

## THE RECESSION: HOW TO ESCAPE UNFAVOURABLE CONTRACTS



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## **The Recession: How To Escape Unfavourable Contracts**

Due to the recession, many businesses are finding that where a contract was regarded as advantageous when it was entered into, it is now seen as unfavourable. Consequently, a contracting party wishing to save costs in this economic climate may look to do so by renegotiating a contract, or simply choose to try and exit a contract that has become unfavourable or that no longer meets its business needs.

This note sets out certain provisions whereby a party to a contract can terminate early.

### **Contractual clauses allowing Termination**

- Many contracts can be terminated for a "material breach" by one or the other party. However the phrase "material breach" is rarely defined by either party in the contract. The courts have ruled that the breach must be "so serious that it deprives the non-defaulting party of the benefit it entered into the contract for in the first place"; for example, failing to pay for services provided may amount to a material breach. It is however very important to analyse the circumstances you find yourself in correctly and to be sure of your grounds prior to adopting this route.

### **What happens when there is no Termination Clause?**

- Where a contract does not contain a Termination Clause, it is likely that the contract can still be terminated on "reasonable notice" on the part of one or both parties. What the courts consider "reasonable" will depend on the individual circumstances of the case and the facts at the time that the notice of termination is given.
- In deciding "reasonable notice" a court will look at:
  - The length of the relationship between the parties and their expectations when they entered into the agreement;
  - The length of the contractual term;
  - The financial dependency of the terminated party upon the contract and the time that it would take such party to replace the lost business; and;
  - The obligations of the parties at the date of the notice to terminate.

### **Termination at Common Law**

- Where no express contractual termination rights exist, it may be necessary to consider whether an immediate right to terminate arises at common law.
- At common law, if one party to a contract is in repudiatory breach (i.e. as a result of its serious breach of the terms of the contract), the innocent party can accept the breach, terminate the contract and seek damages, or elect to affirm (i.e. accept) the contract, which has the effect of treating the contract as continuing and seek damages.

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- Delay in acting quickly when you are aware of a repudiatory breach can amount to an affirmation of the contract and a waiver of your right to immediately terminate the contract.

Accordingly, where you do wish to terminate a contract, you should bear in mind the following points to try and ensure that you do so with the least possible risk:

- Be confident of your grounds to terminate and the consequences of getting this wrong- which could be very expensive.
- Have you reacted quickly enough to the breach? Could the other party seek to argue that you have waived your rights?
- Are there any procedural requirements which are specified in the contract for serving notice of termination?
- Clearly set out your grounds for termination very carefully as these may be scrutinised by a Court later on.

**Need to know more? Ask us. For information/advice on litigation issues, please contact:**

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