TEARS BEFORE BEDTIME
Drafting Effective Early Termination Clauses

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1 INTRODUCTION

1.1 At a rudimentary level, parties enter into contracts to gain a specific intended benefit. That benefit might be the receipt of payment, disposal of an asset that no longer serves them, or the acquisition of a right; whatever that benefit might be – the parties intend that it will put them in a more favourable position than they would have been, had they not entered into the contract.

1.2 It goes without saying then, that it is important for a contract to be carefully drafted to ensure that the parties will gain their respective benefits at the time and in the way that they intended – failing which the parties should have pre-considered levers to pull on, to address unplanned events or implications which jeopardise their expected benefit.

1.3 One of the most important clauses for a contract to contain is an early termination clause, which enables a party to exit a contract in circumstances where it is unfeasible for them continue, or where something has occurred that is a "deal-breaker" for them in their particular circumstances. This might be a common deal-breaker such as an inability to obtain finance or a failure to obtain government approval to conduct a large project, or something as simple and subjective as being refused to keep a pet in a residential body corporate unit that a buyer is purchasing (a deal-breaker which is not necessarily linked to a large monetary sum, but holds significant subjective value for one of the parties).

1.4 This Paper addresses early termination clauses – including when we use them, why we use them, what makes a good early termination clause and some traps to look out for.[1]

2 WHEN TO USE AN EARLY TERMINATION CLAUSE

2.1 "Early termination" refers to the ending of a contract by a party to the contract, before the contract has been completed or fulfilled. It will usually occur before the intended end benefit has been conferred on the parties.

2.2 There are many different scenarios in which early termination could happen:

2.2.1 **Exercise of a right:** Where a contract or agreement is conditional upon an event occurring and that event does not occur, and the contract or agreement gives a party (or both parties) the express right to terminate the contract or agreement without there

[1] This Paper does not address construction, building and insurance contracts, the complexities of which are nuanced and are beyond the scope of this Paper.

having been a breach. This can include steps that the parties are required to take but fail to take, or actions / approvals by third parties that do not come to fruition, or certain thresholds failing to be achieved. These rights usually derive from "conditions precedent" or "conditions subsequent":

a *Condition precedent:* Where an event must occur (unless non-occurrence is excused), failing which the Contract is deemed not to have commenced and a contractual duty deemed never to have arisen. The consequence of a failure of a condition precedent usually occurs automatically, opposed to a positive act of termination by one of the parties. With a condition precedent, the **commencement** of the contract or agreement is at risk if the condition is not fulfilled.

b *Condition subsequent:* A condition that must be fulfilled once the contract is on foot, failing which the contract may be terminated. A condition subsequent usually runs for a specific period of time and brings an end to legal rights at the conclusion of that period. For example, a party may have a right to terminate the contract if a condition is not fulfilled by a certain date, and failing an exercise of the right of termination within a specified period, the legal right to terminate is lost. With a condition subsequent, the **settlement/completion** of the contract or agreement is at risk if the condition is not fulfilled.

2.2.2 **Breach of contract:** Where a party breaches an essential term or seriously breaches a non-essential term. A contract or agreement may include an early termination clause that stipulates termination procedures and requirements in the case of a breach of contract. In the absence of such a clause, common law or statutory principles will generally apply.

2.2.3 **Force majeure:** The occurrence of an extraordinary event or circumstances which is beyond the control of the parties such as cyclone, flood, war etc. Depending on how well the contract is drafted, the parties may be able to terminate the contract pursuant to a force majeure clause. COVID-19 has demonstrated the usefulness of including a force majeure clause within a contract and has highlighted the importance of clear drafting in this regard.

2.2.4 **Repudiation:** At common law, termination may be an available remedy if a party to the contract repudiates the contract.

2.2.5 **Termination for convenience:** If drafted into a contract or agreement, the parties may have an ability to unilaterally terminate the contract without notice. A termination for convenience clause needs to be treated with caution.

2.2.6 **By agreement**: The parties can mutually agree to end a contract or agreement. This would usually happen where the parties are on good terms and the contract no longer serves its intended purpose because the parties' circumstances have changed, or where the parties have re-negotiated the parameters of their agreement and it is more appropriate to sign a new agreement rather than amending the current one on foot. The parties should seek financial advice in the case of a termination by agreement, to ensure that no unintended tax consequences arise.

2.3 At the very commencement of drafting a contract, a practitioner should be asking their client to specify the circumstances or set of events in which they would want an absolute right to be able to walk away from the transaction. This will often shed light on the priorities and temperament of the client, and a practitioner can proceed with drafting the contract through this lens.

3 ALTERNATIVES TO TERMINATING THE CONTRACT

Alternative Dispute Resolution

3.1 Alternative dispute resolution ("**ADR**") avenues, such as mediation, conciliation, commercial arbitration or binding expert determination can enable parties to avoid resource intensive litigation that may arise if a party wishes to dispute the conduct of a party or the validity of the contract termination.[2] While ADR will still require resources, these procedures provide avenues that can create binding decisions without the involvement of the Courts.[3]

3.2 State legislation attempts to provide clear and cost-effective commercial arbitration principles and practices.[4] Mediation and arbitration however will require parties to reach an agreement.[5]

3.3 The parties should be careful when deciding to pursue ADR, and assess from a "big picture" perspective whether the ADR is reasonably likely to bring a closure to the dispute. For example, commercial arbitration can be as complex and expensive as court proceedings. If arbitration fails,

[2] Carter on Contracts [01-140].
[3] Ibid.
[4] (ACT) Commercial Arbitration Act 1986; (NSW) Commercial Arbitration Act 2010 ; (NT) Commercial Arbitration (National Uniform Legislation) Act 2011; (Qld) Commercial Arbitration Act 2013; (SA) Commercial Arbitration Act 2011; (Tas) Commercial Arbitration Act 2011 ; (Vic) Commercial Arbitration Act 2011 ; (WA) Commercial Arbitration Act 1985.
[5] Carter on Contracts [01-150].

the matter may advance to court and also incur all of the costs associated with running court proceedings.

3.4 Contracts and agreements commonly require the parties to engage in ADR prior to being entitled to make an application to the Court. There is extensive commentary about whether the parties can "skip" this step, even if such a step is contractually mandated, and go straight to Court. This is based on the general policy that the jurisdiction of the courts cannot be ousted – and historically Courts have not taken kindly to attempts to do so. Contracts and agreements should therefore reserve the rights of a party and provide mechanisms for an urgent application to the Court, regardless of whether or not there are simultaneous mechanisms for ADR. That is, ADR should not be expressed to be a prerequisite to making an application to the Court.

Injunction

3.5 In some circumstances an injunction can be sought to restrict a party from following through with a threat that has been made to breach a contract or restrict a party from repeatedly breaching a contract.[6] The Courts however will only provide an injunction to require a party to complete a "negative" duty; being one that in substance and form only requires a party to refrain from doing something.[7] The Courts will not award an injunction to enforce positive obligations, being obligations that require a party to proactively do something or take action, to fulfil the obligation.[8]

Specific Performance

3.6 Specific performance is an alternative remedy available once a party has breached a contractual term.[9] Instead of terminating the contract, and in circumstances where damages would be inadequate, specific performance may be ordered by a Court.[10] Specific performance however will not be available where the order will force one party to provide services or where there has already been an election to validly terminate a contract.[11] Furthermore, specific performance cannot be ordered when the contract enables convenient termination and it is possible for a party to unilaterally terminate the contract at any time.[12]

Elect to continue the contract despite repudiation

3.7 As termination does not automatically occur upon repudiation (see later in this Paper for an explanation of repudiation), but instead requires an election, it is possible for a party to elect to

[6] Carter on Contract [46-020]
[7] Carter on Contracts [46-020], [46-030]
[8] Carter on Contracts [46-020], [46-030]
[9] Carter on Contracts [45-010]
[10] Ibid.
[11] Carter on Contracts [45-020]
[12] Ibid.

ignore the repudiatory action and require the continued performance of the contract. To do so, the party entitled to elect to terminate must by words and conduct make it clear that ongoing performance is required and must be willing and able to continue to perform contractual obligations as specified in the contract.[13]

3.8 The contract or agreement should contemplate that an election to continue doesn't amount to a waiver by the electing party of its rights in respect of the loss and damage flowing from the breach.

4 CONSEQUENCES OF EARLY TERMINATION

On the parties

4.1 The consequences of a party validly terminating a contract will usually depend on the drafting of the termination clause. Generally, if the contract has not expressly modified the common law position, the parties will be discharged from the performance of future contractual obligations that fall due from the date of termination. The general exceptions to this are:

4.1.1 rights and liabilities that have already unconditionally been accrued throughout the life of the contract to date - while it is possible to amend these "secondary obligations" (for example by extending the class of rights that will accrue) it is not possible to restrict fully the ability to rely on them[14]; and

4.1.2 the right to seek damages arising from the termination[15].

4.2 If a party wants to confirm the presumption that the common law rights of claiming damages and enforcing accrued rights will continue post termination, it is prudent to include within the contract a statement confirming that termination does not prejudice available common law rights.[16] Confirming the accrual of rights is especially important if a party is terminating for convenience, to clearly communicate that sums payable prior to termination will be owing.[17] Furthermore, if the contract is drafted to make it clear that certain terms of the contract are to continue once termination has occurred, for example a duty of confidentiality, this type of clause will expressly reverse the common law position.[18] Once the contract has been terminated, the party affected by termination can make a claim for damages and/or restitution.

[13] Carter on Contracts [35-260]
[14] Carter on Contracts [38-050]; *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 82
[15] Carter on Contracts [33-310]
[16] Carter on Contracts [38-050]
[17] Carter on Contracts [33-340]
[18] Carter on Contracts [38-050]; [33-320]

4.3 Unless the contract specifically stipulates that performance of parts of the contract can be severed and terminated without terminating performance of the entire contract, part termination is not available.[19]

On stakeholders

4.4 It is prudent for practitioners to consider the effect of a proposed termination on external stakeholders, to holistically advise on the effect of the termination on their client and avoid unintended adverse consequences.

4.5 Stakeholders to a contract are generally considered to be parties that do not have privity of contract in respect of the transaction. This could include financiers (who are providing finance for a transaction), deposit-holders (who are holding the deposit for the transaction and have obligations in respect of that deposit), directors/governors of the parties, and employees of the parties.

On third parties

4.6 The term "third parties" is often interchangeably used with the term "stakeholders".

4.7 However, for the purpose of this Paper third parties are considered to be parties who don't have a direct interest or role in the contract. This could include:

4.7.1 parties to a contemporaneous settlement that is occurring, that is dependent upon the settlement of the transaction in question;

4.7.2 other dependent contracts, such as fitout or building contracts; or

4.7.3 financiers to the parties in a general capacity (to be distinguished from financiers in their capacity as stakeholder providing finance for a specific transaction).

4.8 While the parties (as a general rule) don't have an obligation to third parties when conducting their own contract, it may be prudent for the parties to consider roll on effects to third parties as it relates to their specific circumstance.

4.9 It is also prudent for the parties to have regard to the public policy implications of terminating large, or multiple, contracts.

[19] Carter on Contracts [38-010]

5 TERMINATON FOR CONVENIENCE

5.1 A termination for convenience clause is a clause enabling a party to terminate the contract without cause or reason, at the sole discretion of the terminating party.

5.2 Termination for convenience clauses need to be used and drafted with caution, as this kind of termination is not grounded in the common law.[20] Generally the enforceability of termination for convenience clauses to date has been considered by Australian Courts on a case-by-case basis. Australian Courts in general have refrained from commenting on the general requirements of termination for convenience clauses. This in part is due to the multitude of ways a termination for convenience clause can be drafted, which creates a need to consider the specific wording of the clause as well as the contract as a whole.

5.3 Of particular note is the unsettled issue in Australia as to the application of an implied duty of good faith, and if this implied duty is a matter of fact or law[21]. Without comment as yet from the High Court, there is no settled position as to when a party will owe a duty to act of good faith when relying on a termination for convenience clause, except in specific instances where relevant legislation outlines its applicability.[22]

5.4 This means that practitioners must consider and draft termination for convenience clauses carefully, contemplating:

5.4.1 the effect other clauses within the contract might have on undermining the intention of the termination for convenience clause;

5.4.2 the legal context of the contract; and

5.4.3 the parties' respective bargaining powers.

For example, contracts where the *Australian Consumer Law* legislation applies cannot rely on a termination for convenience clause as this type of clause is legislatively deemed an unfair term.[23] While termination for convenience clauses are allowed in the context of franchising - legislatively, under franchising legislation parties are automatically bound to uphold a duty to act in good faith.[24] Standard form contracts will also most likely implicitly carry a duty to act in good faith.[25]

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[20] Laws of Australia [8.3.1040]

[21] (2017) 45 ABLR 229, 231; *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558

[22] *Caratti Holdings Co Pty Ltd v Coventry Group Ltd* [2014] WASC 403; *Franchising Code of Conduct*; *Competition and Consumer (Industry Codes – Franchising) Regulation 2014*

[23] *Competition and Consumer Act 2010* (Cth) sch 2 section 25

[24] *Franchising Code of Conduct*; *Competition and Consumer (Industry Codes – Franchising) Regulation 2014*

[25] *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558, 569.

5.5 Without such contextualised consideration, it is impossible to advise clients on the conduct, and specifically the applicability of a duty to act in good faith, required to validly terminate a contract in reliance on such a clause. Practitioners should consider this on a case-by-case basis.

Compensation

5.6 To avoid a contract being void due to a lack of good consideration, termination for convenience clauses should include specificities of what compensation is payable by the terminating party to the innocent party.[26] While work completed and payable under the contract is owing at the date of termination (unless waived by the party to whom it is owed), other kinds of compensation that may be payable upon termination have not been settled judicially and it is therefore of the utmost importance that practitioners consider and take instructions from clients as to how compensation should be calculated upon a termination for convenience event, and articulate this clearly in the contract.[27] For example (and non-exhaustively), before the contract is executed by the respective parties, consideration should be given to expectations of compensation for:

5.6.1 Costs that have already reasonably been incurred prior to termination;

5.6.2 Loss of profit (and whether mitigation is necessary and compensable losses are only those that were unavoidable);

5.6.3 Termination costs payable to any subcontractors; and

5.6.4 Acquired resources (or alternatively who bears the onus of paying for transportation costs).[28]

Good faith

5.7 While an implied duty of good faith is not always attached to the conduct of a terminating party relying on a termination for convenience clause, when this duty is applicable, good faith usually entails:

5.7.1 an obligation on the parties to cooperate in achieving the contractual objects;

5.7.2 compliance with honest standards of conduct; and

[26] Laws of Australia [8.3.1040]; *Abbey Developments Ltd v PP Brickwork Ltd* [2003] EWHC 1987
[27] *McDonald v Denny Lascelles Ltd* (1933) 48 CLR 457; (2017) 45 ABLR 229, 239; Laws of Australia [8.3.1040]
[28] (2015) 31 BCL 68, 86-7; (2017) 45 ABLR 229, 239-240; *McMahon Mining Services Pty Ltd v Cobar Management Pty Ltd* [2014] NSWSC 502; The Laws of Australia [8.3.1040]

5.7.3 compliance with standards of conduct which are reasonable having regard to the interests of the parties.[29]

5.8 This means that when good faith is relevant, using a termination for convenience clause to enter into a more commercially appealing deal will not be valid.[30] The terminating party however is not expected to prioritise the interests of the other party,[31] or to make disclosures that would publicise private company information.[32]

An analysis of different kinds of termination for convenience clauses and required conduct

5.9 Generally, the Courts have considered three different kinds of termination for convenience clauses. These are where the clause:

5.9.1 **Category 1 (specific):** Is clearly and unambiguously drafted, specifying in precise language that one (or more) parties has the unfettered ability to terminate the contract at any time and for any reason;

5.9.2 **Category 2 (general):** Refers more generally to the power of the party/parties to terminate for convenience; and

5.9.3 **Category 3 (conditional):** Only allows termination for convenience after the fulfillment of a certain event or procedure.

5.10 The enforceability and required conduct of the terminating party differs from category to category.

Category 1

5.11 "*At its option, at any time and for any reason it may deem advisable*" and "*at any time without a reason*" are examples of clauses that the Courts have considered plainly identify a party's unfettered ability to terminate a contract without reason.[33] As an explicit contractual term, this type of clause is capable of overriding any argument of an implied duty of good faith.[34] To imply good faith would be inconsistent with the commercial realities plainly and expressly agreed upon by the

[29] Sir Anthony Mason, "Contract, Good Faith and Equitable Standards in Fair Dealing" (2000) 116 *Law Quarterly Review* 66; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 [146]; *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 [8].
[30] (2017) 45 ABLR 229, 237; (2015) 31 BCL 68, 69; *Carr v JA Berriman Pty Ltd* (1953) 89 CLR 327; *Abbey Development Ltd v PP Brickwork Ltd* [2003] EWHC 1987.
[31] *Sundararajah v Teacher's Federation Health Ltd* (2011) 283 ALR 720 at [67]-[68]; (2013) 29 BCL 122, 125
[32] (2013) 29 BCL 122, 125-126; *Apple Communications Ltd v Optus Mobile Pty Ltd* [2001] NSWSC 635
[33] *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 130; *Starlink International Group Pty Ltd v Coles Supermarkets Australia Pty Ltd* [2011] NSWSC 1154
[34] (2017) 45 ABLR 229, 238; *LMI Australasia Pty Ltd v Baulderstone Hornibrook Pty Ltd* [2001] NSWSC 886 [75].

parties.[35] Of note however is judicial commentary suggesting that the term "*sole discretion*" does not always negate the obligation of good faith.[36]

Category 2 & 3

5.12 "*Can terminate for convenience*" and "*can terminate by written notice*" are examples of clauses that more generally seek to enable termination for convenience. Without further clarification within the clause, the Courts have previously implied good faith in both of these situations.[37] Contracts that specify a dispute resolution procedure, which is triggered by the termination, usually impose a further obligation on the terminating party to act in good faith while completing dispute resolution proceedings.[38] In those types of contracts, this would lend to the overall inference that good faith is required when terminating for convenience.

Commercial realities that call into question the applicability of good faith

Party Vulnerability

5.13 There has been some judicial commentary in Victoria regarding the duty of good faith arising in circumstances where the parties have unequal bargaining power, making one party vulnerable. In this case, good faith would be more likely to be required. How to determine if one party is "vulnerable" or if the parties are commercial equals has not however been conceptually considered.[39]

Express inclusion/exclusion of duties implied at law

5.14 The intentions of the parties can usually be confirmed by a clause either including or excluding the applicability of all, or specific, implied terms.[40] Regardless of the intention, it should be made as clear as possible in the exclusionary or deeming clause whether good faith is to apply to terminations; in which case practitioners must use caution to not allow dishonesty or unlawful conduct more generally.[41] A clause confirming the contract is an entire agreement does not necessarily have this same effect, as the clause may not be clear in excluding terms implied by law or fact (and as previously mentioned there is judicial uncertainty as to whether good faith is implied as a matter of law or fact).[42]

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[35] *Sundararajah v Teachers Federation Health Ltd* [2009] NSWSC 1443; *Solution 1 Pty Ltd v Optus Networks Pty Ltd* [2010] NSWSC 1060
[36] *Burger King Corporation v Hungry Jack's Pty Ltd* (2001) 69 NSWLR 558 [176]
[37] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, 174.
[38] *Kellogg Brown & Root Pty Ltd v Australian Aerospace Ltd* [2007] VSC 200
[39] (2017) 45 ABLR 229, 235; *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228
[40] (2017) 45 ABLR 229, 238-9
[41] Ibid
[42] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1, 174.

6 TERMINATING WITH CAUSE

Breach of contract

6.1 Generally, the circumstances that give rise to the ability to terminate due to a contractual breach are dependent on the intentions of the parties, and the events that were contemplated in the drafting of the contract as resulting in a contractual breach giving rise to the right to terminate.[43]

6.2 There is no right to terminate without the occurrence of the breach, and the subsequent satisfaction of the procedure specified within the termination clause.[44]

6.3 It is easier to determine the intentions of the parties when specific events are explicitly listed in the termination clause as breaches giving rise to the right to terminate.[45] This is where consideration of essential terms and non-essential terms become necessary.

6.4 Essential terms are commonly described as conditions or fundamental terms. It is a term that is so essential to one or both of the parties, the breach of which would justify terminating the contract. The test of whether a term is essential comes down to the intention of the parties, which can usually be determined by an examination fo the drafting of the contract.

6.5 Non-essential terms are commonly described as intermediate terms that are not ordinarily fundamental, such as warranties. Usually a breach of a non-essential term will sound in damages only, however a sufficiently serious breach of one or more non-essential terms can sound in an ability to terminate a contract if the breach goes to the root of the contract or substantially deprives one of the parties of a significant benefit.

6.6 The parties are able to designate terms as essential terms in the contract, regardless of whether the nature of that term would have been non-essential but-for that designation. This is especially useful if a party would like to have the right to terminate for a breach that otherwise would not be classified as an essential term or serious breach of a non-essential (intermediate) term, such as late payment, as an express contractual designation will prevail.[46] However, it is worth noting that this designation is not effective in ousting the jurisdiction of the Courts, and the Courts will at all times retain the right to designate a term as essential or non-essential even if that is contrary to what the parties have decided.

[43] Carter on Contracts [33-120, [33-130]
[44] Carter on Contracts [33-130]; *Mardorf Peach & Co Ltd v Attica Sea Carriers Corp of Liberia (The Laconia)* [1977] AC 850, 887
[45] Carter on Contracts [33-140];
[46] Carter on Contracts [33-140]; *Mardorf Peach & Co Ltd v Attica Sea Carriers Corp of Liberia (The Laconia)* [1977] AC 850

6.7 There is an urban myth to dispel here; we see many contracts which contain a "catch all" referring to any and all contractual breaches as terminable offences as breaches of essential terms. There is no point is designating every condition as essential, because it will be unlikely to be effective. This is (in the writer's view) problematic drafting, effectively inviting a dispute about whether specific terms are essential or non-essential. There is wisdom in specifying what designation they are, and applying a common law test when drafting. The Courts have generally refused to interpret catch-all clauses literally, instead opting for the scope of the clause to include repudiatory breaches and exclude minor breaches that could be performed.[47] If it is the parties' intention for the right to terminate to arise if any contractual breach occurs, this should be explicitly stated within the termination clause.[48] Furthermore, it will be unlikely that termination will be considered valid if the party wishing to terminate the contract contributed wholly or partly to the event giving rise to the breach occurring.[49]

6.8 It is important for practitioners to advise clients that there is a risk of litigation if the termination procedure and formal requirements established within the contract are not followed.[50] Usually at a minimum this will require consideration of how and when notice of termination should be communicated. The exception to this is the contents of the notice of termination. The Courts have preferred to analyse the contents of the notice, as opposed to requiring strict compliance where the notice is free of minor errors.[51]

6.9 The greater the stakes and commercial consequences of terminating the contract, the greater the risk that the Courts will require the contractual termination procedure to be followed accurately to find in favour of valid termination.[52] If the contract does not specify how the terminating party is to provide notice of termination, notice must be directed to the other party/parties to the contract in a way that a reasonable person would understand to be the terminating party exercising their right of termination.[53] If the contract does not specify when the right of termination must be communicated before its expiry, the terminating party has a "reasonable" time period.[54] If the termination clause stipulates when the right must be exercised, notice must strictly be provided before the specified time limit expires. To ensure the terminating party unequivocally demonstrates an intention to terminate, regardless of the formalities specified in the contract, it is best practice for the termination to be communicated to the party/parties to the contract.[55]

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[47] *Telfair Shipping Corp v Athos Shipping Co SA (The Athos)* [1983] 1 Lloyd's Rep 127, CA; *Antaios Compania Naviera SA v Salen Rederierna AB (The Antaios)* [1985] AC 191
[48] Carter on Contracts [33-150]
[49] Carter on Contracts [33-200]; *New Zealand Shipping Co Ltd v Société des Ateliers et Chantiers de France* [1919] AC 1, 9
[50] Carter on Contracts [33-190]
[51] Carter on contracts [33-250]
[52] Carter on Contracts [33-190]
[53] Carter on Contracts [33-210]
[54] Carter on Contracts [33-230]; *Champtaloup v Thomas* [1976] 2 NSWLR 264, 273
[55] Carter on Contracts [33-240]

6.10 Another basic source of law for notice requirements in the event of a breach is the imposition of statutory duties – for example, section 124 of the *Property Law Act 1974* (Qld) in respect of lease breaches.

Anticipatory breach

6.11 Premature termination, either before the event causing the breach has occurred or before the satisfaction of the outlined termination procedure, is generally invalid.[56] The exception to this general principle is if the breached contractual term is clearly defined as an essential term.[57] Parties attempting to terminate the contract for an anticipatory breach must prove that the breach is clearly (being a threshold lower than certain) going to occur and the effect of the anticipatory breach goes to essentiality of the contract; whether that be because the term is a condition of the contract or because the resulting consequences of anticipatory contractual breach would have serious effects.[58] Early termination clauses however cannot be relied upon for an anticipatory breach of a warranty clause.[59]

Repudiation of contract

6.12 Dependent on the circumstances (as a question of fact),[60] and interpretation of documentation (as a question of law),[61] termination is possible if it can be proven that a party is clearly indicating a lack of readiness and willingness to perform contractual duties. Relevant contractual duties that trigger repudiation include conditions of the contract or all/a significant proportion of contractual obligations owed. While words and conduct as well as actual circumstances and actions can be used to claim repudiation, generally if the alleged repudiating party denies there is an unwillingness or inability to perform the contractual duties, the party asserting repudiation has the ultimate responsibility of proving repudiation.[62]

Repudiation based on words and conduct

6.13 The type of proof required to validly claim repudiation depends on the basis of the assertion. Words and conduct of a party are treated as conclusive, and therefore further proof that the party is subjectively unwilling and unable is unnecessary for repudiation alleged on this bases.[63] The Courts have observed that this generally results in repudiation based on words and conduct being the

[56] *Afovos Shipping Co SA v Pagnan* [1983] 1 WLR 195, Carter on Contracts [33-160]
[57] Carter on Contracts [33-160], [35-100]
[58] Carter on Contracts [33-100]; *Federal Commerce and Navigation Co Ltd v Molena Alpha Inc* [1979] AC 757
[59] *Universal Cargo Carriers Corp v Citati* [1957] 2 QB 401
[60] Carter on Contracts, Repudiation Based on Words or Conduct pg.1; *Cornwall v Henson* [1900] 2 Ch 298, 301;
[61] [61] Carter on Contracts, Repudiation Based on Words or Conduct pg.1; *Re Rubel Bronze and Metal Co Ltd* [1918] 1 KB 315, 322–3
[62] Carter on contracts [35-190]
[63] Ibid

more favoured approach.[64] This type of objective standard of proof is measured by the conclusions a reasonable person would make when confronted with the words and conduct, and may include express refusals to fulfill contractual obligations (e.g. refusing to accept delivered goods) and indications of anticipated breaches (e.g. indicating services will no longer be required prior to contract expiry).[65]

6.14 Invalidly terminating a contract could also amount to repudiation by conduct, even if the party is acting on advice from legal counsel.[66] Wrongfully terminating a contract however may not be classified as repudiation if the party is acting bona fide and the breach is not serious.[67]

Repudiation based on actions

6.15 If a party seeks to allege repudiation based on an actual inability to fulfill contractual obligations, it is necessary to prove that the alleged repudiating party is "*wholly and finally disabled*" from completing the contractual obligations when required. For contractual breaches that are not essential or serious, a consideration of all relevant circumstances must suggest the party's actions frustrate the core purpose of the contract.[68] Care must be taken when determining when the contract stipulates obligations fall due and owing. For example, repudiation is not proven if a party claims obligations falling due "on settlement" cannot be completed by the date settlement happens to be set on in the future. The time to assess the party's ability to perform the contractual obligations is the actual date settlement.[69]

7 RECTIFICATION

7.1 In some cases where early termination is due to a breach of contract, it is necessary to consider if the party in breach has the right to rectify the breach prior to termination becoming effective, and if rectification will negate the right to terminate.

Compulsory requirement to allow time for rectification

7.2 When the termination procedure outlined in the contract provides the party in breach an opportunity to rectify the breach before the right to terminate can be exercised, the party in breach must be provided with the stipulated opportunity for rectification, failing which the termination will be invalid.[70] Usually, the termination clause will provide the party in breach with either a precise rectification time frame (for example a set number of days from the date the terminating party

[64] *Universal Cargo Carriers Corp v Citati* [1957] 2 QB 401, 436–7
[65] Carter on contracts [35-130], [35-140]
[66] Carter on contracts [35-170]
[67] Ibid
[68] Carter on contracts [35-220]
[69] Carter on contracts [35-220]; *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245;
[70] Carter on Contracts [33-270]

provides notice) or the ability for the terminating party to specify a reasonable time frame within the termination notice.[71] Termination will only be effected if the breach has not been rectified within the specified time frame stipulated in the notice of termination.[72]

7.3 What is a "reasonable" time for rectification will of course depend on the circumstances and context of the contract, and will fall to whatever timeframe a reasonable person acting in and efficient but not rushed manner would take in the same circumstances.

7.4 In the absence of a clear drafted notice period attached to a right of termination, practitioners should also be considering if time is of the essence in the contract in question. If time is not of the essence (or example, in New South Wales land contracts), the fact that a condition has breached doesn't sound in an immediate right to terminate. Before an injured party can terminate, there must be notice to remedy provided.

7.5 The required process to be followed if the terminating party wishes to proceed with terminating the contract once the time period for rectification has passed is dependent on the contractual terms.[73] Unless the termination clause is drafted to restrict a claim for damages for the breach of contract, regardless of rectification, this avenue for compensation is available to the terminating party.[74]

Breaches that cannot be rectified

7.6 There are specific contractual breaches that are simply incapable of rectification.[75] For this reason, it is prudent to ensure a termination clause affording the party in breach the opportunity of rectification is drafted to acknowledge the distinction between breaches that can and cannot be rectified.[76] Without such distinction, the termination clause may not in practice achieve the intentions of the parties.[77] This distinction will be heavily fact dependent and providing an exhaustive list of irremediable breaches may be virtually impossible.[78] Drafting the clause to provide the terminating party the discretion to decide if the breach is remediable may be more suitable[79], but is not a bulletproof strategy and may give rise to litigation.

Right to termination unaffected by rectification of breach

7.7 Where a party has a right to terminate a contract due to a breach of contract, the terminating party's right to terminate may not be simply negated because the party in breach has rectified the breach

[71] Carter on Contracts [33-250] (d)
[72] Carter on Contracts [33-270]; *Eriksson v Whalley* [1971] 1 NSWLR 397
[73] Carter on Contracts [33-280]; *Legione v Hateley* (1983) 152 CLR 406
[74] Carter on Contracts [33-280], [33-250]
[75] Carter on Contracts [33-280]; *Akici v L R Butlin Ltd* [2006] 1 WLR 201, 215
[76] Carter on Contracts [33-280]
[77] Carter on Contracts [33-280]
[78] Ibid
[79] Ibid

prior to receiving notice of termination. Depending on the circumstances, the notice of termination may be valid as long as it is provided to the party in breach within the specified time period detailed in the contract, or alternatively in the absence of a time period specified, without unreasonable delay.[80]

8 LIQUIDATED DAMAGES & FORMULAS FOR LOSS

8.1 The inclusion of an agreed damages clause within a contract minimises the risk of litigation being necessary to determine what damages are payable (if any) upon the termination of a contract. Liquidated damages, drafted as either a lump sum or a calculation (using a formula taking into account relevant variables), creates an obligation to pay damages (and not a debt).[81] Drafting a liquidated damages clause avoids the need for a Court to determine judicially the actual loss suffered, and what damages are payable according to common law principles.[82] Care must however be taken in drafting an enforceable liquidated damages clause, as a clause that in substance is a penalty will be unenforceable.

Applicability of the Penalty Regime

8.2 There is current uncertainty regarding when the penalty regime applies to assessing the enforceability of an agreed damages clause. Up until recently, the penalty regime has only applied to damages payable upon termination for breach, as the penalty regime and terminating for a contractual breach are both principles grounded in the common law. The High Court however has recently confirmed that the penalty regime is also available in the equity jurisdiction, and therefore there is no limitation to its application to damages clauses triggered by an event outside of a contractual breach. While making this judicial comment, and providing a reformulation of considerations, the High Court did not specify if termination for convenience clauses trigger the new reformulation. Especially given that termination for convenience clauses can be utilised without any party being in fault, or the occurrence of a specific event, further clarification would be required to know if the penalty regime would apply to damages clauses triggered by convenience terminations before this can be relied upon in that circumstance.[83]

Differentiating between liquidated damages and penalties

[80] Carter on Contracts [33-230]
[81] Damages for breach of contract [332.650]; Carter on Contracts [43-070]
[82] Carter on Contracts [43-070]; [43-100]
[83] Entire paragraph summary of Carter on Contracts [43-160] and (2015) 31 BCL 68, 81-5.

8.3 The Courts have considered various factors when determining if a clause is a liquidated damages clause or an unenforceable penalty. As such when drafting an agreed damages clause it is important to do the following:

8.3.1 Describe the clause (accurately) as liquidated damages. From a drafting perspective, it is important to avoid using the phrase "penalty" when describing liquidated damages. While this is not conclusive of the existence of an unenforceable penalty provision, it raises avoidable doubt.[84]

8.3.2 Contemplate an appropriate (and not overreaching) pre-estimation. The Courts will consider if the amount payable is "*extravagant and unconscionable*".[85] An example of this kind of oppressiveness is a clause that requires the full payment of outstanding instalments because of one minor breach, or one late payment.[86] At the time of contract negotiations it is important to work with clients to ensure the liquidated damages clause represents a genuine pre-estimation.[87] This does not mean the pre-estimation has to be accurate, and the Courts should not consider proportionality when determining validity,[88] but the clause cannot (based upon knowledge known at the time of the signing of the contract) provide a significant advantage greater than potential loss suffered from termination.[89] It may not be possible to estimate the loss that will occur, but this does not restrict the parties from stipulating reasonable liquidated damages, and will in fact likely mean the clause is enforceable as it represents a "true bargain".[90] The amount stipulated within the clause will be treated as the maximum compensation recoverable, and therefore considering the direct and indirect consequences of termination will require significant consideration and discussion with clients.[91]

8.3.3 Contemplate appropriate and reasonable circumstances that should trigger the agreed damages clause. Judicially, it is clear that an agreed damages clause will be interpreted as either a liquidated damages clause or penalty provision for all breaches, considered as a whole, that trigger the operation of the clause.[92] For this reason, it may be best to have separate liquidated damages clauses for different types of breaches, which are dependent on the quantitative value of damages required to adequately compensate those different kinds of breaches.[93] As the penalty regime likely does not currently apply

[84] Carter on Contracts [43-090]
[85] *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79
[86] Carter on Contracts [43-120]
[87] Ibid
[88] *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656
[89] Carter on Contracts [43-080] (for timing of consideration); [43-120] (significant advantage)
[90] *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79, 87–8; Carter on Contracts [43-150]
[91] Carter on Contracts [43-070]; [43-100]
[92] Carter on Contracts [43-110]
[93] Ibid

to termination for convenience events, it will also be prudent to have separate agreed damages clauses for the different termination events.[94]

9 FACTORING IN COMMON LAW TERMINATION

9.1 At common law, damages can only be a prima facie considered if an essential term has been breached, an intermediate term has been breached to a sufficient seriousness, or repudiation has occurred. While these events trigger a contemplation of a common law damages claim; damages are not established until it is proven that the actual loss suffered has been defined, and it can be proven that the terminating party caused the damage, which is not too remote to recover. Without proving causation, which can be difficult and is the source of a lot of litigation, a party can only claim nominal damages.

9.2 Once performance of the contract has been terminated, independent of any claim for damages or recovering contractual debts, a restitutionary claim is available if a party has been unjustly enriched and there has been an absence of consideration.[95] The aim of damages available at common law is to put the injured party in the position they would have been, had the contract been completed. The Courts will refrain from putting an injured party in a better position.[96] Types of damages that may be available include expectation loss, reliance loss and loss of bargains.[97]

10 EFFECTIVE TERMINATION CLAUSES AND OTHER THINGS TO CONSIDER

10.1 Practically and very basically speaking, a well-drafted termination clause will contemplate:

10.1.1 **Who** has the right to terminate – Is it one or both parties?

10.1.2 **What** will trigger a right of termination – Is it a specific action? Is it a failure to take a specific action? Is a third party's action or inaction?

10.1.3 **When** does the right to terminate commence and finish;

10.1.4 **How** must the right to terminate be exercised – Is it notice in writing to the other side? Is it by conduct?

10.1.5 **What if the termination right is not exercised within the required timeframe** – Is the right to terminate lost? Does the right to terminate continue, subject to the other

[94] Carter on Contracts [43-160]
[95] Carter on Contracts [38-030]
[96] Building Contracts Australia [202,205]; *Mann v Patterson Constructions Pty Ltd* (2019) 373 ALR
[97] Building Contracts Australia [202,205]

party's acquisition of a concurrent right to terminate? Does the party with the termination right waive any other rights?

10.1.6 **What are the consequences of termination (be specific)** –

a Refund of deposit, damages, compensation and payment for work done to date or expenditure incurred to date are all common consequences, but will of course depend on the circumstances giving rise to termination.

b It is also important to consider other case-by-case implications that may need to be addressed – for example, what happens if a third party has been contracted in reliance on the primary contract, what if works or services are on foot but incomplete, what happens if there are goods in transit, are there make-good provisions (for example, in the case of a commercial lease it will usually be contractually required that the tenant will make good the premises, redecorate and remove the tenants personal property)?.

c The purpose of termination consequences are to put the parties back in the original position that they had been in, had the early termination not occurred (having regard to the injury suffered by the parties in some circumstances). It enables the parties to bring a close to the contract and move on, rather than spending time "mopping up" after termination.

10.2 Each area of contract law is starting to have statutory intervention which may alter the principle spoken about in this Paper. Such statutory intervention must be considered in conjunction with the common law and the drafting of the contract.

11 CONCLUSION

11.1 Drafting termination clauses is not just a matter of cherry-picking terminable scenarios and listing them out. Equally, terminating contract pursuant to pre-drafted termination clauses (which may have been drafted by another practitioner) may not be as simple as following the procedures set out in the clause. Consideration must be had to the scenario of the termination and the law surrounding the nature of that scenario, common law and statutory intervention.