

Key Terms and Conditions for Buyers and Sellers in the Supply Chain

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Commercial forms – such as quotations, purchase orders and invoices – and associated terms and conditions are ubiquitous in the supply chain and often the only contract that exists between a buyer and seller. When used correctly, these forms operate as an efficient way of documenting the parties' understanding regarding their agreement, avoiding the need to negotiate a complicated contract. Often times, however, businesses treat these form sales documents too casually, and do not properly consider the implications of the exchange of conflicting printed terms.

As the global economy continues to grapple with labor shortages, supply chain disruptions, and elevated prices, it is more important than ever for businesses to think carefully about their quotations and terms and conditions of sale (for sellers) and purchase orders or terms and conditions of purchase (for buyers). Well-crafted terms help both sides manage risk and avoid unnecessary costs. This article provides an overview of some of the key terms buyers and sellers should include in their sales documents to protect their interests.

Key Terms for Buyers in the Supply Chain

Buyers look to their suppliers to be dependable and deliver as promised. Sound contract terms are necessary to protect buyers when problems arise.

1. Disclaim Seller's Terms

One common pitfall a buyer faces is failing to disclaim its seller's terms and conditions. When, as is

commonly the case, a buyer and seller both attach their respective standard terms and conditions to purchase orders, invoices and confirmations, ambiguity can arise as to which party's terms apply. In a sale of goods transaction, the Uniform Commercial Code's ("UCC") "battle of the forms" rules will apply and determine the provisions that make up the agreement. A buyer can improve its chances of winning the battle of the forms with two key steps. First, the buyer should expressly disclaim the seller's terms and conditions in its purchase order terms. Second, the buyer should include a statement that the seller accepts the buyer's terms by acknowledging and fulfilling the order.

2. Explicitly State That Time is of the Essence

In today's difficult supply chain environment, the ability to rely on stable and timely delivery is imperative for a buyer. A buyer in a time-sensitive industry should specify that both time and quantity are "of the essence." A "time is of the essence" clause should indicate it is the seller's responsibility to ensure both time and quantity terms are met using any means necessary (e.g., expedited freight, inventory banks, etc.) in order to ensure the delivery date and required volumes are met. In a sale of goods contract, time is commonly deemed to be "of the essence" regardless of whether the contract says so or not. However, not including a "time is of the essence" clause may provide the seller the opportunity to justify its late delivery or argue that it is not a material breach.

3. Lock-In Your Price or Allow for Price Decreases In the Future

Price is a central term of most contracts and often a negotiation point for both the buyer and the seller. Given today's inflationary environment, a buyer should make sure that prices will remain stable and fixed where possible. Clearly defined pricing minimizes uncertainty and allows for more accurate budgeting. A buyer should include language in its purchase order specifying a fixed price, and should also note that the price locks on issuance of the order.

4. Be Clear About What the Price Includes

In order to guard against hidden costs and disputes over what exactly is the amount owed under a given order, a buyer's purchase order should also make clear whether other associated costs are included in the overall price or are additions to the listed price. A buyer should include a term that explicitly states that the purchase price includes all costs associated with the goods, including those for shipping, delivery and expedited freight. Unless a different arrangement is desired, a buyer also should explicitly state that the freight price includes all taxes, tariffs, import duties and any other costs. This language will help guard against a seller adding fees or charging for ancillary costs not anticipated by the buyer.

5. Include Setoff Language

A setoff provision allows a buyer to withhold payments from the seller in the event of a dispute regarding the agreement. If an issue arises, such as a seller's late delivery or a delivery of damaged goods, this kind of language gives the buyer the flexibility to withhold the amounts that are otherwise owed to the seller for a previous order, from payments for a later one. Purchase orders can provide this flexibility by including a setoff clause, which should also specify that the seller must continue to perform on subsequent orders while the buyer withholds payments for another due to a *bona fide* dispute. This will not only save the buyer money, it will ensure that the buyer continues to receive its orders, and it will provide the buyer with bargaining power when resolving the disagreement with the seller.

6. Narrowly Tailor the *Force Majeure* Provision

Force majeure provisions typically benefit the seller, which is the party responsible for delivering goods or services. As recent events have shown, the ability to weather unexpected supply chain interruptions is crucial for companies both large and small. When unexpected events happen, such as natural disasters, labor or supply interruptions or pandemics, the parties to a contract look for a *force majeure* provision that may excuse their inability to perform to the terms of the contract. Depending on the particular language, the *force majeure* provision may excuse delays or performance all together.

A buyer can craft *force majeure* provisions to its advantage and protection. By ensuring that the provision is explicit as to the events that trigger excused performance or delay, a buyer can limit a seller's ability to use catchall language to excuse its responsibility for a risk not explicitly covered in the provision. The buyer should also seek to exclude from *force majeure* coverage events for which the seller should ordinarily bear the risk, such as labor or material shortages. Doing so will minimize the possibility that a seller will make a *force majeure* claim for an event that should not, in the buyer's opinion, excuse performance.

For more on *force majeure* as a defense to nonperformance see our prior article in the series [Three Key Defenses to Contractual Performance: Force Majeure, Commercial Impracticability, and Frustration of Purpose](#).

7. Include Strong Warranty Protections

Including strong warranties consistent with the division of responsibility between the parties will provide a buyer with recourse in the event that an issue arises with a given order. At a minimum, a buyer should have the seller warrant that its goods are free from defects, meet buyer's specifications, are merchantable, and are fit for their intended purpose. For a buyer that provides a warranty on goods it resells to its own customers, strong warranty provisions in contracts with its suppliers can enable the buyer to pass along warranty costs incurred from customers' warranty claims.

8. Make Sure You Are Fully Covered

To help protect against a breach of warranty by a seller, a buyer should provide for available remedies in its terms. A common remedy for a breach of warranty is for a seller to repair or replace the goods or, at buyer's sole option, offer a refund for the price of the goods. In addition to this remedy provision, a buyer should include an indemnity provisions that requires the seller to reimburse the buyer for any costs flowing from a breach of the warranties by the seller.

A buyer should also ensure that the contract does not prevent the buyer from recovering damages in the event of a breach by the seller. Such a recovery is especially relevant in the current economic environment due to the numerous potential issues that can result from material and labor shortages. If the seller is unable to deliver and the buyer experiences losses as a result, being able to have a claim against the seller can help ensure that the buyer does not bear the brunt of the seller's non-performance.

More often than not, the seller's terms and conditions will exclude recovery of consequential damages—damages that are not directly caused by a given breach, such as lost profits, third party claims, or interest. For a buyer, because its sole obligation is to purchase and pay, the risk of being at

fault is lower than for the seller who is responsible for the majority of the obligations. For this reason, a buyer should avoid agreeing to terms that limit the parties' recoverable damages when possible, even though a mutual damages disclaimer may appear to be a fair approach. If consequential damages are excluded, a buyer may not be able to cover all obligations to its own customers that arose because of a seller's breach. In the event that a buyer cannot avoid an exclusion of consequential damages, the buyer should seek carve-outs for any indemnification obligations, and if possible, for losses arising from the seller's intentional or grossly negligent acts.

9. Give Yourself an Out

A buyer should include strong cancellation terms that allow it to cancel an order for convenience at any time prior to delivery, or permit the buyer to cancel an order at any time if the seller materially breaches the agreement. A buyer should expressly limit its liability in the event of cancellation to the out of pocket costs of the seller. By including cancellation terms, the buyer has an out in the event the relationship with the seller does not go as planned.

Key Terms for Sellers in the Supply Chain

As is likely expected, a seller will look to provide for the inverse of the terms listed above when crafting its terms and conditions of sale. A seller should keep in mind several specific terms before accepting a buyer's purchase orders and when creating its own terms of sale.

1. Reject Buyer's Terms and Conditions

In many situations it is in the seller's best interest to reject the buyer's terms accompanying a purchase order and dictate that the seller's terms apply to the transaction. In order to accomplish this goal, a seller should include language in its terms of sale expressly conditioning acceptance of such terms by the buyer. Doing so will make clear that the seller does not accept the buyer's properly submitted purchase order terms, and that the seller's form is the new offer. The seller's terms should also state that its terms prevail over the buyer's terms, and that performance by the seller does not constitute acceptance of the buyer's terms or any modification to the seller's terms.

2. Incorporate Price Flexibility

While a buyer will want to lock-in prices to the extent possible, a seller will want to incorporate flexibility into pricing provisions in case input costs increase. Such language not only prevents a seller from being locked into a possibly detrimental sale price, but also can give the seller the flexibility to increase prices when confronted with increased labor and material costs. Price flexibility can be achieved in various ways, such as building in an automatic index-based price adjustment mechanism, shortening the term that prices remain in effect, and providing for other periodic price increases. To find additional information and detail on these mechanisms, see our article [Inflation Woes: Four Key Ways for Companies to Address Inflation in the Supply Chain](#).

3. Disclaim Warranties

The warranties that sellers grant to their customers differ not only from one company to another, but also based on the product that is being sold. Under the UCC, a buyer can rely on implied warranties unless the seller includes a conspicuous disclaimer in the contract, and that disclaimer is provided to the buyer before the purchase of the goods. Having a conspicuous warranty disclaimer (commonly in all capital letters and bold font), prevents a buyer from claiming a given warranty disclaimer does not

apply and, therefore, assists a seller in limiting its exposure to potential warranty claims. Given the high costs that can be imposed as a result of breaches of warranties, an appropriate disclaimer can greatly assist a seller in managing costs. When crafting these disclaimers, however, it is important to keep in mind that a seller's ability to disclaim warranties differs for sales to consumers and sales to other merchants.

4. Include a Broad *Force Majeure* Provision

In today's environment of frequent supply chain disruptions, *force majeure* provisions are more important than ever. While a buyer will desire to narrowly tailor a force majeure provision, a seller will typically want to have a broad *force majeure* clause which allows its performance to be excused in a variety of circumstances beyond its control. A seller will want to ensure that there is a "catch all" provision that does not limit the force majeure events to only those listed. Catch all language will help ensure that when unexpected events prevent a seller from performing timely under an agreement (or performing at all), the seller will not be liable for damages. Selling parties should think carefully about what material risks their businesses face, and include these items in a broad force majeure clause.

5. Limit Your Liability

A limitation of liability clause is very important for a seller. In a supply contract, a common provision will expressly exclude consequential, indirect, incidental and/or special damages, and it will often put a cap on the amount of damages the seller (and sometimes the buyer as well) can be required to pay. For a seller of goods, this provision is key in assessing and limiting potential risk exposure. If circumstances arise in which a seller is unable to perform, avoiding paying a buyer consequential damages can make a significant difference in the amount of damages the seller will be responsible to pay. For these reasons, a seller should include a provision to limit liability for damages for as many potential claims as possible.

6. Be Clear About Title and Risk of Loss

The timing of transferring title and risk of loss from the seller to the buyer will vary greatly from purchase to purchase. However, defining when this shift occurs is important because it limits future disputes regarding who is liable if something happens to the goods while in transit. Being clear about the shift in ownership and risk of loss can also help a seller manage costs and avoid unexpected expenses in delivering its product. Today, most businesses look to the "Incoterms" that describe exactly when title and risk of loss transfers from a seller to buyer. Incorporating one of these standard terms can provide clarity for a seller and its buyers and avoid disputes in the future.

Conclusion

While managing interruptions in supply chains, labor shortages, price increases and economic uncertainty, buyers and sellers alike should revisit their sales documents to ensure those documents contain strong terms protecting their respective interests. A thorough review and revision of terms will help to manage risk and keep costs down.

Jenene R. Ebstein also contributed to this article.

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