



Should Santa Sue? You be the Judge

Even Santa has to carefully manage risk and ensure that his contracts deliver the promised terms on time and on budget! Here is a holiday tale emphasizing the importance of having a clear and well-structured risk allocation clause, particularly for 'mission critical' contracts.

Upon return from their annual Mexican vacation in early March, Santa and Mrs. Claus began planning for the next Christmas Season. One issue they knew needed immediate attention was reindeer succession planning: Rudolph was only three years away from his full pension, and Donner and Blitzer were both planning to retire after the upcoming Christmas flight. As one can imagine, there is a steep learning curve for new reindeers to Santa's fleet, including extensive flight training and developing the skills of nose-blinking and bell-jingling. Only about 5% of hopeful reindeer recruits pass the rigorous requirements to be selected for Santa's A Team. If Santa acted quickly, he knew he and Mrs. Claus might be able to prepare new recruits in time to have several of them available to apprentice on the upcoming Christmas run.

After doing some market sounding to determine whether there were any new reindeer providers in the market, Santa turned to his regular reindeer supplier – Arbutus Sled Accessories Ltd. ("Arbutus"). In recent years the demand for reindeer has been in decline, and there appear to be no new companies entering the market. After some initial discussion, Santa agreed to buy 57 reindeer from Arbutus. Both parties understood that Arbutus would purchase the reindeer in Norway at auctions, and then transport them to quarantine stations, where they would undergo the testing for diseases required by Agriculture Canada prior to import into Canada. If one animal tested positive, all other animals in a group would be held in quarantine for a minimum of 90 days. So both parties knew that positive results during quarantine would lead to extra costs for feeding and housing, as well as for locating and transporting replacement reindeer. The signed contract allocated the risk between the parties as follows:

"Santa M. Claus ("Santa") agrees to purchase 57 purebred reindeer for \$2800 Cdn each from Arbutus Sled Accessories Ltd. ("Arbutus") [...] Arbutus does not take the risk of testing according to the federal requirements for import into Canada nor the risk of injury in transport. The price includes transport to Dock B at the North Pole."

Such a poorly worded risk clause led to considerable difficulties between the parties. Arbutus originally purchased a total of 64 reindeer in Norway. Eight reindeer died in transport or in testing. Ten reindeer tested positive for disease, and could not be imported into Canada. Some animals were returned to suppliers, and others were eventually resold. To try and fulfill the contract requirements, Arbutus

bought another 20 reindeer as replacement animals. As healthy animals cleared quarantine, Arbutus made deliveries to the North Pole. Eventually 21 reindeer were delivered before the issue of the extra costs came to light. Arbutus interpreted the contract as meaning that Santa would pay for the extra costs due to disease, testing and injury. When Santa refused to pay the extra expenses, Arbutus stopped delivery of the remaining healthy reindeer.

Santa argued that the risk clause was silent about costs, and that such costs were logically part of Arbutus's business risks as a reindeer supplier, interpreting the risk clause to mean that Santa only accepted risks such as delays in quarantine leading to a reindeer missing a training and flight season. Thus in Santa's view, Arbutus was in breach of the contract by refusing to deliver the remaining healthy reindeer. Arbutus in turn argued that the no-risk clause clearly said that the risks of transportation and testing of the reindeer were not with Arbutus. Therefore the risks, and by necessary implication the costs, were with Santa.

Santa is weighing his options and turns to you – the North Pole Procurement Specialist – for advice. Should Santa Sue? You be the judge.

Answer

As seasoned procurement professionals know, heading to court with your key suppliers is rarely a good idea, particularly when the clause at issue is not well-defined. This risk allocation clause is fairly unclear, so there is always the possibility the decision could go against Santa, and it is quite likely that the relationship between the parties will take a serious hit if they end up in litigation. Given the importance of a reliable source for new reindeer (after all, there aren't many), we suggest that it might be more appropriate for Santa to employ his interest-based negotiation skills, learned through NECI training, to try and come to a reasonable resolution with Arbutus. Both sides may discover they have a common interest in promoting reindeer in particular, and Christmas in general, and that a public court battle would be detrimental to them both. Litigation would also take months, and possibly years, to approach resolution, and Santa is facing serious time-sensitive succession planning issues. Arbutus is equally concerned with delays, as the costs are now mounting and Arbutus needs to be paid for the reindeer ordered. Perhaps some sharing of the costs so as to expedite delivery of the remaining reindeer can be agreed upon, or perhaps a third-party mediator can assist with developing other options for resolution.

Santa will likely need you to help him plan for and assist with the negotiation. Remember, most negotiations are won or lost based on the strength of the preparation, so spend adequate time designing your negotiation strategy, including your BATNA, and exploring the interests of both sides with Santa. Children all over the world are counting on you to find a speedy resolution – could the stakes be any higher?

For the procurement geeks among our readers who need to know how this turned out, this holiday tale is *extremely* loosely based on the case of ***Sarpen Contracting Ltd. v Arbutus Bay Estates Ltd. [1996], B.C.J. No. 830***, a judgment by the British Columbia Court of Appeal. (The link to this article is in the Backstory in the newsletter.)

Happy Holidays!