

Clauses we love to negotiate

by Doug Sanders and Chris Eagles

Despite the push towards more efficiency and speed by standardizing contracts for what appear to be standard purchases and practices, the desire to negotiate is still strong between buyers and suppliers, and in many cases “each contract will have specific issues and prevailing market conditions will also dictate what an owner or a supplier can secure within a contract.” Some contract terms seem to require more to negotiate than others. The IACC has identified those.

THE BALANCE BETWEEN the internal pressure for an organization to standardize its contract forms and the competing pressures from industry to modify or negotiate standard terms is not unique. These realities are universal and result from the difference in perspective that often exists between the owner/purchaser and contractor/supplier of goods and services.

A recent study by the International Association for Contract and Commercial Management (IACC) has identified the most negotiated contractual terms. Although the majority of the respondents to the IACC study provide a global perspective, most of the key terms identified by the global pool of negotiators are just as likely to be an issue whether dealing with a multinational corporation or a local supplier.

The top 10 most negotiated terms in 2007, as identified by the IACC study, were: 1) limitation of liability; 2) indemnification; 3) price charge, price changes; 4) intellectual property; 5) termination (cause/ convenience); 6) warranty; 7) service levels; 8) payment; 9) delivery/acceptance; and 10) confidential information.

Let’s consider the top six most negotiated terms identified in the IACC study and why these terms are frequently at issue.

>LIMITATION OF LIABILITY: A limitation of liability is a contractual term that imposes a specified cap on a party’s liability. The cap may be monetary such that regardless of cause, the contractor/supplier will only be liable to the owner/purchaser for a specific maximum amount, or it may be a limitation that excludes liability for certain losses, such as loss of profits. It could also be a time restriction for the owner/purchaser to take action. Another common form of limitation is an exclusion of consequential damages.

The negotiations generally arise because an owner prefers that suppliers have unlimited liability, such that they are responsible for the entirety of the consequences flowing from their actions. Suppliers, on the other hand, seek to limit their liability to the greatest extent possible, in order to ensure that a single “bad” contract does not destroy a company which may have taken years to develop.

>INDEMNIFICATION: An indemnity is fundamentally an agreement by one party to bear financial losses suffered by the other, either broadly or in respect of a particular event or events.

As with limitations of liability, owners generally seek broad indemnities from suppliers, while giving narrow, or no, indemnities themselves, while suppliers seek to narrow the scope of their indemnity obligations and to expand the indemnities provided by owners. Points of discussion are often which events will trigger an indemnity obligation, and what

limits, if any, will be on such obligation. A clearly drafted and understood indemnity is important, as depending on the parameters of the indemnity, an indemnification event can have significant cost implications, either positive or negative, on any party. Indemnities that are not based on cause are particularly divisive.

>PRICE CHARGE, PRICE CHANGES: The pricing and price change provisions of a contract determine the basis upon which the payment and work change provisions operate. Although the parties to an agreement may differ on their specific preference with respect to the pricing of changes, both parties are likely to derive the greatest benefit from carefully, clearly defined provisions.

An example of a pricing term, which can result in uncertainty if not carefully considered, is the issue of responsibility for rework in a cost plus contract. Rework is any work which has been performed and which must be redone for some reason. Owners generally take the position that, if a supplier must re-perform a certain percentage of its work due to deficiencies, the owner should not be required to compensate the supplier for all the time and materials spent in performance of the rework, plus the supplier’s markup. Contractors take the view that cost plus places all risks, including rework, with the owner.

>INTELLECTUAL PROPERTY: Intellectual property can be patents, trademarks or copyright. A provision for intellectual property within a contract deals with the rights of ownership of any intellectual property created as part of the supply.

Rights of ownership of intellectual property in many contracts is often a source of contention as it is the supplier who is developing the intellectual property and it is the owner who is paying for the supplier to develop such and make use of the intellectual property in connection with the contract. As a result, negotiations take place over what the parties' rights will be with respect to any intellectual property created which may be of value to either party.

Prior to entering into a contract, parties must thoroughly consider what intellectual property may be created during the course of the contract and what rights a party desires with respect to the property. An example of intellectual property on a construction project may be the copyright in the design. The design may have been an improvement that the supplier wishes to implement on future projects. On the other hand, the owner has purchased the design and may not want anything unique used on any other project. Depending on the circumstances, these contrary positions may be alleviated through creative legal solutions which may allow all parties to achieve a mutually desirable result.

>TERMINATION: A termination clause is the right for one party to terminate the contract for some reason and such can have a significant impact on the risks of a contract. Not only is it necessary to consider the events which may trigger a right of termination, it is equally important to consider how a contractual termination will effect the parties other contractual rights.

Owners will often seek the right to terminate a contract for convenience and only allow the supplier the opportunity to terminate on the occurrence of extraordinary events such as an owner bankruptcy or extended *force majeure*. The supplier will want the right to terminate on a breach of a contract by the owner, particularly for defaults in payment, or the occurrence of other owner breaches. Furthermore, a supplier will generally seek lost profits and compensation for overheads if the termination was not attributable to the supplier.

Depending on the nature of the contract, a termination can cause a multitude of issues, especially if it is mid-term. Considering the significant risk a supplier faces with respect to the prospect

of termination, careful consideration must be given to what triggers a right of termination and what consequences flow from such termination. Furthermore, it is important to identify the contractual rights that will survive a termination of the contract, if any, and what termination events will trigger a right of compensation together with the components of such compensation.

>WARRANTY: A warranty specifies the supplier's responsibility following the supply. Notwithstanding any contractual provision speaking to warranty, consideration must be given to the legislation within the relevant jurisdiction of statutory warranties. While some warranties are coupled with limitations of liability (i.e. consumer product warranties), most warranties provide additional supplier obligations to remedy defects within the supplied good or service.

Of course, owners want long, comprehensive warranties and suppliers want short, limited warranties. The supplier also will not wish to be responsible for latent defects for an extended period of time. More detailed negotiations often surround certain aspects of a project having different warranty periods than others. Important factors to consider with respect to warranty are the scope of work, complexity of the supply, and durability of the products installed.

Although most of these negotiated terms will not surprise anyone involved in contract administration or negotiation, these concerns are of a universal nature. They are also re-occurring concerns that cannot adequately be solved with boilerplate terms and conditions, particularly if the "standard" terms and conditions are to be used for various contracts. Each contract will have specific issues and prevailing market conditions will also dictate what an owner or a supplier can secure within a contract. Nevertheless, it is paramount that all owners and suppliers are aware of the implications of all contractual terms and their respective importance in assessing the risks and ramifications of entering into a contract. 

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