Attorneys:

- **Russell F. Anderson**
  randerson@pullcom.com
  203.330.2271
- **Andrew C. Glassman**
  aglassman@pullcom.com
  860.541.3316
- **Nancy A. D. Hancock**
  nhancock@pullcom.com
  203.330.2118
- **Lee D. Hoffman**
  lhoffman@pullcom.com
  860.424.4315
- **Brion J. Kirsch**
  bkirsch@pullcom.com
  860.424.4349
- **D. Robert Morris**
  rmorris@pullcom.com
  203.330.2109
- **Gary B. O'Connor**
  goconnor@pullcom.com
  860.424.4366
- **Kelly F. O'Donnell**
  kodonnell@pullcom.com
  203.330.2264
- **Karen P. Wackerman**
  kwackerman@pullcom.com
  203.330.2278

Battle of the Forms

A Cautionary Tale for Suppliers

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by Andrew C. Glassman

Your company has just been awarded its biggest contract ever and everyone in the sales department is joyously high-fiving each other. This contract for clips will put the company on a whole new growth trajectory now that Air National has accepted you as a preferred supplier. You know this because you just took the call from Air National's EVP of Procurement, who said that she and her team were impressed with your company's focus on quality. A confirmatory email follows with Air National's first purchase order (PO) for 10,000 clips. This PO consists of two pages: the first is an order form which specifies part numbers, pricing, volume requested and dates of delivery; the second page contains Air National's terms and conditions regarding delivery site, warranty and quality standards, change of specification process, product liability obligations to be imposed on your company and a clear expression that Air National has the right to seek recourse from your company for defective clips or clips that are not within specifications. There is also reference to a web address where the Air National Quality Manual can be found. This manual is incorporated into the Air National terms and conditions.

You immediately fire an email back to Air National with your invoice, which contains your company's own form of terms and conditions, confirming acceptance of the PO. Your terms include a limitation of damages to the price paid under the contract for the parts, a limitation of remedy to repair or replacement of defective clips, a limited warranty which merely provides that the clips will be manufactured to the specs within tolerance and that process changes or product configuration changes are subject to negotiation on price. In your excitement to go into production with the clips, and your confidence that the relationship with your new customer will be long and productive, you never focused, or even thought about, the differences in the two sets of terms and conditions and the problems those differences could create.

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This scenario is repeated daily in production facilities across the country. What also is occurring more frequently is that original equipment manufacturers (OEM), under extreme pressure from their end-user customers, are asserting claims against their downstream suppliers based on quality and pricing issues. The terms and conditions that are applicable here have an enormous effect on the outcome of these claims.

This means it's time for you to understand how the law deals with these differing sets of terms and conditions – the customer's and yours.

The law describes this scenario as a "battle of the forms," because the parties have crafted and delivered competing and conflicting writings. This scenario can produce a wholly unintended contract. While a fact finder, be it a judge, a jury or an arbitrator, may conclude that there was no contract because the parties' minds never met on all essential terms, modern commercial law allows a fact finder to determine that a contract was formed even when there are contradictory terms and conditions passed back and forth. Implicit in this conclusion is that there was sufficient agreement to create a valid, binding contract.

What does this mean? How can there be a contract with conflicting terms? And if there is a contract with terms in conflict, what happens to those terms when a dispute arises? The answer is found in UCC § 2-207, which provides a statutory basis for a court to eliminate conflicting terms and conditions in competing writings and to deem contractual only those terms that are consistent. See UCC § 2-207(3).

The biggest problem for downstream suppliers in this regard occurs when the customer's terms and conditions acknowledge that you can be liable per UCC §2-715 for an award of incidental and consequential damages, but your terms and conditions say clearly and unambiguously that you will not be liable for these types of damages. Per UCC 2-207, both these provisions can be eliminated and replaced with a very broad right in favor of your customer. The result for you – liability for consequential damages – can be devastating. Imagine, for a moment, that one of the parts you shipped is defective, and as a result, your customer's assembly line is shut down until the defective part is discovered and removed. The customer's employees are called in, but are idled due to the shutdown and other parts suppliers or fabricators are halted in their work. For an error with a fifteen cent part, you could be facing millions of dollars of liability. Consequential damage claims just like this are regularly asserted by the big volume production companies because their customers specifically impose these charges on them and demand to be made whole if they suffer any loss in production or delay in supply.

Based on your failure to recognize, consider and overcome the battle of forms problem at the contract formation stage, you may be unwittingly assuming this type of liability with potentially disastrous results.

The lesson is this: pay attention at the contract formation stage to the battle of forms and where the terms and conditions of each party conflicts, negotiate the best protections you can get. You may not get any protections at all, but at least you will know what your exposures are and can plan for them accordingly – or you can walk away. And, of course, you may achieve sufficient protection to avoid the most disastrous of

consequences, and that can be enough to conclude that the rewards are worth the risk.

For assistance with these issues contact Andrew C. Glassman in our Manufacturing Practice.