

Get me out of this contract!

The impact of a bad contract and how to get out of one

INTERVIEWED BY ADAM BURROUGHS

Far too often, companies overlook the allocation of risk and liability within the terms of a contract and instead focus on the economic terms. However, ignoring contract language could end up affecting the profitability and success of an agreement.

“A contract says you’ll pay me 20 cents per widget. On the surface, it looks like I’ll have a 10 percent margin. But in reality, there are hidden costs and considerable liability I’m taking on that will reduce my margin and expose me to serious financial risk,” says Patricia A. Gajda, partner, Corporate & Securities, at Brouse McDowell.

Smart Business spoke with Gajda about the importance of reviewing contracts and what, if anything, can be done to get out of a bad one.

What effect can bad terms in a contract have on businesses?

A bad contract is a cost to a business. Getting out of it often requires litigation. Any time a business ends up in litigation or in a lawsuit, it’s going to cost the business a lot of money. Not only is litigation itself an expense, it also diverts a company’s resources and infrastructure away from day-to-day responsibilities, which again adds to its cost.

Companies can get complacent with contracts, tending just to sign without reading, that is until a contract becomes a problem. Fortunately, much of the trouble that comes with contracts can be mitigated through preparation prior to execution of the agreement.

How can companies ensure they don’t get surprised by a contract’s terms?

Businesses should look for the clauses that

PATRICIA A. GAJDA
Partner, Corporate & Securities
Brouse McDowell LPA

(216) 830-6819
pgajda@brouse.com



FOLLOW UP: Ensure the next contract you sign is favorable to your business. Connect with Patricia before you put pen to paper at brouse.com/patricia-a-gajda.



Insights Legal Affairs is brought to you by **Brouse McDowell LPA**

dictate how a contract will be terminated in the event that it’s not working out as expected — the protections that exist for each party. For instance, when it’s a contract with a new customer, the deal might require an investment in equipment, labor and tools. Those investments come with the expectation that the contract will be seen through for a set period of time. But if the other party, because of the terms, can get out of the contract at any time with a 30-day notice, a return will never be realized on all that investment and those investment costs won’t be recouped.

Sometimes a company that’s locked into a contract becomes dissatisfied with the work that’s being done. It often doesn’t rise to the level of a material breach of the terms, but the company might feel as if it could get a better partner. Instead, the company is stuck with work that isn’t up to par with no way to get out of the agreement without a termination clause. Unless the contract requires that the company performs a certain way — that the product must conform to the expected design, specifications or sample provided — recourse is limited.

What is the importance of a termination clause?

If a contract is not working out, generally it’s not working out for either side, so a

company could go to the other party and try to find a way to cancel the contract and come up with a plan to unwind the deal. If that’s not possible, then in the absence of contract terms, the only option is a lawsuit, which will likely drag out longer than any contract term. This is why the termination provision is absolutely critical. It should spell out how a contract is terminated, when it can be terminated and the responsibilities of each party in the event that it is terminated.

How can companies take a better approach to contracts?

It’s good to have a lawyer who knows the business and its contracting tolerances to review contracts with new parties. A lawyer doesn’t need to review every contract. But it’s a good idea to obtain the clauses from a lawyer that should be scrutinized and a sense of the tolerances for certain deal terms. The upfront costs of clarification and protection save money from disputes later.

Outside of legal help, take time to read the contract terms. If it contains language that isn’t clear, get clarification until it’s understood. Get rid of ambiguity and make sure everything that should be covered is covered. Once a contract is signed, that’s what governs the agreement until the term is over. ●