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LEGAL CHALLENGES & CUSTOMER RELATIONS DURING **COVID-19**

Enterprise Playbook Series

INTRODUCTION

Navigating the best enterprise sales tactics continues to be top of mind for Work-Bench as we observe and advise our startups through COVID-19's uncertain markets. We have been collating our favorite resources, including industry blog posts and podcasts as well as recaps from our Weathering the Storm Webinar series and notes from our Sales and Customer Success Lunches in our [Enterprise Sales Guide: COVID-19 Edition](#).

One of the less talked about, but most important areas for enterprise startups to know is how to cover yourself legally when dealing with customer contracts. Knowing the specific terms and clauses within your contracts will help in determining what you're bound by with your customers, and how to best protect yourself during a downturn (or any normal time).

This Enterprise Playbook addresses many of the **legal challenges** sales leaders are facing during COVID-19, including how to best handle **customer and contract evaluation, contract renegotiation, and contract renewal**.

You can also watch our webinar recording on this topic ("Optimizing Customer Relations During a Pandemic - A Legal Perspective") with Dror [here](#).

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CUSTOMER EVALUATION

Simply stated, [not all customers are created equal](#). The first step in developing a strategic approach to your customer pipeline is evaluating your customer's value to you. The focus should be on the 3 P's:

PAYMENT ABILITY


Can your customer pay for your product or service? Payment history is not enough. Previously reliable customers may be struggling. If your customer is a public company, data on their financial health is readily available. For private companies, this task is more difficult. The Library of Congress provides a number of ways that information can be obtained (see it [here](#)). Finally, for venture-backed companies, it is relatively easy to obtain information about their last financing. Startups that raised their last funding more than 18 months ago (even possibly 12 months ago if the startups typically raised funds that frequently in the past), could be entering a period of financial stress.

POTENTIAL

Evaluate the potential of the customer going forward. It is critical to be honest with yourself. Everyone has that customer that is perpetually just about to place a large purchase order. Focus on the customer's growth trajectory and the likely impact of COVID-19 on their market. Consider whether any recent drop in orders is transitory or likely to continue.

PROFITABILITY

While startups and their investors focus on overall margins, few startups take a customer-by-customer approach to profitability. The reality is that two customers buying the same product can differ widely in terms of profitability. On the revenue side, this may result from better pricing given to one customer over the other. However, expenses can vary widely as well. Some customers simply require more hand-holding or have extensive reporting requirements that drive costs. For some customers, every contract modification involves a costly detour to "legal." The list of reasons is long, but the bottom line is that some customers consume a lot more resources for the same purchase. This is the time to identify who are the highest margin customers.



While a “3P Review” may not be possible for all of your customers, it should be done for all significant customers. If done right, this should allow you to rank customers. Clearly customers that rank high on all three dimensions should be a priority and the reverse is true for customers that score poorly. In the middle will be a mix of customers who should receive attention, but on a non-priority basis. You should commence a program of frequent communication with top 3P customers as understanding their challenges will make you a more responsive partner and help cement these relationships. It will also provide you with some level of “early warning,” if a customer is failing.

A WORD ABOUT CHANNEL PARTNERS

The terms reseller, distributor and dealer are used somewhat imprecisely. The key point is whether the channel partner buys and then resells or merely serves as a conduit to your sale to the end customer. If your channel partner buys and then resells, your “customer” is really the channel and your primary focus needs to be a 3P analysis on the partner. If your channel partner is more of a conduit or your collections from the channel are based on their collections from their customers, your 3P analysis needs to look through the partner to the ultimate customers.

CONTRACT EVALUATION

To make strategic adjustments to your customer relationships, you need to understand your contractual flexibility and exposure/liability. Hopefully, all of your customer relationships have some form of agreement — be it clickwrap or 70 page single space — in place. For significant agreements, now is the time to dust them off and review critical terms.

1 TERM AND TERMINATION

When does the agreement terminate? If it auto-renews, what is the notice period to stop the auto-renewal?

2 VOLUME

Are you committed to a minimum volume of production?
Is your customer subject to any minimum order requirements (take or pay)?

3 PAYMENT TERMS

Customers are already taking longer to pay. Contracts with long payment terms increase your credit exposure.

4 EXCLUSIVITY CLAUSES

Does the contract prevent your customer from going to other suppliers? Does the contract prevent you from selling to the customer's competitors?

5 BREACH

Under what circumstances can you terminate the agreement for breach? What is the relevant notice period?

6 LIQUIDATED DAMAGES

Some contracts provide specific payments in the event of late delivery or failure to meet service levels.

WHAT HAPPENS IF YOUR CUSTOMER IS NOT PAYING?

1 REVIEW THE CONTRACTUAL PAYMENT TERMS

Determine at what point does non-payment become a breach. Does breach require notice and is there an opportunity to cure?

2 SEND A REMINDER NOTICE THAT PAYMENT IS LATE

Even when the customer is already in breach, you shouldn't jump to declare a breach unless the client is not a significant, potential future customer. First, send a reminder notice (and anticipate a few follow ups, even a phone call) that payment is late. In some cases, you may discover that full payment is not possible at this time. In those situations, especially where you believe that the customer is likely to recover, you should consider offering payment plans or discounts for immediate payment. Always make sure to document any concessions and make it clear if they are one-time or ongoing.

3 DECIDE WHETHER TO CONTINUE SERVICES

While you are attempting "light touch" efforts at collection, you are left with the question of whether to continue servicing a non-paying customer. If your business has a low incremental cost of service, like a SaaS business, it might initially make sense to continue to provide service. By contrast, if you are providing a product and need to order parts to manufacture, you may need to accelerate the timetable for declaring breach and stopping performance pending payment. Always consult with counsel if you are considering stopping performance and the customer has not clearly contractually breached. Among other things, in some scenarios you may have the legal right to demand assurances from the customer that they will be able to meet their contractual obligations before you have to perform.

4 DECLARE A BREACH

If the "light touch" efforts don't work, you should consider declaring a breach and ratcheting up collection efforts. This also should be done in consultation with counsel because there are statutes that govern collections communications and collection efforts. Often a well written letter by counsel at relatively low cost can achieve significant results.

5 COLLECT BEFORE CUSTOMER BANKRUPTCY

If a customer goes bankrupt, in most cases you will be considered an unsecured creditor and will be "competing" for the same funds as other unsecured creditors of your customer. As a result, if you have doubts about your customer's solvency, you should accelerate the timetable on your collection efforts. Although not a guarantee that you will retain the funds, it is still better to collect the funds pre-bankruptcy. Once a customer goes bankrupt, if significant funds are at stake, you should engage counsel.

WHAT IS FORCE MAJEURE & DO YOU CARE?

Since the COVID-19 crisis started, you may have heard the term “force majeure” thrown around a lot with respect to contracts. “Force Majeure” (and several related legal doctrines) refers to so-called “acts of God” which the contracting parties could not have anticipated and make performance impracticable/impossible (not just more expensive or harder to perform). The bottom line is that the U.S. legal system hates rewriting contracts, so force majeure is a pretty high standard.

Buried in most contracts, however, is a force majeure clause, which is enforced very literally. If a clause defines A, B and C as force majeure events, the occurrence of D will likely not trigger the clause. Normally, a force majeure clause excuses performance by the impacted party, but even the implementation of that concept depends on how the clause is drafted. If a customer is asserting a force majeure clause against you or you are considering asserting it against a customer, you should review the clause carefully to make sure that it applies and what are the consequences. For more information on force majeure, see [here](#).

WHAT IF YOU ARE STRUGGLING?

For some startups, COVID-19-related internal cuts and supply chain issues will make contract performance difficult. If you are struggling, the key in the current environment is to communicate. Bad news may be unavoidable, but in our COVID-19 economy, it will not be unusual. Surprise bad news, however, can cause serious damage to the customer relationship and create liability. Advanced notice will allow your customers to take steps to mitigate the damages caused by your inability to fully perform, which will reduce potential claims against you.

If you can only partially perform your outstanding contractual obligations, the contract inventory process recommended above will be a critical guide. You need to understand the consequences of failing to perform each contract, with a special focus on contracts that have liquidated damages for partial or late performance. Some contracts will have specific provisions dealing with prioritization in periods of allocations (allocation of supply clauses). Once you have identified these priority customers, you will need to develop an equitable means of allocating your remaining capacity. Failure to do so will likely cause you to prioritize the “loudest complainers” which may not reduce your overall legal liability.

CONTRACT RENEGOTIATION

There is likely to be a steady stream of requests to renegotiate contracts as companies seek to cut costs. In normal times, these requests typically occur right before the requesting party has the right to terminate. In the current environment, it will occur “mid-cycle” with increasing frequency. The good news is, that without a termination right, legally in most cases you can hold your customer to their contract. The bad news is, that may not be the smartest thing to do.

Your willingness to renegotiate and the flexibility you show should be driven in large part by the results of the Customer Inventory above. Renegotiation with top 3P customers should clearly communicate to the customer that they are valued and you should attempt to show maximum flexibility. However, recall that one of the things that gave them their 3P standing was their profitability. You should go into negotiations with a good understanding of the “gives” that you can make that have the lowest impact on profitability. For example, if the company’s economic outlook is stable and your cash situation is not critical, this might be the time to extend payment terms. Another key to successful renegotiation is identifying your “asks” ahead of time. For example, the pain of requests for price reductions can partially be offset if the contract is amended to reflect increased minimum order requirements. Renegotiation is very customer-specific and you should do your homework to identify leverage points on both sides before starting the talks.

CONTRACT RENEWAL

In normal times, contract renewals are usually automatic events unless there have been problems. Given the impact of COVID-19, I believe that many companies will use renewal times as a logical point to request COVID-19 “inspired” changes to existing agreements. If your customer has not requested changes, in some cases, it is best to let “sleeping dogs lie” and not rock the boat by reopening contract terms at renewal time. Where customers have introduced new terms or you had problems with the customer in the current period, you will have more freedom to introduce new terms. Among terms that should be prioritized:

1 PAYMENT TERMS

These should be shortened where possible and for customers with significant credit risk, consider requiring partial or full cash up-front payment or letters of credit. Also, non-payment should be made an immediate basis for termination.

2 PRICE ADJUSTMENTS

Has the customer’s orders dropped significantly? Are large customer discounts still applicable? Is the customer especially expensive to service?

3 ADDRESSING INTERRUPTIONS

Based on the current medical thinking, additional waves of COVID-19 related lockdowns are possible. Contracts should be revised to expressly address the consequences for both parties. Consider adding an allocation of supply clause that limits your allocation obligations if supply becomes tight.

4 MORE FLEXIBLE TERMINATION

Contracts often provide for the right to terminate the agreement in the event of the customer's insolvency. These clauses can be modified further to allow for termination based on “early warning signs” of financial instability.

5 FORCE MAJEURE

This is a good opportunity to “bulk up” your force majeure clause. For a model of a more comprehensive clause, see [here](#).

6 ADD AN ALTERNATIVE DISPUTE RESOLUTION CLAUSE

In normal times, there are differing views on alternative dispute resolution clauses in contracts (i.e. contractual requirements to resolve disputes through mediation or arbitration) and which "side" they favor. As a practical matter, the COVID-19 crisis has significantly disrupted the operation of the court system — you just may not get your "day in court" any time soon. If your agreement does not already have such a clause, consider adding one, preferably make arbitration binding (the arbitrator acts like a judge and their order is binding). In addition to usually being less expensive, arbitration will be much quicker than any court-based process.

A REPUTATION IS A HARD THING TO REGAIN

This article is very "legalistic." However, even though you have legal rights and options, does not mean that using them is always the best business decision or, for that matter, the right thing to do. Responding to this crisis requires a lot of tough decisions, often in scenarios with limited/no options. However, how you conduct yourself during this crisis will be remembered long after and alienating customers is never good for business. Show flexibility when you can and if you can't, at least show empathy if your customer is struggling but acting in good faith.

Disclaimer: These materials are for informational purposes only and not for the purpose of providing legal advice. You should contact your attorney to obtain advice with respect to any particular issue or problem. The opinions expressed in this presentation are those of the author alone and may not reflect the opinions of the firm or any other attorney.

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