NORDISK 101: TERMINATION OF A CONTRACT

A question often posed to us, is whether a contract can be legally terminated and, if so, how? In this article, we will set out to answer these questions by looking at the legal requirements and options for termination available under English law.

We start by noting that when a contract is legally terminated, it comes to an end and neither party has any future obligations or rights under it. The contract continues to exist, however, in the sense that there may be claims for damages arising under it prior to or in connection with its termination.

The facts may be such that a common law right of termination arises alongside a contractual right. How are those termination options best exercised?

BY SUSAN CLARK

When? Circumstances allowing Termination

Repudiatory Breach

Under common law legal principles, a contract may be terminated for repudiatory breach. A repudiatory breach is one which is so serious or fundamental to the contract as to allow the innocent or non-breaching party the right to terminate the contract and claim damages, including the loss of the benefit of the contract. As described in our earlier articles, in determining when a contract may be terminated, the law classifies contractual terms into three categories: (1) conditions, (2) warranties and (3) intermediate or innominate terms.

To determine which category a particular term falls into is not always an easy task. The parties may label a term as one of the three in their contract, but this will not guarantee that the courts will agree with that label. In classifying a particular term, the courts will consider the words used by the parties, but they will also look at the contract as a whole as well as the commercial background to see if the parties intended that a right of termination would arise for breach of the term and in what circumstances.

Examples of each type may help to understand this system of classification. An example of a condition is the owners' obligation to proceed on a voyage without unjustifiable deviation. A classic warranty is the promise that a vessel will perform at a given

speed on a stated consumption of fuel. An example of an intermediate term is the obligation to provide a seaworthy vessel. In circumstances where the breach of that obligation results in a breakdown of the main engine for a few days while repairs are made, the charterers would not have a right to terminate and could be readily compensated with monetary damages.

If, however, the repairs would take an inordinate amount of time, judged against the length of the contractual period, such a breach would most likely be repudiatory and allow for termination in addition to monetary damages.

Refusal to Perform as a Repudiatory Breach

If one party to a contract unequivocally indicates that it will not perform its obligations or no longer considers itself bound to do so, the other party may have the right to terminate. A party's refusal to perform can be by express declaration, such as where a charterer states that it cannot and will not continue to pay hire. This would also be what is called an anticipatory breach, which occurs when a party states it will not honour its contractual obligations in the future.

A refusal to perform may also be inferred from conduct. Whether such a refusal is a repudiatory breach will depend upon whether the non-performance amounts to a breach of a condition or deprives the innocent party substantially of the whole benefit of the contract. The test for determining whether repudiation has occurred expressly or by conduct is an objective one: whether in light of all the circumstances a reasonable person would conclude that the other party will not continue to perform or carry out its obligations under the contract.

Contractual Provisions for Termination

Many contracts and charterparties, contain express provisions allowing one or both parties an option to terminate the contract upon the occurrence of a specific event or circumstance, even where this does not amount to a breach, repudiatory or otherwise. Common examples include where a vessel is off hire for a stated period of time or where one party becomes insolvent during the course of the contract.

To claim damages in addition to exercising the option to cancel, the terminator will in most cases also need to establish a breach by the other party. For example, where charterers have the option to terminate if the vessel does not meet the cancelling date in a voyage charter, to claim damages they must also show a breach such as the owners' absolute obligation to commence the approach voyage in time to arrive by that date.

How? Electing to Terminate a Contract Accepting the Repudiation or Affirming the Contract

Termination for a repudiatory breach is not automatic. The innocent or non-breaching party must elect whether to accept the repudiation, bringing the contract to an end, or to affirm the contract and insist that the breaching party perform. The law does not require such an election to be made within a specified time, but generally it must be exercised within a reasonable time, considering the surrounding circumstances. For example, in a volatile freight market, an election should be made relatively quickly.

In addition, the innocent party must be careful not to lose the right of election, for example by waiting too long to decide how to respond or by acting in such a way as to affirm the contract. Once an election is made it cannot be changed, so it is crucial the innocent party proceed cautiously and preferably with legal advice.

Exercising the Option to a Contractual Right of Termination

Once a terminating event under a contract has occurred, the party seeking to terminate must exercise its option to do so within a reasonable time. What is reasonable will depend upon the facts and circumstances in each case, but generally our advice is to do so quickly so as not to jeopardize the option.

In addition, some contracts provide for termination only if a particular incident or problem is not rectified or cured within a specific period of time. In those circumstances, the party seeking to terminate must allow the other side the agreed time before it may exercise its option. Furthermore, most if not all contractual termination provisions require written notice to be given to the other party of the exercise of the option. All details of a termination clause must be followed to the letter or the termination may be unlawful and itself constitute a repudiatory breach of

contract with resulting liability for damages.

Contractual termination rights are in addition to the right to terminate for repudiatory breach, unless the latter right is expressly or impliedly excluded in the contract. However, a party electing to end a contract pursuant to a contractual termination right alone, risks losing the right to sue for damages for a repudiatory breach. To preserve the innocent party's right to claim damages, specifically and importantly the loss of its bargain, the notice of termination must clearly state that the termination is for a repudiatory breach.

As explained above, the non-breaching party must elect to accept a repudiation within a reasonable time to preserve the right to make a claim for damages for future losses, such as loss of profit. A mere statement in a contractual termination notice that all the non-breaching party's rights are reserved will not be enough to maintain a damages claim for repudiatory breach. As stated by the court in the leading decision on this point, "*a right merely reserved is a right not exercised*."[1]

Damages Resulting from Termination

The losses that may be claimed by way of damages when a contract ends depends upon the termination rights that were exercised. Damages for repudiatory breach are meant to put the innocent party in the position it would have been in had the contract been performed, subject to the usual rules on causation, foreseeability and mitigation. Thus, an innocent party that accepts a repudiatory breach is entitled to "loss of bargain damages" to compensate for the lost opportunity for future benefits, such as loss of profits. If the innocent party chooses to affirm the contract, rather than terminate, a claim for damages for losses suffered as a result of the breach may still be made, but of course, there would be no claim for future losses as the contract would remain on foot.

Where a contract is terminated pursuant to a contractual provision, damages will usually be limited to any losses suffered up to the date of termination. In other words, there is no right to recover loss of bargain damages. The difference in damages for repudiatory breach and contractual termination can, therefore, be quite significant.

1 *Phone 4U (in administration) v. EE Ltd.* [2018] 1 Lloyd's Law Rep. 204, at p. 228.

Practical Issues and Several Warnings

Deciding whether you have a right to terminate a contract and how to legally bring about termination can be difficult. If you terminate on the basis of a repudiatory breach and the requirements for establishing such a breach are not met, then you and not your contractual partner may be in repudiatory breach and exposed to significant damages claim.

Terminating on the basis of a contractual provision alone requires carefully fulfilling the requirements for exercising the option and may not give you a claim for any damages. How to terminate and how the decision is communicated can be complicated where the party has both contractual and common law rights based on repudiatory breach to terminate.

One solution in that situation may be to notify the other side of an election to terminate for repudiation and, in the alternative, assert the contractual right. Although such a notice has yet to be tested in the courts, at least one English judge has indicated that it would protect the innocent party's common law and contractual rights of termination.[2]

In any event, a notice of termination should be carefully drafted and state the precise basis for termination. In short, caution must be exercised, and legal assistance should be sought both in reaching a decision on whether to terminate and then drafting an appropriate notice so as to protect a right to damages, if any, and reduce the risk of being found in breach yourself.

2 See Shell Egypt West Manzala GMBH v. Dana Gas Egypt Limited (formerly Centurion Petroleum Corporate) [2010] EWHC 465 at para. 34.

NORWEGIAN SALEFORM 2012 – ARE SIGNATURES ON THE MOA A CONDITION PRECEDENT TO THE FORMATION OF A CONTRACT?

BY EGIL ANDRÉ BERGLUND

Whether or not an obligation or a term is a condition precedent for a contract to be entered into can be a difficult subject under English law. Recently we came across this issue in relation to a sale of a vessel and, given that it arose out of standard wording in Saleform 2012, consider it of wider interest to our Membership.

One of our members had negotiated a sale contract on the well-known and frequently used Norwegian Saleform 2012. The parties were represented by their brokers and a string of e-mail correspondence reflected the terms on an accept/except basis, until meetings of mind were reached, and a recap was circulated from the sellers` broker to the buyers` broker.

The sellers signed the MOA and sent it to the buyers for their signature, however, a signed MOA from the buyers was never returned. The question then arose whether the buyers were bound by the background general principle under English law that the agreement is deemed to be reached when all essential terms are agreed, or whether the signature on the MOA was a condition precedent for a contract being validly entered into.

As some of you may be aware, clause 2 of Saleform 2012 was amended from the previous 1993-version. In the 1993 Saleform, the deposit shall be paid within an agreed number of banking days from the date of the MOA, which effectively would be from the date the recap of the MOA was agreed.

In the redrafting to what is now Saleform 2012, clause 2 was revised to provide that the deposit will be payable (i) three banking days from signature and exchange of the original MOA and (ii) on receipt of

confirmation in writing from the Deposit Holder that the Deposit account has been opened.

Legal authority and commentary

As early as April 2012, two experienced maritime lawyers, including one of the authors of the book *"Sale of Ships: The Norwegian Saleform"* [1] Paul Herring, commented in an article that it is possible that the revised Clause 2 would lead to arguments that the agreement is not binding until signature and exchange of the MOA, *"though this was presumably not the intention of the drafters"*.

This was similarly addressed by Herring in Sale of Ships[2] where he comments as follows:

"However the provisions of clause 2 Saleform 2012 may have the effect of preventing a binding contract from arising until signature…". "The new wording may lead to arguments that the agreement is not binding- and that the deposit period does not start to run- until the MOA has been put into printed form, signed and exchanged however long this takes and however much delay there is. This may not have been the intention of those who drafted the 2012 Form."

It is a basic principle of English contract law that, absent any qualifications made by the parties to the contrary, there is no requirement that contracts should be in writing or that any documents affording written evidence of an agreement should have been signed by the parties. It then follows that if one of the parties wished to be legally bound only upon the signature of a written MOA which incorporated all of the agreed terms, buyers or their representatives would have to make this clear to sellers through the course of offers and counter-offers. Normally this is done with the words "subject to contract" or "subject to details".

Even though we at Nordisk were of the opinion that clause 2 construed correctly did not include a condition precedent for the agreement to be entered into, we acknowledge that the buyers, possibly emboldened by the comments in *Sale of Ships*[3], thought this could be a successful defence. Our research did not reveal any case-law directly on the point under the new Saleform 2012, but the buyers` view would clearly change what was intended to be an innominate term into a condition precedent, which would represent a radical and fundamental change on how MOAs operate. We therefore instructed Counsel from 20 Essex Street chambers to provide a second opinion.

Counsel concurred fully with our rationale and provided some convincing considerations by reference to legal precedence, which, to our minds, should settle the subject.

Almost precisely the same "condition precedent" type argument as fuelled by "Sale of Ships" was run and was rejected by the Court of Appeal in *"The Blankenstein"* [4] (albeit based on the earlier Saleform 1966 contract). The wording in that contract was amended so that it read, as in the Saleform 2012, that the relevant deposit clause was expressly linked to the timing of signature.

On the facts of that case, the relevant MOA was not signed and clause 2 of that MOA provided that the deposit was to be paid *"on signing this contract"*. Both the Court of first instance and the Court of Appeal held that a binding contract had indeed come into existence when a relevant recap offer had been accepted as between the respective brokers involved.

The Court of Appeal held that there was nothing on the facts of the case which led to the conclusion that the parties had intended that the negotiations were not to have contractual force until a formal document had been signed. The Court stated that the mere fact that the parties intended that there should be a formal contract in the agreed standard form signed by the parties did not of themselves reveal any such intention. The Court concluded that the relevant "acceptance" message relied upon would be *"regarded in the shipping market as giving rise to a binding contract of sale not requiring a signed memorandum to validate it"*.

The Court expressly rejected the argument that the parties` signatures and the payment of the deposit by the buyers were "conditions precedent" to the formation of the contract itself. Fox LJ summarised what should be the guiding view on Saleform 2012 also:

"In the absence of a special provision it does not seem to me to carry with it any implication that it is a condition precedent to the existence of contractual relations…. The provision for payment of the deposit was not a condition precedent to the formation of the contract. It was in

1 by Malcolm Strong and Paul Herring
2 Ibid, 3rd Edition
3 Ibid
4 [1985] 1 Lloyd`s Rep 93

my view a fundamental term of the concluded contract."

However, the Court did find that since the MOA had not been signed and signature was the express trigger for payment of the deposit, this meant that the particular obligation to pay the deposit had not yet been triggered. In practice this did not, and for the Saleform 2012 also will not, actually affect the end result for the sellers.

The Court commented that once the MOA had been concluded between the brokers, the *"parties became bound to sign the MOA incorporating the agreed terms within a reasonable time"*. On the facts, the Court held that two weeks had elapsed since the conclusion of the MOA and this amounted to the expiration of a "reasonable" time for the buyers` signature.

Both we and Counsel concur with the view taken by the Court of Appeal, it would be anathema to basic English law principles to allow the buyers to avoid their liability for payment of the deposit and the consequences which follow from that, as a direct result of their own failure or refusal to sign the MOA.

Finally, and by way of 'comfort', the Court of Appeal in *The Blankenstein*, also cited with approval the reasoning in *The Selene G*[5]. In that case, the buyers did not pay the deposit and the sellers rescinded. It was held by Mr Justice Robert Goff that the obligation to pay the deposit was an essential term of the contract. It was not suggested in that case that the payment of the deposit was a condition precedent to the existence of the contract.

Conclusion

We can therefore now safely conclude that signature of the MOA under the Saleform 2012 is a contractual term that obliges buyers to sign the contract, but it does not constitute a condition precedent for the contract to be validly entered into, unless the parties have expressly included such conditions in the negotiation phase as subjects to contract.

In the next edition we will consider what the consequences of a buyer failing to sign a MOA within a reasonable time.

5 [1981] 2 Lloyds Rep 180

CATHERINE O'CONNOR JOINS NORDISK SINGAPORE

We are pleased to announce that Catherine O'Connor joined our Nordisk office in Singapore earlier this month.

Catherine is an experienced FD&D and litigation lawyer and will provide invaluable support to our team in Singapore. Catherine started her career as a trainee solicitor at Mills & Co, whereafter she joined HFW in Hong Kong for four years. More recently Catherine worked with the FD&D team at The North of England P&I Association Limited in Singapore, where she remained for seven years.

Catherine is looking forward to serving Nordisk members both in Singapore and elsewhere, as well as helping the team in Singapore expand and look to future opportunities.

Photos:
Page 1 - Kees Torn
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