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Critical Rules in Negotiating Sales Contracts:
The Lawyer's Job

By

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A. 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. Most of those 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. Third parties may have relationships with the buyer or a remote purchaser or may themselves be remote purchasers of the product. To give a nonexclusive list, potential plaintiffs suing the manufacturer/seller (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). One way to organize one's 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. Potential forms of liability

   a. Section 2-313. The description of the product in a commercial deal may be simple or elaborate. Whether it amounts to a one-line description on an invoice or a forty-page document including detailed specifications in the sale of a complicated piece of industrial equipment, one must always consider 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 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

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 should be addressed by the parties.

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 2-315 requires. For that reason, 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 tort under 402(A) and similar "products liability" torts.

e. General liability in contract other than warranty.

2. Ways to remove or limit the seller's liability.

a. Disclaimer. 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. Specific drafting of the contract to state 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 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 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: (1) the tort of misrepresentation or fraud and (2) torts such as negligence, strict tort, and products liability for personal injury or property damage. One 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." This is a place where general language cannot be carried from one state to another.
3. Limitation of Remedies

a. 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.

b. "Repair and replace" or similar limitations on remedies are also acceptable, but these remedies are subject to two limitations:

(1) failure of essential purpose--if 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 that one bullet does not strike them both down.

(2) Section 2-719 states that remedies are cumulative (i.e., "repair and replace" does not displace others unless it is stated to be the exclusive remedy). One should copy the language of 2-719 in a case in which he wishes a remedy to be the exclusive remedy--as almost always is the case.

c. Denial of Consequential Damages

Under Section 2-719, an agreement barring consequential damages is permitted and is presumptively bad only in the case of personal injury.

d. Take or Pay and the Like

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 in any five succeeding years."). Is that an agreed remedy? If it is, what does it mean and how is it tested? Under 2-719? Or as a liquidated damage clause under 2-718? If it is neither, how is it to be interpreted?

e. Rights to cure; to cancel; modification of Section 2-609

4. Agreed Statute of Limitations, 2-725.
   Compare current 2-725 with proposed 2-725(c) alternative 2.

   The statute authorizes reduction to one year but not less. If one year is agreed upon, when does the year start? Many contracts are ambiguous. (E.g., "3 years or 30,000 miles"). Must one sue within 3 years or is it enough that the defect appears within that time?


   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 2-607(3) of the current UCC with Proposed 2-606(c)(1). Consider a contractual notice requirement.

C. Special Problems in the Negotiation of Liability Terms of Sales Contracts

1. Battle of the Forms or face to face negotiation?

   Both current 2-207 and proposed 2-207 disadvantage the seller if the contract is made by exchange of forms. Rarely the seller
gets some varying term into the contract under 2-207(1) or 2-207(2).

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 revised and old 2-207) with the terms of the UCC. Typically that means that the buyer enjoys the benefits of 2-314 (expansive implied warranties) and the benefits of all forms of damage remedies, including consequential damages. Moreover, 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 seller is to insist upon 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.

2. 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 might be pursued by a seller who is concerned about suits by remote buyers. First, one can examine the existing 2-318 and the proposed 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 2-318 will limit the remote buyers’ claims under Article 2. It does not touch claims in tort. Second, the seller might get an indemnity from the first buyer to protect the seller against the claims of remote buyers. Third, 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.
3. 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.

D. 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. 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. Insurer of 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.

Consider the defenses that would be raised and then consider what might have been done on the seller’s behalf in the original contract:

a. No rights in this third party, 2-318.

b. No tort claim because of "economic loss" doctrine.

c. No timely notice (contractual or statutory), 2-607(3).
d. Statute of limitation (contractual or statutory, 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 early overhaul in 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 2-315, and, if so, is it limited by the terms of 2-317?

3. 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 2-607(3) (or alternatively by revised 2-606(c)(1)). In which if either case will that be an effective defense for the seller?
Revised Section 2-207. When Varying Terms Are Part of the Contract.

(a) In this article, "varying terms" means terms prepared by one party and contained in a standard form writing or record.

(b) If an agreement of the parties contains varying terms, a contract results if Sections 2-204 and 2-206 are satisfied.

(c) Varying terms contained in the writings and other records of the parties do not become part of a contract unless the party claiming inclusion proves that the party against whom they operate expressly agreed to the terms or assented to and had notice of the terms from trade usage, previous course of dealing or, course of performance. Between merchants, the burden of proof is by a preponderance of the evidence. Otherwise, it is by clear and convincing evidence.

(d) If a contract with varying terms is formed under subsection (a), the terms are:

(1) terms upon which the writings or records agree;

(2) terms varying terms included under subsection (c);

(3) terms to which the parties have otherwise agreed; and

(4) any supplementary terms incorporated under any other provision of this [Act].

Revised Section 2-313. Express Warranties By Affirmation, Promise, Description, or Sample.

(a) Except as otherwise provided in subsection (b):

(1) An affirmation of fact or promise by the seller, including a manufacturer, made directly or through a dealer to the buyer which relates to the goods presumptively becomes part of the agreement
between the seller and buyer and creates an express warranty that the goods will conform to the affirmation or promise. To create an express warranty by affirmation or promise, it is not necessary that the seller use formal words, such as "warrant" or "guarantee", or have a specific intention to make a warranty.

(2) A description of the goods presumptively becomes part of the agreement between the seller and buyer and creates an express warranty that the goods will conform to the description.

(3) A sample or model that is made part of the agreement presumptively creates an express warranty that the whole of the goods will conform to the sample or model.

(b) An express warranty is not created under subsection (a) if the seller establishes by clear and convincing evidence that the buyer was unreasonable in concluding that an affirmation, promise, description, or sample became part of the agreement.

(c) Except as otherwise provided in subsection (d), a description, affirmation of fact, or promise made by a seller, including a manufacturer, to the public which relates to goods to be sold presumptively creates an express warranty to any buyer that the goods will conform to the description, affirmation, or promise. Subject to Section 2-318, the buyer may enforce the express warranty directly against the seller, whether or not the express warranty is part of the contract with the buyer's immediate seller.

(d) An express warranty is not created under subsection (c) if the seller establishes that the description, affirmation of fact, or promise:

(1) was made more than a reasonable time before or after the sale;

(2) was made to a segment of the public of which the buyer was not a part; or

(3) resulted from a mistake upon which the buyer did not reasonably rely.
Revised Section 2-318. Extension of Express or Implied Warranties.

(a) A seller's express or implied warranty, made to an immediate buyer, extends to any person who may reasonably be expected to buy, use, or be affected by the goods and who is damaged by breach of the warranty. In this section, "seller" includes a manufacturer, "goods" includes a component incorporated in substantially the same condition into other goods, and "protected person" means a person to whom a warranty extends under subsection (a).

(b) Except as otherwise provided in subsection (c), the rights and remedies of a protected person against a seller for breach of a warranty extended under subsection (a) are determined by the enforceable terms of the contract between the seller and the immediate buyer and this article.

(c) A buyer's rights and remedies for breach of a warranty are determined under this article, as modified by subsection (d), without regard to privity of contract or the terms of the contract between the seller and the immediate buyer if:

(1) the buyer is a consumer to whom a warranty was extended under subsection (a) and the Magnuson-Moss Warranty Act applies or the seller is a merchant under Section 2-314(a) who sold unmerchantable goods; or

(2) the buyer is a member of the public to whom an express warranty was made by the seller under Section 2-313(c) or (d).

(d) A buyer under subsection (c) has all of the rights and remedies against a remote seller provided by this article, except as follows:

(1) To reject or revoke acceptance, notice must be given to the remote seller within a reasonable time after the buyer discovers or should have discovered the breach of warranty.

(2) Upon receipt of a timely notice of rejection or revocation of acceptance, the remote
seller has a reasonable time either to refund the price paid by the buyer to the immediate seller or cure the breach by supplying goods that conform to the warranty. If the seller complies with this paragraph, the remote buyer has no further remedy against the seller, except for incidental damages under Section 2-715(a). If the remote seller fails to comply with this subsection, the buyer may claim damages for breach of warranty, including consequential damages under Section 2-715(b).

(3) Except as provided in paragraph (2), a buyer has no right to consequential damages unless expressly agreed with the remote seller.

(4) A claim for relief for breach of a warranty extended under subsection (a) or created under Section 2-313(a)(3) accrues no earlier than the time the remote buyer discovered or should have discovered the breach.

(e) A seller may not exclude or limit the operation of this section.


(1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or

(b) fails to make an effective rejection (subsection (1) of Section 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller’s ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of apart of any commercial unit is acceptance of that entire unit.
Revised 2-606(c)(1): If a tender has been accepted, the following rules apply:

(1) The buyer, within a reasonable time after the buyer discovers or should have discovered a breach, shall notify the seller of the breach. However, a failure to give proper notice does not bar the buyer from any remedy that does not prejudice the seller.

Revised Section 2-725(c) second alternative

(c) If a breach of warranty or indemnity occurs, [a claim for relief] accrues when the buyer discovers or should have discovered the breach.