Minimizing The Risks Of Business Termination

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Terminating a business relationship can be difficult and costly, but sometimes necessary. This is the first of four columns that will discuss how a supplier can minimize the risks of termination at various stages of the relationship, starting at the beginning. Later columns will focus on similar issues during the relationship, when first considering termination, and, finally, when termination becomes inevitable.

Quite simply, the best way to avoid the risks of termination is to avoid termination altogether. The best way to do that is to carefully choose one's business associates, and clearly articulate what each side should expect from the relationship, from the beginning.

Choose members of the distribution channel carefully. There is a period at the start of every relationship where the parties are deciding whether they want to work together. This process is too often focused on the positive aspects of the potential partner. Thus, niggling concerns that, in retrospect, were red flags, are largely ignored.

When choosing a distributor, ask tough questions up front, and don't accept answers at face value. In other words, "trust but verify." For example, what other suppliers has the distributor has worked with? What happened? How long has the distributor been in the market? What is its track record? What do the distributor's

customers think? What about its former customers? Just as when interviewing a prospective employee, the distributor's "resume" can reveal a great deal, and both positive and negative issues should be investigated further.

Equally important is how the supplier sells the potential distributor on the relationship. An astonishing amount of litigation results when a supplier over-sells the opportunity, the product or both. The distributor who makes a substantial investment in reliance on those promises only to determine that they were empty may have significant legal claims.

Another factor to consider is how potential distributors are identified. Too often distributors are like football coaches – they get fired by one team only to be snapped up by another. Maybe it is time to look elsewhere for talent. Recruiting suppliers from non-traditional sources can significantly expand the talent pool with the added benefit of fostering loyalty by those grateful for an opportunity.

Have a carefully-drafted, written contract. Once a distributor has been identified and vetted, careful consideration should be given to the terms of the relationship. Unfortunately, it is still too common for the "formalities" of a carefully crafted written contract to be ignored. It cannot be stressed enough: the lack of a written contract doesn't mean there is no contact – it merely means that the terms of the contract are whatever someone is willing to testify they are. The Uniform Commercial Code (UCC) will supply certain "default" terms, but those terms are generally more buyer-friendly than seller-friendly. Industry practice may also inform the terms of a relationship, but there are few industry norms so clear or universal that they provide the same certainty a well-written contract provides.

A well-written contract need not be long or complicated. It does, however, clearly address the essential aspects of the relationship, which include:

- *Parties*. Is the supplier a person or an entity? What kind of entity? What entity? These questions have legal implications and may also implicate other terms that should be included in the contract.
- *Territory and product definitions*. The nature of the territory impacts the distributor's ability to succeed and the supplier's flexibility to address market issues. Defining the product impacts the supplier's ability to create multiple channels of distribution, add to or withdraw products from its line, etc. Antitrust issues may also arise.
- *Performance requirements*. The single most common reason for termination is that the distributor has failed to meet its performance obligations. To enforce such a termination, practical, reasonably attainable, but challenging, expectations applied fairly and uniformly by the supplier are crucial. The supplier's obligations should also be clearly spelled-out.
- *Term and termination*. It is common for contracts to have no specific end date or to provide for automatic renewal absent advance notice by one of the parties. Equally common is termination on 30 days (or some other short period) of notice for any or no reason and immediate termination on certain specified events. Cure requirements should also be considered and drafted

to avoid creating ambiguity.

- *Warranty*. Unless the product involved requires compliance with the federal Magnuson-Moss Warranty Act, the basic provisions of the UCC governing express and implied warranties are the default for most products. Thus, it is important to know what those provisions are, and tailor them appropriately to avoid unexpected liability.
- *IP*. Will the distributor be allowed to use the supplier's trademarks, logos, and copyrighted material? Under what terms? Will payment be required? How these questions are answered has ramifications for policing IP rights in other contexts as well as whether certain state "franchise" or "dealer" law may apply.
- *Terms and conditions of sale*. This often is addressed in a separate document and changed as circumstances dictate. Given the buyer-friendly provisions of the UCC, it is important to make clear in the distribution contract that the supplier's terms supercede any contrary provisions in the distributor's purchase orders or other documents.
- "*Boilerplate*." These provisions address what law will govern, what courts will have jurisdiction over disputes, whether arbitration will be required and the like. Without these provisions, litigation concerning the termination may take on an additional layer to address these issues.

These limited examples of the questions that should be considered provide a sense of the crucial role that these terms play in any relationship. Clarity on these issues will get the relationship off to a good start, provide a good foundation going forward, and significantly improve the ability to end the relationship, if necessary, with a minimum of uncertainty and risk. Combined with the strategies discussed in the next columns, the likelihood of a successful relationship is enhanced and the risks of termination minimized.

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