Eliminate Contract Termination During Its Term

Roberta F. Howell

The first column [1] of this series discussed strategies for minimizing the risks of terminating a distribution relationship by carefully structuring the relationship from the beginning. In this column, we identify strategies for minimizing the risks of termination during the contract term.

Monitor the contract. As noted in the first column, care in structuring the terms of a relationship from the beginning is crucial, but change is inevitable. It is important to recognize change and adapt. Contractual relationships are no different. Contract terms should be reviewed regularly and issues noted as they arise. Those issues may be practical (something is just not working), legal (the law has changed in some respect and the contract needs to be revised to accommodate that change) or market-based. Over time, these issues will become significant enough to justify an amended agreement. But like any change, contract modifications can generate fear and resentment if not handled properly.

Update the contract as necessary. Make change itself a routine part of the relationship. If revised/updated contracts are a regular part of the process, and if the changes take into account concerns of both parties, then the likelihood of resistance is lessened. Sometimes, however, a change may be necessary, regardless of that resistance. If a distributor refuses to sign, then what? Even states that heavily regulate the distribution relationship, like Wisconsin, allow a manufacturer to insist on a new contract, if done correctly, and a distributor's failure to sign may be good cause for termination. The important thing is that the changes are required across the channel and the consequences of failure to sign are applied uniformly.

Set reasonable performance standards. The single most contentious issue between suppliers and distributors is the setting, and enforcement, of performance standards. Failure to meet performance standards is the number one reason for termination. Surprisingly often, however, the way that the standard has been set or enforced in the past and/or across the channel prevents it from being a sufficient reason.

Performance standards must be practical and they must be fair. The best standards are not set unilaterally by the supplier, but with the input and consent of the distributor. Presumably, the distributor knows the idiosyncrasies of its market far better than anyone else and, while it is perfectly reasonable to set a stretch goal and require the distributor to overcome some local obstacle, that should be done carefully and realistically. Perhaps more important, where a distributor is meaningfully involved in setting the standard and agrees to it, it will be invested in meeting that standard and be hard-pressed to argue that the standard wasn't fair in the first place.

Factors to consider in setting performance standards include:

- Whether the standard should be quantitative or qualitative or both and, either way, how it will be measured;
- The standard should be significant enough to push the distributor to do better, but not unattainable;
- The standard should be clear and leave as little open to discretion or interpretation as possible; and
- Most important, the standard should be applied, and enforced, evenhandedly.

Even-handed enforcement — fairness — is key. Setting the standard is only half the battle. It is not enough to simply say, "you must do x" and then turn your attention elsewhere. Monitor performance against standards on a regular basis. Anticipate problems and address them early, before they become insurmountable. Work with distributors to help them determine why they're not meeting standards and provide them with assistance to help them improve their performance. Ask if there is some reason for the problem that is beyond the distributor's control and what you can do to ameliorate the problem. For example, was there a major disruption in the economy in their territory? Or more broadly, was there a personal issue of the principal or key employees that impacted their ability to perform? How can you help? These are the kinds of questions a jury will be asking themselves if you have to defend your actions, so you should ask yourself first and carefully consider the answers before acting.

In some organizations, field sales representatives understandably want to react quickly and decisively for a number of legitimate business reasons. Sometimes, though, a more measured approach is best. Just as with employees, distributor turnover has a number of real, economic costs that are not always easy to recognize, much less to measure, but are real nevertheless. Thus, it is important that termination be a last resort, not a first one. At the same time, however, it is equally important not to over-invest in a distributor that just can't be saved.

Maintain good records. Good records are crucial — records about how the standards were set, how they have been enforced, what has been done to assist troubled distributors and the like. Often the termination is proposed and steps are taken to effectuate it before reviewing the written documentation, only to find that the written documentation concerning the distributor's performance is glowing. Another common problem is that nobody can answer when asked how a similar situation was handled in the past. If good records are maintained, decisions about termination will be better-informed and more consistent and, if necessary, can be supported by proof that shows the decision was made property and for the right reasons.

Educate employees. Last, but by no means least, it is important to educate the in-house and field sales personnel about these issues. They are the ones who interact on a daily basis with the distributor. They know if there are unusual circumstances to be taken into account, and it is their personal agendas that may be getting in the way of good decisions. If they understand what they should be doing, and how painful a cross examination by a distributor's lawyer can be, they will do a better job. They will also be less likely to say things they shouldn't and better decisions are more likely to be made. Then, when termination occurs, the costs and risks of doing so will be reduced.

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