Terminating Long-Term Technology Agreements
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One of the most frequent questions we receive from clients is how to get out of a relationship with a technology supplier, either because the client is unhappy with the supplier's performance or its business needs have changed.

Unless you have planned ahead, getting out of a technology contract can be difficult. Most contracts allow either party to terminate due to a material breach that remains uncured after 30 days' notice or upon the bankruptcy of the other party. Unfortunately, there is a big gap between being dissatisfied with the supplier's performance and demonstrating a material breach.

The standard for proving material breach is high; in fact, courts have noted that a breach must be so significant "that [it] goes to the root of the contract" or where "a party fails to perform a substantial part of the contract or one or more of its essential terms or conditions, the breach substantially defeats the contract's purpose." Also, the facts surrounding the breach are frequently unclear, disputed by the parties or the breach may have been waived by the parties' conduct. As a result, we recommend that the buyer should include additional, more specific, termination rights in the contract.

The right to terminate for convenience is the buyer's most certain way out of the contract; however, most suppliers are less inclined to allow termination for convenience, especially if they have invested capital to perform (e.g., the supplier acquired new equipment or software to perform) or have structured the payments so that the profits are deferred until the end of the relationship (e.g., providing transition services without charge).

Similarly, termination of the contract may result in significant costs for the supplier, as the supplier may have hired additional employees to perform the services or entered into agreements with contractors or leased space and the contracts cannot easily be terminated nor the assets redeployed to other projects or customers.

Reaching a Compromise

In these cases, the parties can compromise by allowing the buyer to terminate for convenience; provided that the buyer pays a termination fee to cover the supplier's stranded costs and, in some cases, a portion of the anticipated profits.

The buyer should also include other termination rights which provide the buyer with specific and predictable ways to exit the relationship, such as the right to terminate for the supplier's change of control, which protects the buyer from a new vendor that may be less qualified to perform the services or less enthusiastic about performing the services.

The supplier's financial deterioration should also trigger a termination right for the buyer because the supplier's financial situation may degrade the quality of services.

The buyer should look to draft termination rights which essentially serve to define a material breach, including breach of specific critical provisions, such as violation of law. Other termination rights may include the buyer's ability to terminate if the supplier fails to complete the initial transition of the services by a certain time. Similarly, the buyer should have the right to terminate the agreement if the supplier consistently fails to achieve the service levels. This right provides the buyer with a clear way out of the agreement if the supplier's performance is not up to the contracted level of service and also eliminates any argument that the supplier is "substantially" performing.

The buyer should also require the right to terminate for the supplier's repeated breaches of the agreement, even if the individual breaches are not material, but the volume of all the breaches could be considered material or disruptive to the buyer's business. This termination right is helpful to prevent disruption caused by a breach/cure, breach/cure scenario.

The buyer should also consider whether it may be helpful to have the option to terminate certain services, in addition to its right to terminate the entire agreement. Partial termination of the services can cause a variety of complications for both parties and these issues should, at a minimum, be contemplated at the time of contracting.

Limits on Termination

In contrast to the various termination rights negotiated by the buyer in long-term technology contracts, the buyer should seek to limit the supplier's right to terminate the contract. In long-term contracts, the buyer had handed over control of certain business functions to the supplier, and in some cases may have even transferred its employees, equipment and contracts to the supplier, causing the buyer to be dependent on the supplier for the performance of those functions. Consequently, the supplier's termination would be highly disruptive to the buyer's business and would either require the buyer to bring the services back in-house or find an alternative vendor.

For these reasons, the supplier's right to terminate should, ideally, be limited to the buyer's failure to pay. A supplier may argue that the parties should have reciprocal rights to terminate for material breach, but the parties are not similarly situated, and the potential impact of an unplanned termination is much greater on the buyer. Also, monetary remedies are usually a sufficient remedy for the buyer's breaches and termination is not necessary.

In addition to limiting the supplier's termination rights, the buyer should curtail the supplier's ability to abandon the contract and walk away from the deal.

A supplier may be tempted to walk away from a deal if it determines that it is cheaper to breach the agreement than it is to continue performing. For example, a supplier that has undertaken the development of a new software platform on a fixed price basis may realize that it will cost more to continue development of the platform than the fixed fees and decide to abandon the work. To counter this scenario, the buyer should include an anti-abandonment provision, which prohibits the supplier from abandoning the contract and provides that the supplier has unlimited liability for the buyer's resulting damages.

Consider Transition

When contemplating termination rights, the buyer should also consider what is required to transition the services away from the current supplier to an alternative third-party provider or back in-house. Ideally, the parties should work through these termination rights during the initial contract negotiations rather than after the relationship has deteriorated.

The buyer should contemplate whether it will need knowledge transfer regarding how the services are currently performed, provision of parallel operations during the transition or assistance in training the replacement personnel. The buyer should also consider whether it will need the right to solicit certain supplier personnel that were dedicated to its account.

Likewise, the buyer should consider whether it will want the right to purchase the dedicated equipment, third-party contracts and licenses from the supplier. If intellectual property is developed under the agreement for the buyer or embedded in any of the deliverables but is owned by the supplier, the buyer should consider what rights it will need to operate its business after the termination and whether it can obtain licenses to such intellectual property from the supplier.

The buyer should document these requirements in a termination assistance services provision in the agreement and should ensure that the supplier continues to perform the underlying services in accordance with the service levels and at the current fees during the termination assistance period.

A well-drafted termination assistance services provision and exit plan will allow the buyer to transition the services with as little business interruption as possible.

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