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## How to Negotiate a Sales Contract

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# How To Negotiate a Sales Contract

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*by James J. White*

All section references are to the UNIFORM COMMERCIAL CODE ("UCC"); and "Proposed section" refers to the July 29-August 5, 1994 DISCUSSION DRAFT UNIFORM COMMERCIAL CODE REVISED ARTICLE 2. SALES (American Law Institute-National Conference of Commissioners on Uniform State Laws 1994).

## **A. Introduction**

1. In my experience, lawyers begin negotiating only after the business people have decided upon the description and quality of the product, the time of delivery, and the mode and amount of payment. The lawyers are left with the pathological problems – who gets what in case of trouble.
2. Most of those pathological problems relate to the seller's responsibility if the product does not conform to the contract or otherwise fails to please the buyer. These failures can cause economic loss to the buyer, economic loss to a remote purchaser, or personal injury or property damage to immediate or remote parties.
  - a. Third parties may have relationships with the buyer or a remote purchaser or may themselves be remote purchasers of the product.

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A complete set of the course materials from which this outline was drawn may be purchased from ALI-ABA. Call 1-800-CLE-NEWS, ext. 1650, and ask for S965.

- b. To give a nonexclusive list, potential plaintiffs suing the manufacturer/seller could be the buyer, remote buyers, employees of either, or third parties who are unrelated (bystanders to an accident) or who are actually purchasing the use of the product (passengers on an airplane that crashes).
- c. One way to organize your thinking is to visualize all of the potential plaintiffs and to speculate about all of the potential causes of action that they might assert against the original seller and against people that might intervene between the original seller and the plaintiff.

## B. A Liability Checklist

### 1. Check for potential forms of liability.

- a. *Description of the Product – Section 2-313.* The description of the product in a commercial deal may be simple or elaborate.

- i. Whether it amounts to a one-line description on an invoice or a 40-page document including detailed specifications in the sale of a complicated piece of industrial equipment, you must always consider section 2-313 and the express warranties. All descriptions in or associated with the contract are likely to be express warranties and those warranties will always run to the buyer and may run to the remote parties. A particularly vexing problem, though an infrequent one, is the question of the liability of third parties arising out of noncontractual documents such as advertisements, advertising brochures, and the like. I consider those below.

- b. *Implied Warranties of Merchantability and Fitness – Sections 2-314, 2-315.*

- i. Fitness for an ordinary purpose is a broad warranty; it is often ignored by or unknown to the business people, but it provides powerful and pervasive liability that the parties should address.

- ii. Fitness for a purpose should almost never arise in a well drafted contract negotiated between two sophisticated parties. Rarely does a sophisticated party place the kind of knowing dependence upon seller's assurances that section 2-315 requires. For that reason, section 2-315 should seldom be a problem for the seller and seldom offers much hope for a buyer.

- c. *Misrepresentation and Similar Torts.*
- d. *Negligence, Strict Liability Under Restatement of Torts (Second) §402(A)* (ALI, Philadelphia 1965), and similar “products liability” torts.
- e. *General Liability in Contract Other Than Warranty.*

2. Consider ways of removing or limiting the seller’s liability.

- a. *Disclaimer – Section 2-316.* Section 2-316 gives a blueprint for disclaiming the warranty of merchantability – a conspicuous writing that mentions merchantability. It also states that express warranties trump disclaimers of express warranties.
- b. *State the Parties’ Liabilities.* Apart from warranties there may be duties in the contract that the seller or buyer must perform and if they are unwilling to bear liability for failure to perform those duties, the duty should be removed from the contract. To leave the duty and attempt to limit the liability as described below is more treacherous than a straightforward negotiation for removal of the obligation.
- c. *Specific References to Torts.* The law of most states provides that tort liability can be disclaimed if the disclaimer is sufficiently prominent and specific. A legal realist might question those statements, for they often appear in cases in which the seller defendant has tried but failed to disclaim liability for a tort and thus the court’s statement is dictum; it rings hollow in the ears of a disappointed defendant who, before the fact, thought he had done exactly what the court has told him that he did not do. To disclaim tort liability, it is important to be explicit and it is advisable to list torts that are to be disclaimed in detail. An unhappy buyer may assert two different kinds of tort:
  - i. The tort of misrepresentation or fraud; and
  - ii. Torts such as negligence, strict tort, and products liability for personal injury or property damage.
- d. You should not be satisfied with a general reference to strict tort if, in the relevant state, the “strict tort” cases are tried and labeled as “products liability.” For these torts, general language cannot be carried from one state to another.

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**COURSES**

Information: Ext. 1630; To Register: Ext. 1631

**The Emerged and Emerging New Uniform Commercial Code** (New York; December 7-9; *Call for price information.*)

**AUDIOTAPES**

Information: Ext. 1605; To Purchase: Ext. 1651

**The Emerged and Emerging New Uniform Commercial Code**  
(Course of Study; 1993; \$360)

**BOOKS**

Information: Ext. 1619; To Purchase: Ext. 1650

**Consumer Product Warranties under Federal and State Laws**

by Curtis R. Reitz (2d ed. 1987; \$83 + \$3 s/h)

**The Law of Sales**

by Ray D. Henson (1985; \$76 + \$3 s/h)

**A Transactional Guide to the Uniform Commercial Code**

by Richard M. Alderman (2d ed. 1983, with 1987 Supp.; \$217 + \$7.50 s/h)

**PERIODICALS**

Information: Ext. 1604; To Purchase: Ext. 1650

**Reviewing and Revising Draft Transactional Documents (A Checklist)**

by Louis M. Brown, *The Practical Lawyer*, June 1990, p. 63 (\$7.75)

**Warranties and Remedies for Their Breach Under  
the Uniform Commercial Code**

by Ray D. Henson, *The Practical Lawyer*, July 1985, p. 31 (\$7.75)

3. *Limitation of Remedies.* Limitation of remedies is and should be considered an alternative route to the same destination as disclaimer of liability. If there is no liability, there can be no remedy; if there is liability, but only a limited remedy, the remedy sought by the plaintiff may not be available and the result may be the same under either case.
  - a. "Repair and replace" or similar limitations on remedies are also acceptable, but these remedies are subject to two limitations:
    - i. Failure of essential purpose – if the seller promises to repair, but cannot or will not, the remedy "fails" and other remedies will be available. Here it is important to divorce the consequential damage limitation from the repair and replace theory so one bullet does not strike them both down.
    - ii. Section 2-719 states that remedies are cumulative (that is, "repair and replace" does not displace other remedies unless it is stated to be the exclusive remedy). You should copy the language of section 2-719 in a case in which the client wishes a remedy to be the exclusive remedy – as almost always is the case.
  - b. Under section 2-719, an agreement barring consequential damages is permitted and is presumptively bad only in the case of personal injury.
  - c. Certain terms (such as the take or pay term in gas sale contracts) are sometimes construed to be agreed remedies. It is important to think through exactly what a clause says (e.g., "Buyer may take its gas annually, but need not do so if it pays for it. When buyer has paid, it may take the gas in any five succeeding years."). Is that an agreed remedy? If it is, what does it mean and how is it tested? Under section 2-719? Or as a liquidated damage clause under section 2-718? If it is neither, how is it to be interpreted?
  - d. Consider also the rights to cure, cancel, and modify under section 2-609.
4. *Agreed Statute of Limitations – Section 2-725.* Compare current section 2-725 with proposed section 2-725(c), alternative 2.
  - a. Section 2-725 authorizes a reduction to one year but not less. If one year is agreed on, when does that year start? Many contracts are an-

biguous (e.g., “three years or 30,000 miles”). Must one sue within three years or is it enough that the defect appears within that time?

5. *Choice of Forum*. The courts of New York? Arbitration? For a plaintiff, Heaven is juries from Texas, and for a defendant that would be Hell.
6. *Contractual Notice*. Compare section 2-607(3) of the current UCC with proposed section 2-606(c)(1). Consider a contractual notice requirement.
7. *Liability Terms*. The negotiation of the liability terms of sales contracts presents special problems.
  - a. Should you engage in a battle of the forms or a face-to-face negotiation?
    - i. Both current 2-207 and proposed 2-207 disadvantage the seller if the contract is made by an exchange of forms. Rarely, the seller gets some varying term into the contract under section 2-207(1) or 2-207(2).
    - ii. If the buyer’s form is well drafted, it will conflict with seller’s form on the important provisions and the parties will be left (under both proposed and current section 2-207) with the terms of the UCC.
    - iii. Typically, that means that the buyer enjoys the benefits of section 2-314 (expansive implied warranties) and the benefits of all forms of damage remedies, including consequential damages.
    - iv. Moreover, a buyer who uses a “mine and mine only” term typically escapes the seller’s statute of limitations restriction and other terms that may improve the seller’s position. The only certain cure for a seller is to insist on a negotiation of the terms. There is no term a seller can put into the contract that will defeat an equally clever term on the buyer’s form.
8. *Rights of Third Parties*. Since the first seller cannot negotiate with remote buyers, it will not be possible for the seller to get a direct agreement from remote parties. Consider some alternatives that a seller might pursue who is concerned about suits by remote buyers.
  - a. You can examine the existing section 2-318 and the proposed section 2-318. In some circumstances the proposed law is better than the existing

law and will limit the rights of remote buyers to the same rights that would have been enjoyed by the initial buyer. At best section 2-318 will limit the remote buyers' claims under Article 2. It does not touch claims in tort.

- b. The seller might get an indemnity from the first buyer to protect the seller against the claims of remote buyers.
  - c. The first seller might get an intermediate buyer's agreement to have the ultimate purchaser sign a disclaimer or limitation of remedies that protects the original seller.
9. *General Duties Versus Specific Duties.* Section 2-317 states that explicit express obligations override implied obligations when there is a conflict. This section has been used with little success by sellers who give express warranties (e.g., three years or 30,000 miles) to consumers. Not surprisingly the courts have been generous in finding that such warranties are cumulative and not in conflict. In commercial cases express warranties may be found to conflict with and so cancel implied warranties.

### C. Hypothetical Cases

1. Assume a seller who manufactures expensive earth-moving equipment. Each unit of equipment used in open pit mining costs \$400,000; the equipment is sold to a distributor who sells it to the miner. Invariably the miner is insured. Further assume that the equipment is destroyed in a fire – arguably caused by a defect in the equipment – without injury to any person or to any other property. The insurer of the remote buyer sues manufacturer. The complaint alleges breach of contract, breach of warranties (express and implied), strict tort, negligence, and possibly misrepresentation plus local variants on product liability.
  - a. Consider the defenses that would be raised and then consider what might have been done on the seller's behalf in the original contract:
    - i. No rights in this third party, section 2-318;
    - ii. No tort claim because of "economic loss" doctrine;
    - iii. No timely notice (contractual or statutory), section 2-607(3); and
    - iv. Statute of limitation (contractual or statutory, section 2-725).



2. Buyer manufactures light planes; seller manufactures the engine for the plane. Seller makes certain changes in its stock engine so it will fit buyer's aircraft and seller makes explicit warranties about the performance of its engine in general without warranting its performance in this particular application. The engine overheats and requires an early overhaul in the buyer's airplane. Buyer sues seller for breach of the implied warranty of merchantability and fitness for a particular purpose. Assume that the express warranties given by the seller to the buyer (power output and fuel use on a test stand) are not broken, but buyer nevertheless claims breach of the implied warranties of merchantability and fitness for a particular purpose. Is there a warranty under section 2-315, and, if so, is it limited by the terms of section 2-317?
  - a. In the foregoing case, assume that various employees of seller and buyer worked on the engine after early indications of overheating. When, after many failures two years later, the buyer sues the seller, the seller argues that the buyer's suit is foreclosed by section 2-607(3) (or alternatively by proposed section 2-606(c)(1)). In which, if either, case will that be an effective defense for the seller?

#### **D. Conclusion**

1. When negotiating a sales contract, contemplate all potential plaintiffs and all potential causes of action that might emerge from the contract.
2. Use a liability checklist to identify the essential terms of the contract that you must address in your negotiations.
3. Give special attention to the negotiation of the liability terms of the sales contract.
  - a. Weigh the advantages and disadvantages of face-to-face negotiations as opposed to a battle of the forms.
  - b. Consider the rights of third parties.
  - c. Remember that express obligations override implied obligations, except in consumer contracts.