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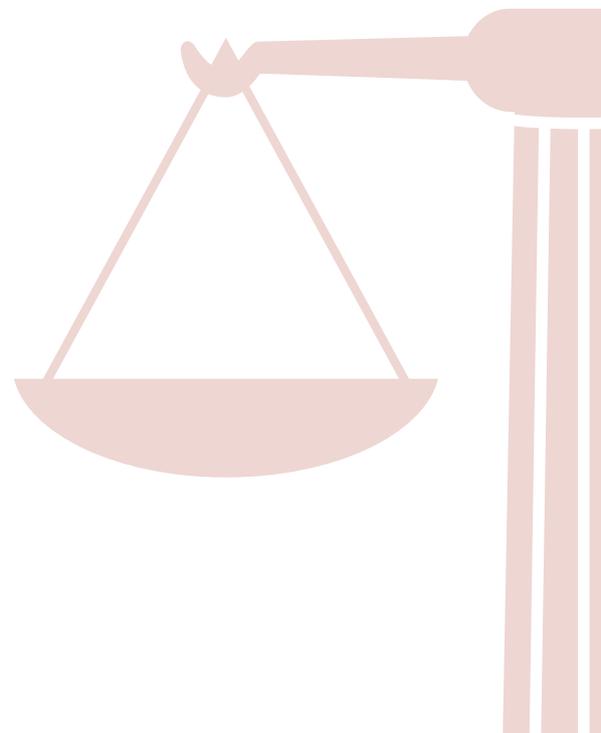
RIGHTS TO TERMINATE A COMMERCIAL CONTRACT  
SUCCESSFUL USE AND LIABILITY FOR MISUSE

by

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# RIGHTS TO TERMINATE A COMMERCIAL CONTRACT

## SUCCESSFUL USE AND LIABILITY FOR MISUSE

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### INTRODUCTION

It is often the case that one party to a commercial contract (“the promisee”) wishes to bring that contract to an end, whether as a result of default on the part of the other party (“the promisor”) or otherwise<sup>1</sup>. As litigators are well aware, such decisions must be taken with utmost care because - in wrongly purporting to terminate a contract - a promisee can, in principle, leave itself exposed to a claim for substantial loss of bargain damages from the promisor.

In such circumstances, issues can arise out of the particular terms in which the promisee purports to terminate. Moreover, particularly complex issues can arise out of attempts to rely upon more than one termination right at the same time. It is hoped that the thoughts offered below will assist in understanding the potential consequences of framing a termination notice in particular terms, and in understanding the circumstances in which a promisee may successfully use alternative termination rights together.

### THE COMMON LAW RIGHT TO TERMINATE

Every breach of contract gives the innocent party a cause of action. However, only a repudiatory breach of contract<sup>2</sup> gives the innocent party a right to terminate its contract at common law. Where a promisee elects to terminate its contract at common law, by accepting such a repudiation by the promisor, it must generally communicate its decision to the promisor<sup>3</sup> by some unequivocal act which is inconsistent with the subsistence of the contract<sup>4</sup>.

Once the repudiation has been accepted by the promisee, it may not be withdrawn<sup>5</sup>. At that point, both parties are released from their respective unperformed primary obligations, and the promisor comes under a secondary obligation to pay damages to the promisee<sup>6</sup>, unless the contract expressly provides for some other consequence to flow from such termination. The promisee’s communication of its decision to terminate for repudiatory breach generally creates the necessary causal link between the promisor’s repudiatory breach and the promisee’s loss of bargain for loss of bargain damages to be recoverable by the promisee<sup>7</sup>.

<sup>1</sup> The ‘promisee’ and ‘promisor’ terminology adopted in this article is derived from Carter, *Breach of Contract*, Hart Edition, 2011.

<sup>2</sup> As defined in *Chitty on Contracts*, 32<sup>nd</sup> Edn., para. 24-017.

<sup>3</sup> **Heyman v. Darwins Ltd** [1942] A.C. 356, 361.

<sup>4</sup> **State Trading Corp of India Ltd v. M. Golodetz Ltd** [1989] 2 Lloyd’s Rep. 277, 286.

<sup>5</sup> **Scarf v. Jardine** (1882) 7 App. Cas. 345, 361.

<sup>6</sup> **Moschi v. Lep Air Services Ltd** [1973] A.C. 331, 345, 350, 351.

<sup>7</sup> **Phones 4U Limited v. EE Limited** [2018] EWHC 49 (Comm), [73].

## CONTRACTUAL RIGHTS TO TERMINATE

Often, commercial contracts contain express provision for the circumstances in which, and process by which, each of the parties shall be entitled to terminate the agreement in question. If the qualifying circumstances exist and the promisee gives notice of its decision to terminate in accordance with the terms of the contract, then (as with common law termination) the parties are generally discharged from their respective unperformed primary obligations. Unless the contract provides otherwise, the financial consequences of contractual termination again fall to be determined by reference to common law damages principles.

## SIMULTANEOUS EXERCISE OF TERMINATION RIGHTS

### Identical consequences

A promisee may be armed with alternative rights to terminate which give rise to identical consequences. In such circumstances, the promisee may rely on one or both of its rights in terminating the contract and does not, in principle, have to choose between them<sup>8</sup>.

Provided that the alternative rights to terminate arise from the same conduct (e.g. conduct which amounts to both a repudiatory breach of contract and a breach which engages a contractual termination provision), there is no reason in principle why, if a promisee terminates the contract without stating the particular legal basis on which it does so, it cannot be treated as doing so under any clause that entitles it to do so and *also* in accordance with its rights at common law. Indeed, in such circumstances, even reference to a particular clause upon which the promisee relies would not inevitably mean that the promisee was *only* relying on that clause<sup>9</sup>. In such a case, it has been suggested that the fact that the two grounds for termination have identical consequences might be thought to support the notion that the promisee was intending to rely on both grounds at the same time<sup>10</sup>.

### Different / inconsistent consequences

More difficult are those questions relating to whether (and if so in what circumstances and how) a promisee may rely upon alternative termination rights which have different or inconsistent consequences.

Clear taxonomy is important in dealing with those questions. It is thought that, properly understood:

- Termination rights are alternative to one another when they derive from different sources. For example, two distinct contractual clauses, or one contractual clause and the common law.
- There is a distinction to be drawn between alternative termination rights which give rise to different consequences and those which give rise to inconsistent consequences<sup>11</sup>.
- Termination rights give rise to different consequences when those consequences are not identical but – equally – do not conflict with one another (e.g. when the financial claim that flows from

<sup>8</sup> Stocznia Gdynia SA v. Gearbulk Holdings [2009] EWCA Civ 75, [44]; Newland v. Toba [2014] EWHC 661 (Comm) [52], [54].

<sup>9</sup> Dalkia Utilities v. Celtech [2006] EWHC 63 (Comm), [143]. It is thought that this comment was intended to relate only to those cases in which alternative termination rights give rise to identical or different, but not inconsistent, consequences, as those terms are defined below.

<sup>10</sup> Phones 4U v. EE, [102].

<sup>11</sup> See, *inter alia*, Dalkia v. Celtech, [144]; Newland v. Toba, [54].

one of the promisee's alternative termination rights is less valuable than the financial claim that flows from another of its rights)<sup>12</sup>.

- Termination rights give rise to inconsistent consequences when those consequences conflict with one another or are mutually exclusive (e.g. when the exercise of one termination right leads to the conclusion that the promisor would be entitled to retain certain plant and equipment relating to a construction project, while the exercise of an alternative termination right leads to the conclusion that the promisee would be entitled to that same plant and equipment)<sup>13</sup>.

## DIFFERENT CONSEQUENCES

Where a promisee has alternative termination rights open to it which give rise to different consequences, questions may arise as to:

- (a) Whether the promisee can rely upon both of those rights at trial in pursuing a claim for loss of bargain damages / for the contractually determined financial consequences which flow from a valid termination; and
- (b) If so, in what terms the promisee must cast its termination notice in order to do so.

As to the first of those issues, it is thought that the answer is, in principle, 'yes'. A promisee faced with alternative rights is only required to elect between them when their consequences are inconsistent, not merely when their consequences are different. Accordingly, it follows that there is no fundamental principle which prevents a promisee with alternative termination rights from relying upon termination rights in the alternative to one another, merely on account of their different consequences<sup>14</sup>. The case-law to date has not always reflected this proposition<sup>15</sup>.

As to the second of those issues, it is thought that where the promisee relies upon both rights in its termination notice in the alternative to one another, and complies with the contractual requirements attaching to the exercise of any contractual right that is engaged on the facts, then it ought to be entitled to rely upon either or both of those rights in seeking to pursue loss of bargain damages at trial.

Where the promisee only expressly relies upon one right in its termination notice, and the alternative rights arise out of different conduct or circumstances, then the promisee cannot recover loss of bargain damages arising out of the uncited ground, for the reasons set out under the heading 'retrospective invocation of rights' below. More difficult issues arise where the promisee only expressly relies upon one right in its termination notice and the alternative rights arise out of the same conduct or circumstances. In such a case, it is thought that the answer may depend upon the nature and source of the termination right which was not cited in the promisee's termination notice:

- If the right not cited in the termination notice is a contractual right, which demands that a specific termination procedure be followed or that specific contents of a termination notice be given, then the promisee ought not to be entitled to rely upon that right in seeking to pursue a claim for damages / contractual compensation at trial. That conclusion arises not because the

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<sup>12</sup> See, *inter alia*, **Dalkia v. Celtech**, [144].

<sup>13</sup> **Dalkia v. Celtech**, [144]; **Newland v. Toba**, [53]; Handley, para.14-002.

<sup>14</sup> **Newland v. Toba**, [54]

<sup>15</sup> **Stoczniá Gdynia** (CA), [44].

promisee has elected against the exercise of the alternative right, but because it has not complied with the contractual requirements applicable to its exercise.

- If the right not expressly relied upon in the termination notice is a common law right, then the promisee ought to be entitled to rely upon that right in seeking to pursue a claim for damages / contractual compensation at trial:
  - o The mere fact of having cited a particular contractual termination right in the termination notice ought not, of itself, to engage the principles of waiver or estoppel:
    - Where it is said that there has been a ‘waiver’ of a right to terminate for breach or repudiation, the concept of waiver seems largely parasitic, in that a conclusion of waiver seems always to be reached on the basis of election or estoppel<sup>16</sup>.
    - There will generally be no such loss of an alternative right to terminate by reference to the principles of election unless the promisee’s conduct in its termination notice is inconsistent with that alternative right<sup>17</sup>.
  - o Equally, there will generally be no such loss of an alternative right to terminate by reference to the principles of estoppel because (in the absence of inconsistent consequences) the promisee will be unable to establish that it relied upon the promisee’s purported termination in such a way as would render it unconscionable for the promisee to resile from its position as set out in its termination notice<sup>18</sup>.
  - o In giving a notice which unequivocally purports to terminate the contract, the promisee has complied with the only procedural requirement attaching to the right to exercise a common law termination right<sup>19</sup>.

## INCONSISTENT CONSEQUENCES POST-TERMINATION

Where a promisee is armed with alternative termination rights which give rise to inconsistent consequences post-termination, a question may arise as to whether the promisee can rely upon both of those rights at once in its termination notice. It is thought that the answer to that question ought in principle to be ‘no’.

That is because, if the time comes when one party to a contract is required to elect between alternative rights with inconsistent consequences, and it elects between them, it cannot escape the consequences of its election merely by proclaiming that its conduct ought not to be treated as an election in law; that its conduct is without prejudice to its rights; or that all its rights are reserved<sup>20</sup>. Accordingly, the fact that the promisee’s rights give rise to inconsistent consequences (as opposed to merely different consequences) requires it to elect between its alternative rights and to bear the consequences if its election in favour of termination on a particular ground proves to have been unfounded at trial. Comments in the case law to date reflect that conclusion<sup>21</sup>.

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<sup>16</sup> Carter, *Breach of Contract*, para. 10-45.

<sup>17</sup> Carter, *Breach of Contract*, paras. 10-08; 11-15.

<sup>18</sup> Carter, *Breach of Contract*, para. 11-21.

<sup>19</sup> **Vitol SA v. Norelf Ltd** [1996] AC 800, 810-811 per Lord Steyn; **Newland v. Toba** [2014] EWHC 661 (Comm), [50].

<sup>20</sup> **Bremer v. Mackprang** [1979] 1 Lloyd’s Rep 221, 225; **Oceanic Freighters v. MV Libyaville** [1975] 1 Lloyd’s Rep 537, 553 – 554; **Antaios Naviera v. Salen** [1983] 1 WLR 1362, 1370H.

<sup>21</sup> **Newland v. Toba**, [53].

## **INCONSISTENT CONSEQUENCES PRE-TERMINATION**

The foregoing analysis is concerned with inconsistent consequences arising after the termination of the contract. However, many contractual termination rights provide that the contract shall terminate, not immediately upon the giving of a termination notice, but upon the expiry of a notice period beginning with the giving of a termination notice. Accordingly, it is possible for alternative termination rights to give rise to inconsistent consequences both:

- During the notice period applicable to both rights; and/or
- As regards the length of the notice period applicable to each right.

The former type of inconsistency might well arise where:

- One right requires the promisor to make an attempt to cure its default so as to prevent the promisee's termination notice from taking effect pursuant to its terms; and
- The other right provides that the promisor is to take steps preparatory to the termination of the contract pursuant to the terms of the termination notice.

The latter type of inconsistency will invariably arise because:

- The exercise of a common law right to terminate for repudiatory breach generally takes effect immediately upon communication of acceptance of the promisor's repudiatory breach<sup>22</sup>, whereas many contractual termination rights expressly provide that the termination of the contract shall take effect only after the expiry of a defined notice period; or
- Because many large-scale commercial contracts contain standard wording which provides for alternative contractual termination rights, many of which are subject to differing notice periods.

It is thought that the general conclusions on inconsistent consequences post-termination (reached above) would apply by analogy to inconsistent consequences arising in either of those two respects:

- Where alternative termination rights carry the same notice period but provide for inconsistent consequences to flow from the giving of a termination notice prior to the termination of the contract, the promisee will necessarily have to elect between its rights.
- Where alternative termination rights carry different notice periods, that of itself means that the rights give rise to inconsistent consequences and that the promisee will necessarily have to elect between his rights.

In the latter case, no doubt the promisee's commercial preference would be to extend or reduce the contractual notice periods applicable to one or more of its contractual termination rights, so as to bring its various notice periods into line with one another. However, in the majority of cases that is unlikely to be an option open to the promisee. As a matter of general principle, it is only where a provision has been inserted into a contract for the sole benefit of one party that that party may unilaterally waive the provision<sup>23</sup>. Where, by contrast, a provision has been included in a contract for both parties' benefit,

<sup>22</sup> *Norwest Holst Ltd v. Harrison* [1985] ICR 668, 683.

<sup>23</sup> *Hawksley v. Outram* [1892] 3 Ch. 359, 375-6

unilateral waiver by one party is impermissible<sup>24</sup>. It is thought that in the majority of cases the courts will treat termination notice periods as having been inserted for the benefit of the promisor or for both parties, such that unilateral waiver by the promisee is not possible.

Moreover, it is thought unlikely that the promisee could circumvent the issue by giving alternative termination notices in a staggered fashion, with a view to bringing an end to the contract on the same date, whichever of the rights is deemed to have been relied upon. If the differing notice periods of themselves comprise inconsistent consequences, forcing an election to be made, then the giving of a termination notice relying upon the right with the longest notice period would - of itself - amount to an irrevocable election against the alternative rights due to be cited in subsequent notices.

Even if the promisee were able to stagger its termination notices as a matter of principle, it is thought that problems would emerge from such a course of action. Namely:

- The promisee would be constrained by the contract to make its first termination notice that which corresponded to the termination right with the longest notice period, rather than that which corresponded to the termination right which the promisee and/or its advisors considered to have the greatest prospects of success.
- It would be open to the promisor to treat the promisee's first termination notice as a repudiatory breach of contract and to purport to accept that repudiation. Were the promisor to do so, and to be held to have validly accepted the promisee's repudiatory breach, then that would bring an end to the parties' contract before the promisee in fact issued its later termination notices.

It follows from the foregoing that a promisee armed with alternative termination rights with inconsistent consequences must elect between those rights.

## RETROSPECTIVE INVOCATION OF RIGHTS

It is often said that a promisee which purports to accept a promisor's repudiation may subsequently "justify" its termination at trial, even if the promisee gave a wrong reason for doing so at the point at which it purported to terminate<sup>25</sup>. This is commonly known as the **Boston Deep Sea Fishing** principle.

However, it is important to recognise that the **Boston Deep Sea Fishing** principle is defensive only. It allows the promisee to defend itself against a claim for loss of bargain damages, if brought by the promisor. That is because the fact that the promisee could have terminated for some reason other than that which it gave when it purported to terminate is directly relevant to the hypothetical counterfactual which the court is required to consider in assessing whether the promisor has a right to loss of bargain damages<sup>26</sup>.

As an aside, the Supreme Court has recently suggested that in assessing that counterfactual it would be for the promisee who wrongfully purported to terminate the contract to prove, as a matter of fact, that – but for its breach - it would have availed itself of an alternative termination right<sup>27</sup>. However, it is

<sup>24</sup> **Heron Garage Properties Ltd v. Moss** [1974] 1 W.L.R. 148, 153B-E.

<sup>25</sup> **Boston Deep Sea Fishing v. Ansell** (1888) 39 Ch D 339, 352, 364; **Stocznia Gdanska v. Latvian Shipping Company** [2002] EWCA Civ 889, [32].

<sup>26</sup> **The Mihalis Angelos** [1971] 1 QB 164, 196-197; **Bunge v. Nidera** [2015] UKSC 43, [23]; **Phones 4U v. EE**, [108].

<sup>27</sup> **Bunge**, [23].

thought that in answering that question the promisee is in fact likely to benefit from a fair wind in the form of the ‘minimum obligation rule’. Put simply, the court is likely to assume that the promisee would have conducted itself in the manner most beneficial to it, by exercising an alternative right. The assumption underlying that rule is so strong that the court may even “ignore evidence that the promisee would not have availed [itself] of the alternative right”. That is because the promisor’s loss is only that to which it was entitled from the promisee, not that which it would have actually received<sup>28</sup>.

The **Boston Deep Sea Fishing** principle cannot be used offensively. Put another way, if a promisee purports to terminate solely for repudiatory conduct X, but can only establish the existence of repudiatory conduct Y at trial, that does not entitle it to loss of bargain damages of its own. In such circumstances, as a matter of fact, the promisee did not purport to terminate for repudiatory conduct Y. The promisee therefore cannot found a claim for loss of bargain damages upon hypothetical facts (i.e. it cannot rely upon the fact that it *would* have terminated for repudiatory conduct Y had it not purported to terminate for repudiatory conduct X)<sup>29</sup>.

For the same reason, a promisee which validly terminates pursuant to a contractual provision which is engaged *other than* by breach on the part of the promisor cannot avail itself of loss of bargain damages *as if* it had terminated the contract at common law for the promisor’s repudiatory breach<sup>30</sup>. Nor, in such a case, does the fact that the promisee reserved its rights in its termination notice have any effect on the proper legal analysis; a right merely reserved is a right not exercised<sup>31</sup>.

It is an open question as to whether, and if so when, a promisee which does not communicate *any* basis for its termination can pursue a claim for loss of bargain damages for repudiatory breach at common law (or whether it is limited to reliance upon the **Boston Deep Sea Fishing** principle in justifying its termination and thereby defending any claim for loss of bargain damages that the promisor may bring against it in due course<sup>32</sup>). It is thought that:

- If the basis for the termination is objectively clear from the context to the termination notice (albeit not expressly referred to in the termination notice itself) then the promisee ought to be entitled to claim loss of bargain damages. In such circumstances, it will have complied with the common law requirement to communicate its decision to the promisor by some unequivocal act, which is inconsistent with the subsistence of the contract; and it will (objectively viewed) have terminated *for the relevant breach*, in such a way as to create the necessary causal nexus between the promisor’s repudiatory breach and the promisee’s loss of bargain losses sought to be recovered<sup>33</sup>.
- By contrast, if the basis for the termination is not objectively clear from the context to the termination notice, then the promisee ought not to be entitled to claim loss of bargain damages. In such circumstances, it will not have objectively communicated its decision to terminate *for the relevant breach*, and therefore there will be no causal nexus between the promisor’s repudiatory breach and the loss of bargain damages sought to be recovered.

<sup>28</sup> *Kramer on Contract Damages*, 2nd Ed., para. 13.34.

<sup>29</sup> **Leofelis v. Lonsdale** [2012] EWHC 485 (Ch), [61]-[68]; [2012] EWCA Civ 985, [17]-[21], [27]-[28]; **Phones 4U v. EE**, [108]-[129].

<sup>30</sup> **Phones 4U v. EE**, [116] ff; [132].

<sup>31</sup> **Phones 4U v. EE**, [132].

<sup>32</sup> **Phones 4U v. EE**, [124].

<sup>33</sup> **Phones 4U v. EE**, [73], [124].

## **CONCLUSION**

The decision to terminate a commercial contract invariably carries considerable risk. It is hoped that the thoughts offered above comprise a useful analytical framework for those charged with analysing the consequences of such a decision, in the face of a complex mass of case-law on the subject.

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