This session will cover

- Planning an exit strategy before ever signing a contract –
  - consistent with your overall (sourcing or servicing) strategy,
  - reduces risk of being locked in an unsatisfactory relationship or paying more to part ways and minimises operational impact

- An exit strategy helps:
  - identify possible risks,
  - defines potential losses,
  - ensures continuity of services & minimum business and customer disruption

- Planning for what happens after the relationship ends:
  - cost of transitional services,
  - flexibility to contract with another third party provider or bring the services back in-house.
**War stories**

- The AstraZeneca and IBM dispute – dispute about transitional arrangements
- The Al Jadeed and United Broadcasting dispute – potential delay in payment of licensing fees & ineffective termination notices
- Supplier retaining customer information after termination of software tool application development, fixed line, mobile telephony and mobile internet data connectivity services agreement
- Termination of a fixed term strategy consulting contract, with no termination clause & no breach
- Termination of a fixed term direct debit agreement, with limited termination clause & no breach

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**Key issues when negotiating the contract**

- What hat are you wearing? e.g. – procurer v supplier, providing sponsorship or endorsement
- Who are you dealing with? Is this a sub-contract? Back-to-back arrangements
- Do you need lots of wriggle room or do you need obligations clearly locked-in at the start? Conditions precedent?
- Essential terms, which will determine termination provisions (e.g. in sponsorship – reputation, scandal). Is time of the essence?
- Drafting termination clauses: Specifying material breaches, cascading termination clauses, cure periods, notice periods, mutuality, compensation, management of repeated minor breaches
Key issues when negotiating the contract

- Endeavours clauses can be tricky: is it better to particularise the obligations?
- Care when amending a complex agreement(s) & consistency
- Contractual &/or common law termination rights? Consider retaining termination under the contract and termination at law
- Automatic termination rights at absolute discretion: mutuality, notice period, compensation (excluding implied terms and good faith)
- What costs will you provision for upon termination & who bears those?
- Be aware of the nature of contractual damages so that you take this into account in your drafting and negotiation
- Exclusion and limitation of liability provisions & indemnities

Key issues when negotiating the contract

- Boiler-plates, notices, surviving rights, waiver.

**Transitional Ongoing Service Requirements**

- Need for partial termination of one phase of work only or a purchase order (or variations).
- Service provider’s obligation to continue performing the services at the same level of quality for the transition period and to continue to comply with all contractual obligations.
- Provision that the service provider give all work product (or code etc) at regular intervals during the transition period.
- Specifications for consulting at a reduced hourly rate, upon request.
- Tailor the compensation arrangement for the transition period in such a way to motivate the service provider to perform.
Key issues when negotiating the contract

Transitional Ongoing Service Requirements

- Requirements for the provision of parallel services for a certain period, with the right to extend the term as necessary to resolve issues before the final cutover.
- Service provider's obligation to keep the same service provider team performing services during the transition period.
- Confidentiality on any communications regarding termination.
- **Documentation and Knowledge Transfer:** Purchase of assets, assignment of sub-contracts, right to use material & IP in interim.
- Clearly delineate which party owns the work performed by the service provider and which party is responsible for solidifying the transfer of ownership.

Key issues when negotiating the contract: Data Security and Privacy

- Data privacy and security are critical.
- Provide for the immediate transfer of all data that belongs to your institution, including customer information.
- Determine an acceptable method by which the service provider will destroy and remove your company’s proprietary information, including information about the system, operations and business.
- Terminating any sublicenses to third-parties.
- Taking custody of any tangible property (PCs, servers, network equipment) provided to the service provider.
Costs - Transition, termination and timing

- Transition, termination and timing are a key part of the financial aspects of an exit strategy.
- Be sure the contract:
  - Will not penalize your institution for an early exit, especially if the termination is due to the service provider’s failure to perform adequately.
  - Specifies when compensation should be paid and how much, including compensation for any continuing base services and transition activities. For example, payment for transition services may be made at different milestones of the transition or when the transition has been completed successfully. In either case, there may be a monetary bonus to the service provider when the transition services are completed successfully.
  - Specifies the return of any pre-paid fees for which services have not been rendered.

Why are robust termination clauses important?

- A last resort when things go wrong
- Current economic climate, in which commercial parties may be unwilling or unable to honour their contractual obligations
- Less tolerance for continued poor performance
- Prevention of disputes through clear and unambiguous contractual termination clauses
- Avoid uncertainty & unpredictability: Law is complex and controversial. Different outcomes on appeal from first instance decisions
- Other drafting techniques to provide flexibility –
  - express suspension, redirection, step-in rights
  - structuring the term of the agreement, holding over
Contract termination rights

- Sources of termination rights:
  - Contract:
    - Failure of contingent condition (precedent & subsequent)
    - For cause (breach, delay, repudiation)
    - At will/convenience
    - Event (e.g. insolvency, appointment of receivers, adverse press coverage, unsafe conduct, use of underage workers, criminal activity, force majeure)
    - Expiry
  - Is there an express power to terminate in the contract?
    - If Yes, does the conduct fall within the scope of that power?
    - Ensure that you have a laundry list of rights that you can rely on to terminate where you are the procurer, sponsor or endorser
    - If No, does the aggrieved party have a right to terminate anyway?

Express powers to terminate must be construed according to their natural and ordinary meaning and read in light of the contract as a whole
Better to be cautious & conservative when construing the obligation
Carefully consider the factual matrix and the nature of the term breached to inform you if a right to terminate has arisen
Beware:
- Where a clause extends rights beyond common law rights, the contract is likely to construed precisely on its terms & any ambiguity read down to the common law position
- Impact of good faith (caution where choosing to opportunistically terminate)
Termination for convenience

- Only permitted where there is an express term in the contract
- Advantages of termination for convenience vis-à-vis termination for breach:
  - Ability to terminate the contract without the need to defend reasons for doing so
  - Mitigating risk of repudiation of contract
- Disadvantages of termination for convenience vis-à-vis termination for breach:
  - May forego right to damages, e.g. for loss of bargain
  - May encounter an allegation of breach of good faith obligation (unless clearly excluded in the contract)

Common law termination rights

- Concurrent with rights conferred by contract, unless expressly and clearly excluded in the contract
- Arises where there is:
  - Any breach of a condition/essential term
  - A serious breach of an intermediate term – the breach deprives the innocent party of substantially the whole benefit of the contract
  - Repudiation or renunciation (inability or unwillingness to perform the contract)
- Is it a condition:
  - Focus on the nature & seriousness of the breach/impact
  - Common intention of the parties at the time of contracting
  - Classification in contract & contract as a whole
Common law termination

- Will damages be an adequate remedy?
  - All breaches of contract entitle the innocent party to receive damages, but not all breaches entitle the innocent party to terminate
  - Termination rights exercised by the election of the innocent party
  - Beware: A right to terminate for breach can be lost by election to treat the contract as remaining on foot or by conduct constituting affirmation or waiver or that raises an estoppel

Restriction on right to terminate

- Unless validly excluded by the contract, the same restrictions that apply to a right to terminate conferred by law apply to a right to terminate conferred by contract:
  - the party terminating must:
    - be ready, willing and able to perform
    - not have prevented the other party from performing
    - not have dispensed with the requirement for the other party to perform
**Time stipulations**

- **Contract**: Make it clearly an essential term
- **Essential conditions at common law**
- In the absence of any time stipulation, performance must occur within a reasonable time: *Canning v Temby* (1905)
- If tardiness is the main breach – is there a valid justification?
- Extension of time where one contracting party prevents the other from performing: *Agricultural & Rural Finance Pty Limited v Gardiner* (2008)
- **Tactics**: Consider if there is any other remedy available: Interest for late payment or liquidated damages for delayed work

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**Remedies for wrongful termination**

- Other party is entitled to terminate & seek damages (maybe in excess of contract sum)
  - Usual claim: contract rates for work performed & loss of profits
  - If difficult to estimate loss of profits (e.g. where contract ended too early): reliance expenditure
- Other party affirms the contract but sues for damages
- Alternatively, a quantum meruit claim for work already performed
  - Perhaps preferable where a tricky termination & where there is minimal or no profit margin for remaining period
  - Loss is usually assessed based on contract price and events which actually occurred (overhead + profit margin)
Addressing dangers faced when terminating a contract

- Get the correct contract and check it carefully. Is it signed?
- Look for any possible variations, side agreements or collateral contracts, and pre-contractual representations
- Value of claim: What are the numbers?
  - What is the contract value & any future value? What is the profit margin if fulfilled?
  - What has been paid? What payments are in dispute/outstanding?
  - What portion of the other party’s business does this contract comprise? What is the value of the relationship?
  - Evaluate savings from termination v worst case scenario
- What are the dispute resolution provisions and do they apply? Any continuing obligations?

Consider issues such as:
- Does your contract exclude (expressly or implicitly) common law rights (complete statement of termination rights?)
- Will you lose a common law damages claim by terminating contractually? (Loss of bargain v liquidated damages)
- Are there enforceable exclusion or limitation clauses?
- Be prepared to act quickly and decisively to preserve your options: but "terminate in haste, repent at leisure" – act after you investigate the relevant factual matrix (relevance of surrounding circumstances & post-contractual conduct – cost)
- Protection of legal professional privilege when investigating
- Think tactically - reserve your legal rights when deciding your approach (in correspondence & discussions)
Addressing dangers faced when terminating a contract

- If electing contractual termination, carefully follow the procedure outlined in the contract
- Is there a right to terminate & is there room for interpretation? (Cf. repudiation)
  - Where a clause includes ambiguity and a draconian right, the innocent party may be better placed to rely on the common law rights, unless they are excluded
  - Courts do not offer lenience to those who liberally interpret the contract clause to their own benefit to achieve termination
- Consider good faith obligations? (Will it arise, will there be a breach, is there an exclusion?)
- Any justification or defence you need to better understand?
- Be the devil's advocate & not the yes man

Addressing dangers faced when terminating a contract

- Has the right to terminate been inadvertently waived?
- Does estoppel apply?

Drafting the termination notice:
- Communicate the breach & cure clearly (provide a reasonable opportunity to comply, at least as per the contract)
- If likely to be contentious: write as if a judge will be reading your letters
- Have notice and other procedural provisions (content, timing, mode of service) been complied with? Make sure that you can prove service! (*Pan Foods*: Court adopting a non-technical approach)
- If simultaneously exploring settlement – keep without prejudice and open correspondence clearly separate
Addressing dangers faced when terminating a contract

- If electing common law termination, reflect this in the termination notice accepting repudiation.
- Communication of an election to terminate is essential (it should be made even if termination is otherwise agreed).
- Beware of the following risks:
  - Delay in electing to terminate? You may need to await another serious breach.
  - Toxic environment of mistrust: Risk that the original innocent party commits a serious breach instead (e.g. non-payment).
- A communication asserting that the contract has already been terminated by prior notice or course of events may not be effective.

Managing the end of a contract without the need for litigation

- Managing expectations: You may initially have the high moral ground but if you elect to terminate, you bear the burden of proof (basis to terminate & loss).
- Termination by agreement: consideration required in order to be effective at law – deed of termination & release.
- Alternative dispute resolution, including commercial negotiations, mediation, expert determination or arbitration (carefully evaluate your position, the desired commercial outcomes & the numbers before attending).
- Variation of contract, or assignment of rights.
- What to do if you receive a termination or show cause notice?
  - Consider providing a proper analysis of the termination rights and point out why there is no basis to terminate.
  - Give them an opportunity to retract.
Foreign suppliers & supplying to government

- Where the supplier is in a foreign jurisdiction - obtain local law advice before taking steps to terminate a contract even if the contract contains clear termination provisions and is stated to be governed by Australian law.
- East/West link

Key Contacts

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