CLIENT ALERTS & INSIGHTS

Managing Risk When Terminating Vendor Relationships

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Key Takeaways

- Terminating a vendor relationship is not as simple as stopping performance. Companies should carefully follow the contract's termination provisions, including notice requirements, cure periods and other procedural obligations. Failure to do so can create breach-of-contract claims even when vendor performance issues exist.
- Business frustrations alone rarely justify an immediate exit. Courts apply doctrines such as material breach and frustration of purpose narrowly, making it risky to bypass contractual termination mechanics based on strategic misalignment or deteriorating commercial relationships.
- Liability risks often continue after termination. Organizations should plan for post-termination obligations-such as transition assistance, data and information transfers, outstanding payments, and cooperation requirements-while weighing the costs of a unilateral termination against the potential benefits of a negotiated exit that minimizes disruption and dispute risk.

Vendor relationships may deteriorate for a variety of commercial reasons, including underperformance, strategic misalignment or shifting business priorities. Under such circumstances, the more difficult question is how to exit a vendor relationship without increasing liability risk. Termination is not merely a cessation of performance; it is a process governed by contractual mechanics, equitable principles and practical realities that can draw claims and disputes. An understanding of termination obligations and mechanics is essential before implementing an exit strategy.

Mechanics of Contractual Termination. Commercial contracts often set forth the circumstances, procedures and timelines under which a party can terminate a contractual relationship. These provisions customarily address termination for cause (requiring written notice, potential limitation based on materiality, specification of the breach and a defined cure period) and termination for convenience (often conditioned upon advance notice, wind-down cooperation and payment of accrued obligations). The specificity of these provisions is material because courts enforce these procedural requirements. Even if it is believed that a counterparty's performance warrants the waiver of a cure period, the express terms of the contract controls absent a recognized legal doctrine that

displaces them. For example, a party that terminates for cause without affording the contractual cure period-or that fails to deliver notice as prescribed-may be found in breach of the contract.

Equitable Considerations and Common Law Principles. Common law doctrines such as frustration of purpose, impossibility, impracticability or material breach can support a claim for the immediate termination of a contract. Although these doctrines are available in principle, they are narrow in application. Frustration of purpose is a contractual defense that excuses a party from performing their duties when an unexpected event destroys the core reason for the agreement. It requires the principal purpose of the contract to have been substantially frustrated by an unforeseeable event for which the terminating party bears no fault. Courts will not enforce termination for cause where a commercial relationship has become unprofitable or strategically misaligned. Similarly, material breach requires a showing that the breach goes to the essence of the contract and not mere deficient performance. Bypassing a built-in cure mechanism gives rise to significant litigation risk. Parties should not assume the strength or depth of their grievance excuses compliance with their contractual termination obligations and procedures.

Wind-Down Exposure. Even if termination is properly initiated, the wind-down period presents its own commercial and compliance challenges. Contracts frequently impose post-termination obligations, including the return of confidential information, transition assistance, payment of outstanding invoices and cooperation in the orderly transfer of services or data to another vendor. A party that abruptly ceases performance, withholds cooperation or fails to satisfy payment obligations may be in breach during the wind-down period, independent of the underlying dispute. Importantly, services are rarely construed to be performed *gratis* even following the effective date of termination. This risk is compounded when the terminating party has adopted an adversarial posture, as courts scrutinize conduct during wind-down periods for evidence of bad faith or a failure to mitigate damages. Best practices require documenting compliance with post-termination obligations, maintaining contemporaneous records and avoiding the temptation to treat the relationship as finale until all contractual obligations are discharged.

Cost-Benefit Analysis. The decision to terminate a vendor contract calls for strategic calculation rather than reactive responses. Direct costs may be incurred, including early termination fees, accrued charges, transition costs and the expense of procuring replacement vendor services. Indirect costs such as claims of breach, litigation expenses, business disruption and reputational exposure can be significantly greater. Parties need to consider and model these costs against any projected savings before committing to an exit. In many cases, a negotiated termination that involves mutual release, agreed-upon timelines and a clear allocation of wind-down responsibilities tend to produce more favorable outcomes than a unilateral exit. Negotiating a consensual termination tends to be most advantageous before the parties' relationship deteriorates or a formal dispute arises. In most circumstances, the parties will retain their rights and remedies to pursue necessary legal action following termination, unless otherwise waived.

The Benesch Vendor Disputes Litigation Task Force is experienced with helping clients navigate the legal and financial complexities of terminating vendor relationships. By taking a disciplined approach that accounts for procedural compliance, documented performance and strategic negotiation, our team works to minimize exposure and position clients for the strongest possible outcome, whether at the negotiating table or in litigation.

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