

CAN THEY TERMINATE YOUR RESIDUALS?

By Paul A. Rianda, Esq.

Some of the most important, and contentious, provisions in most of the contracts I negotiate are the termination provisions. These are contentious provisions because they govern the circumstances under which an ISO can cease paying a sales agent its residuals. Below I will discuss termination provisions, the circumstances under which residuals can be terminated and tips for drafting such provisions.

What is a Termination Provision?

In most agent contracts there is a section titled “term and termination” that contains the provisions that are the subject of this article. This section of the typical Agent Agreement usually states how long the agreement will remain in effect, which in most contracts is anywhere from 1 to 5 years. Here you will also find the most important terms in the contract that set forth the exact circumstances that will allow an ISO to cease paying the agent its residuals.

The typical termination provision allows the ISO to cancel the agent’s residual payments if there is a breach of the agreement. I find this type of provision to be detrimental to the agent to the extent that it allows the ISO to cancel the residual payments under a broad range of circumstances. For instance, often times the typical agent contract will contain a provision that the agent must get the written consent of the ISO for all of the agent’s marketing materials that use the ISO’s name. If the agent produces some marketing materials, utilizes them without the consent of the ISO and then as a result the ISO is somehow notified of this breach, the agent could conceivably lose its right to its continuing residual stream. There are dozens of duties and responsibilities in the typical Agent Agreement that could serve as the basis for the agent’s residual stream being terminated.

Another termination provision in most agent contracts allows the ISO to terminate the residual payments if there is a violation of the Visa and/or Mastercard rules. The problem with this type of provision for an agent is that there are hundred if not thousands of such rules. It is therefore difficult for an agent to comply with such a complex and extensive set of rules, especially since a copy of the rules is almost never provided to the agent.

There are also a number of other provisions in Agent Agreement that allow an ISO to cease payment of residuals. One is the provision that terminates the residual if the agent tries to move the merchants it has provided to the ISO to another credit card processor. Agent contracts usually have a provision that states if the agent becomes bankrupt or insolvent then the residual payments will end.

The other thing to check for in an agent contract is “hidden” provisions that allow an ISO to terminate the residuals. Often times there will be a long provision in the Agreement, such as the paragraph dealing with confidentiality, that will contain a sentence that states if that paragraph is violated then the residual can be terminated by the ISO. This points out the importance of carefully reading every single paragraph in an agent contract.

How to Modify the Termination Provision:

Termination Provisions

From the perspective of an agent, there are a number of things it can do in order to try and preserve its rights to a continuing residual stream. The first thing to do is to make sure the Agent Agreement allows for the agent to continue to receive its residual in spite of any cancellation, termination or expiration of the agreement. If this is not clearly stated in the agreement, the ISO can take the position that it can cease paying the residuals to the agent if the agreement is terminated or expires, even without cause.

The next important step is to try to limit the circumstances under which the ISO can terminate the residual. The typical provision that allows the residual to be terminated for a material breach and the myriad other reasons I have set forth above is much too broad from the agent's perspective. What I generally try and do is limit the situations that an ISO can terminate the residuals to a few limited circumstances. These limited circumstances must be clearly set forth in the contract and there must be an explicit statement that for these reasons, and no others, the ISO can terminate the residual payments.

One provision that ISO's generally want to include as a reason for terminating the residual payments is if the agent tries to move merchants to another processor. This is a reasonable limitation imposed by the ISO. However, the agent needs to make sure that it has the right to move a limited number of merchants if, for example, the merchant no longer wishes to process with the ISO. Without such an exception, moving even one merchant could cause an agent to lose its rights to its residual stream.

ISO's also usually want to be able to terminate the residual if there is some kind of fraudulent activity involving merchants. Again, this is a reasonable position taken by the ISO but the agent can still get some additional concessions to allow it a little more protection. Agents generally should request that there only is a breach of the Agent Agreement if the agent knew about the fraud and assisted in the fraud. If a merchant submits false information to the agent and the agent does not know about it, then the agent should not have to suffer for the merchant's fraudulent activity.

Another way for the agent to limit its exposure is to promise to make good any monetary losses of the ISO caused by the agent. If the agent causes a monetary loss to the ISO, the contract can call for the agent to continue to receive its residual if it reimburses the ISO for the loss. This can take the form of a direct payment by the agent to the ISO or the residual stream can be used to extinguish the loss by the ISO. The Agent Agreement should be clear however, that once the loss is paid off, the agent will again continue to receive its residual stream.

The termination provisions, as the most important terms in an Agent Agreement, are the terms you should spend the most time reviewing and revising. In the long run, it is prudent to do so in order to secure your financial future.

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