

# Termination of Contracts: A Balancing Act or the Tightrope over the Morgul Vale?

**Written by Conjoint Professor Kim Lovegrove, Partner at Lovegrove Solicitors and a Conjoint Professor in the Faculty of Engineering and Build Environment at the University of Newcastle.**

**18th February 2011**

There is termination done correctly, and on the other hand there is incorrect or wrongful termination. The later form of termination is commonly known as “repudiation” of contract.

## **Termination Done Correctly**

Assuming one has a written contract, the contract will have a termination protocol or procedure. “Touch wood” the termination procedure will be well crafted and will articulate a clear road map that enables a party to terminate the contract.

Unless the contract has summary termination provisions where termination can be effected immediately then the contract should contain termination procedures. Ordinarily there will be a notice requirement where notice will need to be in writing. Ordinarily the contract will list the default grounds, a default menu of sorts. If indeed one of the stated defaults has been committed by a wrong doer, the contract will require that the other party specify the default and ordinarily the contract will state that the default will need to be rectified within a given period of time.

Typical defaults are:-

- Failure to pay on time
- Failure to carry out tasks on time
- Failing to work or discharge one’s obligations to an agreed standard
- Failure to achieve contractual KPI’S

If the default is not rectified within the contractually stipulated period then the non offending party can terminate the contract.

To achieve termination correctly, the default must be clear, unambiguous, and incontestable. Prudence suggests also, you ensure that facts which are capable of being corroborated are indeed corroborated by uncontroversial and clear evidence. There is every chance that the “terminated” party will take umbrage with the “sacking”. If this occurs issue will be taken with the grounds for termination, the basis upon which it occurred and the way by which it occurred.

## **Incorrect Termination**

If a party to a contract has its contract terminated in circumstances where the grounds to terminate were fraught or the way by which the termination occurred was flawed then this is referred to in legal vernacular as a repudiation or “the evincing of an intention to no longer be bound by the contract”.

The consequences of repudiation can be parlous for the repudiator. Damages can be sought for repudiation, depending on the commercial dealing the damages can be sizeable and could range from the thousands to the millions of dollars. The damages will be the losses that are sustained by the aggrieved party that flow from the repudiation. Repudiation at law only crystallizes if the repudiation is accepted by the aggrieved or the “terminated” party. A repudiator could commit a repudiatory act but the other side may elect not to accept the repudiation and may elect to renegotiate or patch things up.

Once repudiation has been accepted however the contract is at an end. Before a party decides to accept repudiation he/she or it should have regard to the consequences of the cessation of contractual relationships. There can be a down side to acceptance and the downside may be the inability of one being able to rely upon contractual remedies.

Take for instance a contract that allows a contracting party to lodge a caveat, charge or a debenture on the other party’s property. If the ability to lodge the charge is based upon a contractual condition then its legal potency likewise

relies upon the existence or efficacy of the contract. If the contract is at an end the ability to maintain the charge may well be at an end. Thus the innocent party, when confronted with a serious contractual breach that would be of sufficient gravitas to constitute repudiation, may elect not to allege, let alone accept repudiation. He, she or it may instead choose to invoke contractual remedies and may choose to initiate legal proceedings for damages or specific contractual performance.

So the decision to accept repudiation has to be intelligent and carefully thought through. In the building industry for instance it is common for lawyers to bang off letters accepting repudiation with considerable alacrity as it enables their client to lodge a claim in "quantum meruit". A quantum meruit claim enables a builder to claim all provable costs incurred in the carrying out of the building work. This can prove to be a "God Send", particularly in circumstances where the contract was attended by very tight margins, but should not be misinterpreted as a carte blanche as the costs have to be proven.

### **Sadly, many contractual termination clauses are poorly drafted**

A great many termination conditions have not been carefully crafted. If a condition is cryptic the termination procedure may become complex and convoluted. One may have a situation where there is significant default but the contract does not characterize the default and the contract may be found wanting in terms of the termination road map, or formula to be adopted. Great care must be taken when this situation presents itself and the party that is intent on effecting redress must nevertheless be able to establish that there is a default and would be very well advised to act reasonably and be seen to act reasonably. The default should be brought to the other party's attention and unless something heinous has occurred there should be the affording of the opportunity to rectify the default.

### **The importance of lawyers in this dynamic**

It is crucial to involve skillful lawyers if one is considering terminating a contract. Termination instruments need to be very carefully crafted and there must be strict adherence to the letter of the contract.

I stress skillful lawyers as we have over the years chanced upon termination notices that have been crafted by lawyers, yet the notices have been deficient and the incompetence in their crafting or wording have had repudiatory consequences. Defaults may not have been properly specified, and where the contract insists upon a time for rectification, the time may not have been afforded in the termination instrument. Sometimes contracts have been terminated by a simple termination letter, yet the contract required a default notice to be issued at first instance and only upon the failure to rectify the default was the ability to terminate triggered. Where a contract spells out a clear termination procedure or road map one deviates from the road map at one's own peril.

### **Review your contracts and terms of engagement**

There is no time like the present review one's terms of engagement. If the contracts fail to take heed of some of the pointers in this article in the fullness of time a problem will present itself. If there has been any misunderstanding by the reader about what the contract should allow for in the termination road map we will provide a bullet point synopsis.

A sound contract will contain a lucid and logically drafted termination clause. There may be grounds for immediate termination but these grounds are only for the most heinous or diabolical scenarios and they need to be spelt out .

For the non summary dismissal scenarios, there should be:-

- A default clause
- The default clause will spell out the types of defaults that can culminate in termination
- The types of defaults should be purpose crafted for the type of industry or dealing
- They should state that in the event of the default occurring, written notice will be given, stating the default, and stating the period of time for rectification of same
- The termination clause will also state that once the notice of default has been issued and the default has not been rectified within the specified period of time the contract can then and only then be terminated by further written notice.

If a default event occurs then it's time to contact your lawyer to craft the instruments. The lawyer will require proof of the default, he or she will say the default event will need to be able to be corroborated evidentially and the lawyer will discuss the gravity of upping the termination "ante".

### **Be careful not to commit a repudiatory act in the heat of the moment**

Not long after I commenced practice a particular case came to my attention. It involved a builder and a couple of home owners. The builder had contracted to build a house and by all accounts the builder's margin was pretty tight.

As the project proceeded it became evident that there was no love lost between the contracting parties, incompatible personalities, cultures, a veritable pot pourri of fractiousness.

Matters reached a crescendo and one day the home owner wife yelled out "get the @&%## off my land and if you don't get off I'll call the police". The builder without hesitation vacated the building site and he then in quick fashion sent her a letter saying that by unceremoniously ordering him off the site she had repudiated the contract and he accepted their repudiation.

The owner then engaged another builder to complete the project - the completion cost blew out by \$2,000,000.00, and the owner sued for the difference. The matter went to trial and the builder chose to represent himself in court.

The other side had a barrister and instructing solicitors and the case ran for 3 weeks. The legal costs were close to \$200,000.00.

The owners' case was that the builder failed to complete the job and the extra costs of the job should be visited upon the builder. The owners lost, and it was held that by ordering the builder off the site in language that was unambiguous in its intent albeit couched in expletive laden invective the owner had evinced an intention to no longer be bound by the contract and indeed had repudiated the contract. Needless to say the legal team and the owners were horrified and the builder's argument was vindicated. He knew (and he was right) that it was a very simple case.

The contract had a default clause, it provided that if there was a default it had to be specified, the relevant contractual provision cited and a time to rectify the contract stipulated. Furthermore the contract provided that if the defaults were not rectified within that period, then and only then could a notice of termination be dispatched and the contract would be legitimately concluded.

The builder's case was that by telling him in no uncertain fashion to get the "@#\$%" off the building site and unless he left the police would be called up to remove him, that the venerable lady had evinced an intention not to be bound by the contract, had denied him the ability to have access to the project and denied him the ability to continue with the project - and in so doing had paid scant regard to the default provisions of the contract. The arguments were persuasive and they highlighted the dangers of impulsive and poorly considered communications. As an aside, the legal pleadings that made up the builder's statement of defense quoted verbatim the profanities that were expressed by the home owner when she concluded their affairs. Although not one to condone the use of colorful language, there is little doubt that the direction to leave could not have been misconstrued because the severity of the language made it quite clear that the builder had overstayed his welcome.