



04. Negotiating Commercial Contract Terms



**NCMA 2014 March Workshop
Negotiating Commercial Contract Terms:
Buyer & Seller Perspectives**

March 12, 2014

*Mark Tremblay CPCM CFCM
Benjamin Turkel Esq. CFCM*

Raytheon

Customer Success Is Our Mission

Elements of a Commercial Contract

1. *Recitals:*

- Identifies the **offer**
- Identifies the **acceptance**
- Identifies the **consideration**
- Acknowledged by **signature**

Statement of the Agreement

- (“ Buyer needs a widget and would like to buy Seller’s widget..”)
- (“ Seller agrees to provide the widget under the terms of the Contract”)
- (“ Buyer agrees to pay \$XX for Seller providing the widget”)

2. Terms and Conditions:

Active and Passive

- **Active** refers to terms that govern performance (the “business” deal)
- **Passive** refers to terms that allocate risk and remedies (the “legal” deal)

3. Statement of Work:

Schedules and Attachments

- Defines what is to be performed and to what standards (note: “not how”)

Size & Shape Will Vary- But Same Elements are always there

Active Terms: Tied to Performance

- **Who is responsible for what? (the “business” deal)**
 - Deliverables
 - Delivery Schedule & Acceptance
 - Price & Payment Terms
 - Performance / Payment Guarantees
 - Responsibilities of the Parties
 - Change Management
 - Communications and Reporting
 - Compliance with Laws/Export requirements
 - Representations
 - Permits/ Furnished Information/Equipment/Facilities

The terminology “Active” and “Passive” clauses are derived from IACCM. See “A Short Guide to Contract Risk”: H. Haarpio and G. Seidel, Gower Publishing Company 2013”

Passive Terms: Tied to Remedies

- **What Happens if Things go Wrong? (the “legal” deal)**
 - Indemnity (general & patent)
 - Warranty
 - Force Majeure
 - Order of precedence
 - Confidentiality
 - Survivability; Severability
 - Limitation of liability
 - Termination (convenience/default)
 - Remedies
 - Disputes & Governing law
 - Representations
 - Liquidated Damages
 - Foreign Corrupt Practices

Commonly Negotiated Terms

▪ **Payment**

- What must Seller satisfy to receive payments and how will Seller be Paid?
 - (e.g. milestones, certificates of acceptance)
 - Open account or letters of credit?
 - Guarantees?

▪ **Delivery, Inspection & Acceptance**

- How are goods inspected, delivered and sold off to Buyer?
 - How and where will delivery take place?
 - What are Buyer's rights for inspection/rejection?
 - Who's responsible for shipment/customs?
 - What constitutes acceptance and when does it occur? Where does title and risk of loss pass

▪ **Warranty**

- What's covered, under what conditions, and for how long?
 - Goods are new; free from defects in workmanship; perform in accordance with the requirements of the contract; are not counterfeit
 - Services are of high professional standards
 - Software is free of bugs; viruses, malicious code; no undisclosed or unlicensed 3rd party software
 - Non-infringement of 3rd party Intellectual Property.
 - License grants

Commonly Negotiated Terms

▪ **Limitation of Liability**

- What is my total potential liability under the contract?
 - Limitation on types of damages; direct and indirect (multiple, punitive, consequential)
 - Cap on damages
 - Liquidated Damages tied to schedule
 - Exclusions

▪ **Indemnity**

- Who is responsible for damage or injury to property, people, infringing intellectual property, poor performance in general?
 - What is the extent of coverage? Are there any limitations of coverage?
 - Is it an obligation to pay for damages caused or also an obligation to stand in other parties shoes and defend?
 - Is it proportional and reciprocal, or “broad form” responsibility?

▪ **Disputes & Governing law**

- How are disputes resolved, where and what law governs the interpretation and enforceability of the contract?
 - Arbitration- binding or not?
 - Which State or Country laws?

Payment

▪ Buyer concerns...

- Cash outlay
- Payments tied to some tangible result/benefit
- Invoice data requirements and format are clear
- Timing of payments are clear
- Not overpaying in relation to work performed
- What sureties do I have to protect payments made?

▪ Seller Concerns...

- Cash Inflow
- Timely payment
- Buyer financial means
- Payment mechanism is clear
 - Open account or L/C
- Cash Positive or neutral
- Minimal to no withholdings
- Preferred currency
- Hidden deductions
 - Taxes, duties, discounts

Delivery, Inspection & Acceptance

▪ Buyer concerns...

- Right to inspect at reasonable times & places
- Bi-lateral acceptance
- Acceptance process is clear
- No title, risk of loss until acceptance
- Acceptance revocable for latent defect, fraud or misrepresentation
- Accept where delivered
- Damages for delay

▪ Seller Concerns...

- Minimal interference
- Clear acceptance process that is achievable
- Acceptance timely & not unreasonably withheld
- Payment follows quickly
- Title/risk of loss passes on acceptance
- Liquidate/Reduce any sureties
- Damages for delay

Warranty

▪ Buyer concerns...

- Doesn't start until after accepted
- Long as possible without extra cost
- All rights available
- New product
- Free from defects in design & workmanship
- No infringement of 3rd party IP
- Remedies for breach
- Turnaround times

▪ Seller Concerns...

- Extent of coverage
- Risk tied to length and cost
- Expressly stated- no implied warranties
- Exclusive remedies
- Turnaround times

Limitation of Liability

▪ Buyer concerns...

- Why have a limit?
- Downside risk if project is not satisfactorily completed
- Downside risk of litigation
- Why limit direct vs. indirect damages? Consequential should be available for breach of IP or confidentiality, death, gross negligence
- Cap should be adequate to cover possible loss
- Insurance coverage as floor

▪ Seller Concerns...

- Risk mitigation- lower overall risk
- Managing risk to things in Seller's control-
- Direct vs. indirect
- Tied to contract value and complexity
- Proportional risk compared to to upside benefit of project

Indemnity (general/patent)

▪ Buyer concerns...

- Allocate risk to responsible party
- Seller pays for damages caused
- Defending claims is as expensive as ultimate liability- Seller defends
- Seller should indemnify against any IP infringement- worldwide

▪ Seller Concerns...

- Allocate risk to responsible party
- Proportional and reciprocal
- Party responsible pays their share of defense costs
- World-wide IP coverage is impossible to research-defend where products built and used

Disputes & Governing law

▪ **Buyer concerns...**

- How arduous and expensive to resolve
- Continued performance during dispute
- Home court advantage
- Arbitration fair or “Solomonesque?”
- Judgment enforceable in any locale with jurisdiction

▪ **Seller Concerns...**

- How arduous and expensive to resolve
- Continued performance during dispute
- Home court advantage
- Fair arbitration proceedings- favorable venue?
- Judgment enforceable in any locale with jurisdiction

Bridging the Gap



Bridging the Payment Gap

▪ Buyer

- Only want to pay in proportion to the value of goods received
- Want to have sufficient withholdings to ensure full performance
- Payments made when goods accepted
- Maintain control of the purse strings as long as possible

▪ Seller

- Want to ensure timely payments when goods received
 - Let's Consider clear payment criteria
 - Documentary L/C
- Would like some financing of significant investment costs
 - Advance payment backstopped by corporate or bank guarantee
- Better payment terms can help reduce overall price
- Agreeable milestones based on set values- include sufficient withholding to protect your interests

Bridging the Gap - Payment

- 1. Buyer shall pay the Agreement Price to the Seller at the times and in the manner specified in the Schedule 1 Milestone Payment plan and Delivery Schedule.
- 2. Payments due shall be made by interbank wire transfer to Seller's named account below, consisting of an Advance Payment of xx%, and a confirmed documentary letter of credit for the balance of the Agreement Price. All payments shall be made in immediately available US dollar funds for goods and services provided in accordance with Schedule 1 and terms of this Agreement.
- 3. Seller shall make an advance payment of xx% (\$USD) within 5 days of submission by Seller and receipt by the Buyer of the following documents:
 - Commercial Invoice
 - Advance Payment Guarantee in the amount of the Advance Payment
- 4. Within xx days of receipt of the advance payment, Buyer shall establish a documentary letter of credit for the balance of the Agreement Price, issued and confirmed by major multinational banks mutually acceptable to Buyer and Seller. Drawings under the Letter of Credit shall be made in accordance with the Schedule 1 Milestone Payment Plan at the stated amounts upon presentation of the following documents:
 - Commercial Invoice
 - Certificate of Acceptance in the form specified in the Agreement for the product or service provided
- 5. If Buyer does not sign the applicable Certificate of Acceptance within 5 days of presentation without giving Seller official notice citing the reason for not signing, acceptance shall be deemed made and upon signature by Seller, Seller shall be entitled to present the documents to the bank for payment
- 6. Partial payments and partial shipments permitted. Early deliveries and payments are permitted commensurate with early acceptances made.

Buyer/Seller concerns about proportional yet timely payments addressed

Buyer/Seller concerns about cash flow and protection addressed

Buyer gets to accept goods before payment

Bridging Delivery, Inspection & Acceptance

▪ Buyer

- It's not accepted until I say its accepted
- How do I ensure you will deliver as promised? We want positive and negative incentives for delivery
- What standards should be met?
- What protections do I have if not accepted?

▪ Seller

- Right to inspect on non-interference basis
- Have defined acceptance criteria
- Establish timeframes for who, what and when inspections & acceptance take place
- Mutually signed Certificates of Acceptance
- Agree to rectify and reperform at my expense if unsatisfactory
- Title and risk of loss will pass on acceptance
- Some reasonable timeframe to hear from you on acceptance
- Bonus for early completion/LDs for late delivery?

Bridging the Gap - Acceptance

- 1. Buyer shall have the right to inspect progress of the work at all reasonable times as well as participate in all final acceptance procedures in accordance with the terms of this Article
- 2. Products shall be accepted on an interim basis for major end item deliveries and final basis for system acceptance.
- 3. Interim acceptance shall occur at the Seller;s place of manufacture through the Factory Acceptance Test procedures conducted in accordance with Specification XYZ.
- 4. At least 30 days prior to a Factory Acceptance Test, Seller shall notify Buyer of the time and place for testing. Buyer shall be able to have 3 representatives witness the FAT, one who will be duly authorized to execute the Certificate of Acceptance upon successful completion of the milestone.
- 5. If the results of the test are unsatisfactory, Seller shall rectify the cause of failure and repeat the test until successful completion in accordance with the terms of this Agreement. Late Deliveries shall be subject to liquidated damages as set forth in Article xxx.
- 6. Final Acceptance shall occur at Buyer;s specified location through the System Acceptance Test Procedures conducted in accordance with Specification XYZ. (Same 30 day notice and same Certificate of Acceptance process)
- 7. Title and risk of loss to all Products shall pass to Buyer upon Final Acceptance.
- 8. Seller shall provide Buyer suitable use of office space to support witnessing and conduct of acceptance testing

Buyer/Seller concerns about right to inspect/accept without undue interference

Mutually established specifications and test procedures

Buyer gets to approved acceptance

Buyer gets incentives for delivery

Bridging Warranty

▪ Buyer

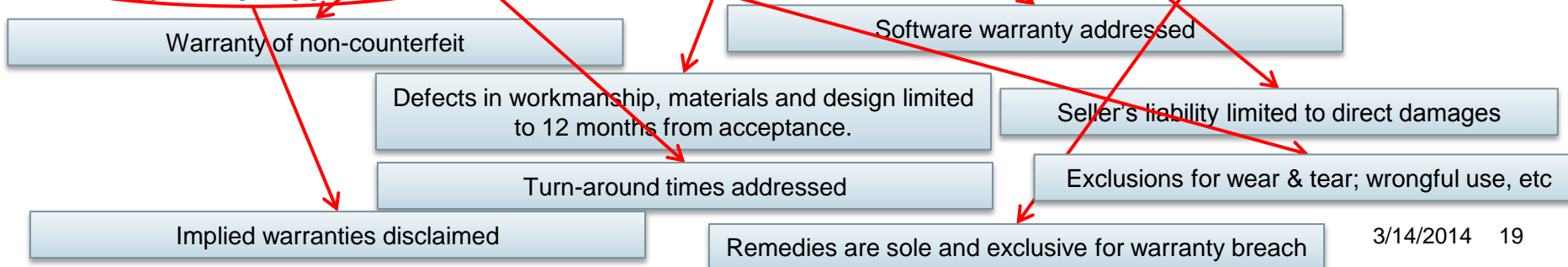
- I want protections from defects, workmanship, design, performance
- I want as long a warranty as possible
- I want my full rights under law
- How about turnaround time to repair/replace
- What happens if you can't fix it?
- What about latent defects?
- I don't want the warranty running out if I have a warranty claim
- Who pays for shipping and packaging?
- I decide if an item is a warranty fix

▪ Seller

- We stand by our products- warrant defects in material and workmanship
- The longer the warranty- the higher the cost- let's balance protection and price (most things occur in 1st year)
- Reasonable turnaround times are understandable- lets consider transportation time in that equation
- Latent defects is often difficult to assess – consider for unopened, packaged items
- Costs of warranty are negotiable
- Once we agree, let's agree this is the exclusive remedy for warranty claims
- Misuse, negligence don't count
- Let's agree to a quick way to assess the item for cause of defect or failure

Bridging the Gap - Warranty

- (a) Seller warrants the goods delivered are (i) new (ii) for a period of 12 months from date of acceptance, free from defects in workmanship, materials, and design and (iii) in accordance with all the requirements of this Purchase Order. Seller further warrants that the performance of work and services shall conform with the requirements of this Purchase Order and to high professional standards. All warranties in this Purchase Order shall survive inspection, test, final acceptance and payment of goods and services.
- (b) Seller warrants that the goods delivered pursuant to this Purchase Order shall (i) be and only contain materials obtained directly from the Original Component Manufacturer (OCM) or the Original Equipment Manufacturer (OEM), (collectively, the Original Manufacturer (OM)) or an authorized OM reseller or distributor; (ii) not be or contain Counterfeit Items, as defined below; and (iii) contain only authentic, unaltered OM labels and other markings.
- (c) Seller warrants that any software delivered under this Purchase Order: (i) shall not contain any viruses, malicious code, Trojan horse, worm, time bomb, self-help code, back door, or other software code or routine designed to: (a) damage, destroy or alter any software or hardware; (b) reveal, damage, destroy, or alter any data; (c) disable any computer program automatically; or (d) permit unauthorized access to any software or hardware; (ii) shall not contain any third party software (including software that may be considered free software or open source software) that (a) may require any software to be published, accessed or otherwise made available without the consent of Buyer, or (b) may require distribution, copying or modification of any software free of charge; and (iii) shall not infringe any patent, copyright, trademark, or other proprietary right of any third party or misappropriate any trade secret of any third party.
- (d) Seller shall be liable for and save Buyer harmless from any direct damages that Buyer may suffer from breach of any of these warranties; damages of an indirect or consequential nature are expressly disclaimed. Remedies for breach of this warranty shall be upon mutual agreement and includes the repair, replacement or reimbursement of the purchase price of nonconforming goods within ninety (90) days of any written notice of warranty claim inclusive of transportation time, and, in the case of services either the prompt correction of the defective services at no cost or reimbursement of the amounts paid for such services. Return to Seller of defective or nonconforming goods and redelivery to Buyer of repaired or replaced goods shall be at Seller's expense. Goods or services required to be corrected, repaired or replaced shall be subject to this Section and the Inspection Section of this Purchase Order in the same manner and to the same extent as goods or services originally delivered under this Purchase Order, but only as to the repaired or replaced goods or parts thereof or the corrected service thereof. The foregoing remedies are Buyer's sole and exclusive remedies for Seller's breach of this warranty.
- (e) Notwithstanding the foregoing, Seller shall not be responsible for ordinary wear and tear, defects of a cosmetic nature, environmental limitation, required maintenance, unauthorized maintenance or modification or use for unintended purposes. SELLER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES INCLUDING WARRANTY OF MERCHANTABILITY OR USE FOR A PARTICULAR PURPOSE.



Bridging Limitation of Liability

■ Buyer

- I'm buying your product, why should I agree to limit your liability for any risk?
- You need to take responsibility for the consequences of your acts or omissions
- If you don't accept, someone else will
- I'm not an insurance company for my suppliers

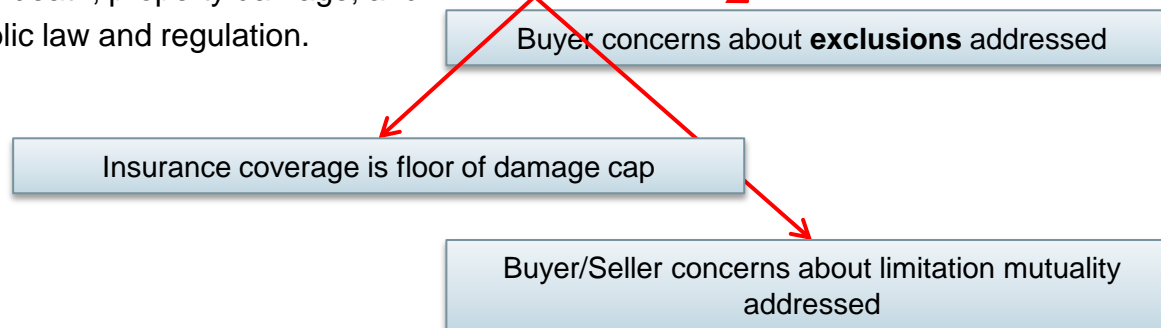
■ Seller

- LOL helps balance risk and opportunity to provide best competitive price
- It doesn't make economic sense to pass on all risk (and thus) cost to the Seller for those items each of us can best control.
- Contract risk should reside with the party best positioned to manage that risk
- It's Fair to take risk regarding things we can control
 - Our costs, our products, our people, our suppliers, the schedule,
- Its Burdensome to take risk on things outside our control
 - Your people, your actions, acts of third parties,
- A reasonable LOL keeps overhead/insurance costs down, provides for prudent shared risk mgt.
- Major insurance firms seek LOL coverages to avoid added insurance premiums
- All these factors come into play to determine the risk and opportunity we are willing to share in relation to the contract value we are agreeing to.
- No need to drive costs and price up for risks that are low probability but high impact outside our

Balanced risk can help reduce costs on both sides

Bridging the Gap - LoL

- (A) Except as required by mandatory provisions of law, and ~~except as set out in Section xxC, below~~, in no event shall either party or its affiliates and/or their respective customers, employees and/or agents be liable (whether in contract, tort or otherwise) to the other party under this Purchase Order for any special, exemplary, indirect, incidental, speculative or consequential damages.
- (B) ~~Except as required by mandatory provisions of law, and except as set out in Section xxC, below~~, the liability of each party, and that of its affiliates, their respective customers, employees or agents, to the other party under this Purchase Order shall not exceed the greater of any amounts recoverable from such liable party's insurance or ___ times (_x) the full value of this Purchase Order on a per claim basis.
- (C) Damages arising from the following situations are ~~exceptions to the limitations on liability set out in Sections xxA and xxB, above~~:
 - misappropriation of proprietary information or breach of the obligation of confidentiality;
 - patent and copyright infringement
 - personal injury, death, property damage; and
 - violation of public law and regulation.



Indemnity

▪ Buyer

- You should absorb general risks in consideration of getting this job
- I'm not an insurance company
- You should protect me from any patent infringement claims- anywhere

▪ Seller

- We should share in risks in reasonable proportion to our respective liability
 - To the extent its my fault, I'll pay: to the extent its your fault: you pay
 - Proportional & reciprocal
- Re Patent indemnity- no problem protecting you where products are produced and will be used
 - Geographic limitations help limit the bounds of meritless claims- 200 countries in world- can't possibly know all the patent laws and searches
 - Help control costs with reasonable coverages

Bridging the Gap - Indemnity

- (a) **General.** Seller shall indemnify and save Buyer and its customer(s) and their respective officers, directors, employees and agents harmless from and against (i) all claims (including claims under Workers' Compensation or Occupational Disease laws or other equivalent laws in Seller's country) and resulting costs, expenses (including attorney fees and costs) and liability which arise from personal injury, death, or property loss or damage attributed to, or caused by, the goods supplied, or the services performed by Seller pursuant to this Purchase Order, except to the extent that such injury, death, loss or damage is caused by the negligence of Buyer, and (ii) all claims (including resulting costs, expenses and liability) by the employees of Seller or any of its subcontractors.
- (b) **Intellectual Property.** Seller warrants that all goods and services (for purposes of this Section 16 hereinafter "items"), provided by Seller pursuant to this Purchase Order, which are not of Buyer's design, shall be free, in the United States and all countries the United States has entered a bilateral or multilateral trade agreement with, from claims of infringement (including misappropriation) of third party intellectual property rights and that any use or sale of such items by Buyer or any of Buyer's customers shall be free from any claims of infringement. Seller shall indemnify and save Buyer, and its customers harmless from any and all expenses, liability, and loss of any kind (including all costs and expenses including attorneys' fees) arising out of claims, suits, or actions alleging such infringement, which claims, suits, or actions Seller, hereby, agrees to defend, at Seller's expense, if requested to do so by Buyer. Seller may replace or modify infringing items with comparable items acceptable to Buyer of substantially the same form, fit, and function so as to remove the source of infringement, and Seller's obligations under this Purchase Order including those contained in Section 13 and in this Section 16 shall apply to the replacement and modified items. If the use or sale of any of the above items is enjoined as a result of such claim, suit or action, Seller, at no expense to Buyer, shall obtain for Buyer and its customers the right to use and sell said item.
- (c) Buyer's obligations under this section are conditioned on all of the following: Buyer receiving prompt notice of a claim from the Seller. Buyer will be entitled exclusively to control the defense. At the Buyer's expense, the Seller will provide reasonable assistance in defense of the claim including, but not limited to, promptly furnishing the Buyer with all relevant information within its possession or control. Because the Buyer will provide the defense, the Buyer will not be liable for any attorney fees or costs of Seller. The Seller may participate in the defense at its own cost. The Seller may not enter into any settlement, assume any obligation or make any concession without the prior written approval of Buyer, which may not be unreasonably withheld.
- (d) In no event shall Seller be obligated to defend or be liable for any infringement claim arising from (i) the use of the materials in combination with other materials not provided by Seller, where the infringement claim is based on such use and combination to the extent such combination is not reasonably contemplated by the nature of the product produced by Seller (ii) the use of the materials in the operation of any process, where the infringement claim is based on the such use in conjunction with the operation of a process to the extent such use is not reasonably contemplated by the nature of the product produced by Seller (iii) any materials manufactured to Buyer's designs provided that compliance with such design could not have been reasonably accomplished in a non-infringing manner (iv) any materials manufactured by a process directed by Buyer, where the infringement claim is based on the process directed by Buyer provided that compliance with such process could not have been reasonably accomplished in a non-infringing manner

IP indemnity is geographically limited

Seller responsible if product causes harm

Conditions for Seller's defense & indemnity

Seller is only responsible for its negligence. Not responsible for Buyer's negligence...

Exclusions from Seller's defense & indemnity

Disputes & Governing Law

▪ Buyer

- I want a process I'm familiar with
 - Home court advantage
 - Experience in locale
- I'm not necessarily looking to make it easy to resolve
- I don't want to spend a lot of money to resolve

▪ Seller

- I'd prefer a process I'm familiar with as well
- I would like a fair and equitable process to resolve
- I'd like my Sr. management to get a vote in the decision
- I don't want to spend a lot of money to resolve

Bridging the Gap – Disputes & Law

- This Agreement shall be governed and construed in accordance with the Laws of England without regard to its conflict of laws provision.
- Any dispute or difference between the parties hereto arising out of this Agreement or as to its interpretation or construction shall be settled by mutual agreement between the Parties. All disputes shall first be attempted to be resolved through a progressive set of settlement discussions before senior representatives of each Party as follows:
 - First; on behalf of the Seller, the Vice President and a person authorised on behalf of the Buyer. If unable to resolve;
 - Second; the President of Seller and the person authorised by the Buyer for that purpose. If still unable to resolve;
 - Third; the Chief Executive Officer of Seller and the person authorised by the Buyer for that purpose.
- Any Party wishing to commence settlement proceedings shall send a written Request for Settlement to the forenamed representative of the other Party. Following this sequence, if the Parties are still not able to settle, the dispute or difference shall be referred to arbitration for a final and binding settlement and/or decision. The arbitration shall be carried out under the Rules of Conciliation and Arbitration of the International Chamber of Commerce. The arbitration panel shall consist of three Arbitrators, one Arbitrator to be appointed by each party and the third Arbitrator being appointed by the two Arbitrators already appointed. In the event that the two Arbitrators cannot agree upon the third Arbitrator, then the third Arbitrator shall be appointed by the International Chamber of Commerce and the Arbitrator shall not be of Buyer or Seller nationality. The venue of such arbitration shall be in London, England and the language of the arbitration shall be English.

Buyer/Seller neutral venue to resolve Governing law

Buyer Seller establish arbitration process to further mitigate protracted legal process

Buyer Seller address internal dispute procedure to mitigate protracted process

Questions?

