FEES & BURGESS, P.C.

SUPPLY CHAIN MANAGEMENT MEMO

Volume 6, Issue 4 November 2009

MANAGING CONTRACTUAL ISSUES WHILE JUGGLING THE DUAL ROLES OF BUYER AND SELLER

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- **Corporate Law & Government Contracting**
- **Insurance Defense**
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- **Corporate Counsel Services**

Most companies routinely find themselves playing the role of buyer and seller when trying to provide goods or services to their customers. In these situations, the company in the middle will typically have contractual terms it has negotiated with both its customer and one or more subcontractors or suppliers who are supporting the contract with the company's customer. Something that people often overlook in these kinds of arrangements is provisions in their contract with one party that can impact their relationship with the other party. These issues are particularly common when one or both contracts apply to more than one delivery of goods or performance of services. Failure to account for these potential contracting conflicts can expose companies to potential liability, or result in an inability to adapt to changes as they occur.

One reason why there might be a disconnect between a company's contract with its customer and its contract with its supplier/subcontractor is that different personnel were involved in negotiating the two contracts. For example, a company might have a sales department and a purchasing department, with each handling one contract or the other. If a company is going to use different employees to negotiate the various contracts relating to a project or transaction, it is critical that the employees communicate with one another during the negotiation of all the contracts involved to prevent contracting gaps or conflicts.

Part of the danger in being in the middle is that many companies in this position choose to deal with their customers or their subcontractors/suppliers using boilerplate forms, without considering how the use of non-boilerplate terms with the party on the other side of the equation can create problems. One of the areas where this commonly occurs is with termination provisions. For instance, say ABC Corporation (ABC) negotiates a one-year, customer-specific contract for the sale of manufactured goods with its customer that gives the customer the right to terminate the contract after giving fifteen days written notice of its intent to terminate. ABC then turns around and enters into a one-year contract with supplier XYZ Corporation (XYZ) for the provision of specialized parts that are incorporated into the products for ABC's customer. However, rather than drafting a supplier-specific agreement with XYZ, ABC decides to use a boilerplate supplier agreement drafted by its legal counsel as a supposed "one size fits all" contract.

The problem with this particular form agreement is that it only allows ABC to terminate its contract with XYZ or cancel open purchase orders issued pursuant to the contract after providing thirty days written notice to XYZ.

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Managing Contractual Issues While Juggling the Dual Roles of Buyer and Seller

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In this scenario, if ABC's customer gives ABC notice today that it is terminating their contract in fifteen days, the best ABC can do is give XYZ notice that ABC wants to terminate their contract and cancel all open orders in thirty days. This may mean that ABC is stuck having to accept parts it ordered from XYZ that will not be consumed by ABC's customer.

The lesson to be learned here is that if your contract with your customer allows the customer to terminate the agreement or cancel orders placed with you after giving so many days written notice, your contract with any supplier or subcontractor providing goods or services in support of your contract with the customer needs to specify that you have the right to terminate your contracts/orders with the supplier or subcontractor after a shorter notice period.

Similar issues can arise in the area of schedule flexibility. If your contract with your customer allows the customer to move up or push back delivery or performance deadlines, your contract with any underlying supplier or subcontractor needs to allow the same amount of flexibility, if not more.

Sometimes flexibility in your contractual relationship with a supplier or subcontractor can end up impacting your relationship with your customer. One example of where this can occur is with price changes. Using the example above, if ABC's contract with XYZ states that the parties will review pricing for the parts provided by XYZ quarterly and make appropriate adjustments to account for changes in the market, ABC's contract with its customer needs to expressly allow for corresponding price adjustments. This is another area where the use of boilerplate terms with one party might create an issue. Let us assume ABC does not have a long-term contract with XYZ, and is instead purchasing parts from XYZ using ABC's standard purchase order form, issued periodically based on demand. After ABC submits its first order for parts at a given price, there is probably nothing in ABC's purchase order terms and conditions preventing XYZ from quoting a higher price to ABC the next time ABC wants to submit an order. Once again, this is a situation where the contract between ABC and its customer needs to allow for adjustments in price.

Another issue that is sometimes overlooked is obligations expressed in the company's contract with its customer requiring the company to flow down certain contractual terms to a supplier or subcontractor. This issue arises under almost every contract where a government entity (whether city, county, state, or federal) is the customer, but mandatory flow down provisions are also occasionally seen when contracting with customers in the private sector. The key here is to make sure, if your contract with the customer requires you to include certain provisions in your contracts with suppliers or subcontractors, that you actually incorporate those terms into your contracts with suppliers or subcontractors. It sounds like common sense, but you would be surprised how often this is not done, especially when different employees within the company are involved in negotiating the two contracts.

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This is another one of those areas where using boilerplate purchase order terms to purchase goods or services from a supplier or subcontractor can get you in trouble.

If a customer inserts an obligation into their contract with you mandating that you flow down a contract term, chances are pretty good that your failure to do so will leave you with a dissatisfied customer, if they discover the omission. Even worse, if the supplier or subcontractor engaged in some form of conduct that is in violation of the contract provision that you failed to include in your contract with them, you could find yourself getting sued by your customer. Worse yet, if your customer is a government entity, you might find yourself facing fines, suspension, debarment, and/or criminal charges, depending on the provision you failed to flow down that was violated.

The underlying lesson here is to avoid tunnel vision when negotiating contracts. If the contract terms you negotiate while playing the role of buyer might have an effect on your relationship as a seller, or vice versa, you need to make sure that the terms you negotiate in both roles are in sync.

Calendar of Events
Coming in 2010 watch our site for dates.
feesburgess.com

Huntsville, Alabama

International Commercial Contracting: Identifying, Avoiding, and Managing Risk Areas

Topics to be discussed are:

- What unique risks are involved with international contracts dealing with the sale of goods?
- How to identify, allocate, and manage risks in international contracting?
- Which laws apply to international contracts and when?
- What are the practical differences in drafting domestic and international contracts?
- How are disputes resolved between international contracting parties?
- How can a party secure the other party's performance?
- Will U.S. laws apply outside of the U.S. to international contracts?

Session 1: Introduction to International Contracting
Session 2: Drafting 101
Session 3: Drafting 101 Continued
Session 4: Special Considerations in International Contracting

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Calendar of Events

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Huntsville, Alabama

Negotiation and Resolution of Federal Government Contractor Claims under the Contracts Disputes Act

Attendees of this program will learn how to prepare, negotiate, and submit contract disputes to the government for resolution under the Contract Disputes Act of 1978, as well as options for appealing claims denied by the government. Included in this program will be a discussion of:

- the disputes process generally
- definition and elements of a claim under the Act
- drafting a claim and costs recoverable
- subcontractor "pass through" claims
- negotiation prior to requesting a Contracting Officer's final decision
- alternate methods of dispute resolution
- "deemed denials" of final decision requests
- appealing the final decision of the Contracting Officer

This course is designed to meet the requirements of the National Contract Management Association's (NCMA) certification programs for 1 hour of CPE.

For more information *click here*.

Huntsville, Alabama

Uniform Commercial Code/ CCCM Certification Training

Presenters: Allen L. Anderson and Jeffrey L. Roth of Fees & Burgess, P.C.

The program consists of 6 hours of training in one day covering an overview of the Uniform Commercial Code, Articles 1, 2, and 2A. This training, similar to the basic material presented by the same presenters for the National Contract Management Association at its 2009 World Congress held in Long Beach, California, was used as a fasttrack study session as preparation for the Certified Commercial Contracts Manager exam.

Continuing education credits will be applied for from the Institute for Supply Management (ISM) and the National Contract Management Association (NCMA).

To view agenda, click here.

**** 10% or more discount for additional attendees from the same firm/company. Also ask for the special NCMA and ISM member discounts.***

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SPEAKERS

Fees & Burgess, P.C., provides speakers, training programs, seminars, and webcasts for various trade associations; business groups; and clients. For information regarding a program contact Sylvia Taylor at staylor@feesburgess.com.

To remove your name from our mailing list, please e-mail staylor@feesburgess.com.

NEWSLETTERS

Fees & Burgess, P.C., also publishes *F&B Quarterly Bytes* focusing on multiple practice areas and *F&B HR Corner* focusing on human resource issues. To receive any of these e-newsletters, please provide Sylvia Taylor at staylor@feesburgess.com with your contact information.

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