

Termination of Contract: A practical guide on when and how to terminate a contract and common mistakes

Simon Chapple

Barrister

13th Floor St James Hall

schapple@stjames.net.au

Adjunct Fellow, School of Law

University of Western Sydney

Overview

- A refresher on termination of contract
 - Termination at common law
 - Termination pursuant to contract
- Restrictions on the right to terminate
 - Duty of good faith
 - *Contracts Review Act 1980*
 - *Australian Consumer Law*
- The effect of estoppel on the right to terminate
 - Representations made during the course of the contract
 - Customary basis of the relationship
- Common mistakes
 - Wrongful termination
 - Loss of termination right
 - Errors in the termination notice

Termination at common law

Termination by agreement

- Express agreement between the parties
- By implication
 - Where it is plain from the conduct of parties to a contract that neither intends that the contract should be further performed, the parties are regarded as having so conducted themselves as to abandon the contract.
 - The inference of abandonment will be drawn where an ‘inordinate’ length of time has been allowed to elapse, during which neither party has attempted to perform, or called upon the other to perform.
 - Abandonment is a matter of fact to be inferred from an objective assessment of the conduct of the parties.
 - **Example:** *Ryder v Frohlich* [2004] NSWCA 472

Termination at common law (2)

Termination for breach

- Step 1: Identify the term alleged to have been breached
- Step 2: Determine the nature of the term (i.e. is the term essential). If essential, any breach (no matter how minor) will permit the innocent party to terminate.
 - Motivation for entry into contract (*Tramways Advertising Pty Ltd v Luna Park* (1938) 38 SR (NSW) 632)
 - Structure of contract (*Associated Newspapers Ltd v Bancks* (1951) 83 CLR 322)
 - Likely consequences of breach at the time of entry
 - Assessment of damages
- Step 3: If the term is not essential, look at the nature of the breach
 - *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* (2007) 233 CLR 115 (breach must be “sufficiently serious”, be a “fundamental breach”, go to “the root” of the contract or deprive the promisor of a “substantial part” of the contract)

Termination at common law (3)

Termination for repudiation

- Repudiation occurs where a party is either unwilling or unable to perform its contractual obligations, that is, evincing an intention no longer to be bound by the contract or stating that it intended to fulfil the contract only in a manner substantially inconsistent with its obligations and in no other way (*Shevill v Builders' Licensing Board* (1982) 149 CLR 620; *Laurinda Pty Ltd v Capalaba* (1989) 166 CLR 623)
- Contract is terminated only if and when the innocent party 'accepts' that repudiation
- The innocent party must itself be willing to perform the contract.

Termination at common law (3)

Important principles:

- Repudiation is not to be inferred lightly. It is a serious matter (*Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 7)
- Not necessary to prove a subjective intention to repudiate. Whether there has been repudiation is a question of fact to be determined objectively (*Laurinda Pty Ltd v Capalaba* (1989) 166 CLR 623).
- Conduct may not be repudiatory if it is based on a bona fide misapprehension of contractual rights (*DTR Nominees Pty Ltd v Mona Homes Pty Ltd* (1978) 138 CLR 423)
- Repudiatory conduct may be a single act, or the accumulation of conduct in circumstances where one act constitutes a repudiation (*Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 7)
- Repudiatory conduct may be 'cured' by the party in breach, but only prior to the acceptance of the repudiation.

Termination pursuant to contract

Contractual right may co-exist with the common law right

- Common law termination rights may be excluded, but this requires clear words (*Concut Pty Ltd v Worrell* (2000) 176 ALR 693)

Termination as a result of default

- Typical clause allows a party to terminate in the event of the other party's failure to perform certain obligations. Typically, if one party breaches a specified provision of the contract, the other party may issue a notice to 'show cause' requiring the contractor to give reasons why the contract should not be terminated. If the party fails to show cause, or the reasons are not satisfactory, the contract can be terminated.
- The right to terminate for failure to 'show cause' must be exercised reasonably (perhaps even where that requirement is not expressly stated): *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234

Termination under contract (2)

Termination for convenience

- Typical clause allows a party to terminate a contract at its sole discretion.
- Possible arguments to limit the operation of such clauses:
 - Termination must be in accordance with an implied duty of good faith
 - Must not be inconsistent with the express language of the clause (*Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15; *Tomlin v Ford Credit Australia* [2005] NSWSC 540; *Sundararajah v Teachers Federation Health Ltd* [2011] FCA 1031)
 - Termination for convenience clause is 'unjust' pursuant to the *Contracts Review Act 1980* (NSW) (relief cannot be granted to a person who entered into contract in the course of a trade, business or profession)
 - Termination for convenience clause is 'unfair' pursuant to s . 23 of the *Australian Consumer Law* (must be a standard form consumer contract)
 - Exercise of the right of termination is 'unconscionable' within the meaning of ss. 20-22 of the *Australian Consumer Law* (must be in trade or commerce / supply of goods or services)

The effect of estoppel on the right to terminate

- Representations in the course of performance
 - Case study: *Franks v Equiloan Securities Pty Ltd*
- Conduct of the parties and conventional basis of relationship
 - Case study: *Waterman v Gerling Australia Insurance Company Pty Ltd*

Loss of termination right by representations during 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

Loss of termination right by representations during 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.

Loss of termination right by representations during 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.

Loss of termination right by representations during 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.

Loss of termination right 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.

Loss of termination right 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.

Loss of termination right through course of conduct (3)

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.

Common issues that arise in terminating contracts

- Common errors in termination notices (and how to draft the notice when you have multiple rights of termination)
- Termination for delay and getting the time stipulations in the termination notice right
- Election not to exercise right of termination and subsequent loss of that right
- The consequences of wrongful termination

Errors in 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.

Errors in 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.

Waiver of termination rights

Meaning of waiver

- The term “waiver” is best understood as an umbrella term. The High Court in *Agricultural and Rural Finance Pty Limited v Gardiner* [2008] HCA 57 has held that “waiver” is made up of two principles: estoppel and election

Principle of election

- If a party makes a choice to terminate/affirm the contract and acts in a manner that constitutes ‘unequivocal conduct’, they are bound by that choice.
- Some considerations:
 - Be careful to ensure that any ‘silence’ is not misleading
 - Acceptance of further performance or payment under the contract may be an election to affirm the contract
 - 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.

Wrongful termination

- **Important:** The utmost care must be taken in terminating a contract. A party that wrongfully terminates a contract may be taken to have repudiated the contract.
- However, it is arguable that it is not always the case that a wrongful termination of itself constitutes a repudiation, where for example the wrongful termination was pursuant to a bona fide misinterpretation of the contract (*Wimpey Construction (UK) Ltd* [1980] 1 WLR 227)

Questions?

Simon Chapple

Barrister

13th Floor St James Hall

schapple@stjames.net.au

Adjunct Fellow, School of Law

University of Western Sydney