

Less than convenient termination

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Termination for convenience is a “must have” right for most customers when they enter into substantial supply contracts. However, insisting on this right from the very start of the contract can cause considerable problems for suppliers. A recent negotiating guide for the UK public sector identifies rights to terminate for convenience as one of the top four issues that can bog down negotiations. It recommends that customers consider forgoing this right for a period at the start of the contract.

Just how far should a customer push for the right to terminate for convenience? Not as far as you may think. Well that’s the guidance from a recently released negotiating guide for the UK public sector.¹ Given the highly sensitive nature of this issue for suppliers, the guide counsels customers to at least consider forgoing this right for a period at the start of the contract.

While the guide focuses on ICT contracts in the public sector, it contains material that can also be leveraged for any substantial supply contract (not just ICT) in the public and private sectors.

Why bother with this right to terminate?

Most customers push for the right to terminate for convenience to deal with the risk that changes in their market, structure or policy may mean that the contractor’s services are no longer required. If that occurs, the normal rights to terminate for insolvency or material breach won’t help the customer to avoid the unwanted bills. As a result, the need to protect the public purse or shareholder funds means that this is a “must have” provision for most long term engagements.

What’s the big deal for the supplier?

If the customer can pack up its toys and walk away at any time the overall deal becomes less financially attractive for the supplier.

While the likelihood of early termination might be low, the impact could be significant. And the more the customer pushes for this right the more the contractor wonders if it’s missing some critical information about what’s around the corner. The guide elaborates on some of the consequences of a less-than-certain financial model:

- *“An increase in the risk premium included in the tender price; and/or*
- *The Contractor organisation giving preference (in terms of allocation of scarce resources) to other business opportunities which are deemed to be more secure; and/or*
- *An increase in the possibility that sub-contractors will be reluctant to participate in the competition in favour of less uncertain revenue opportunities.”*

It’s no surprise then that this issue can bog down negotiations, particularly on larger deals. The guide helpfully observes that where a customer inappropriately sticks to its guns on the need for this right from the start of the contract it can work against the formation of a relationship that will contribute to overall project success.

Deferring the right to terminate

The guide recommends that customers seriously consider forgoing rights of early termination during the start of a project, as this is when loss of the “secure” revenue stream is most keenly felt by the supplier.

As a result, customers are encouraged to work through whether the immediate future is certain enough to justify deferring this right for

¹ *The ICT Services Model Agreement Negotiating Guide.* This can be obtained at www.partnershipsuk.org.uk.

a period. As the guide points out, a right of early termination should be a measure of last resort and only where the change in organisation or policy is so significant that it couldn't be handled by the normal change control process. Indeed, if there is uncertainty as to whether or not such a change might occur the customer may wish to postpone its procurement until greater certainty is achieved.

In our experience, most customers are willing to defer a right to terminate for convenience for at least the first 12 months of a contract.

But what about early termination charges?

Early termination charges tend to be part and parcel of working through the issues around early termination. They are often relied on as the means to get the provision "over the line" with the supplier.

The UK's standard ICT contract caters for a fairly comprehensive early termination fee (including providing some compensation for loss of return). However, the guide notes that these protections still do not "reflect the long-term commitment required of the Contractor in the procurement of a major project." In other words, they're not a silver bullet and there's still good reason to consider deferring rights to terminate for convenience during the start of the agreement.

All in all, the guide suggests a practical means of resolving some of the problems associated with early termination, while recognizing that it is still an option that most customers need.

We welcome your feedback on this article and any enquiries in relation to its contents. This article is intended to provide a summary of the material covered and does not constitute legal advice. We can provide specialist legal advice on the full range of matters contained in this article.

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