

## TERMINATION FOR MATERIAL BREACH IN SOFTWARE CONTRACTS

### EXECUTIVE SUMMARY:

1. The customer must ensure that the supplier not automatically shut-off software by the use of malicious code, even in the event of a material breach of payment.
2. Customers have a valid interest in applying Termination for Cause for breaches by suppliers of their roles and responsibilities.
3. Termination for Cause against customers needs to be focused on material breach of payment not including disputed charges, or for a blatant violation of Intellectual Property Rights.
4. Rather than the customer committing to de-install the software in such cases, it is better that the supplier be obligated to seek an injunction to enforce its rights.

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Suppliers may suggest that suppliers and customers are equal partners in commercial transactions. From a customer's perspective, it may not be so. Suppliers and customer both sign the contract. Their roles and responsibilities, benefits and risks, may differ significantly.

Let us take the example of a customer acquiring and installing software to support its accounting function (customers still do this even with the ascendancy of Software as a Service – SaaS). If the software functions well, the customer will be able to meet its accounting obligations. However, if the software goes down completely for an extended period of time, the company may be at risk of going out of business. Even for failures of a lesser degree, when essential business functions are impeded or disabled, the company's continued operations may be at risk.

The supplier on the other hand runs the risk of not getting paid. Such non-payment undermines its ability to meet its commercial obligations and shareholder expectations. However, in most cases, it will not place the supplier at risk of going out of business.

Generally, the roles and responsibilities of the supplier are much more substantial than those of the customer. It is true that the supplier needs the customer's cooperation to successfully install and implement. The prudent supplier spells out such obligations in a Statement of Work (SOW). The customer's main obligation is to pay for the products and services, as per the contract terms. What it takes to deliver and maintain a well-working enterprise software package is much greater than what it takes to cut a check, even though the latter also requires due diligence. (Another key obligation of the customer is to respect the intellectual property rights of the supplier, for example, by refraining from re-selling the software if not authorized.)

So the supplier's fiction that the parties are equal translates to "Either party may terminate for a breach of contract." The smart customer says no. You, the supplier, have to mitigate your risk that we will not pay you, but you cannot do that by shutting down the software (and the customer's business)! Make your case in court. Get an injunction. Let the court validate your claim.

As a precaution against non-payment, it is reasonable for the parties to put in place at least two successive written notices by the supplier to the customer of a failure to make timely payment--with

thirty days to cure the breach. If the customer fails to cure, the customer will have agreed to de-install and cease use of the software. That contractual commitment can be enforced in court.

Suppliers frequently build in code that allows them to shut down the customer's software completely with a single command. It is ill-advised for the customer to allow the use of such code. Even if one of the customer's business units makes a serious technical mistake delaying payment, the customer cannot allow the supplier to shut down the customer's business. So, the customer may reasonably insist that the supplier not install such "malicious code."

Here's where materiality comes in to further refine the give and take. If the company owes \$1,000,000 and pays \$999,999.99, technically it is in breach of contract. However, it is not a material breach. Oxford Dictionaries defines material as "important; essential; relevant."

So, yes, the customer may terminate either for a material breach (or a series of non-material breaches that together might reasonably be regarded as a material breach because of their cumulative effect). The supplier has the right to request measures to ensure timely payment, provided that the customer's business is not disrupted.

When customers and suppliers dispute charges, the payment of such "disputed charges" is typically suspended or held in abeyance until the charges are resolved. The contract should reflect "material breach of its payment obligation not including disputed charges."

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Title: TERMINATION FOR MATERIAL BREACH IN SOFTWARE CONTRACTS

Best Practices Functional Area: Contract Terms

Best Practices Functional Sub-area: Termination

Information Technology Category: Software

Information Technology Sub-category: Software – Malicious Code

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