

Identifying and managing risks when performing and terminating contracts

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Overview

- Risks that arise in the performance of a contract
 - Representations in the course of performance
 - Case study: *Franks v Equitiloan Securities Pty Ltd*
 - Conduct of the parties and conventional basis of relationship
 - Case study: *Waterman v Gerling Australia Insurance Company Pty Ltd*
 - Case study: *Moratic Pty Ltd v Gordon*
- Risks that arise on termination of the contract
 - Wrongful termination
 - Loss of termination right
 - Drafting of the termination notice
 - Case study: *John Tumminello v TAB Limited*

Representations during course of performance

The test in broad terms:

1. The plaintiff assumed that a particular expectation would be fulfilled
2. The defendant induced the plaintiff to adopt that expectation
3. The plaintiff acted or abstained from acting in reliance on the expectation
4. The defendant knew or intended him to do so
5. The plaintiff's action or inaction would occasion detriment if the assumption is not fulfilled
6. The defendant failed to act to avoid that detriment

Representations during course of performance (2)

Case Study: *Franks v Equitiloan Securities Pty Ltd* [2008] NSWSC 33

- Windy Dropdown Pty Ltd - owner of a development at North Curl Curl
- Equitiloan Pty Ltd – provided finance to Windy
- Finance terms:
 - Interest on the principal at 10.25%
 - Default interest at 16.25%
 - Default included a failure to repay the principal by a certain date
- Dispute arose in relation to the requirement to pay the default interest
- Held that Equitiloan had a prima facie right to default interest
- Question was whether Equitiloan was estopped from enforcing that right.

Representations during course of performance (3)

Case Study: *Franks v Equitiloan Securities Pty Ltd* [2008] NSWSC 33

- Conversation in March 2000:
 - Windy: *I am very concerned about what will happen in April. Do you propose to do anything about the loan?*
 - Solicitor: *I can assure you that nothing will happen. If everything is proceeding properly, we are more than happy to continue with the project. We will continue to fund the project.*
- Held that the the elements of promissory estoppel were established and that Equitiloan could not charge default interest.

Representations during course of performance (4)

Some considerations:

- A concession made by a party in a contractual relationship to not insist on strict performance of a contractual obligation may prevent that party from later insisting on strict performance of that obligation.
- If a party wishes to make a formal concession, ensure that as far as possible the concession is in writing and drafted carefully. For example, if extending the time allowed for payment, state precisely on what basis and for what reason. Alternatively, consider a formal variation of the contract.
- If a party wishes to resile from a concession and insist on strict performance of the contract, it must give reasonable notice to the other party, and the notice must be sufficient to allow the other party to reverse any detriment that it may suffer.
- If a party wishes to enforce its strict contractual rights, it is prudent to enquire about communications between the parties to determine whether an estoppel may prevent such enforcement.

Risks that arise through course of conduct

The test in broad terms:

1. The plaintiff has adopted an assumption as to the terms of its legal relationship with the defendant
2. The defendant has adopted that same assumption
3. Both parties have conducted their relationship on the basis of that mutual assumption
4. Each party knew or intended that the other party would act on that basis
5. Departure from the assumption will occasion detriment to the plaintiff.

Risks that arise through course of conduct (2)

Case Study: *Waterman v Gerling* [2005] NSWSC 1066

- Waterman owned an aircraft, which was insured with Gerling.
- Insurance policy:
 - Payment of premiums by instalments
 - Instalment not paid by due date, cover to cease at midnight of due date.
- Payments of instalments
 - First instalment – due on 6 July 1997, paid on 16 July 1997
 - Second instalment – due on 6 September 1997, paid on 29 October 1997
 - Third instalment – due on 6 December 1997, paid on 19 January 1998
- New policy issued on 19 June 1998, covering the period from 6 June 1998 – 6 June 1999
 - First instalment – due on 6 June 1998, paid on 21 July 1998
 - Second instalment – due on 6 September 1998, not paid
 - Third instalment – due on 6 December 1999, not paid
- Aircraft destroyed in an accident on 2 January 1999.

Risks that arise through course of conduct (3)

Case Study: *Moratic v Gordon* [2007] NSWSC 5

- Lease of hotel between Gordons (lessor) and Danahers (lessee)
 - 12 year lease
 - Rent of \$26,000 pa (increasing by 4 per cent each year) (the “fixed rent”)
 - Further rent equivalent to 4 per cent of annual liquor purchases (the “further rent”)
- Gordons did not charge the ‘further rent’ and never referred to it
- Danahers sold business to Moratic in May 1999 for \$100,000.
Lease was assigned to Moratic.
- No mention made to Moratic of the ‘further rent’. Purchase price calculated only on the basis of the ‘fixed rent’
- Gordons did not charge the ‘further rent’ and never referred to it
- Dispute arose in October 2006 in relation to payment of the ‘further rent’, which amounted to \$972,478.

Risks that arise through course of conduct (4)

Some considerations:

- A customary course of dealing by parties in a contractual relationship, which is different from the course of dealing envisaged in the contract, may prevent parties from later insisting on strict performance of certain contractual obligations.
- Review standard administrative forms and procedures to ensure that they are consistent with the course of dealing envisaged in the contract (or draft the contract so that it is consistent with standard procedures).
- If a customary relationship has developed beyond the scope of the relationship envisaged by the contract, consider executing a formal variation of the contract.
- If a party wishes to resile from a customary method of performing the contract and insist on strict performance of the contract, it must give reasonable notice to the other party, and the notice must be sufficient to allow the other party to reverse any detriment that it may suffer.
- If a party wishes to enforce its strict contractual rights, it is prudent to enquire about the nature of the customary relationship between the parties to determine whether an estoppel may prevent such enforcement.

Wrongful termination

- Right to terminate may arise:
 - By application of common law principles
 - By operation of a specific clause in the contract
- Under common law, right to terminate may only be exercised
 - if the clause is a 'condition', or the breach is so serious as to deprive the party of substantially the benefit of the contract
 - If the non-terminating party is not 'ready, willing and able'
- Under contract, by following the procedure in the termination clause
- Termination where there is no legal right may amount to a repudiation and entitle the non-terminating party to damages

Wrongful termination (2)

Some considerations:

- Termination of a contract under the common law (ie. where the contract provides no express right of termination) is a serious step and should not be taken lightly. If in doubt about the right to terminate, consider writing to the party in default seeking an assurance that they intend to perform the contract according to its terms.
- If terminating pursuant to a contractual right, ensure that any time limits or requirements for notice are strictly complied with. Also consider whether the contract (expressly or impliedly) imposes any obligations of good faith.
- Consider whether any estoppel may operate to prevent the party exercising a right of termination in relation to a particular breach.

Loss of termination right

- When a party has a right to terminate a contract, they are faced with a choice:
 - Terminate the contract; or
 - Continue with the contract.
- If a party makes a choice and acts in a manner that constitutes ‘unequivocal conduct’, they are bound by that choice.
- Some considerations:
 - Parties should seek advice at an early stage and formulate a view as to whether they wish to terminate the contract or continue with their contractual relationship.
 - If a party wishes to terminate a contract, consideration must be given to how the parties conducted themselves after that right of termination arose.

Drafting the termination notice

- When a party has a right to terminate a contract pursuant to a clause in the contract, they must comply with the procedure set out in the clause.
 - The termination notice must be:
 - Clear and unambiguous
 - Will be construed by a court “non technically” and in accordance with business common sense
 - What is required of a notice is to be determined by the terms of the contract, including what is to be discerned as the purpose of the notice
- A termination notice that contains even minor errors (even typographical) should not be fatal to the right of termination, but may still lead to litigation that will not only be costly, but may also delay the process of bringing the contract to an end.

Drafting the termination notice (2)

Some considerations:

- If using a standard form of termination letter, ensure that it is amended to reflect the contract. If a party does not wish to rely on a particular clause, or on particular conduct, do not refer to it.
- If a party has multiple rights of termination, a party may refer to those different rights in the termination notice, but ensure that it is made clear what right is relied upon.

Questions?

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