

Recovering Expenses When A Customer Cancels An Order

In this age of reduced dealer and manufacturer inventories, customers are being encouraged to place orders well in advance of need. Often times, you can not guarantee the equipment will arrive before the customer needs it. Consequently, it seems there is an increase, or at least the potential for an increase, in the practice of customers placing orders with several dealers for the same piece of equipment, and then, after one of the dealers is able to obtain the equipment, the customer cancels his order with the other dealers. There may be any number of other reasons a customer cancels an order before delivery. A dealer posed us the following question, and with the help of the Association's attorney, we prepared the response.

Question: Can we keep all or some of a customer's down payment on a wholegoods order to cover our expenses when the customer cancels the order prior to delivery without creating a controversy?

Answer: When a customer cancels his order for a piece of wholegoods equipment prior to delivery, the dealer may have already incurred expenses in procuring the item if it is not in stock, and or in getting it ready for delivery to the customer's specifications. There may also be costs involved (freight, restocking, etc.) in returning the item to the manufacturer if it has already been received. If the dealer has incurred such expenses, it is only right he be compensated for these costs. To circumvent any disagreement over the right to these costs, the dealer should follow these practices:

- 1) Make certain the customer has signed a legally binding purchase agreement for the equipment at the time of the order. This agreement should contain binding "contract to buy" language. Blank order forms will not suffice as they are no more than an "intent to purchase" agreement, even if accompanied by a down payment.
- 2) The purchase agreement should contain language that entitles the dealer to "liquidated damages" in the event of a cancellation on the part of the buyer. Liquidated damages are exact, agreed upon damages. The language should establish a set dollar amount of liquidated damages the dealer will incur to order, receive, return, and/or pre-deliver the item. This amount will most likely vary from item to item and depend on whether it is a normal stock item or one you need to order. The amount should be a reasonable amount to cover the damages.

One very simple way to accomplish this would be to insert "non refundable" after the place in the agreement that lists the amount of the down payment. This would work most of the time but in a dispute would be a problem because it is not specified that there are damages and the specified amount of damages.

A better way would be to have the following clause in the contract:

Liquidated Damages: Customer / Buyer understands that Dealer / Seller will incur expenses in obtaining and or preparing the item(s) to be delivered under this contract, the exact amount of which are uncertain at this time; and in recognition of the obligations of the parties under this contract, each to the other, and the efforts to be taken in preparation of the item(s) for delivery, Customer/Buyer agrees to pay Dealer/Seller as liquidated damages, the sum of \$ _____ in the event Customer/Buyer cancels this order for any reason other than a price increase, or otherwise fails to take delivery of the item(s) as required by the terms of this contract.

- 3) The down payment received from the customer should always at least be equal to or greater than the amount of liquidated damages expressed in the agreement.

When the customer knows up-front he cannot cancel without penalty and by establishing the exact amount the customer will forfeit in the event he does cancel, you will hopefully avoid any disagreement or ill will with your customer.

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