



## Termination of commercial contracts

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Common reasons for terminating a contract include unsatisfactory performance of the whole or part of the contract by the other party, refusal by the party to perform the contract at all, or that the other party has breached some other provision of the contract. Other reasons might include:

- the contract is no longer practical for one party to continue (for example, the party can get the goods/services more cheaply elsewhere)
- the party no longer requires the goods or services or cannot fulfil the contract, or
- one of the parties has gone into or is about to go into insolvency.

It is always important to assess the relationship between the parties before terminating – if there is an on-going relationship, an alternative approach may be appropriate, for example:

- formally renegotiating the contract with a view to varying its terms, or
- following a prescribed dispute escalation procedure (or instituting one) to try to achieve a mutually acceptable solution.

Termination means that the contract is 'discharged'. The contract does not actually cease to exist (remaining in place so far as accrued rights and obligations are concerned), but the future rights and obligations of the parties fall away.

### **Contractual termination**

Some contracts will expressly come to an end after a fixed period of time. Others will require some positive step to be taken by one or both parties to bring about termination.

Contractual termination rights will operate in addition to common law rights to terminate (*see the 'Termination at common law' section*) unless they are expressly or impliedly excluded.

Contracts usually make express provision for termination in certain specified circumstances and the steps that should be followed in order to effect termination. The circumstances specified may include, for example:

- certain types of breach (usually 'material' breaches that would justify termination at common law)
- change of control of a party to the contract, or
- actual or threatened insolvency of a party to the contract.

Contracts also often provide that a right of termination will only arise after the defaulting party has failed to remedy its breach within a given period. In such circumstances, the aggrieved party must give the defaulting

party the opportunity to remedy its breach before proceeding to terminate.

If the contract contains no express provision on termination, a term allowing termination on reasonable notice may sometimes be implied. What is reasonable notice in the circumstances is a question of fact to be determined at the time of the termination but the courts have considered the following matters relevant:

- the formality of the relationship between the parties. More formal relationships are likely to require greater notice of termination
- the length of the commercial relationship and how much the parties have invested in it. Longstanding relationships involving substantial investment are likely to require greater notice, and
- the duration and scope of the obligations of the parties under the contract. Again, the longer the term of the contract and the broader its scope, the greater the notice period likely to be required.

Note that termination clauses in contracts can be held to be unfair (and, as a consequence, invalid) either because of consumer rights legislation, eg Consumer Rights Act 2015, or because they are considered unreasonable pursuant to the terms of the Unfair Contract Terms Act 1977.

### **Termination at common law**

The following breaches justify termination at common law:

- breach of a condition of the contract
- repudiatory breach of an 'intermediate' or 'innominate' term of the contract
- a party's outright refusal to perform all or the substantial part of its obligations under a contract ('anticipatory breach' or 'renunciation'), or
- where one party makes it impossible (by act or omission) to perform the contract.

In the absence of express termination provisions, when considering whether or not a breach gives rise to a right of termination, it is relevant to consider the classification of the term(s) breached. Even if not expressly labelled as such, contractual terms can be classified as:

- 'conditions' (a term, the breach of which entitles the aggrieved party to terminate)
- 'warranties' (a term, the breach of which (however serious) does not entitle the aggrieved party to terminate, but which could lead to an award of damages); or
- 'intermediate' or 'innominate' terms (the remedy for breach of which depends on the nature and effect of the breach at the time it happens, but which may amount to a repudiation of the contract).

The label given to a particular term of the contract is not determinative – its classification is a question of substance, not form. If termination seems too drastic a remedy for a breach of a term that is labelled a condition, the term may instead be interpreted as an intermediate term not justifying termination.

### **Repudiatory breach**

Whether or not a breach is repudiatory in nature (so as to justify termination) depends on a number of factors. The approach of the courts is firstly to consider what benefit the injured party was intended to obtain from the performance of the contract and secondly to consider the effect of the breach on the injured party and whether it operates to deprive the aggrieved party of substantially all of the benefit the parties intended that party to obtain under the contract, for example:

- the level of the financial loss. A court is more likely to consider non-payment to be a repudiatory breach if the sums owing are substantial and the delay in payment lengthy
- how much of the benefit under the contract the injured party has already received. The court will consider the work that has already been done and assess its value. If it is worthless then the court is more likely to find that there has been a repudiatory breach
- whether the aggrieved party can be adequately compensated by an award of damages. Where it can be compensated without the whole contract being terminated, the court will be less likely to find a repudiatory breach
- whether the breach is likely to be repeated. If there has been some mistake or misunderstanding, the court may have

some sympathy, but if the defaulting party does not have the money to pay then non-payment will be regarded as a repudiatory breach, and

- whether the guilty party is likely to resume compliance with its obligations. Again, if there has been a mistake or misunderstanding which could explain the lack of compliance, the court is less likely to find a repudiatory breach.

## **Election**

When faced with a repudiatory breach by the defaulting party, the aggrieved party may elect either:

- to treat the contract as continuing and force the defaulting party to comply with its obligations ('affirming' the contract). It may be preferable to affirm the contract if, for example, it is difficult to find an alternative supplier. Whilst you will lose the right to terminate the contract for that particular breach, the option to claim damages for the breach remains, or
- to terminate the contract ('accepting' the repudiation) and claim for damages.

Before exercising its election, it is important for the aggrieved party to be sure that there has in fact been a repudiatory breach. If the court disagrees with the aggrieved party's assessment then it may be held to have acted in a repudiatory breach itself.

Election is an important decision and one which needs to be made by the aggrieved party without undue delay, pending which, the aggrieved party should avoid doing anything which could be interpreted as affirming the contract. Indeed, delay itself can be interpreted as affirmation.

## **Anticipatory repudiatory breach**

An anticipatory breach (or renunciation) is where one party, by words or conduct, demonstrates its intention not to perform either all of its obligations under the contract, or to perform them in a way that is substantially different from the requirements in the contract.

If the anticipated breach can be shown to be repudiatory in nature then the aggrieved party is entitled to terminate the contract at that point, even though the actual date for performance has not yet been reached.

In order to prove this, it is necessary to demonstrate that the defaulting party has made it clear, beyond reasonable doubt, that it no longer intends to perform its side of the bargain.

In such a situation, it is possible to choose either to accept that the contract has been repudiated and terminate at that point, or wait until the date for performing the obligation passes and treat the defaulting party as being in actual breach at that juncture. It is often easier to justify an actual breach rather than an anticipatory breach as being repudiatory.

## **Affirming the contract**

If the aggrieved party elects to affirm the contract, it is important to:

- communicate its affirmation to the defaulting party clearly and unequivocally
- stipulate tight deadlines for the defaulting party to perform its obligations
- reserve the right to claim damages for breach at a later date, and
- if appropriate, state that time is of the essence and set a reasonable deadline for the defaulting party to comply with its contractual obligations. This will make it easier to argue that there is a material breach if the defaulting party breaches the contract again.

## **Terminating the contract**

If the aggrieved party opts to terminate the contract, it should check what the contract says about termination and what procedure must be followed. The contract may stipulate that a termination notice must be served in a particular way.

Termination notices need to be drafted carefully, otherwise they may be considered invalid. See section 10 below for key points to include.

Many contracts will include a dispute resolution procedure which the parties will need to follow before court or

arbitration proceedings are commenced. Check the provisions carefully. They may require the parties to discuss all disputes informally before any formal action is taken and in some instances may also require the parties to participate in a mediation.

If you are intending to serve a termination notice then consider sending a separate without prejudice letter at the same time suggesting a meeting or dialogue to attempt to resolve the matter. Without prejudice correspondence and negotiations are not admissible as evidence in court and, therefore, will not prejudice your case in respect of termination.

It is acceptable to exercise both contractual and common law rights of termination at the same time.

However:

- if the relief available under contractual and common law termination is identical, it is not necessary to specify which right is being exercised in order to bring about an effective termination, and
- in cases where the consequences of exercising the two rights are different, but not inconsistent, it is necessary to make it clear which right is being exercised or that both rights are being exercised, otherwise there will not be the certainty required for an effective termination.

Note that there may be a difference in the level of damages you can recover depending on whether termination is contractual or repudiatory at common law.

### **Termination notice requirements**

State whether you are terminating under the contract, and if so which provision, or state that the breach is repudiatory, entitling you to terminate.

State when termination is effective from. This can be immediate, or state the notice period required in the contract.

Set out comprehensive details of the alleged breach by the defaulting party. Be as specific as possible, including dates of key incidents and correspondence.

Be specific in relation to details of the monies claimed or loss suffered.

Include provision for claiming interest and costs.

If the defaulting party has indicated that it will not comply with future obligations, your notice should also:

- include references to this indication, and
- state that you wish to terminate the agreement as a result of this confirmation, which amounts to an anticipatory repudiatory breach.

### **Practical points**

If you are thinking of exercising a contractual termination right:

- consider carefully whether contractual termination suits your purposes better than the common law right, as you may be making an irrevocable election
- read all the relevant contractual provisions very carefully and follow them exactly. For example, are you obliged to give the party in breach an opportunity to remedy?
- take steps to mitigate your loss. A party cannot recover damages for losses which could have reasonably been avoided, so consider how you might be able to prevent or reduce loss.

If you receive a notice of termination:

- consider in detail whether it complies with the contractual requirements, and
- decide what (if any) use you can make of it to advance your position, for example service of the notice could itself

constitute a repudiatory breach.

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