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The Fine Print Matters: How to Not Get Burned When Writing Paper

Paper. Paper. Paper.

Everybody wants to write lots of "paper." At trade shows, special showings and anywhere else manufacturers can get a promise to pay from retailers or distributors. But other than a pseudo-promise to pay, on terms at that, what else is on that paper?

What's on that paper are obligations and rights to purchase and deliver products. The ones ultimately sold to Joe Shop Owner, so both sides can continue to enjoy their lifestyle. So what's the big deal? Frankly, it's the "deal" that is the big deal. Being familiar with some key concepts with respect to products supplied to retailers and through distributors, especially in the context of importing products made or sourced overseas, is critical for your business.

We Agreed to What?

In the zeal to do business, it is often the case that the "fine print" on the back of a purchase order or FOB invoice becomes very important - usually only when there is a problem. Contract disputes occur all too often. Yet non-monetary and non-deadline details of a contract (i.e., the "fine print'), often are overlooked by even the most seasoned executives. Fine print matters; here's why.

Risk Management and Allocation.

The key issue, from both business and legal perspectives, is "risk allocation." Knowing the risks you took on, and those you transferred or dodged, is obviously key. What risks do you face? How can you manage or allocate those risks in the event of product liability or other adverse consequences?

These questions have been around as long as people have been doing business. However, nowadays, product problems usually result in retailers being dragged into the liability trap by plaintiffs. As such, they are forced to demand that manufacturers or distributors provide them with a defense, and to "indemnify" them against liabilities (allegedly) caused by the manufacturer. "Boilerplate" terms can have significant consequences in the event of a dispute between manufacturers, distributors, and retailers. The most successful businesses use these terms and indemnity to their advantage.

Indemnity is really a form of insurance, and as we know from insurance policies and warranties, the devil lurks in the details. In this respect, to "indemnify someone" can mean many things, depending on what activities are indemnified, when an indemnity obligation is triggered, and if an obligation is actually triggered under terms of a contract. It's a term that lawyers and business folks spend far too much time negotiating - often in a manner that defies logic and the principles of fifth grade English class. That said, a well-worded and strategically drafted indemnity clause can provide enormous benefits in the event of a liability claim.

An obligation to indemnify someone means that you are agreeing to provide a "defense" of claims made against that party, *and* potentially any actual damages that may be covered and proven by a third party. The trigger of indemnity, whether it is a claim, an allegation, an investigation, or actual "liability" as determined by a court of law, is usually the first place to start when analyzing risk management and indemnity obligations.

The actual type of obligations triggered are dependent on how they are described or otherwise identified in the contract. Virtually all indemnity provisions will provide that the indemnifying party will have to defend the insured in the event that the indemnity trigger occurs (duh). What that means, and how it is defined in the contract, is that the indemnifying party will have to pay lawyers and/or technical experts to provide a defense in response to the third party claims of a consumer or governmental agency or other

disgruntled entity. Obviously, those costs can be substantial for a manufacturer or distributor. No one really budgeted to defend a retailer accused of selling products that exceed California levels of harmful chemicals. This has certainly been the case in Proposition 65 litigation over the last several years in this industry.

Damages? Prove It Please!

The next concept of indemnity is whether the indemnifying party agreed to pay for the damages suffered by the consumer or other entity. This is similar to when an insurance company actually has to pay for the repairs to the car that you accidentally ran into when you were watching that perfect wave peel off on Highway 5 at Basilone Road. In other words, the insurer may have to both pay for a defense if the person you hit sues you, and the actual cost to repair their car if covered by the insurance policy.

Breach Is In the Eye of the Beholder.

Indemnity can also be triggered if a party breaches the contract, or a representation or warranty agreed to in the contract. In this respect, if requirements for product sourcing, or a Restricted Substances List, are violated or otherwise cause product liability through enforcement by government agencies or private bounty hunters, the indemnifying party may have to pay damages for breach. A retailer may even test the products provided by a manufacturer, and then determine that in fact, the product contains a restricted chemical. In this breach situation, an indemnity obligation could require payment of "damages" - even though no person was actually harmed.

Environmental enforcement and private bounty hunter lawsuits have definitely triggered thousands of indemnity obligations.

Understanding indemnity and what's written down on paper between you and potential retailers and distributors can be significant for your business when a contract dispute eventually arises.

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