT SHALL MANUFACTURER'S LIABILITY FOR A PRODUCT (WHETHER ASSERTED AS A TORT CLAIM OR CONTRACT CLAIM) EXCEED THE AMOUNTS PAID TO MANUFACTURER. IN NO EVENT SHALL MANUFACTURER'S LIABILITY HEREUNDER EXCEED THE GREATER OF $1 MILLION OR 5% OF THE AMOUNTS ACTUALLY PAID BY CUSTOMER DURING THE 12-MONTH PERIOD PRECEDING THE EVENTS WHICH GAVE RISE TO THE CLAIM. IN NO EVENT WILL MANUFACTURER BE LIABLE FOR COSTS OF PROCUREMENT OF SUBSTITUTE GOODS BY CUSTOMER. THESE LIMITATIONS SHALL APPLY NOTWITHSTANDING ANY FAILURE OF ESSENTIAL PURPOSE OF ANY LIMITED REMEDY. NOTWITHSTANDING THE FOREGOING, THIS SECTION SHALL NOT (I) AFFECT CUSTOMER'S OBLIGATION FOR TERMINATION PAYMENTS OR (II) LIMIT EITHER PARTY'S OBLIGATIONS UNDER [LIST THE CONFIDENTIALITY AND INDEMNITY SECTIONS].

Example 3 – Liquidated Damages Clause (Seller Favored)

SELLER hereby acknowledges that the BUYER may incur liquidated or other similar damages if Supplier fails timely to deliver any Product. If SELLER fails timely to deliver any Product in accordance with the mutually agreed delivery date (as evidenced by written correspondence between the parties), then promptly after the request of the BUYER, SELLER shall reimburse the BUYER for any liquidated or similar damages incurred and paid by the BUYER as a direct result of SELLER's failure timely to deliver the Product (but not in excess of the

Gross Margin portion of the purchase price of the Product. Notwithstanding the foregoing, except to extent that SELLER receives compensation from the respective third party supplier, SELLER shall not be liable for any such damages if the late delivery is a direct result of (i) the failure of any third party supplier timely to deliver to SELLER any Components, provided SELLER uses reasonable commercial efforts in the procurement process, (ii) the withdrawal from SELLER of any Components allocated by the BUYER or any third party supplier or (iii) any act or omission of the BUYER. Nothing in this Section is intended or shall be construed to create any obligation of SELLER with respect to any defective Product delivered by SELLER to the BUYER in good faith. Except for the right to terminate this Agreement, the provisions set forth herein constitute the sole remedy of Customer under this Agreement with respect to any failure by Supplier timely to deliver any Product.

Comments:

- While this is couched as a liquidated damages clause, it is effectively a limitation of liability clause. Under general contract law, the buyer would clearly be able to recover its "direct" damages (which would include amounts paid by the buyer to third parties) in any case; here, the seller did a particularly good job limiting Buyer's claim for damages to its gross margin.
- Seller has no liability if the late delivery was caused by one of its subsuppliers.

Example 4 – Liquidated Damages Clause (Seller Favored; Variation on Example 2)

Seller hereby acknowledges that Customer may incur liquidated or other similar damages if Seller fails timely to deliver any Product. If Seller fails timely to deliver any Product in accordance with the mutually agreed delivery date, then promptly after the request of Customer, Seller shall reimburse Customer for any liquidated or similar damages incurred and paid by Customer as a direct result of Seller's failure timely to deliver the Product (but not in excess of the net profit portion of the Product Price determined in accordance with the Pricing Model). BUYER must notify Seller of the possibility of liquidated damages at the time the PO is placed. Notwithstanding the foregoing, Seller shall not be liable for any such damages if the late delivery is a direct result of (i) the failure of any Materials supplier other than Seller timely to deliver to Seller any Materials, or (ii) any act or omission of Customer including but not limited to the failure to clearly state Customer' exposure to liquidated damages in the respective PO. Customer shall use reasonable commercial efforts (i) to negotiate contracts with its customers that do not obligate Customer to incur liquidated or other similar damages and (ii) to otherwise minimize the liquidated or other similar damages incurred by Customer. Notwithstanding any provision of this Agreement to the contrary, if Supplier pays liquidated damages according to this Section ___, except for the right to terminate this Agreement provided in Section ____, the provisions of this Section shall constitute the sole remedy of Customer under this Agreement with respect to any failure by Seller timely to delivery any Product.

Example 5 – Liquidated Damages Clause (Negotiated)

During the course of a Specific Agreement, the Seller shall notify the Customer immediately of any and all factors which may disrupt the timely performance of the Seller obligations under the Specific Agreement, including any actual or potential labour dispute.

On-time delivery is the essence of the Specific Agreement. Therefore, delays in delivery exceeding one (1) business day beyond the mutually-agreed written contractual date of delivery shall render the Seller liable for liquidated damages without the Customer having to prove it has suffered any loss or damage. When no due date has been agreed, the Seller acknowledged due-date shall be considered as the contractual date of delivery.

The liquidated damages shall be calculated on the price of the delayed Products. Unless otherwise provided in a Specific Agreement, the liquidated damages shall be one per cent (1%) for each calendar day of delay of the price of the delayed Product up to a maximum of fifteen percent (15%) of the price of the delayed Product. Should the parties wish to impose a minimum liquidated damages amount, they should so specify it in the Specific Agreement.

The liquidated damages provided herein shall be Customer's sole remedy in the event the Seller fails to timely deliver Product to the Customer, and shall apply whether the Customer elects to cancel an Order (in the event its customer no longer wants the Product) or accepts the late delivery (of the Product). In no event shall the Customer be able to recover from the Seller any penalties which it is required to pay to its customers or other third parties which penalties are in excess of the limitation set forth in this Article.

Notwithstanding the provisions of this Article 25, the Seller shall not be liable for any damages (including liquidated damages) if the late delivery is a direct result of (i) the failure of any vendor of Customer Controlled Materials to timely deliver to the Seller any Customer Controlled Material, provided the Seller uses reasonable commercial efforts in the procurement process and has ordered the Material in accordance with the appropriate vendor lead-time or (ii) a force majeure or (iii) any act or omission of the Customer, including the withdrawal from the Seller of any components allocated by the Customer.

In case of delay in delivery exceeding twenty (20) calendar days beyond the contractual date of delivery, the Customer shall be entitled to terminate the Specific Agreement and/or all or part of the related Order as per Article "Termination" 30.1, subject to its liability for Excess and Useless Material set forth therein.

Comment:

- It is critical to define the date on which the liquidated damages commence. Often, Buyer pushes the Seller to expedite the order, and the Seller offers to do that on a "reasonable efforts" basis. For example, the Buyer might understand that the product's standard lead time is 15 weeks, but has asked the Seller to deliver it in 12 weeks. Do the liquidated damages commence after 12 weeks or after 15 weeks?
- While under US law, a party cannot recover both liquidated damages and penalties, this is not true in all jurisdictions. For non-US based contracts, it is critical to foreclose all possible theories of recovery (e.g., explicitly state that the liquidated damages are the sole remedy and that penalties are not available).

Example 6 – Liquidated Damages Clause (Negotiated)

10.8 REMEDIES (LATE DELIVERY)

(a) Seller hereby acknowledges that Buyer may incur damages if Seller fails timely to deliver any Product, including but not limited to penalties and "line down" damages. Buyer acknowledges that Seller's pricing and other terms and conditions are based on assuming only a certain amount of risk under the Agreement.

(b) Accordingly, if Seller fails timely to deliver any Product in accordance with the mutually agreed delivery date of a Product (the "Commitment Date"), then promptly after the request of Buyer:

(i) Seller shall reimburse Buyer for any contractually-required payments Buyer has made to any third party customer as a direct result of Seller's failure timely to deliver the Product, but not in excess of ten percent (10%) of the purchase price of the Product which is the subject of the late delivery; and

(ii) Following the second late delivery during the contract term, Seller shall pay to Buyer up to $10,000 per day of "line down" charges (equal to the damages Buyer suffered as a result of the delay), but not in excess of the Line Down Maximum Amount.

a. If the "line down" is due, in whole or in part, to the act of a third party supplier(s) (other than Seller), the Line Down Maximum is $10,000 per incident with a maximum of $100,000 per year.

b. If the "line down" is due to an act of Seller or Seller's internal production facilities, the Line Down Maximum is $50,000 per incident with a maximum of $350,000 per year, unless the line down is due to Seller's Intentional Failure to Perform, in which case there shall be no cap.

For the purpose of this Agreement, Seller's Intentional Failure to Perform shall mean Seller's intentional failure to manufacture the Product in order to manufacture product for another customer instead of Buyer, where Supplier's failure to perform has not been excused (e.g., as a result of Buyer's breach of contract).

Notwithstanding the foregoing,

(x) Seller shall not be liable for any such damages under 10.8(b)(i) if the late delivery is a direct result any act or omission of Buyer, including but not limited to, ordering Product quantities in excess of the flexibility limits permitted under Section 9. This limitation shall not apply to damages under 10.8(b)(ii) above.

(y) For the purpose of this section, the "Commitment Date" shall mean the date by which Seller has committed to deliver the Product in accordance with this Agreement, and shall not include "Customer Request Dates" which are less than the contractually agreed-upon Product leadtimes (e.g., "book and chase" orders).

(z) Except for Buyer's ability to terminate this Agreement for cause (and recover its cost of cover in accordance with Section 25.7 (e) hereof, the provisions of this Section 10.8 shall constitute the sole remedy of Buyer under this Agreement with respect to any failure by Seller timely to delivery any Product.

Comments:

- The language set forth in this section was a compromise. The customer understood that certain items were outside of the supplier's control (e.g., receipt of materials from third parties), but wanted the supplier to have some skin in the game in the event of a late delivery. The agreement reflects certain caps in those situations. However, the customer was concerned that the supplier might simply not perform (e.g., because it got a better offer for the products/capacity), and did not want to be limited in that situation. Hence, the term "Intentional Failure to Perform" was created.

Example 7 – Limitation of Liability (Negotiated With Subcaps for Likely Breaches)

25.7 LIMITATION OF LIABILITY

(A) IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER FOR ANY INDIRECT, CONSEQUENTIAL, INCIDENTAL, PUNITIVE OR SPECIAL DAMAGES OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS, EVEN IF SUCH OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. FOR THE PURPOSE OF THIS SECTION, BOTH LOST PROFITS AND DAMAGES RESULTING FROM THE VALUE ADDED TO THE PRODUCT BY BUYER SHALL BE CONSIDERED CONSEQUENTIAL DAMAGES. IN NO EVENT SHALL EITHER PARTY'S LIABILITY FOR A PRODUT (WHETHER ASSERTED AS A TORT CLAIM OR CONTRACT CLAIM) EXCEED THE AMOUNTS PAID TO SELLER FOR SUCH PRODUCT HEREUNDER. SUBJECT TO THE CAPS IN SECTION 25.7(B), IN NO EVENT SHALL EITHER PARTY'S LIABILITY FOR ALL CLAIMS ARISING OUT OF OR RELATING TO THIS AGREEMENT EXCEED THE LESSER OF (I) THE TRAILING TWELVE MONTH REVENUE [OR FOR THE FIRST TWELVE MONTHS, $3,000,000] OR (II) TWENTY MILLION DOLLARS. THESE LIMITATIONS SHALL APPLY NOTWITHSTANDING ANY FAILURE OF ESSENTIAL PURPOSE OF ANY LIMITED REMEDY. NOTWITHSTANDING THE FOREGOING AND EXCEPT AS PROVIDED IN SECTION 25.7(B), THE PROVISIONS OF THIS SECTION SHALL NOT APPLY TO LIMIT (Y) EITHER PARTY'S INDEMNIFICATION OBLIGATIONS OR (Z) BUYER'S OBLIGATIONS FOR TERMINATION PAYMENTS IN ACCORDANCE WITH [THE TERMINATION SECTION]. THE LIMITATIONS SET FORTH IN THIS SECTION SHALL APPLY WHERE THE DAMAGES ARISE OUT OF OR RELATE TO THIS AGREEMENT.

(B) NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN CONTAINED,

(1) SELLER'S LIABILITY FOR ANY AND ALL BREACHES OF SECTION 14 (WARRANTY) SHALL NOT EXCEED THE GREATER OF (A) THE COST OF THE PRODUCT OR (B) THE LIMITATIONS SET FORTH IN SECTION 14.

(2) SELLER'S LIABILITY FOR ANY AND ALL BREACHES OF SECTION 17 (FAILURE EPIDEMIC) SHALL NOT EXCEED THE LIMITATIONS SET FORTH IN SECTION 17.

(3) SELLER'S LIABILITY FOR ANY AND ALL CLAIMS ARISING OUT OF OR RELATING TO SELLER'S FAILRUE TO TIMELY DELIVER PRODUCT (WHETHER BASED ON SECTION 10.8 OR OTHERWISE) SHALL NOT EXCEED THE GREATER OF (I) THE

LIMTIATIONS SET FORTH IN SECTION 10.8 OR (II) $2,000,000; PROVIDED, HOWEVER, THAT THIS LIMITATION SHALL NOT APPLY IN THE EVENT BUYER CAN DEMONSTRATE BY CLEAR AND CONVINCING EVIDENCE SELLER'S INTENTIONAL FAILURE TO PERFORM.

(4) EACH PARTY'S LIABILTY FOR ANY AND ALL CLAIMS BASED ON THE ACTS OR OMISSIONS OF A THIRD PARTY SOURCED MATERIAL SUPPLIER OF SUCH PARTY (INCLUDING BUT NOT LIMTIED TO CLAIMS UNDER [VARIOUS SECTIONS]) SHALL BE LIMITED TO THE RECOVERY RECEIVED FROM SUCH PARTY'S SOURCED MATERIAL SUPPLIER BUT IN NO EVENT SHALL SUCH PARTY'S LIABILTIY EXCEE: (I) $1,000,000 PER OCCURRENCE AND (II) $3,000,000 PER YEAR. THE PARTIES ACKNOWLEDGE THAT, WITH THE EXCEPTION OF LINE DOWN CHARGE SET FORTH IN SECTION XX, NEITHER PARTY SHALL BE LIABLE FOR ANY ACT/OMISSION OF A SUPPLIER NOT SOURCED BY THAT PARTY.

Comments:

- This contract contemplated a "ramp up." For the first several months, volumes would be low (and, accordingly, the customer wanted some minimal protection (e.g., $3,000,000) even though its volumes were small. Over time, the $20,000,000 cap would supersede the "trailing twelve month" cap. The $20 million cap was, in the seller's view, very high. Accordingly, the seller attempted to take some of the sting out through the use of subcaps.
- Note the language in (B)(3). Section 10.8 related to a liquidated damages clause for late delivery, but the liability cap was drafted to cover all late deliveries (whether or not they fit into the liquidated damages for late delivery section). What if the customer elected not to base a claim on Section 10.8, but rather forego the liquidated damages under that section and create a claim based on a separate section.
- The concept of "Intentional Failure to Perform" was a compromise - The customer wants to make sure that the seller did put another customer's (including their competitor) demand above their own. The buyer was more sympathetic to unintentional breaches.
- Section (B)(4) arose because the seller was forced to take responsibility for an item for which it does not typically take responsibility - the failure of a third party to timely deliver components necessary for the manufacture of the customer's product. The parties were at an impasse on this issue, and decided that the seller would responsibility for the third party vendor, but only to a point (the cap).

Example 8 – Limitation of Liability (Negotiated With Subcaps for Likely Breaches)

(a) LIMITATION OF LIABILITY. WITH THE EXCEPTION OF THE PARTIES' INDEMNIFICATION OBLIGATIONS UNDER SECTION 19, A WILLFUL MISAPPROPRIATION OF THE OTHER PARTY'S INTELLECTUAL PROPERTY RIGHTS, OR A BREACH OF A PARTY'S CONFIDENTIALITY OBLIGATIONS, IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER FOR ANY INDIRECT, CONSEQUENTIAL, INCIDENTIAL, PUNITIVE OR SPECIAL DAMAGES, OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. THE LIMITATION SET FORTH IN THIS SECTION SHALL ONLY APPLY WHERE THE DAMAGES ARISE OUT OF OR RELATE TO THIS AGREEMENT. FOR THE PURPOSE OF THIS SECTION, BOTH LOST PROFITS AND DAMAGES RESULTING FROM VALUE ADDED TO THE PRODUCT BY CUSTOMER SHALL BE CONSIDERED CONSEQUENTIAL DAMAGES.

(b) CAPS ON LIABILITY FOR WARRANTY AND EPIDEMIC FAILURE. NOTWITHSTANDING ANYTHING TO THE CONTRARY HEREIN CONTAINED, IN NO EVENT SHALL SUPPLIER'S COLLECTIVE/COMBINED LIABILITY FOR ANY AND ALL BREACHES OF SECTION 12 (WARRANTY), 13 (EPIDEMIC FAILURE), AND/OR 14 (IN-WARRANTY) EXCEED THE FOLLOWING AMOUNTS:

I. IF THE PRODUCT DEFECT IS ATTRIBUTABLE TO DEFECTIVE WORKMANSHIP, THE GREATER OF (I) TWO MILLION DOLLARS ($2,000,000) OR (II) THE AMOUNT PAID TO SUPPLIER FOR THE PRODUCT;

II. IF THE PRODUCT IS AN ODM PRODUCT, AND THE DEFECT IS ATTRIBUTABLE TO SOMETHING OTHER THAN DEFECTIVE WORKMANSHIP (E.G., DEFECTIVE

SPECIFICATIONS), THE GREATER OF (I) TWO MILLION DOLLARS ($2,000,000) OR (II) EIGHT PERCENT (8%) OF THE TRAILING EIGHTEEN MONTH REVENUE FOR THE CORRESPONDING PRODUCTS; PROVIDED, HOWEVER, THAT UPON TERMINATION OF THE AGREEMENT, THE "TRAILING EIGHTEEN MONTH REVENUE" SHALL BE DEEMED TO BE THE TRAILING EIGHTEEN MONTH REVENUE FOR THE EIGHTEEN MONTHS IMMEDIATELY PRIOR TO TERMINATION).

THE PARTIES ACKNOLWEGE THAT IF THE PRODUCT IS NOT AN ODM PRODUCT, THEN SUPPLIER SHALL HAVE NO EPIDEMIC FAILURE OR WARRANTY LIABILITY OTHER THAN FOR DEFECTIVE WORKMANSHIP AS LIMITED IN (I).

THE PARTIES ACKNOWLEDGE THAT ALL COSTS TO REPAIR OR REPLACE THE PRODUCTS, CONDUCT ANY RECALL, AND/OR CREDIT CUSTOMER WITH THE PURCHASE PRICE OF THE PRODUCT SHALL COUNT TOWARDS THE FOREGOING LIMITATIONS OF LIABILITY.

(c) CAPS ON LIABILITY FOR INDEMNIFICATION. IN NO EVENT SHALL SUPPLIER'S LIABILITY FOR INDEMNIFICATION EXCEED TWO MILLION DOLLARS ($2,000,000) IF AND TO THE EXTENT THAT THE INDEMNIFICATION IS REQUESTED OR MADE PURSUANT TO A CLAIM INVOLVING ANY "JOINT INTELLECTUAL PROPERTY" AS THAT TERM IS DEFINED IN ADDENDUM #1 (E.G, THAT THE JOINT INTELLECTUAL PROPERTY INFRINGES A THIRD PARTY'S INTELLECTUAL PROPERTY RIGHTS); OR SIX MILLION DOLLARS ($6,000,000) (EXCLUDING ANY DEFENSE COSTS) TO THE EXTENT THAT THE INDEMNIFICATION IS REQUESTED OR MADE PURSUANT TO A CLAIM INVOLVING SUPPLIER'S BACKGROUND INTELLECTUAL PROPERTY (E.G, THAT SUPPLIER'S BACKGROUND INTELLECTUAL PROPERTY INFRINGES A THIRD PARTY INTELLECTUAL PROPERTY RIGHTS).

(d) LATE DELIVERY. IN NO EVENT SHALL A CLAIM BASED IN WHOLE OR IN PART ON CUSTOMER'S FAILURE TO TIMELY DELIVER PRODUCT EXCEED THE GREATER OF (I) THE LIMITATIONS SET FORTH IN SECTION 4(K) OR (II) $500,000.

(e) OTHER CAP. WITH RESPECT TO EACH PRODUCT LINE COVERED BY THIS AGREEMENT (AND NOT ALL PRODUCT LINES COMBINED), WITH THE EXCEPTION OF ANY WILLFUL MISAPPROPRIATION OF THE OTHER PARTY'S INTELLECTUAL PROPERTY RIGHTS, A BREACH OF A PARTY'S CONFIDENTIALITY OBLIGATIONS, OR A BREACH OF A PARTY'S INDEMNIFICATION OBLIGATIONS AS SPECIFIED IN SECTIONS 16(a) or 16(b), IN NO EVENT SHALL EITHER PARTY'S LIABILITY HEREUNDER FOR ANY BREACH OTHER THAN WARRANTY, EPIDEMIC FAILURE AND INDEMNIFICATION (WHICH ARE SUBJECT TO THE LIMITATIONS SET FORTH ABOVE) EXCEED THE GREATER OF (I) THE TRAILING EIGHTEEN MONTH'S OF REVENUE EARNED BY SUPPLIER FOR THAT PRODUCT LINE AND (II) FIVE MILLION DOLLARS ($5,000,000).

Comment:

- In this example, the seller was able to limit its liability for indemnification.

Example 9 – Limitation of Liability (Heavily Negotiated)

13.2 Limitation of Liability.

(a). EXCEPT AS SET FORTH BELOW, IN NO EVENT SHALL A PARTY, ITS DIRECTORS, OFFICERS, EMPLOYEES, AGENTS, SUBCONTRACTORS OR OTHER REPRESENTATIVES BE LIABLE TO THE OTHER FOR SPECIAL, CONSEQUENTIAL, INCIDENTAL, EXEMPLARY OR INDIRECT COSTS, EXPENSES OR DAMAGES, OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS, EVEN IF SUCH OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. FOR THE PURPOSE OF THIS SECTION, BOTH LOST PROFITS AND DAMAGES RESULTING FROM VALUE ADDED TO THE PRODUCT BY CUSTOMER SHALL BE CONSIDERED CONSEQUENTIAL DAMAGES.

(b). EXCEPT AS SET FORTH BELOW, IN NO EVENT SHALL EITHER PARTY'S AGGREGATE LIABILITY ARISING OUT OF OR RELATED TO THIS AGREEMENT (WHETHER ASSERTED AS A TORT CLAIM OR CONTRACT CLAIM) EXCEED FIVE MILLION DOLLARS ($ 5,000,000 USD) ("CAP').

(c). NOTWITHSTANDING THE LIMITATIONS OF LIABILITY SET FORTH HEREIN, (i) THE LIMITATIONS SET FORTH IN SECTION "(a)" SHALL NOT LIMIT EITHER PARTY'S LIABILITY FOR BREACH OF SECTIONS 6 (INTELLECTUAL PROPERTY OWNERSHIP), 7 (LICENSE GRANTS), SECTION 14 (CONFIDENTIALITY), SUPPLIER'S INTENTIONAL REPUDIATION OF THE CONTRACT OR INTENTIONAL REFUSAL TO SUPPLY PRODUCT HEREUNDER BUT ONLY TO THE EXTENT THAT SUPPLIER IS CUSTOMER'S "SOLE SOURCE" (E.G, CUSTOMER IS PURCHASING ONE HUNDRED PERCENT OF ITS REQUIREMENTS FROM SUPPLIER) OF THE PRODUCT WHICH IS THE SUBJECT OF THE ALLEGED REPUDIATION OR CUSTOMER'S INTENTIONAL REFUSAL TO PERFORM ITS OBLIGATIONS UNDER SECTION 2.2 AND (ii) THE LIMITATIONS SET FORTH IN SECTION "(b)" SHALL NOT APPLY IN THE EVENT OF A BREACH OF SECTIONS 6 (INTELLECTUAL PROPERTY OWNERSHIP), 7 (LICENSE GRANTS), SECTION 14 (CONFIDENTIALITY); EITHER PARTY'S OBLIGATIONS UNDER SECTION 13.1 (GENERAL INDEMNITY); SUPPLIER'S INTENTIONAL REPUDIATION OF THE CONTRACT OR INTENTIONAL REFUSAL TO SUPPLY PRODUCT HEREUNDER BUT ONLY TO THE EXTENT THAT SUPPLIER IS CUSTOMER'S "SOLE SOURCE" (E.G, CUSTOMER IS PURCHASING ONE HUNDRED PERCENT OF ITS REQUIREMENTS FROM SUPPLIER) OF THE PRODUCT WHICH IS THE SUBJECT OF THE ALLEGED REPUDIATION; OR CUSTOMER'S INTENTIONAL REFUSAL TO PERFORM ITS OBLIGATIONS UNDER SECTION 2.2, AND (iii) WITH RESPECT TO THE LIMITATIONS IN SECTION "(b)", THE COST OF THE REPAIR OR REPLACEMENT OR CREDIT OF THE PRODUCT UNDER SECTION 11 (PRODUCT WARRANTIES) AND CLAIMS MADE BY SUPPLIER FOR AMOUNTS OWED HEREUNDER AND UNPAID BY CUSTOMER SHALL NOT COUNT TOWARDS SUCH CAP. EXCEPT AS SET FORTH HEREIN, THESE LIMITATIONS SHALL APPLY NOTWITHSTANDING ANY FAILURE OF ESSENTIAL PURPOSE OF ANY LIMITED REMEDY.

(d). FOR THE PURPOSE OF THIS AGREEMENT, THE STANDARDS OF "INTENTIONAL REPUDIATION" AND/OR "INTENTIONAL REFUSAL" SHALL NOT BE DEEMED SATISFIED IF THE ACCUSED PARTY ATTEMPTED TO PERFORM ITS OBLIGATIONS BUT WAS INCAPABLE OF PERFORMING THEM, UNABLE TO PERFORM THEM OR WAS NEGLIGENT, GROSSLY NEGLIGENT OR RECKLESS IN THEIR PERFORMANCE. THE BURDEN OF PROVING "INTENTIONAL REPUDIATION" AND/OR "INTENTIONAL REFUSAL" SHALL BE ON THE PARTY ATTEMPTING TO ESTABLISH "INTENTIONAL REPUDIATION" AND/OR "INTENTIONAL REFUSAL" OF THE OTHER PARTY AND MUST BE PROVED BY CLEAR AND CONVINCING EVIDENCE. IN ADDITION, FOR THE SAKE OF CLARITY, AS CONCERNS "INTENTIONAL REPUDIATION", THE PARTIES INTEND FOR THE LIMITATIONS SET FORTH IN SECTIONS "(a)" AND "(b)" TO APPLY IN THE EVENT OF AN INTENTIONAL REPUDIATION IF SUPPLIER IS NOT CUSTOMER'S SOLE SOURCE FOR THE PRODUCT

