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News & Types: Commercial, Competition & Trade Update

What Terms to Focus Upon When a Supplier Has Little Leverage to Negotiate a Supply Arrangement

11/19/2026

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Practices: Commercial, Competition & Trade

Purchasers often present suppliers with standard agreements that heavily favor the buyer. Even when suppliers have limited leverage or resources to negotiate extensively, targeted revisions to a handful of key provisions can significantly reduce risk and help protect profitability.

When a supplier is reviewing a purchaser drafted supply agreement where there is apparent little leverage to negotiate changes, suppliers should pay particular attention to the following areas:

1. Limitation of Liability

Uncapped liability can expose suppliers to losses far exceeding the value of the contract. Consider negotiating an aggregate liability cap and exclusions for consequential damages, lost profits and business interruption, subject to appropriate exceptions.

2. Indemnification

Broad indemnification provisions may require suppliers to defend and reimburse purchasers and their customers for claims beyond the supplier's responsibility and the contract’s value. Suppliers should seek to limit indemnification obligations to losses arising from their own acts, omissions, breaches or defective products or services, as appropriate and establish clear defense and settlement procedures.

3. Product Recalls and Field Actions

Recall-related costs can include the purchaser’s and its customer’s labor, replacement parts, logistics and customer notifications. Responsibility should be allocated based on causation, with reasonable investigation rights, documentation requirements and appropriate financial limitations.

4. Forecasts and Purchase Commitments

Nonbinding forecasts may leave suppliers investing in inventory and production capacity without guaranteed

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orders. Suppliers should seek binding forecast periods, firm purchasing commitments defined forecast horizons, and reimbursement protections for customer-specific inventory and non-cancelable commitments.

5. Termination for Convenience

Purchasers may create the right to terminate a contract despite significant supplier investments and commitments. Suppliers should negotiate reasonable notice requirements and compensation for finished goods, work in process, stranded inventory, committed costs and unamortized buyer-specific investments.

6. Pricing, Setoff and Chargebacks

Unilateral deductions, productivity reductions, pricing adjustments and disputed chargebacks can erode margins and disrupt cash flow. Suppliers should seek objective pricing mechanisms, supporting documentation requirements, dispute procedures and prompt payment of undisputed invoices.

7. Warranty Obligations

Overly broad warranties may extend beyond agreed specifications or create disproportionate remedies. Clearly defining warranty scope and duration, excluding defects attributable to purchaser and its customer's designs or misuse, reasonable remedies, such as repair, replacement or refund remedies can help limit exposure.

8. Unilateral Changes

Changes to specifications, quality standards or delivery requirements can create unexpected costs. Agreements should include documented change-control procedures and corresponding adjustments to pricing, lead times and validation expenses.

9. Tooling and Intellectual Property

Disputes involving molds, dies, manufacturing processes and engineering developments can jeopardize valuable business assets. Agreements should clearly distinguish purchaser-funded tooling from supplier-owned equipment and define ownership, licensing, maintenance and transfer rights for both physical and intellectual property.

10. Delivery Penalties

Premium freight charges, line stoppage claims and other penalties can be disproportionate to a delayed shipment. Suppliers should seek to limit recovery to reasonable, documented losses directly attributable to the supplier and subject to appropriate mitigation and liability limitations.

Even when purchasers are unwilling to make extensive changes to their standard agreements, targeted revisions to key provisions can significantly improve risk allocation and reduce potential exposure. Before signing, suppliers should evaluate whether the agreement appropriately balances commercial risk with their business objectives.

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If you have questions about a supply agreement, contract risk allocation or commercial negotiations, please contact Reinhold F. Krammer or a member of Masuda Funai's Commercial, Competition & Trade Practice.

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