

# Manufacturing Custom-made Goods in the United States

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A Practice Note discussing issues in US custom manufacturing agreements. It presupposes that a product designer (buyer) operating in the US wishes to engage a manufacturer operating in the US to manufacture products according to the buyer's specifications. This Note does not discuss every issue regarding manufacturing custom-made goods and does not address consumer product liability issues. It addresses the major terms that each party must consider when drafting or negotiating an effective contract for the manufacture of custom-made goods in the US.

Manufacturers can produce and sell goods that are either:

- **Standard (off-the-shelf).** Manufacturers use traditional mass production processes to make standard goods, which are all identical and produced in large quantities.
- **Custom made.** Manufacturers make custom-made goods based on a customer's unique specifications, for example regarding material or design.

For sample manufacturing supply agreements that can be used for either standard or custom-made goods, see *Standard Documents, Manufacturing Supply Agreement (Pro-seller)* (<http://us.practicallaw.com/8-520-6860>) and *Manufacturing Supply Agreement (Pro-buyer)* (<http://us.practicallaw.com/6-522-5143>).

Custom manufacturing relationships are complex and likely implicate specialty areas of the law. Each transaction raises issues that are unique to the relevant parties and circumstances.

This Note is a guide to help parties to custom manufacturing agreements identify and manage commonly occurring risks that are special to these agreements. It does not present a comprehensive list of all possible issues and considerations.

## PRICE, TIMING AND QUANTITY TERMS

To ensure that it can achieve its contractual expectations, each party to a custom manufacturing agreement must carefully consider the implications of the agreement's price, timing and quantity terms.

### PRICING CONSIDERATIONS

Pricing under a custom manufacturing agreement can be either:

- **Fixed.** Product designers (buyers) typically prefer a fixed price because fixed price contracts allow the buyer to more easily plan and budget. For a sample fixed price pricing provision, see *Standard Clauses, General Contract Clauses: Pricing Terms (Services, Pro-customer): Section 1.3* (<http://us.practicallaw.com/1-520-6509#a342490>).
- **Variable.** Variable prices are based on amounts that are not quantified at contract formation. The manufacturer is more likely to favor this approach because it can yield higher prices, however, buyers who have the requisite bargaining power may also try to include a price reduction mechanism (such as a most favored nations (MFN) provision). Depending on the nature of the transaction and the parties' bargaining power, one or both parties in custom manufacturing agreements may find it necessary or desirable to:
  - peg pricing to input costs (like raw materials), for example where input costs are particularly volatile;
  - include a fixed-interval price increase mechanism in the contract;
  - include an MFN provision (for example, see *Standard Clauses, General Contract Clauses: Pricing Terms (Sale of Goods, Pro-buyer): Section 1.5* (<http://us.practicallaw.com/1-520-3879#a499654>));
  - make price contingent on meeting quantity estimates; or



- include a change order provision to ensure that the contract appropriately addresses design changes and potential impacts on pricing (for a sample change order provision, see *Standard Clauses, Services Agreement: Change Order Clause (Change Order Request Procedure)* (<http://us.practicallaw.com/8-521-9532>)).
- **A combination of fixed and variable.** For example, this type of pricing for services can be structured as:
  - a variable pricing provision subject to a fixed cap on fees; or
  - as staged pricing, with one or more stages of the manufacturing based on variable conditions and one or more other stages based on fixed fees.

### Variable Pricing Pitfalls

Although fixed prices can provide significant benefits, like predictability and relative ease of drafting or negotiating, variable fees may be more appropriate in certain transactions or industries that require pricing flexibility. However, since variable pricing provisions are typically based on variables that are unknown at contract formation or that are within the discretion of only one of the parties, variable pricing can subject a party to pricing that is significantly different than originally expected.

Therefore, parties who use variable pricing provisions should try to predict and mitigate the potential negative impacts on and of pricing throughout the agreement's term. For example, for pricing based on:

- Input costs:
  - the parties should review recent market and purchasing trends to try to accurately predict costs; and
  - the buyer should insist on the right to review relevant books and records periodically to verify that the manufacturer is calculating the price correctly. For a sample audit rights provision, see *Standard Clauses, General Contract Clauses: Audit Rights* (<http://us.practicallaw.com/4-567-1110>).
- The buyer's forecasts:
  - the buyer should review recent purchasing trends to try to forecast as accurately as possible; and
  - the parties should try to predict how substantial deviations from quantity estimates impact price-related costs and adjust pricing terms as appropriate.

### QUANTITY AND TIMING CONSIDERATIONS

Under Article 2 of the Uniform Commercial Code (UCC), a sale of goods contract is not enforceable unless the contract specifies the quantity of goods to be sold. In manufacturing and other sale of goods agreements, the parties either:

- Specify the quantity by reference to a stated number.
- Establish quantity by reference to the buyer's requirements for the specified goods. This type of contract is known as a requirements contract (see *Requirements Contracts Considerations*).

### Requirements Contracts Considerations

Requirements contracts typically:

- Obligate the buyer to purchase all or a set percentage of its requirements of the goods from the manufacturer.

- Obligate the buyer to purchase its stated requirements of the goods **exclusively** from the manufacturer.
- Obligate the manufacturer to supply the buyer its stated requirements of the goods.
- Allow the manufacturer to sell any excess over the buyer's requirements to third parties.

For a sample clause to be used in a requirements contract to specify the percentage of its requirements of the goods that the buyer must purchase exclusively from the manufacturer and that the manufacturer must sell to the buyer, see *Standard Clauses, General Contract Clauses: Quantity (Requirements Contract)* (<http://us.practicallaw.com/8-529-8586>). For more information on requirements contracts, see *Practice Note, Requirements Contracts for the Sale of Goods* (<http://us.practicallaw.com/4-519-4760>).

Although parties to requirements contracts can enjoy certain benefits, such as a more predictable supply and demand, requirements contracts can also impose significant risks, such as:

- Being locked into an unfavorable contract.
- The buyer's inability to quickly secure alternative supplies if the manufacturer cannot supply the buyer's requirements.
- The manufacturer being burdened with unsellable inventory. To preempt this liability, the manufacturer should:
  - require the buyer to give a binding forecast of quantity and the timing of delivery;
  - expressly state the impact of deviations from the forecast on price and delivery terms, considering the additional costs associated with warehousing delayed product shipments; and
  - include termination rights and specify damages for substantial deviation from quantity forecasts, for example by using a liquidated damages clause (see *Standard Clauses, General Contract Clauses: Liquidated Damages* (<http://us.practicallaw.com/2-508-1113>)).

### WARRANTIES, INDEMNIFICATION AND INSURANCE

Like in other commercial contracts, each party under a custom manufacturing agreement seeks to minimize its risk while maximizing its reward. Warranties, indemnification and insurance are some of the most powerful risk allocation provisions, and therefore are key contractual negotiation points in most custom manufacturing agreements.

Although there are many negotiation points regarding warranties, indemnification and insurance that are common to custom manufacturing agreements, some of the most common and contentious include:

- Warranties of quality and fitness (see *Product Warranties of Quality and Fitness*).
- Warranties against infringement of intellectual property (see *Intellectual Property Infringement Warranties and Indemnification*).
- Environmental indemnities and warranties (see *Environmental Warranties and Indemnification*).
- Insurance (see *Insurance Coverage to Support Contract Obligations*).

## PRODUCT WARRANTIES OF QUALITY AND FITNESS

While the manufacturer typically wants (and is permitted under the Uniform Commercial Code (UCC)) to provide no or limited product warranties (*UCC § 2-316*), a manufacturer may have difficulty negotiating a contract for the sale of goods without providing any express warranties.

The buyer typically prefers to maximize its warranty coverage afforded under the UCC by seeking to include:

- Many broad express warranties. For example, buyers typically want a manufacturer warranty that the products meet all legal requirements (in addition to a warranty that the manufacturer will perform its contractual obligations in accordance with laws). For more information on express warranties, see *Practice Note, UCC Article 2 Express Warranties* (<http://us.practicallaw.com/8-519-5098>).
- All unqualified implied warranties. For more information on implied warranties, see *Practice Note, UCC Article 2 Implied Warranties* (<http://us.practicallaw.com/1-521-1351>).

Parties commonly compromise by agreeing that:

- The buyer assumes the risk of design defects.
- The manufacturer assumes the risk of defects in material and workmanship.

For sample pro-seller product warranties, see *Standard Document, Manufacturing Supply Agreement (Pro-seller): Section 9.3* (<http://us.practicallaw.com/8-520-6860#a862845>). For sample pro-buyer warranties, see *Standard Document, Manufacturing Supply Agreement (Pro-buyer): Section 9.3* (<http://us.practicallaw.com/6-522-5143#a862845>).

## Warranty Disclaimers

Custom manufacturing agreements (especially those favoring the manufacturer) sometimes contain more language regarding the disclaimer of warranties than the warranties themselves. The nature of the transaction and the balance of the parties' negotiating power dictate whether the disclaimers are unilateral or reciprocal. If the manufacturer has the requisite bargaining power, it typically tries to:

- Include a statement that the express warranties in the agreement are the only warranties provided by the manufacturer, and that all other warranties, express and implied, are disclaimed.
- Specifically disclaim:
  - all implied warranties (see *Practice Note, UCC Article 2 Implied Warranties* (<http://us.practicallaw.com/1-521-1351>));
  - any warranties that it is an expert in the design of the product, and state affirmatively that the buyer is not relying on the manufacturer for design expertise; and
  - warranties to remote purchasers, which may include imposing an affirmative obligation on the buyer to ensure the goods are delivered to the ultimate user with a conspicuous disclaimer of the manufacturer's warranties.

For sample manufacturing agreement warranty disclaimers, see *Standard Document, Manufacturing Supply Agreement (Pro-seller): Section 9.5* (<http://us.practicallaw.com/8-520-6860#a591931>) and *Section 9.6* (<http://us.practicallaw.com/8-520-6860#a130699>).

## INTELLECTUAL PROPERTY INFRINGEMENT WARRANTIES AND INDEMNIFICATION

The issue of product intellectual property (IP) rights is one of the most heavily negotiated areas in a custom manufacturing agreement. Parties allocate their IP rights and risks under IP:

- Ownership and licensing provisions (see *Intellectual Property Ownership and Confidentiality*).
- Infringement warranties and indemnification. Each party typically seeks to protect itself by shifting infringement-related liabilities to the other party.

Depending on the balance of the parties' bargaining power and the degree to which the design of the products is based the buyer's design, the manufacturer typically wants the buyer to:

- Warrant that the goods do not infringe on any third-party IP rights.
- Defend and indemnify the manufacturer against infringement of third-party IP rights. For a sample buyer IP indemnification provision, see *Standard Document, Manufacturing Supply Agreement (Pro-seller): Section 10.3* (<http://us.practicallaw.com/8-520-6860#a877027>).

The manufacturer should expect the buyer to seek to obtain similar warranties and indemnification rights, especially if the manufacturer successfully obtains IP warranty and indemnification rights. For IP provisions favoring the buyer, see *Standard Document, Manufacturing Supply Agreement (Pro-buyer): Section 9.3(a)(iv)* (<http://us.practicallaw.com/6-522-5143#a338754>) and *Section 10.1(e)* (<http://us.practicallaw.com/6-522-5143#a275263>).

For information comparing and contrasting warranty and indemnification protection under commercial contracts, see *Practice Note, Remedies: Adequate Liability Coverage: Comparison of Selected Attributes of Certain Contractual Remedies* (<http://us.practicallaw.com/0-553-7425#a471782>).

If the parties include any IP warranty or indemnification, they should consider excluding the provision from the limitation of liability (see *Standard Clauses, General Contract Clauses: Limitation of Liability* (<http://us.practicallaw.com/7-507-5628>)).

## ENVIRONMENTAL WARRANTIES AND INDEMNIFICATION

Parties' environmental sensitivities and liabilities have increased in light of increased:

- Regulation.
- Consumer sensitivities.
- Implementation of corporate environmental and social responsibility programs.

Environmental risks relating to custom manufacturing typically arise from:

- The manufacturer's or its suppliers' breach of environmental laws or regulations.
- Contamination caused by the manufacturer's or its suppliers' manufacturing activities or products.

Therefore, depending on the manufacturer's products, business model, supply chain and environmental stewardship history, the buyer should:

- Conduct meaningful due diligence of the manufacturer and its supply chain. For information regarding conflict minerals due diligence, see *Practice Note, Conflict Minerals Diligence* (<http://us.practicallaw.com/0-510-6930>).
- Ensure that the manufacturer bears the full risk of environmental contamination by granting warranties and indemnification rights.
- Ensure that the manufacturer warrants compliance with all applicable environmental laws.

If it grants any warranty or indemnification rights, the manufacturer should ensure that the warranties:

- Are qualified by disclosure, to try to prevent the buyer from claiming under warranties regarding matters fully and fairly disclosed by the manufacturer.
- Support the transaction price paid by the buyer, to try to prevent the buyer from easily establishing a claimable loss for a warranty claim.

For sample environmental representations under an asset purchase agreement, see *Standard Document, Asset Purchase Agreement (Pro-Buyer Long Form): Section 4.18* (<http://us.practicallaw.com/6-384-1736#a206333>).

### INSURANCE COVERAGE TO SUPPORT CONTRACT OBLIGATIONS

In many custom manufacturing agreements, parties allocate risk through covenants requiring one or both parties to maintain specific levels of insurance coverage. Depending on the nature of the transaction and the parties' bargaining power, either party may require the other party to obtain insurance coverage to:

- Mitigate a contract obligor's financial exposure to the specified risk of liability by shifting liability risk from the obligor to its insurer, in exchange for an insurance premium that usually represents a fraction of the total coverage the policy provides.
- Limit a contract obligee's risk that the contract obligor does not have the financial capacity to cover its liabilities under the contract.

Each party should consult with its risk management representative to ensure that each party's insurance requirements are consistent with relevant product and industry requirements.

Since the manufacturer is typically the party with the most risk-related obligations under the agreement, the buyer usually wants the manufacturer to support its indemnification or other obligations by obtaining the appropriate insurance or bonds.

For a sample insurance provision, see *Standard Documents, General Contract Clauses: Insurance Covenant (Sale of Goods)* (<http://us.practicallaw.com/7-524-9426>). For general information on credit support, see *Practice Note, Credit Support in Sale of Goods Transactions* (<http://us.practicallaw.com/4-523-3894>).

### INTELLECTUAL PROPERTY OWNERSHIP AND CONFIDENTIALITY

Custom manufacturing agreements typically pose difficult questions regarding the parties' IP use and ownership and confidentiality rights and obligations. To ensure that their rights are adequately protected, parties must specify:

- The manufacturer's rights regarding manufacturing the goods for others or on its own behalf. If not, the buyer should include an exclusivity or non-compete provision. Parties should consider that exclusive dealings can have antitrust implications (see *Practice Note, Exclusive Dealing Arrangements* (<http://us.practicallaw.com/2-523-2602>)).
- Ownership rights regarding each party's background and foreground IP (for an explanation of background and foreground IP, see *Practice Note, Drafting or Reviewing a Commercial Contract: Intellectual Property Rights* (<http://us.practicallaw.com/2-531-1345#a575041>)). For example, the parties should specify:
  - each party's IP rights, for example by stating that the buyer owns the product design, dies or molds; and
  - whether the buyer can demand delivery of designs, dies or molds and provide them to a competing manufacturer.

For a sample IP ownership provision that favors the buyer, see *Standard Document, Manufacturing Supply Agreement (Pro-buyer): Section 12.1* (<http://us.practicallaw.com/6-522-5143#a1001025>). For a sample IP ownership provision that favors the manufacturer, see *Standard Document, Manufacturing Supply Agreement (Pro-seller): Section 12.1* (<http://us.practicallaw.com/8-520-6860#a1001025>).

- Rights and obligations regarding trade secrets and other confidential information. For example:
  - to protect its IP rights, the buyer typically insists that the manufacturer be bound to keep drawings or know-how confidential; and
  - the manufacturer often keeps pricing and delivery terms confidential, especially if price is keyed to input costs and the buyer has pricing-related audit rights.

For general information on IP, see *Practice Note, Intellectual Property: Overview* (<http://us.practicallaw.com/8-383-4565>). For more information on drafting and negotiating confidentiality provisions, see *Confidentiality and Nondisclosure Agreements Toolkit* (<http://us.practicallaw.com/3-502-1883>).

### INPUTS, QUALITY CONTROL AND INSPECTION

Parties should be particularly careful when drafting and negotiating input, quality control and inspection rights because these can significantly impact the quality the products, which are the agreement's main deliverables. Under custom manufacturing agreements, the buyer:

- Wants significant control over product inputs to ensure better quality and price control, for example, by having the right to force the manufacturer to use:
  - preferred vendors; and
  - consigned materials (for consignment agreement drafting and negotiating tips, see *Drafting and Negotiating a Consignment Agreement Checklist* (<http://us.practicallaw.com/5-533-9625>)).

If the buyer successfully obtains these rights, the manufacturer should insist that it be exculpated for the material's defects, adequacy or incorporation into the final product.



- Often requires maintenance and audit rights regarding input sourcing records (for sample audit rights provisions, see *Standard Clauses, General Contract Clauses: Audit Rights* (<http://us.practicallaw.com/4-567-1110>) and *General Contract Clauses: Audit and Inspection Rights (Short Form)* (<http://us.practicallaw.com/9-569-9866>)). For example, if any of the inputs could be conflict minerals, the buyer may need to demonstrate sourcing to be able to make accurate public legal disclosures (see *Conflict Minerals Rule Compliance Toolkit* (<http://us.practicallaw.com/4-524-2148>)).
- May insist on the right to inspect the manufacturer's plant to preempt problems before they manifest, especially if it is sophisticated and familiar with best manufacturing practices (see *Standard Clauses, General Contract Clauses: Inspection Rights* (<http://us.practicallaw.com/9-569-5887>) and *General Contract Clauses: Audit and Inspection Rights (Short Form)* (<http://us.practicallaw.com/9-569-9866>)).

Common key audit- and inspection-related negotiation points include:

- Whether independent third parties must conduct the audits or inspections. For more information on the costs and benefits of independent third-party inspectors and auditors, see *Standard Clauses, General Contract Clauses: Inspection Rights: Drafting Note: Independent Third-party Inspector* (<http://us.practicallaw.com/9-569-5887#a227160>).
- Access rights, including regarding the notice, timing and frequency of the inspections.

### SPECIFICATIONS: CHANGES AND COMPLIANCE

The parties should draft the custom manufacturing agreement so that design specifications are:

- Flexible (see *Specification Change*).
- Clear, concise and comprehensive (see *Specification Compliance*).
- Accompanied by a robust set of non-compliance procedures (see *Specification Compliance*).

### SPECIFICATION CHANGE

Parties should determine whether, considering the nature and value of the contract, it is worthwhile to include provisions (often called change order provisions) to allow the parties to quickly and easily revise the specifications to better:

- Meet future goals and contingencies.
- Avoid disputes.
- Protect against unanticipated risks.
- Protect against unwarranted cost overruns.

For example, when the products are of a new design, the buyer typically wants the right to change the design, in which case the parties must determine:

- How these changes must be made. For example, parties reduce their risks by using a written change order as compared to verbal instructions. For a sample change order form, see *Standard Document, Services Agreement: Change Order Form* (<http://us.practicallaw.com/0-522-5179>).

- The impact of changes on production time, considering whether retooling is required.
- The impact of changes on price, considering whether retooling is required.
- The frequency with which changes can be requested.

For sample change order provisions, see *Standard Clauses*:

- *Services Agreement: Change Order Clause (Change Order Request Procedure)* (<http://us.practicallaw.com/8-521-9532>).
- *Services Agreement: Change Order Clause (Excusable Events)* (<http://us.practicallaw.com/2-523-5139>).
- *Services Agreement: Change Order Clause (Change Directives)* (<http://us.practicallaw.com/5-523-5048>).

### SPECIFICATION COMPLIANCE

The parties can better ensure that the manufacturer adheres to the specifications and activities and deliverables under the agreement likely meet the parties' expectations when:

- The specifications are drafted clearly, concisely and comprehensively.
- The agreement has a robust set of non-compliance procedures that set out:
  - the buyer's inspection rights;
  - the buyer's rights on discovering non-conformities of delivered goods;
  - the buyer's notice obligations regarding product non-conformity;
  - the parties' rights and obligations regarding the return or destruction of non-conforming goods (for example, regarding return costs);
  - the parties' rights and obligations regarding field inspections, recalls and returns (for more information on product recalls and returns, see *Practice Note, Product regulation, safety and recall country questions: US* (<http://us.practicallaw.com/7-102-2045>)); and
  - whether the parties' rights under the non-compliance procedures are exclusive.

For a sample pro-buyer inspection rights provision, see *Standard Document, Manufacturing Supply Agreement (Pro-buyer): Section 4.5* (<http://us.practicallaw.com/6-522-5143#a824756>). For a sample pro-manufacturer inspection rights provision, see *Standard Document, Manufacturing Supply Agreement (Pro-seller): Section 4.6* (<http://us.practicallaw.com/8-520-6860#a824756>).

### SHIPPING AND DELIVERY TERMS

Although in certain situations, there are distinct differences between the terms "shipping terms" and "delivery provisions," this Note treats them as synonyms (for information on the differences between these terms, see *Practice Note, Delivery of Goods: Delivery Provisions versus Shipping Terms* (<http://us.practicallaw.com/6-521-8246#a120259>)).

Shipping and delivery terms can vary greatly depending on the nature of the products and the industry, they generally address the allocation of risk and expense between the parties relating to the delivery of goods. Depending on the importance of the goods to the buyer's business and the value of the transaction to the manufacturer, delivery provisions can have critical implications for each party's business. Therefore, the parties should:

- Specify how the goods are delivered to the buyer, a third-party distributor or directly to the customer (shipments sent directly to the customer are called drop shipments). For information on drop shipments, see *Practice Note, Drop Shipments* (<http://us.practicallaw.com/8-556-2166>).
- Carefully consider the use of accepted mercantile symbols in their contract (for example, Incoterms® rules, which are various shipping terms published by the International Chamber of Commerce), since parties commonly:
  - misunderstand the meaning behind the symbols and acronyms; or
  - fail to correctly specify the terms (for example, failing to set out the version of the Incoterms® rules being used such as Incoterms® 2010, Incoterms® 2000 or an earlier version).

For more information about Incoterms® rules, see *Practice Note, Delivery of Goods: Incoterms® Rules* (<http://us.practicallaw.com/6-521-8246#a703186>).

- Specify when the risk of loss passes to the buyer (see *Practice Note, Delivery of Goods: Non-acceptance of Delivery* (<http://us.practicallaw.com/6-521-8246#a167779>)).
- Identify which of the parties must insure the shipment.
- Consider the parties' respective ability to send and receive large, unusual or otherwise challenging shipments. For example, to receive a shipment, the buyer may need to consider whether its loading dock can accommodate freight vehicles.

## TERMINATION-RELATED CONSIDERATIONS

Expiration or earlier termination can have significant practical implications, especially since the agreement covers custom-made goods. Therefore, each party should anticipate and plan to mitigate the potential negative implications, for example:

- The manufacturer should try to avoid being left holding goods that it cannot effectively resell (see *Manufacturer Termination-related Considerations*).
- The buyer should try to find a secondary source for the goods (see *Buyer Termination-related Considerations*).

For a sample termination provision, see *Standard Clauses, General Contract Clauses: Term and Termination* (<http://us.practicallaw.com/2-507-0812>).

## MANUFACTURER TERMINATION-RELATED CONSIDERATIONS

To help mitigate the effects of expiration or earlier termination, the manufacturer can:

- Take a purchase-money security interest (PMSI) in the goods that it sold to the buyer. For more information on PMSIs, see *Practice Note, Purchase Money Security Interests (PMSI)* (<http://us.practicallaw.com/1-515-2196>).

For a sample PMSI payment clause, see *Standard Clauses, General Contract Clauses: Payment Terms, Purchase-money Security Interest (PMSI)* (<http://us.practicallaw.com/4-519-9437>).

- Take a security interest in any buyer manufacturing equipment, consigned inputs, dies or molds. For more information on security interests, see *Practice Note, UCC Creation, Perfection and Priority of Security Interests* (<http://us.practicallaw.com/6-381-0551>).
- Obtain cash in advance or an evergreen retainer. Either of these approaches typically provides better credit protection than security interests because the manufacturer does not have to resell the goods or equipment to recover the amounts due.
- Include a liquidated damages clause in the agreement. For a sample liquidated damages clause, see *Standard Clauses, General Contract Clauses: Liquidated Damages* (<http://us.practicallaw.com/2-508-1113>).
- Include either a right to terminate for convenience or expansive conditions or events of termination based on the buyer's acts or omissions. Terminations conditions that favor the manufacturer include:
  - the manufacturer's reasonable determination of insecurity;
  - the buyer's insolvency (an ipso facto clause) (see *Standard Clause, Ipso Facto Clause* (<http://us.practicallaw.com/1-381-3321>)); and
  - the buyer's failure to pay.
- Include expansive termination-related rights, for example, the manufacturer's right to:
  - cease manufacturing and scrap goods in progress;
  - divert shipments in transit; or
  - require the buyer to segregate goods it received but for which it did not pay (to strengthen the enforceability of the manufacturer's security and reclamation rights).

## BUYER TERMINATION-RELATED CONSIDERATIONS

To help mitigate the effects of expiration or earlier termination, the buyer can:

- Make the manufacturer's termination rights contingent on the buyer meeting the manufacturer's demand for adequate assurances. For more information on adequate assurances, see *Practice Note, Anticipatory Repudiation and Adequate Assurances of Future Performance* (<http://us.practicallaw.com/9-519-7153>).
- Include either a right to terminate for convenience or expansive conditions or events of termination based on the manufacturer's acts or omissions. Terminations conditions that favor the buyer include:
  - the manufacturer repudiates or threatens to repudiate the agreement;
  - the manufacturer's insolvency (an ipso facto clause); or
  - a prolonged force majeure event.
- Include expansive termination-related rights, for example, the buyer's right to:
  - require the manufacturer to segregate purchased, unshipped goods (to strengthen the enforceability of the buyer's security and reclamation rights);

- obtain title and possession of all finished goods completed before termination;
- obtain access to and all requested information and documentation regarding the manufacturer's manufacturing process, including on-site inspections, bill-of-material data, tooling and process detail and samples of supplies and components;
- obtain by assignment (or require the manufacturer to assign to an alternative seller) any or all supply contracts or orders for raw materials or components relating to the agreement and any outstanding purchase orders; or
- obtain other post-termination support, for example, a promised supply of goods for a period after termination.

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