# DIRE STRAITS AND DRASTIC REMEDIES

Should things go badly wrong, customers fairly expect remedies, including rights to step in and walk away. During negotiations, suppliers naturally prefer to pass lightly over remote risks but must protect themselves against 'hair-trigger' remedies that could be abused.

### Limit Drastic Remedies to Dire Circumstances

Customer-oriented contracts permit customers to terminate for material breach and other grounds that are, in effect, examples of material breach, such as failures to execute disaster recovery plans, repeated service level failures or numerous minor miscues that, taken together, are material breach. The devil is very much in the details, including materiality thresholds and cure periods.

- 'Materiality' is, in essence, a label for a conclusion: default sufficiently serious to justify termination. The term defies precise definition but references to the entire engagement are helpful. Thus 'material breach of the Agreement' or 'material breach of the Agreement, considered as a whole' are better than 'material breach of an obligation' (which might mean minor obligations).
- Where remedies relate to specific situations, materiality may be quantified – for instance, as excessive numbers of unexcused failures to meet service levels, three or more consecutive failures or gross liability for credits ('penalties')[1] in excess of a large dollar threshold.
- Serious failures to perform recovery services after a calamity would almost always be material breach unless the same calamity constitutes *force majeure* and prevents execution of the recovery plan. Suppliers should make sure that *force majeure* clauses cover such emerging risks as cybercrime, irregular hostilities and the acts and omissions of governments, their security forces and intelligence agencies, among others. In many places, unlisted risks are deemed assumed.
- Customers often propose that unsuccessful transition be treated as grounds for termination. Their concern is understandable, but not every intermediate milestone is truly critical; time lost to delays can often be recovered; and drastic remedies should be limited to failures to complete transitions on time, after a reasonable 'grace' or cure period.

### Notice and Cure Periods

Cure periods must be reasonable. Thirty days is typical, but not always sufficient. Compromise language sometimes allows additional time, when necessary, provided the supplier promptly proposes a corrective action plan and thereafter diligently prosecutes it to completion within an agreed period.

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1 Although credits should not be characterized as 'penalties' (which the law will not enforce) the term is widely used by business people.

# COMMENTARY | DIRE STRAITS AND DRASTIC REMEDIES



Many customer forms permit termination for numerous minor breaches, if they are 'material in the aggregate.' Customer concerns about epidemic failures are understandable, for a thousand cuts may indeed equal a hemorrhage; but even so, there should be a notice that the customer regards minor failures as material, and an opportunity for corrective action.

Some customer forms would permit immediate termination for so-called 'incurable' breaches that cannot be reversed or retracted – such as releases of confidential information. One can, of course, imagine dire 'worst cases' (such as publication of a secret formula or other trade secret) but actual cataclysms are rare. More often, mitigation is possible. Root causes can be identified, media wiped, and measures taken to prevent recurrence. Termination may be limited to the very worst cases and otherwise tied to failures to cure root causes of lesser incidents.

**Step-In Rights**

Customers often request rights to 'step-in' and perform services themselves, or engage others to do so temporarily, in order to stabilize troubled operations or take corrective action. Rarely, if ever, are step-in rights actually exercised, for they are cumbersome, impractical and, in any event, a half-measure. Failures sufficiently serious to justify stepping in would usually justify default termination.

However that may be, suppliers can accommodate customer requirements by: (i) limiting 'trigger' events to the most serious failures; (ii) conditioning exercise upon reasonable (if abbreviated) notice and cure periods; (iii) permitting abatement of charges but (iv) requiring customers to pay for substitute service and assume related liabilities. Step-in rights must be temporary. Within a reasonable time, the customer or its proxy must 'step out' and normal service should resume; or else the customer should terminate.

If third parties (often competitors) are engaged to oversee operations or provide substitute service during 'step-in', the incumbent's proprietary methods and intellectual property must be protected. Third party oversight or management of leveraged operations supporting multiple customers rarely makes sense and should be resisted. Customers so inclined may be reminded of the potential risks and liabilities, then asked to provide a robust indemnity.