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Manufacturing Agreements: Key Issues and Practical Insights

Client Updates

International manufacturing arrangements are a cornerstone of cross-border commerce, enabling companies to scale production, accelerate innovation, and reach new markets. However, treating a manufacturing relationship as a straightforward purchase transaction is a common and costly mistake. In practice, these engagements operate as integrated operational ecosystems involving supply chains, regulatory requirements, quality systems, and intellectual property. When the contract does not reflect how the parties actually work day-to-day, the resulting friction can lead to disruption, delay, and losses that far exceed the value of the products.

This client update provides an introductory and practical overview of selected issues that commonly arise in international manufacturing agreements, with a focus on points that tend to drive disputes and that can often be mitigated through clearer drafting and practical operational alignment.

1. Structure of the Arrangement and the Parties' Roles: At the outset, the parties should define the structure of the relationship in operational terms, not only by legal labels. The agreement should clearly specify which services are included, such as production, procurement of materials, packaging and labeling, quality testing and release, storage, logistics support, and any regulatory or documentation-related obligations. It is also advisable to address exclusivity (if any) and permitted subcontracting.

2. Product Specifications and Quality: Quality and conformity are often at the center of manufacturing disputes, particularly where the relevant expectations are spread across multiple documents or evolve over time without proper documentation. Specifications should therefore be clearly defined, internally consistent, and incorporated into the agreement, including relevant drawings, bills of materials (BOMs), approved samples where relevant, and any required standards or certifications. Key topics typically include:

- a. Inspection and testing procedures and criteria, documentation requirements, record-retention obligations, and the allocation of responsibilities in connection with each stage of the quality process.
- b. Acceptance and rejection mechanics, including timelines, notice requirements, and the consequences of deemed acceptance (if any).
- c. Handling of non-conforming products, including rework, replacement, credits, root-cause analysis, corrective and preventive actions, treatment of systemic or repeated failures, and allocation of the

associated costs.

3. Forecasts and Lead Times: Commercial disputes frequently stem from the gap between non-binding forecasts and the practical realities of capacity planning. To mitigate these risks, parties should clearly define the role and binding nature of forecasts, the process for issuing and accepting purchase orders, and the rules for modifications and cancellations. It is also important to address lead times, minimum order quantities, and responsibility for excess or obsolete inventory, particularly where the manufacturer makes commitments in reliance on the customer's projections.

4. Intellectual Property and Tooling: From an IP perspective, the agreement should distinguish between background intellectual property and any improvements or derivative developments created during the engagement, and should clearly allocate ownership and usage rights accordingly. Where appropriate, restrictions should be included to prevent use of the customer's IP, confidential information, or know-how for third parties or for any purpose outside the relationship. In addition, the agreement should address ownership of molds, dies, fixtures, test equipment, and other dedicated tooling, as well as, where relevant, maintenance, insurance and return rights.

5. Warranty: Parties should consider how warranty obligations operate in a manufacturing context and align remedies with the practical path to resolution. The agreement should specify the available remedies (such as repair, replacement, rework, or credit) and clearly allocate responsibility where defects arise from the customer's specifications or supplied materials, as opposed to manufacturing or process failures. Where relevant, the parties should also include a recall or field action framework that addresses decision-making authority, notification obligations, regulatory interface, cooperation requirements, and cost allocation.

6. Termination and Exit Planning: It is often advisable to draft the agreement with the end of the relationship in mind. Exit planning is particularly important where continuity of supply, access to tooling, inventory treatment, and transfer of documentation are critical. Common issues include run-off production, last-time buys, treatment of work in progress and remaining inventory, return of dedicated tooling, and transfer of relevant documentation (including quality records and other manufacturing documentation necessary to support an orderly transition). Where transition assistance is contemplated, it should be defined with sufficient clarity, including scope, timing, and commercial terms, to ensure it is actionable when needed.

Careful planning, informed allocation of risk, and drafting that reflects the parties' operational reality can materially reduce disputes and help protect business continuity.

Our firm advises companies in Israel and abroad on a broad range of trade and commercial agreements, including manufacturing, development, supply, distribution, support, and service agreements. We would be

pleased to assist with structuring, drafting, negotiation, or review of manufacturing arrangements, as well as with dispute prevention and resolution.

This update is intended to provide general and concise information only. It does not constitute a full or complete analysis of the issues discussed, does not constitute a legal opinion or legal advice, and should not be relied upon as such.

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