IT BYTES

ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

WHEN CAN A CONTRACT BE TERMINATED AT COMMON LAW?

WHEN DOES THIS QUESTION TEND TO ARISE?

When considering options to end a contract, it is important to consider rights to terminate the contract at law in addition to any specific termination rights that may apply under the negotiated terms of the contract. Rights at law are also important to consider during the negotiation and drafting of the contract, as it may be appropriate to exclude rights at law so that the rights in the contract itself are in effect exhaustive.

WHAT DOES THE LAW SAY?

As a rule of law, unless it is excluded by the terms of the contract, a party has a right to terminate a contract where there has been:

- a breach of an essential term (otherwise known as a condition);
- a sufficiently serious breach of an intermediate term; or
- a repudiation of the contract.

Breach of a condition

Where a term is classified as a condition, the non-breaching party will have a right to terminate for any breach of the condition, even if the breach is minor. The question of whether a term is a condition is typically assessed by looking at the contract as a whole, the surrounding circumstances and the likely consequences of a breach. A term will be considered a condition where it is so essential that the parties would not have entered the contract unless the condition was going to be strictly performed. For example, if the contract specifies that 'time is of the essence' for a certain obligation, that obligation will likely be interpreted as a condition so that even a slight delay may trigger a right to terminate.

Sufficiently serious breach of an intermediate term

As noted above, breach of a contract term that is classified as a 'condition' will automatically trigger a right to terminate. By contrast breach of a contract term that is classified as a 'warranty' will trigger a right to claim damages but not a right to terminate. There are terms that are not intended to be so important as to qualify as a condition, but are also more important than mere warranties. For these 'intermediate terms', whether a breach will trigger a right to terminate will depend on the nature of the breach and its consequences. Courts have found that a right to terminate will arise where the breach of the intermediate term is so serious as to deprive the non-breaching party of substantially the whole benefit of the contract. This is assessed at the time of termination rather than at the time of the breach or when the contract was formed.

Repudiation

A non-breaching party may also be entitled to terminate a contract as a matter of law where the other party has repudiated the contract. Repudiation occurs where a defaulting party's actions show that they are unable or unwilling to perform their obligations under the contract. A party may repudiate the contract by engaging in conduct that demonstrates an intention to no longer be bound by the contract or to perform it only in a way which is substantially inconsistent with its terms. This conduct could take the form of express statements or simply by actions that show the party is not ready, willing and able to perform the whole of the contract or a fundamental obligation. For example, a purchaser under a contract for the sale of land may consider that the seller has repudiated the contract if the seller disposes of the property to a third party instead.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

Before purporting to terminate a contract it is important to be very clear as to your rights. If a party purports to terminate a contract when in fact they don't have a right to do so, then that of itself may be taken as a repudiation of the contract resulting in a turning of the tables as the other party will then be in a position to terminate based on that repudiation and then seek damages.

In drafting and negotiating the termination regime under an IT contract, the key issue for the parties is to create certainty about which breaches will give rise to a right to terminate. It is good practice to:

1. Include terms in the contract expressly permitting parties to terminate in specific circumstances. This may include situations where a party can terminate 'for cause' (where the right will only be triggered by a breach or other failure by the other party) or 'for convenience' (where no trigger event is required). In either case, it will be important to be clear on when the rights may be exercised. For a right to terminate for cause, it is typical to limit the trigger events to certain types of breaches (e.g. breaches of certain critical terms, or other 'material' breaches that are not remedied within a specified period). For a right to terminate for convenience, it is typical for there to be a minimum notice period or for some payment to be made in addition to or in lieu of notice.
2. Use clear and precise language to indicate whether certain obligations are so essential to the contract that they should be treated as conditions (i.e. so that any breach will give rise to a right to terminate). For example, terms as 'we guarantee' or 'fundamental obligation' or 'any breach give rise to a right to terminate' may be taken as indicators of a condition. By contrast, it is also common for suppliers to specify that reperforming services or refunding payment will be the exclusive remedies available for certain types of breaches, effectively signalling that the provisions in question are intended as warranties that will not trigger a right to terminate if breached.
3. Consider whether a party's rights to terminate at law should be expressly excluded by including a specific term in the contract to that effect. This will generally be more advantageous for the supplier given it will usually have the majority of the obligations to perform under the contract, and will want to control the circumstances in which the customer can bring the contract to an end.

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