The Termination of Contracts for Breach

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Introduction

An innocent party’s right to terminate a contract arises from a particular type of breach of contract by a defaulter. The factual matrix of the breach and the nature of the term breached in each case inform the innocent as to whether the right has arisen. In this paper I have used the term “the innocent” to describe the party who is seeking to terminate and the word “the defaulter” to describe the other party to the contract. However, it is not uncommon for the defaulter to be able to point to other breaches by the “innocent”.

Common law rights to terminate arise in one or more of the following three ways:

- Any breach of a condition (or essential term) of the contract;
- A serious breach of an intermediate term of the contract; or
- Conduct that shows the defaulter is unable or unwilling to comply with the contract.

Contractual rights to terminate are of two main types:

- Termination of the contract in total; or
- Termination of the engagement of a contractor,

in both cases arising from actual conduct, as described in either the contract’s termination clause or a term arising under statute.

Frequently, the common law right to terminate is the most important consideration.

The right to terminate at common law

Any right to terminate under a provision of the contract terms requires careful consideration of the meaning of the words in the contract and the common law informs that meaning, particularly if the contract is silent or ambiguous as to the meaning of the words. Further, even if the contract includes a termination clause, unless there is clear express exclusion of the common law right to terminate, the common law right remains alive and parallel to any contractual right to terminate.

Defining the terms

Termination of a contract is usually achieved by full performance. Here, however, we are talking about early termination. Termination is not rescission notwithstanding the fact courts have sometimes used that term. To rescind a contract means to unwind it back to its initiation. Termination takes a snapshot at the time of termination. The contract is given its full effect up to the time of termination and, as we will later see, some aspects of the contract continue after termination.
The emergence of the common law right to terminate

There has not always been a common law right to terminate partly performed contracts. At one time, the promises made by contracting parties were considered to be independent covenants. By the later part of the 18th century this was recognised as potentially causing great injustice where the innocent party was obliged to provide evidence of its full performance of the contract to claim damages for breach by the defaulter, even when the defaulter had long been in the most serious breach of the contract.

In Boone v Eyre\(^1\) the vendor sold to a purchaser a plantation in the West Indies, complete with a stock of slaves. The purchase price was £500 plus an annuity of £160 per year. The purchaser stopped paying the annuity because he discovered that the slaves were not legally owned by the vendor at the time of the sale. Lord Mansfield rejected the purchaser's argument but said that where covenants go to the whole of the consideration on both sides, they are mutual. However he held that the legal ownership of the slaves was not such a covenant and damages was an adequate remedy for this breach.

In Bettini v Gye\(^2\) an opera singer, Bettini, was engaged by Gye for a three month season and was required to be in London six days before the opening night for rehearsals. Bettini arrived only two days before opening night because of illness and Gye refused to continue with the contract. The court considered whether the requirement to be in London 6 days before opening night was a condition precedent to the obligation of Gye to employ Bettini or was an independent agreement. Lord Blackburn said it was the latter. Bettini was entitled to damages for wrongful repudiation of the contract and Gye was not entitled to terminate the contract. The term breached was considered to be an independent agreement; it was akin to a collateral contract that had been breached and therefore did not give rise to the right to terminate.

This is to be contrasted with Poussard v Spiers and Pond\(^3\). Spiers and Pond engaged Poussard to sing the lead role in a new opera. The opera was scheduled to open on 28 November and Poussard attended numerous rehearsals up to 23 November when she became ill. On 25 November, Spiers and Pond were told that Poussard would probably be unable to sing on opening night. They engaged a replacement who sang in her place. On 4 December Poussard had recovered and wanted to sing, but they refused to let her. She sued for breach of contract but failed, as the court said that her earlier inability to sing went to the essence of the contract. The promise to sing from opening night onwards was a condition and its breach entitled them to terminate.

This approach of distinguishing between conditions precedent and independent agreements morphed through time into calling the two classes of terms conditions and warranties. The term “warranty” had been previously viewed as a representation that, if breached, entitled the innocent to a remedy in deceit. Over time, “warranty” became a term that described a less important term of the contract.

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1 (1777) 1 H.Bl. 273; 126 ER 160
2 (1876) 1 QBD 183
3 (1876) 1 QBD 410
When the *Sale of Goods Act 1895* commenced, the distinction between conditions and warranties was enshrined into statute.

11. **When conditions to be treated as warranty:**

   (1) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition, or may elect to treat the breach of such condition as a breach of warranty, and not as a ground for treating the contract as repudiated;

   (2) Whether a stipulation in a contract of sale is a condition the breach of which may give rise to a right to treat the contract as repudiated, or a warranty the breach of which may give rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated, depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.

The last sentence of s11(2) above illustrates the difficulty faced when attempting to draft or interpret a clause in a contract. At this stage of the development of the law there developed a greater degree of focus on the classification of the term rather than the effect of the breach.

**Criticism of the focus on the dualistic classification of the contractual terms**

Emphasis on the classification of the term led to some unfortunate results. For example, because s13 of the *Sale of Goods Act 1893* (UK) designated the description of goods sold to be a “condition”, when a Hobart supplier delivered a shipment of cases of fruit with 24 cans per case rather than the 30 cans described, the Court held that the UK buyer was entitled to terminate the contract. The real reason for the termination was a 6 month delay in delivery that was not attributable to the seller.⁴ There was no suggestion that total quantity of fruit delivered was incorrect.

Similar injustice is apparent in the High Court of Australia decision in 1923 of *Bowes v Chaleyer⁵*. In March 1920 Bowes ordered from Chaleyer a quantity of silk. The goods were to be shipped and the delivery was to be in two parts; half as soon as possible and half two months later. In May the parties negotiated an increase in price and Bowes then tried to cancel the order but Chaleyer insisted the order was contractually binding. Of the 89 pieces of silk ordered, 19 were shipped on 21 October 1920 and 41 on 17 November 1920. The mathematically inclined will observe that this was more than half. The balance of 29 pieces of silk was shipped on 13 December 1920. As can be seen, less than two months had elapsed between the first shipping date and the last.

⁴ *Re Moore and Co Ltd and Landauer and Co* [1921] 2 KB 519; see also *Bowes v Chaleyer* (1923) 32 CLR 159

⁵ (1923) 32 CLR 159
Bowes refused to take delivery of any of the silk, claiming that the order had been cancelled back in June 1920. Chaleyer sold the silk to others and sued Bowes for the difference between the sale price and the original agreed contract price. At first instance, Chaleyer succeeded, the Court finding that the contract had not been cancelled. Bowes appealed to the High Court on the basis that the terms of the shipping dates had not been complied with and therefore, the contract had been repudiated by Chaleyer. The majority in the High Court agreed and held the stipulation as to shipping dates and quantities should be considered a condition precedent. On the basis of the classification of the term, Bowes was entitled to terminate the contract for breach of a condition, notwithstanding the breach had not resulted in significant impact on the outcome of the bargain. In a scathing dissenting judgement, Isaacs and Rich JJ lamented the conclusion reached by the majority and said:-

“There cannot be a doubt that the respondent in all substantial respects has faithfully carried out his part of the transaction: the right goods were procured, the prices are correct, there was no delay and, indeed, the only fault ascribed to him is a too speedy performance. No potential or actual damage is suggested by the fault ascribed; the defence is purely formal. All the elements of real justice are on the side of the respondent. It must be acknowledged in favour of the appellant that the objection now relied on was not his own. When the circumstances come to be scrutinized, the appellant's silence on this point was only natural. No honest reasonable merchant in his position would have dreamt of asserting that what is now alleged as a fatal breach was such as frustrated the adventure or destroyed the foundation and substance of the contract. Not even in the course of the appellant's evidence is such an idea suggested. But that is what, in our opinion, is necessary to enable the appellant to succeed. The present objection was evolved as a dernier ressort by the ingenuity of his legal advisers.”

The “test” to determine whether a term is a condition

In order to determine whether a party was entitled to terminate at common law, it became necessary to set some guiding rules to establish what contractual terms were conditions. In 1938 Chief Justice Jordan of the NSW Supreme Court made the following oft quoted comments (references omitted):

“In considering the legal consequences flowing from a breach of contract, it is necessary to remember that:-

(i) the breach may extend to all or to some only of the promises of the defaulting party;
(ii) the promises broken may be important or unimportant;
(iii) the breach of any particular promise may be substantial or trivial;
(iv) the breach may occur or be discovered:-
a. when the innocent party has not yet performed any or some of the promises on his part, or after he has performed them all; and

b. when the innocent party has received no performance from the defaulting party, or has received performance in whole or in part;

and to remember also that the resultant rights of the innocent party and the nature of the remedies available to him may depend upon some or all of these matters.

The nature of the promise broken is one of the most important of the matters. If it is a condition that is broken, that is, an essential promise, the innocent party, when he becomes aware of the breach, has ordinarily the right at his option either to treat himself as discharged from the contract, and to recover damages for loss of the contract or else to keep the contract on foot and recover damages for the particular breach. If it is a warranty that is broken, that is, a non-essential promise, only the latter alternative is available to the innocent party.

The question whether a term in a contract is a condition or a warranty, ie, an essential or a non-essential promise, depends upon the intention of the parties as appearing in or from the contract. The test of essentiality is whether it appears from the general nature of the contract considered as a whole, or from some particular term or terms, that the promise is of such importance to the promisee that he would not have entered into the contract unless he had been assured of a strict or a substantial performance of the promise, as the case may be, and that this ought to have been apparent to the promisor. If the innocent party would not have entered into the contract unless assured of a strict and literal performance of the promise, he may in general treat himself as discharged upon any breach of the promise, however slight. If he contracted in reliance upon a substantial performance of the promise, any substantial breach will ordinarily justify a discharge. In some cases it is expressly provided that a particular promise is essential to the contract, eg, by a stipulation that it is the basis or of the essence of the contract; but in the absence of express provision the question is one of construction for the Court, when once the terms of contract have been ascertained."6

Criticism of the “test”

The “test” has not been without its critics. Murphy J was particularly strident:

“This "test" is so vague that I would not describe it as a test. It diverts attention from the real question which is whether the non-performance means substantial failure to perform the

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6 Tramway Advertising Pty Ltd v Luna Park (NSW) Ltd (1938) 38 SR NSW 632 at 641
contractual obligations. The inquiry into the motivation for entry into the contract is not the real point.”

Kirby J recently repeated Justice Murphy’s comments and continued:

“As a matter of logic and principle, there is much force in this criticism. It is difficult to see how reference to the "common intention" of the parties at the time of contract formation advances the decision in a case such as the present. It is an artificial criterion in that it demands the drawing of inferences as to the parties' reactions to contingencies that in fact might (and usually would) never have been anticipated. It also affords scope for the importation of subjective considerations in a manner inconsistent with the modern general approach to the formation of contracts. In my view, it is preferable to place the “test” on a different footing and to inquire into the objective significance of breach of the term in question for the parties in all the circumstances. I would favour that approach. If it is adopted, it is difficult to see what purpose purporting to conduct a retrospective investigation of the "common intention" of the parties serves. The court creates an objective postulate. It applies it to the facts. There is then no need to resort to the fiction that Tramways Advertising introduces.”

The emergence of a third classification: the “intermediate” term

Notwithstanding these dissenting views, the above passage forms the starting point for the analysis by the majority of the High Court in its most recent consideration of the common law right to terminate in Koompahtoo. This recent decision adopts the test for distinguishing between conditions and warranties but confirms the subsequent English position in extending the number of classes of contractual terms to three: conditions, warranties and intermediate terms. The first recognised authority to introduce the third classification of contractual terms was Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd, a decision of the English Court of Appeal. Hong Kong Fir was decided in 1961 and passed into the mainstream law of contract as understood and practised in Australia, although not formally adopted by the High Court until Koompahtoo.

In Hong Kong Fir the owners of a ship entered into an agreement with a charterer for a two year period. A term of the agreement required the ship to be seaworthy. After a few months, the charterer complained of a lack of seaworthiness and terminated the agreement. The owners claimed unlawful repudiation and sought damages. The Court of Appeal said breaches of such a term could vary widely in importance; they could be trivial or serious. The Court recognised that, while a trivial breach of such a term would not be sufficiently serious to justify termination, a serious breach would have that effect.

7 DTR Nominees at [1978] HCA 12 para 5
8 Koompahtoo Local Aboriginal Land Council v Sanpine Pty Limited [2007] HCA 61 per Kirby J at para 101
9 Koompahtoo Local Aboriginal Land Council v Sanpine Pty Limited [2007] HCA 61
10 [1962] 2 QB 26
11 Koompahtoo at para 50
Before *Hong Kong Fir* it had been held that contractual terms included only “conditions” and “warranties”; that is, essential obligations and non-essential obligations. A breach of the former, however slight, entitled termination of the contract. A breach of the latter was actionable in damages only.

In *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd*\(^\text{12}\) Mason ACJ, Wilson, Brennan and Dawson JJ said:

“That since the judgment of Diplock LJ in *Hong Kong Fir* it has been recognized in England that a term in a contract may stand somewhere between a condition and a warranty. Such an intermediate or innominate term, it has been held, is capable of operating, according to the gravity of the breach, as either a condition or a warranty. In *Hong Kong Fir* the obligation of seaworthiness was readily classified as innominate because a breach of the obligation might be trivial, making damages an adequate remedy, or grave, in which event it should have effect as a breach of condition. The innominate term brings a greater flexibility to the law of contract, as Lord Wilberforce has remarked on more than one occasion. Although nothing less than a serious breach of an innominate term entitles the innocent party to treat the contract as at an end, the breaches … merit this description.” (references omitted)

The comments in *Ankar* were obiter as the Court found that breached terms were essential. However in *Koompahtoo*, the High Court confirmed *Hong Kong Fir* as Australian common law and said it may not be the case that any breach of a particular term will entitle the other party to terminate but some breaches of such a term may do so. In *Hong Kong Fir* Diplock LJ said of some terms:

”all that can be predicated is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract; and the legal consequences of a breach of such an undertaking, unless provided for expressly in the contract, depend upon the nature of the event to which the breach gives rise”\(^\text{13}\)

**The current common law position in Australia: Koompahtoo**

Given *Koompahtoo* represents the most recent decision of the High Court on this topic, I have attempted to summarise the majority summation of the legal principles. The following sets out the present Australian common law position on termination of a contract for breach, where the terms of the contract do not exclude the common law.

The innocent party has the option to terminate its contract with the defaulter if:

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\(^\text{12}\) (1987) 162 CLR 549, 562

\(^\text{13}\) [1962] 2 QB 26 at 69-70.
1. The defaulter has breached an essential term, often described as a condition;
2. The defaulter has committed a sufficiently serious breach of a non-essential term; or
3. The defaulter renounces the contract by evidencing an intention to be no longer bound by it. In particular the defaulter:
   a. Shows it intends to fulfil the contract only in a manner substantially inconsistent with its obligations and not in any other way; or
   b. Shows it is unable to perform the contract, even if apparently wanting to do so.

Of these, 1 and 2 are properly described as “repudiation” by the defaulter and 3 as “renunciation” by the defaulter. The term “renunciation” may surprise some but the High Court has clearly spelt out that this is the correct description of such an action.\textsuperscript{14}

The above propositions require some explanation but it is important to first recognise that the common law right to terminate can be expressly excluded by agreement.

**Is the common law right to terminate excluded?**

Parties can expressly exclude the common law right to terminate by the terms of their contract but unless they do so, the innocent party’s right to terminate at common law continues notwithstanding the presence in the contract of a termination clause.

“A party entitled to terminate a contract for repudiation or fundamental breach may rely upon both a specific contractual right to terminate the contract and the common law right to terminate unless, as a matter of construction, the former excludes the latter.”\textsuperscript{15}

**Is the breached term an essential term (condition)?**

Whether or not a term is essential is determined by:-

a. express words; or
b. the “test” set out in the above quotation from Tramways

I have attempted to reduce the “test” to two logical propositions:

1. If an objective bystander interpreting the contract as a whole would reasonably form the view that the innocent party would not have entered into the contract unless assured of strict and literal performance of the term, then the term is essential and any breach of it entitles termination; or

\textsuperscript{14} Koompahtoo at para 44

\textsuperscript{15} Progressive Mailing House Pty. Ltd v Tabali Pty. Ltd [1985] HCA 14 per Deane J at para 8; Mazelow Pty Ltd v Herberton Shire Council [2002] QCA 119 at para 7
2. If an objective bystander interpreting the contract as a whole would reasonably form the view that the innocent party would not have entered into the contract unless assured of substantial performance of the term and a substantial breach has occurred then the term is essential and the innocent party is entitled to terminate.

The circularity highlighted by Kirby J in *Koompahtoo* is apparent from the second of these propositions. As Kirby J says, in order to decide whether the term is classified as a “condition” one must assess the seriousness of the breach. In any event, there appears to be significant overlap with what follows in relation to intermediate terms and in that regard, the second of the propositions may in some circumstances be redundant.

**What is a “serious” breach of an intermediate term?**

The cases are full of helpful descriptions of a “sufficiently serious breach” and it is appropriate to list some of them to set the scene. Frequently, such a term is described as a term that goes to the root of the contract.

“A judgment that a breach of a term goes to the root of a contract, being, to use the language of Buckley LJ in *Decro-Wall International SA v Practitioners in Marketing Ltd*16, ”such as to deprive the injured party of a substantial part of the benefit to which he is entitled under the contract”, rests primarily upon a construction of the contract. Buckley LJ attached importance to the consequences of the breach and the fairness of holding an injured party to the contract and leaving him to his remedy in damages. These, however, are matters to be considered after construing the agreement the parties have made. A judgment as to the seriousness of the breach, and the adequacy of damages as a remedy, is made after considering the benefit to which the injured party is entitled under the contract.17

In *Hong Kong Fir* Upjohn LJ said:

“[D]oes the breach of the stipulation go so much to the root of the contract that it makes further commercial performance of the contract impossible, or in other words is the whole contract frustrated? If yea, the innocent party may treat the contract as at an end. If nay, his claim sounds in damages only.”

In the same case, Diplock LJ said:

“The test … has been stated in a number of metaphors all of which I think amount to the same thing: does the occurrence of the event deprive the party who has further undertakings still to

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16 [1971] 1 WLR 361 at 380; [1971] 2 All ER 216 at 232
17 *Koompahtoo* at para 55
After quoting the above passages, the NSW Court of Appeal summarized what constitutes a sufficiently serious breach in four propositions:

“First, it is the effect of the breach on the contract as a whole which matters: in order for a right to terminate to exist, the performance of the contract must be rendered substantially different from that intended by the parties, as a consequence of the [defaulter]’s breach.

Second, the seriousness of the breach depends not only on the breach itself but also on the consequences of the breach, both actual and foreseeable, for the [innocent].

Third, the assessment of the consequences of the breach is essentially a factual matter on which opinions are likely to differ. The [innocent] bears the onus of proof.

Fourth, there is a link with the doctrine of frustration in that, in commercial contracts at least, the degree of seriousness required is the same as that applied under the doctrine of frustration.”

While the decision of the NSW Court of Appeal was overturned by the High Court on the merits, the summary of these propositions is, in my respectful opinion, helpful.

**Further considerations when assessing the breach**

The observation of the NSW Court of Appeal in *Koompahtoo* that opinions are likely to differ on the consequences of the breach was clearly prescient in the circumstances and reflects the difficulty faced by legal practitioners when advising clients. In my own experience, this is one of the most difficult areas for advice to clients. Does the factual matrix support a finding that the breach is serious enough to justify termination? It is obvious that I am not the only person to find this difficult given the number of decisions that have been reversed on appeal and the frequency of dissenting judgments when decisions are appealed.

Even where the contract terms include a termination clause, there is often a value judgement to be made as to whether a substantial breach has occurred. In other words, the common law position as to substantial breach often informs the express right to terminate under the contract. How then is one to assess whether the substantial failure to perform entitles termination? The various touchstones set out above are useful but frequently none are conclusive. Some secondary considerations are discussed below but many more appear from the cases.

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18 Sanpine Pty Ltd v Koompahtoo Local Aboriginal Land Council & Ors [2006] NSWCA 291 at para 177
The degree of performance compared to the breach

If the contract has been in large part performed, it is less likely that the breach will be substantial enough to warrant termination.

In *Carr v J A Berriman Pty Ltd*\(^9\) the principal entered into a contract with a builder for the construction of a factory. Two breaches by the principal caused the builder to seek to terminate the contract; a failure to deliver the site in the condition specified in the contract and a unilateral decision to remove from the contract the fabrication of steel framing. It was the second breach that was decisive in the view of the High Court in finding that the termination was effective. In its reasons, the Court noted that the loss of the fabrication represented about one quarter of the builder’s estimated profit on the entire project and the removal from the contract of that percentage of the overall value was a substantial breach.

However, mathematical ratios are not in themselves decisive. In *Fairbanks Soap Co. Ltd v Sheppard*\(^20\) the parties contracted for the construction of a machine for $10,000. The machine was almost completed when the builder refused to finish the machine unless he was paid a large proportion of the price, contractually agreed to be paid on completion. The builder was concerned that once he made the machine operational that the purchaser would not pay the contract sum. The purchaser refused to pay and terminated the agreement. The builder complained that he had only to undertake about $600 worth of work to complete and was therefore justified in insisting on the payment. But the court said that faced with such a deliberate breach of the contract terms the termination was legal. The builder admitted that he had deliberately made the machine non operational.

If tardy performance is the breach – is there a valid reason?

Where building works are delayed by weather, the High Court has opined that “*while the state of the weather is quite irrelevant on the question whether a breach of contract has been committed, it is very relevant on the question of the intention of the [defaulter] with reference to the performance of the particular promise in question.*”\(^21\)

Will damages be an adequate remedy for the innocent?

Usually, breaches of contract can be compensated by damages. One factor that may assist in justifying termination is a factual matrix that supports a finding that damages would not be an adequate remedy. In *Associated Newspapers Ltd v Bancks*\(^22\) a newspaper contracted with a cartoonist on a ten year contract to provide a weekly Ginger Meggs cartoon. The newspaper was required to publish the cartoon on the front page of its comic section. The newspaper commenced publishing the cartoon on the third page. Mr Bancks

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19 (1953) 89 CLR 327  
20 [1953] 2 DLR 193  
21 *Carr v J A Berriman Pty Ltd* (1953) 89 CLE 327 at para 19  
22 (1951) 83 CLR 322
terminated. The High Court noted that an artist requires payment, but also requires publicity. The breach of the contractual term could not readily be compensated by damages as it went to the root of the contract. This is to be contrasted with Shevill v Builders Licensing Board\(^\text{23}\) where the lessee’s breach of contract by failing to pay rent on time could be compensated by way of guarantees the lessor had obtained, with no real impact on the lessor.

**What types of conduct show an intention not to be bound by the contract?**

This can be a difficult question to answer. Often there will be overlap with a serious breach of an intermediate term and the innocent party may be able to send a notice alleging dual grounds for termination.

It may not be sufficient to point to the defaulter’s incorrect interpretation of the contract as a basis for termination without clearly enunciating to the defaulter the correct interpretation and giving opportunity for compliance. In *DTR Nominees Pty Ltd v Mona Homes Pty Ltd*\(^\text{24}\) the High Court considered a case where one party wrote to the other “rescinding” the contract for a breach. In a contract for the sale of 9 blocks of land the vendor agreed to lodge and register the plan of subdivision. The plan attached to the contract covered the entire 35 lots of the proposed subdivision. As it transpired, the vendor lodged a plan that only covered the 9 lots sold intending to subdivide the remaining lots as a second stage of the project. When the purchaser realised this lesser subdivision was being progressed as a first stage, it terminated (“rescinded”) the contract on the basis that the vendor had lodged a plan which was different from the one annexed to the contract. The vendor said that it had always intended to carry out the subdivision in two stages and responded by claiming wrongful termination (“repudiation”) by the purchaser and terminated the contract. The majority of the High Court said:

“It was urged that the [purchaser], because it was acting on an erroneous view, was not willing to perform the contract according to its terms. No doubt there are cases in which a party, by insisting on an incorrect interpretation of a contract, evinces an intention that he will not perform the contract according to its terms. But there are other cases in which a party, though asserting a wrong view of a contract because he believes it to be correct, is willing to perform the contract according to its tenor. He may be willing to recognize his heresy once the true doctrine is enunciated or he may be willing to accept an authoritative exposition of the correct interpretation. In either event an intention to repudiate the contract could not be attributed to him.”\(^\text{25}\)

The High Court appears to be suggesting that the correct response to the attempted wrongful termination would have been to offer a proper analysis of the contractual regime. Perhaps surprisingly, the High Court

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\(^{23}\) (1982) 149 CLR 620  
\(^{24}\) [1978] HCA 12  
\(^{25}\) *DTR Nominees at* para 21
said the recipient of the notice seeking to terminate was not entitled to regard the notice as a repudiation because it had not enunciated to the sender the true interpretation of the contract.

“In any event, on the evidence this Court would not be justified in finding that the [purchaser] acted otherwise than in accordance with a bona fide belief as to the correctness of the interpretation which it sought to place upon the contract. Consequently it is a case of a bona fide dispute as to the true construction of a contract expressed in terms which are by no means clear. In these circumstances the Court is not justified in drawing an inference that the [purchaser] intended not to perform the contract according to its terms or that it repudiated the contract. That being so, the [vendors] were not entitled to rescind the contract for "anticipatory breach" as they purported to do by their notice of 19th July 1974 (references omitted)."

The case is unusual in its facts, in that the contract was “by no means clear”, and that at first instance, the Supreme Court of NSW agreed with the vendors’ view and said they were entitled to terminate for the repudiatory conduct of the purchaser. However, in order to reach that conclusion, the Court accepted the evidence of the vendors as to their subjective intentions when the contract was formed, as a means of interpreting its terms. While the case is extant authority of the High Court it is perhaps limited to contracts that are decidedly ambiguous. In the end result, the High Court treated the contract as having been mutually abandoned and ordered the vendors to return the purchaser’s deposit.

Perhaps the safest approach when provided with an alleged termination notice based on alleged renunciation is to satisfy oneself that the contract terms relied upon are not ambiguous and that the other side cannot be operating under a misapprehension. If there is doubt as to this issue, a letter enunciating the true construction of the contract should be adequate, but such a letter would require careful wording and would presumably have to offer an opportunity to recant.

**Interpreting termination clauses**

A cautious approach is called for when utilising termination clauses that extend the rights of the party beyond the common law position. Where a procedure is laid out, ensure it is followed to the letter and any ambiguity in the drafting is analysed. Where a clause includes ambiguity and a draconian right, the innocent is better placed to rely on the common law rights, unless they are excluded. The cases show that Courts do not offer lenience to those who liberally interpret the contract clause to their own benefit to achieve termination.

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26 *DTR Nominees at* para 23
Diploma v Marula – a typical case study

In Diploma Construction v Marula27 the WA Court of Appeal examined whether a building contract had been legally terminated. Marula was a plastering subcontractor engaged by Diploma to carry out solid plastering on a three-storey multi unit development. The parties entered into a written lump sum contract for $239,800. The contract included clause 8.1(a):

8.1 If [Marula]:-

(a) fails to carry out any of its obligations under this Subcontract and fails to rectify the default within 3 days of becoming aware of details of the default (by notice from [Diploma] or otherwise);

[Diploma] may, at any time and without prejudice to any other rights or remedies available to it under this Subcontract or otherwise, by notice to [Marula] terminate this Subcontract.

On any view of it, this is a draconian termination clause in that the 3 day period for remedy of any default after “becoming aware of details of the default” is very short in the context of a construction project and further, the clause renders every obligation under the contract to be a “condition”.

Soon after work commenced on 14 March 2003 the parties began complaining to each other. Diploma was frustrated about lack of progress. Marula said other trades were impeding its work, the roof was leaking water onto the walls making it difficult to apply plaster and Diploma’s ceiling fixers were working alongside Marula’s plasterers creating safety issues. These complaints were the parties’ theme song for the remainder of the dispute. The complaints were initially verbal, but by 12 June, Diploma had started to complain in writing and by mid July, the dispute escalated with almost daily faxes and phone calls from both sides. On 11 July Diploma sent the following fax:

“Please be advised the plasterers schedule given to me for Friday 11-7-03 has not been carried out. ie no solid plasterers were on site today & the setting plasterers working in units 37, 38, 42 left site 11.00 am (reason given) they had to go to get their pay from you in Gosnells etc. Clearly a more suitable method should be found. The setters also advise me (Matt) they will be back Monday not Saturday.”

Marula responded in writing repeating its three complaints and saying that these issues were responsible for the lack of progress. Marula verbally promised weekend work on 12 and 13 July but little occurred. On 14 July Diploma sent a fax saying:

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27 [2009] WADC 1
Further to your letter dated the 11/7/03, Diploma deny [sic] that all trades are working in and around one another. Diploma advice [sic] that Safety is of the Highest Standard, [sic] We therefore give you Notice that you are in breach of your Contract, pursuant to clause 8.1 Part A.

You are required to recommence work Tomorrow morning, Tuesday 15th July 2003, [sic] if you do not return to work your Contract will be Terminated. We reserve the right to deduct liquidated Damages and any other Costs that arise from your breach of contract.

More faxes in similar vein followed during that week with Marula continuing to maintain its three complaints. In addition, it sought an expert opinion as to defects in the plaster caused by the leaks. On 19 July, Marula wrote to Diploma conceding the leaking had reduced but maintaining the other two complaints. Marula said that if unimpeded, it could finish the plastering within 5 to 7 days. On the following day, Diploma terminated the contract by written notice. Another plastering subcontractor commenced Marula’s unfinished work the following day. Marula said the termination notice was a repudiation of the contract and accepted the contract was terminated.

Diploma relied on two faxes to establish Marula was in default because it had failed to follow directions. In the first fax, Diploma complained about what happened on site that day, in terms of plastering, and in the second it complained about the failure of Marula to keep its promise to work on 12 and 13 July.

Another term of the contract allowed Diploma to issue directions to Marula. The Court said a “direction” bears its ordinary meaning of “an instruction what to do, how to proceed or where to go”. There was no specific instruction on the faxes. Marula was not in default because the faxes had not asked it to do anything. Therefore, Diploma was not entitled to terminate the contract. In any event, the faxes did not specify the default in sufficient detail. The Court said the notice must “direct the contractor's mind to what is said to be amiss”. It was not enough to say Marula already knew the details of the default. Diploma was found to have repudiated the contract.

This is a typical example of parties becoming increasingly alienated until one party acts reactively without careful consideration of the contractual terms. There is a large amount of detail in the reported decisions at first instance and on appeal. On my own analysis of that detail, Diploma would have been well within its rights to terminate had it slavishly followed the contractual provisions or sufficiently availed itself of its common law rights by building an evidentiary path towards the moment of termination.

As is common, the Diploma contract required the innocent party to send the defaulter a notice specifying the default. The content of the notice is of critical importance.
Drafting and responding to Notices to Show Cause

It is not uncommon for the notice specifying the default to be called a “Notice to Show Cause” (why the contract should not be terminated). There have been many cases dealing with the required form and content of such notice. As with most formal notices to be sent under a contract, the Courts adopt a “non technical” approach to the construction of the notice, but it is essential that a reasonable recipient is left in no doubt that the right reserved is being exercised.

In *Hometeam Construction Pty Ltd v McCauley* the Court quoted with approval the following passage from *Hudsons Building and Engineering Contracts* (11th ed, Para 12.033):

“The [termination] clause must be carefully considered and closely followed in all respects, both as to the contents and timing of the notices, but the Courts will usually regard the notices as commercial documents, and provided they make clear reference to the substance of what is required by the determination clause (and ideally, of course, by express reference to the applicable clause of the contract and special grounds in respect of which they are given) the form of words used will usually not be important. Applying this principle notices referring the reader to the applicable clause of the contract and identifying the default are generally likely to be sufficient.

*Particularly where a determination clause is conditioned on a number of different eventualities or defaults of the contractor, it is evident that any required preliminary notice should sufficiently identify the particular ground relied upon, if that is called for by the contract (and particularly where continuation of the default is made a condition of any second notice), but further detail, particularly in regard to a generalised ground like due diligence, will not usually be called for”*

It is not uncommon for parties to terminate and then seek legal advice, presumably to save legal fees. As can be seen below, the consequences of illegal termination are potentially dire and this approach is often false economy.

**Delay in terminating**

It is not uncommon for the innocent party confronted by serious breach of contract of the defaulter to be unsure whether to pull the trigger to terminate or allow another opportunity for the defaulter to mend their ways. Commercial drivers are uppermost and the innocent party often lives on in hope the defaulter will repent and conform. In the context of construction contracts, it is not uncommon for works to be partly completed and the innocent must weigh the consequences of terminating or continuing the contract. This will

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28 [2005] NSWCA 303 at para 133.
typically involve the cost of locating another contractor to complete the partly constructed project, usually at a higher cost than the unpaid contract sum, together with the likelihood of difficulty and delay in recovering the additional cost from the defaulter.

The innocent will be faced with a dilemma: should it write to the defaulter pointing out the breach and adverting to its right to terminate or should it simply terminate? If it does the first, is it then precluded from terminating until the defaulter commits another serious breach? In other words, when does the delay in termination become an election to affirm the contract?

By delaying in terminating, is the innocent party electing to affirm the contract and thereby locking itself out of the opportunity to terminate? The following proposition of Mason J is of assistance:-

“If a party to a contract, aware of a breach going to the root of the contract, or of other circumstances entitling him to terminate the contract, though unaware of the existence of the right to terminate the contract, exercises rights under the contract, he must be held to have made a binding election to affirm. Such conduct is justifiable only on the footing that an election has been made to affirm the contract; the conduct is adverse to the other party and may therefore be considered unequivocal in its effect. The justification for imputing to the affirming party a binding election in these circumstances, though he be unaware of his alternative right, is that, having a knowledge of the facts sufficient to alert him to the possibility of the existence of his alternative right, he has acted adversely to the other party and that, by so doing, he has induced the other party to believe that performance of the contract is insisted upon. It is with these considerations in mind that the law attributes to the party the making of a choice, though he be ignorant of his alternative right. For reasons stated earlier the affirming party cannot be permitted to change his position once he has elected”.29

In short, any action that leads the defaulter to believe that the contract remains on foot is to be avoided until the decision is made; otherwise the election to affirm has been made. In the context of a building project, a lengthy delay in communicating would undoubtedly be constructive affirmation if the works are proceeding during the delay.

In Elders Trustee & Executor Co. Ltd v Commonwealth Homes & Investment Co. Ltd30 the High Court considered a case where the innocent discovered his right to terminate 8 years after purchasing some shares. The right arose because of a breach of legislation by the defendant that made the contract voidable. The High Court reversed the decision of the Full Court of the Supreme Court of South Australia which held that his conduct amounted to an election to affirm or to laches and acquiescence precluding him from disaffirming. The High Court stated the principles in the following terms:-

29 Sargent v ASL Developments Ltd. Turnbull v ASL Developments (1974) 131 CLR 634 at 658
30 (1941) 65 CLR 603
"The necessity for knowledge as an element in election may be treated under the following headings: 1. Knowledge as to the existence of a right to elect. 2. Knowledge as to the happening of the circumstances which warrant the exercise of the right. 3. Knowledge as to the existence of circumstances which would affect the choice.

Subject to certain qualifications, we may say that knowledge of all three kinds is a necessary prerequisite of conclusive election between two estates, but that in the law of contracts, election is irreversible although knowledge of the first and third kinds was absent. But a distinction must be drawn between cases where the party's conduct is unequivocal in its effect and cases where this conduct does not necessarily amount to a waiver but is merely some evidence that he has in fact elected to affirm. Where rights are exercised, either in virtue of an estate or interest in property, or by virtue of a contract, which would not exist unless the estate, interest or contract endured or remained in force, it may well be that the party exercising them loses the right to determine the estate or interest on breach of condition or the contract for breach of some term going to the root of it, unless he is able to show not merely that he was unaware of the existence of his right but of the facts amounting to breach of condition or of contract. But in the present case the plaintiff did not exercise any rights adversely to the company. He did nothing inconsistent with renunciation or disaffirmance. He merely acted as if he were a shareholder and failed to disclaim that character. He so conducted himself that it might be considered a natural inference, if he knew that he had a right of election, that he had resolved to affirm. Further, it is possible that his conduct, if he had had that knowledge, might be regarded as raising an equity against allowing him to rescind at so late a stage. But in the absence of knowledge of his rights we do not think that in the actual circumstances any equity arose from his conduct, and clearly it could not be inferred that he made an actual election.”

**Summarising the considerations on election**

In brief, there are three relevant considerations for election in this context:

1. Does the innocent know it is legally entitled to choose?
2. Does the innocent know the facts that entitle it to choose?
3. Does the innocent know the entitlement to choose might expire?

In *Khoury Government Insurance Office of NSW* the High Court said:

“A person confronted by two truly alternative rights or sets of rights, such as the right to avoid or terminate a contract and the right to affirm it and insist on performance, may lose one of them by acting “in a manner which is consistent only with his having chosen to rely on (the other) of them” ... While actual "prejudice to the other side" may be relevant, particularly in

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determining whether an election should be imputed to a person who is not shown to have made a conscious decision to elect it is not necessary that such prejudice be demonstrated to establish a completed election between the right to affirm and the right to avoid a contract. An election, unlike estoppel, is concerned with what a party does and not what he causes the other party to do. At the latest, it is complete or "final" when made and "communicated" to the other party.

Where an election is not shown to have been consciously made, the words or conduct relied upon to impute it must unequivocally evidence "the exercise of one of the two sets of rights and (be) inconsistent with the exercise of the other". It would seem however that, at least where the alternative rights arise under the terms of the one contract, a party may be held to have elected to affirm it notwithstanding that he was unaware of the actual right to avoid it. Even in such a case however, the party alleged to have elected to affirm the contract must be at least aware of the facts giving rise to the right to avoid the contract (references omitted)."

In Mandurah Enterprises Pty Ltd v Western Australian Planning Commission\textsuperscript{32} the Court said:

\begin{quote}
However, in relation to election between inconsistent rights there must be an unequivocal act with knowledge of the material facts. Subject to one qualification, the law is unclear as to whether there must also be knowledge as to the existence of a right to elect. The qualification is that knowledge of the right to elect is not required where the election is between contractually conferred rights or property rights. Moreover, the balance of authority suggests that where a party acts unequivocally in a way that is only consistent with an election one way, it is not necessary to establish that the party was aware of their right to elect" (references omitted)
\end{quote}

The salient point here is the express qualification of the Court as to knowledge of the existence of the right to elect.

If a further serious breach occurs the right to elect to terminate is renewed.

After an election to affirm has occurred, if the innocent party subsequently commits a serious breach the roles may be reversed and the contract may be terminated by the previous defaulter. This scenario is not unlikely once a party has relinquished the option to terminate due to the other party’s serious default; having gone to the brink of termination and stepped back, there is often an enduring atmosphere of mistrust. The contractual relationship is often strained until completion. For example, in the context of building projects, the principal might become a reluctant and late payer after becoming aware of the builder’s previous serious defaults.

\textsuperscript{32} [2008] WASCA 211 at para 107
Statutory rights to terminate

This is a convenient point to refer to the statutory right to terminate contracts for domestic building work. These comments do not apply to commercial building work contracts. Where a builder performs domestic building work to a total value of more than $12,000 the Building Work Contractors Act 1995 (SA) imposes requirements on the builder as to the form of the contract and the indemnity insurance that must be obtained. A failure to comply with these requirements leads to an entitlement under section 36 of the Act to terminate the contract at any time up to the completion of the building work. The Magistrates Court is given jurisdiction to:-

*make such orders as it thinks just:*

(a) providing for the return or repayment of the whole or part of any consideration, or the value of any consideration, given by the building owner under or in relation to the contract; or

(b) providing for payment to the contractor in respect of any materials supplied, or any building work or other services performed, by the contractor under or in relation to the contract

In relation to such a statutory right to terminate, there would be no room for the builder to assert that an election to affirm has taken place by allowing it to carry out the work prior to the termination of the contract. The discretion of the Court would be the builder’s recourse in terms of seeking the “orders as it thinks just”. This is an unusual legislative provision in that it expressly provides that the right to terminate exists until the completion of the work.

Any legislative provision that offered a right to end a contract without expressly dealing with the timing of taking up the offer would present a different scenario and in that context, an election to affirm might well have taken place by reason of delay in acting.

Remedies for wrongful termination

Wrongful termination is in itself a serious breach of contract and entitles the other party to terminate. The roles quickly reverse and the party with the high moral ground can quickly find itself the “defaulter”. The party initially seeking to terminate effectively repudiates or renounces the contract by wrongfully seeking to terminate. The other party then has to decide whether to accept the repudiation and terminate the contract itself or to affirm the contract and insist on the other party performing its remaining obligations.

Wrongful termination exposes a party to substantial risk. The other party, although possibly in default itself, is entitled to terminate the contract and seek damages as the “innocent”.

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33 Sections 28 and 34 of the Act  
34 Section 36 of the Act
However, the somewhat troubling authority of *DTR Nominees* discussed above indicates that caution must be exercised where contract terms are not clear in their meaning and one is presented with a wrongful termination based on an alleged renunciation.

**Damages after termination**

It is irrelevant whether the termination has occurred as a result of a serious breach by the defaulter or from repudiation through a wrongful termination. It will be seen that the potential damages are often well in excess of the balance of the contract sum. In simple terms, the accrued rights at the time of termination are preserved. The usual formula in contracts for the performance of work would see the contract rates applied to work already performed and damages for loss of profit applied to the balance.

Damages following termination follow the usual contractual principles for damages, as set out in *Hadley v Baxendale*\(^\text{35}\) with the alternative available to the innocent of claiming in *quantum meruit*\(^\text{36}\) for the work already performed under the contract. In other words, the innocent party is entitled to be compensated by the defaulter in sufficient amount to put them in the same position they would have been in, had the contract been fulfilled by the defaulter but also has the alternative of seeking restitution in *quantum meruit* for the reasonable benefits that have accrued to the defaulter.

In *Commonwealth v Amann Aviation Pty Ltd*\(^\text{37}\) the High Court summarised the principle from *Hadley v Baxendale*:-

> “the plaintiff is entitled to recover such damages as arise naturally, that is, according to the usual course of things, from the breach, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach”

In general, the assessment of damages for breach of contract is not controversial and does not warrant further discussion here. However, the assessment of damages for repudiatory breach can have curious outcomes where the contract is terminated early and little or no opportunity has been given for testing the parties’ ability to perform. In *Amann*, the contract with the Commonwealth was for an aerial coastwatch service to the North coast of Australia for a period of three years, with a possible renewal of the contract for a further period at the discretion of the Commonwealth. Amann gambled on a renewal of the contract term and spent $6.6m fitting out custom made aircraft. If the contract had not been renewed after the three year term, Amann would have made a loss on the venture but Amann made a commercial decision that it would be well placed to win the renewal of the contract after the three year term expired and would reap major financial rewards during the renewed term.

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\(^{35}\) (1854) 9 Exch 341  
\(^{36}\) *Quantum meruit* is a latin phrase literally meaning “what it deserves”.  
\(^{37}\) (1991) 174 CLR at para 51
Amann commenced service on the date specified in the contract but not all of its aircraft complied with the specifications; some aircraft failed to fly on the day and it was obvious that Amann was going to commit further breaches in the coming weeks as it needed to make further modifications to the aircraft. The Commonwealth terminated the contract after only three days but failed to provide a notice to show cause as required in the contract. Amann treated the attempted termination as a repudiation and in turn terminated the contract. The Commonwealth was held to be in repudiatory breach. The assessment of damages was a major issue. If the loss of Amann was confined to the initial three year period, its total revenue under the contract would not have adequately compensated it for its capital expenditure. It could not claim the usual loss of profit as there was no profit to claim.

The trial judge awarded about $400,000 to Amann. On appeal, the Full Court awarded Amann $6.6m being their total expenditure in reliance on the contract reduced by a factor determined by the probability that the contract would not have been renewed. The High Court upheld this award. In brief, the case indicates that the loss of bargain damages available to the innocent include not only loss and damage on the contract terminated but extend to potential future profits on any renewed term of the contract, reduced by the probability that the contract might not have been renewed.

The quantum meruit alternative

In Sopov v Kane the Supreme Court of Victoria Court of Appeal, considered the quantum of damages that should be awarded to a builder where the building contract had been illegally terminated by the owner when the work was almost completed.

In 1999, Sopov engaged Kane Constructions (“Kane”) to carry out the renovation and extension of a disused boiler house under a standard form contract, AS2124. The works under the contract were to be completed in 130 days but a year later were still incomplete. Kane had raised complaints about the plans and drawings, the lack of a suitably qualified superintendent and the failure of the superintendent to allow claims for variations and extensions of time and to certify progress claims.

Ultimately, when Progress Claim No. 14 was certified by the superintendent and not paid by Sopov, the dispute escalated. Sopov deducted liquidated damages for delays from the amount certified by the superintendent. Kane issued a notice to Sopov asking why it should not terminate the contract due to Sopov’s refusal to pay the certified amount. Sopov responded, saying it was entitled to withhold the payment because Kane had delayed completion.

Kane disagreed, suspended work and removed its equipment from the site. Sopov then threatened to call on the bank guarantee. Kane terminated the contract, saying that Sopov’s threats were a repudiation of the contract. Sopov then took over the works, engaging a major subcontractor previously contracted to Kane.

38 Sopov & Anr v Kane Constructions Pty Ltd (No 2) (2009) 257 ALR 182
Kane then claimed against Sopov and, due no doubt to the difficulties over delays, variations and the dispute with the subcontractor having resulted in Kane losing money on the contract, elected to claim in *quantum meruit*. It is unusual for a party to claim in *quantum meruit* if there is an agreed contract price and an enforceable contractual claim.

The first hurdle for Kane was to overcome Sopov’s contention that it had been justified in calling on the bank guarantee and that Kane’s termination was wrongful. If this contention was accepted by the Court, the contract would remain on foot.

In the Supreme Court, the trial judge agreed with Kane that Sopov had repudiated the contract and said Kane was entitled to terminate and bring the claim in *quantum meruit*. However the trial judge said that the amount of the *quantum meruit* claim was to be assessed by a consideration of what was due under the contract. The judge refused Kane’s claim for variations that had been disallowed under the contract and reduced its claim for delay damages on the basis of the terms of the contract.

Both parties appealed; Sopov said that Kane was only entitled to claim under the contract and Kane appealed as to the amount of the damages awarded in *quantum meruit*. The Court of Appeal heard the appeal in two stages. In November 2007, the Court heard the first stage of the appeal and upheld Kane’s right, as the innocent party to a terminated contract, to elect whether to bring its claim in *quantum meruit* or in contract. The Court referred assessment of the damages to mediation. The mediation failed. The second stage proceeded and the Victorian Court of Appeal assessed the damages on a *quantum meruit* basis without regard to the contract terms.

Sopov sought leave to appeal to the High Court but this was refused. While there is some residual uncertainty from the manner in which Sopov’s legal team ran its defence, and was therefore precluded from raising some arguments in the Court of Appeal, the decision must be seen as the current state of the law on the entitlement to damages for wrongful termination of a construction contract – and arguably any similar type of contract.

The following propositions can be put:

1. An innocent party who accepts the defaulting party’s repudiation of a contract has the option of either suing for damages for breach of contract or suing in *quantum meruit* for work done.\(^{39}\)
2. The contract price agreed between the parties does not impose a ceiling on the quantum recoverable by the innocent party. The contract price is struck prospectively, based on the parties’ expectations of the future course of events. *Quantum meruit*, on the other hand, is assessed with the benefit of hindsight, on the basis of the events which actually happened.\(^{40}\)

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\(^{39}\) *Ibid* at para 6; see also *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at 277

\(^{40}\) *Sopov v Kane* at para 26
3. The value of *quantum meruit* includes a profit margin that may be added to the actual cost incurred. The existence of the entitlement to a profit margin is entirely consistent with the restitutionary objective of measuring the value of the benefit conferred. The inclusion of a margin for profit and overhead means the calculation approximates the replacement cost of the works. It is an appropriate index of value to ascertain what it would have cost the principal to have the works carried out by another builder in comparable circumstances which must necessarily include that other builder’s margin.\footnote{Ibid at para 35}

The *quantum meruit* claim of the builder in *Sopov* included delay costs and substantial additional payments that would not have been recoverable under the contract terms. These costs included $278,524 in variations that had been disallowed by the superintendent. Kane’s plastering subcontractor had run into financial and other difficulties requiring Kane to spend an additional $438,870 in engaging others to rectify and complete the plastering. An amount of $538,271 had been incurred by Kane due to the project being delayed. All three of these claims had been disallowed by the trial judge because they were outside the contract. However, the Court of Appeal allowed their recovery. The recovery of these additional items may not have succeeded had Sopov’s legal team not apparently gambled on the concept of the contract sum and its terms capping the rights of Kane to recover and in so doing failed to lead evidence as to reasonableness of the amounts claimed by Kane.

The Court of Appeal expressed reservations about the alternative of *quantum meruit* being available. The Court noted that there is widespread academic criticism of this approach but said it was constrained to follow this line in view of the 1992 refusal of the High Court for leave to appeal in *Renard Constructions v Minister of Public Works*.\footnote{(1992) 26 NSWLR 234} It was noted by both Courts that it was only at the Court of Appeal that Sopov first raised the argument that *quantum meruit* should not be available as an alternative remedy when a contract is terminated unlawfully. The Court of Appeal said “Quite simply, [it has] been raised too late”.\footnote{*Sopov v Kane* at para 15} The result of not raising the point until too late was that the builder, Kane, had not run its case on the claim for contractual damages and Sopov had not presented adequate answering evidence on the reasonableness of the costs and the delays. It is true the High Court refused leave to appeal but the lack of evidence as to reasonableness of the amounts claimed and the lateness of the submissions may have impacted on that decision and the High Court may have regarded the case as an inappropriate vehicle to expand on the law. We are left to guess what might have otherwise happened but in the interim presume that the result in *Sopov v Kane* is to be followed in similar cases.

In summary, where a contract is terminated early, the innocent party is entitled to damages sufficient to put them into the position that they would have been in had the contract been fully performed, or in the alternative, to sue in *quantum meruit*. For that reason, the first question posed to the innocent party

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\footnote{Ibid at para 35}
\footnote{(1992) 26 NSWLR 234}
\footnote{*Sopov v Kane* at para 15}
considering termination of a contract by the prudent legal adviser relates to the potential profit margin likely to accrue had the contract been fulfilled. If the contract was an unhappy one, in that the margin was negative or minimal, then the *quantum meruit* path might save the day.

**Breach and standard form contracts**

The construction industry uses a number of standard form contracts. While this paper has general application, I have included two common termination clauses to illustrate the difficulties.

**The HIA Plain Language Building Contract for New Homes 2004**

As the termination clause refers to clauses 7.4 and 9.5 I have reproduced them below. The words in square brackets are included in the standard form. While is not expressly stated in the contract, it appears these words are not contractual terms but are intended as explanatory notes.

Clause 7.4  *You must not give instructions to our suppliers or subcontractors or to our workers, except to our supervisor*

Clause 9.5  *However, you and they must not disrupt the work.*

Clause 28: Termination of Contract

*[It would be very unwise to terminate (that is, bring to an end) this contract before getting legal advice.]*

28.1  *We may terminate this contract by written notice if*

28.1.1  *you fail to make any payment due*

28.1.2  *you take possession of the work without our consent*

28.1.3  *you disobey clauses 7.4 or 9.5 or*

28.1.4  *there is any other substantial breach of this contract by you.*

*[A substantial breach is a serious disobedience of this contract showing that the disobeyer does not want to respect it any longer.]*

28.2  *You may terminate this contract by written notice if there is a substantial breach of this contract by us.*

28.3  *Either you, or we, may terminate this contract by written notice if the other*
28.3.1 does an act of bankruptcy or

28.3.2 comes under external administration, if a company.

[These words have special legal meanings. See the Bankruptcy Act and the Corporations Law.]

28.4 Either you, or we, may terminate this contract by written notice if someone else lawfully takes possession of any of the other’s property.

28.5 Termination does not affect rights arising from a breach of contract.

Where a clause extends the rights of the contractor beyond the common law rights, the contract is likely to be construed precisely on its terms and any ambiguity is likely to be read down to the common law position. The following comments are relevant:

1. The common law right to terminate is not excluded from the HIA contract and therefore the common law rights exist in parallel to the contractual rights.

2. Clause 28.1.1 does not deal with the timing of the failure to make the payment. An owner might complain if the clause was used to terminate because of a slightly late payment. In my own view, one could not rely on the clause to terminate for a minor infringement as to timing of payment as the contract has other provisions to compensate the builder for a late payment – e.g. interest. The Court will employ a construction of the contract that takes into account all of its terms where there is any ambiguity in the termination clause. It would probably be effective in the face of a refusal to pay, but the common law right to terminate would in any event deal with that.

3. Clause 28.1.4 is not helpful in that by referring to “any other” substantial breach of the contract, it possibly equates the remainder of the provisions in clause 28 with a “substantial breach”. This might result in the reading down of the otherwise draconian nature of clause 28.1.3. It is unlikely that the giving of instructions of a minor nature to the builder’s workers would be a “substantial breach” of the contract. For example, telling the painter about a drip on the floor would not be a substantial breach, but would be a breach of clause 28.1.3.

4. Clause 28.4 is ambiguous in that the “someone else” might well be said to mean someone other than “you” or “we”. I presume that the clause intends to deal with the actions of a mortgagee taking possession of the site.

These comments demonstrate the difficulties likely to be confronted by a builder relying on this termination clause without also having the common law right to terminate and bring into focus the need for careful drafting and cautious application of termination clauses.
The ABIC MW-1 2003 Major Works Contract

This ABIC contract includes a “termination of engagement clause” rather than a termination of contract clause. It is an architect supervised contract, where the architect performs the role of a superintendent of the works as agent of the owner.

The clause is set out below:

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Termination of engagement

Owner may require contractor to remedy default

Q1. 1. If the contractor fails to meet a substantial obligation under this contract, the owner may give the contractor a written notice requiring the contractor to remedy the default within 10 *working days. The notice must specify the default, and state that it is given this clause.

2. If the default is not remedied, or the contractor fails to show reasonable cause why it cannot be remedied within 10 *working days, or such additional days as agreed with the architect, the owner may terminate the engagement of the contractor by giving the contractor a written notice of termination.

3. The notice of termination must state that it is given under this clause and a copy must be given to the architect.

Owner may immediately terminate

Q2. 1. If an *insolvency event occurs in relation to the contractor, the owner may immediately terminate the engagement of the contractor by giving the contractor a written notice of termination.

2. The notice of termination must state that it is given under this clause and a copy must be given to the architect.

Owner may take possession of the site

Q3. 1. If the owner terminate the engagement of the contractor under clause Q1 and Q2 before the architect has issued the notice of practical completion:-

   - Clause D3 applies as if the architect had issued the notice of practical completion on the day the owner terminated the engagement of the contractor, and clauses E1 and E2 apply, except that the owner must take out the insurance; and
   - The owner may take possession of the *site and exclude the contractor from it.

2. The owner may take possession of any documents, plant, tools, unused materials and equipment on the *site belonging to the contractor, and may use them in completing the works. The owner
must make available for collection by the contractor, the items of which it has taken possession, as soon as it receives the certificate issued under clause Q9. The owner is not liable for fair wear and tear of anything of which the owner has taken possession.

3. At any time after termination of the contractor’s engagement, the architect may instruct the contractor to remove all or some of its property from the site. The contractor must comply within 10 working days, failing which the owner may remove the property identified in the architect’s instruction, and dispose of it. The owner must give notice in writing to the contractor and the architect of the amount the property is disposed for. The owner must pay the contractor the amount the property is disposed for, less the costs of removal and disposal.

Assignment of contractor’s rights

Q4 1. Where the engagement of the contractor has been terminated under clause Q1 and Q2, the contractor must assign to the owner all of its rights under any subcontract relating to the supply of labour, services, materials or equipment for the work if directed to do so by the architect.

Owner may contract with other to complete the works

Q5 1. If the owner terminates the engagement of the contractor under clause Q1 or Q2, the owner may contract with others to complete the works.

Owner not bound to make any further payment to contractor

Q6 1. Where the engagement of the contractor has been terminated under clause Q1 or Q2 the owner will not be bound to make any further payment to the contractor unless an obligation to pay arises under clause Q9.

Owner may pay subcontractors or suppliers

Q7 1. If the owner terminates the engagement of the contractor under clause Q1 or Q2, the owner may at its sole discretion directly pay any subcontractor or supplier for any work, materials or equipment necessary to complete the works. Any sum paid by the owner to the subcontractor or supplier is to be taken into account by the architect in preparing its certificate under clause Q9, provided the owner has not already paid the contractor for the same work, materials or equipment.

Architect to give assessment of cost of completing the works

Q8 1. Where the engagement of the contractor has been terminated under clause Q1 or Q2, the architect must promptly make a written assessment of the costs to the owner of completing the works and issue to the contractor and to the owner a copy of that assessment. For this purpose, the cost to the owner of completing the works excludes any amount payable by the
owner under clause Q7. That assessment is to be reflected in the certificate made under clause Q9.

**Architect to give certificate of amount payable to contractor or owner**

**Q9**

1. Where the engagement of the contractor has been terminated under clause Q1 or Q2, and the assessment required under clause Q8 has been made, the architect must *promptly prepare a certificate as to the amount payable, including *GST, by one party to the other and issue it to the contractor and to the owner. That certificate is to be calculated using the following procedure.

2. The architect is to determine the amount of the *contract price as adjusted at the date of termination of the engagement of the contractor.

3. The architect is to determine the total of:
   - The value of building work completed, including *GST, assessed in the last certificate issued under clause N4;
   - The cost of the owner of completing the *works, including *GST, as assessed by the architect under clause Q8;
   - Any sum paid directly by the owner to a subcontractor or supplier, including *GST, under clause Q7 not already paid to the contractor for the same work, materials or equipment necessary to complete the *works;
   - The architect’s assessment of any claim by the owner under this contract for a set off of monies due; and
   - Any liquidated damages in accordance with clause M11, since any previous certificate, calculated up to the date of termination of the engagement of the contractor.

4. The architect is to determine the total of: -
   - The amount of security drawn or appropriated to date; and
   - The amount of any security or cash retention held by the owner in accordance with subclause C2.2.

5. The certified amount payable to the owner or the contractor, as the case may be, is the total determined in subclause Q9.2, less the total determined in subclause Q9.3, plus the total determined in subclause Q9.4.

6. The architect must also state on the certificate the value of any remaining security by *unconditional guarantee.
7. If a certificate is issued under this clause, it takes the place of a final certificate under clause N11, and clause C9 applied.

**Contractor or owner to pay under clause Q9**

**Q10**  1. If the balance calculated by the architect under clause Q9 is a positive figure, the owner must pay the contractor the balance. If the balance is negative, the contractor must pay the owner the balance.

2. On receiving the certificate, the party to be paid must prepare a *tax invoice (if applicable) equal in value to the certificate and present both documents to the other party for payment.

3. The amount stated as owing must be paid within the period shown in **Item 4 of schedule 1** after delivery of the certificate and the *tax invoice.

**Contractor may require owner to remedy default**

**Q11**  1. If the owner defaults by:-

- Failing to make a progress payment on time; or
- Failing to meet any other substantial obligation under this contract

The contractor may give the owner a written notice requiring the owner to rectify the default within 10 *working days after receipt of the notice, the contractor will be entitled to proceed under clause Q12 to suspend the necessary work, or subsequently under clause Q13 to terminate its engagement. A copy of the notice must be given to the architect.

**Contractor may suspend if default not remedied**

**Q12**  1. If the owner fails to rectify the default or the owner fails to show reasonable cause why it cannot be remedied within 10 *working days after receiving a notice given under clause Q11, or the architect fails to issue a certificate within 5 *working days after a notice is given under clause N8, the contractor may immediately suspend the necessary work by giving the owner written notice.

2. The notice must state that it is given under this clause. A copy of the notice must be given to the architect.

3. If, after the suspension of the necessary work, the owner rectifies the default, the contractor is entitled to make a *claim to adjust the contract for any loss, expense or damage that results from the suspension of work.

4. The requirements for making a *claim to adjust the contract and the procedures to be followed are stated in Section H.
Contractor’s subsequent right to terminate

Q13 1. After the contractor has given the owner written notice of suspension under clause Q12, the contractor may terminate its engagement under this contract by giving the owner written notice of termination.

2. The notice must stage that it is given under this clause. A copy of the notice must be given to the architect.

Contractor may immediately terminate

Q14 1. If an *insolvency event occurs in relation to the owner, the contractor may immediately terminate its engagement under this contract by giving the owner written notice.

2. The notice must stage that it is given under this clause. A copy of the notice must be given to the architect.

Termination by contractor for default by owner

Q15 1. If the contractor terminates its engagement under clause Q13 or Q14 the owner must pay the contractor the amount the owner would have had to pay if the owner had wrongfully repudiated the contract

Procedure for contractor to make claim

Q16 1. Within a reasonable time of terminating its engagement under clause Q13 or Q14 the contractor must submit to the architect a claim setting out the contractor’s entitlement, calculated on the same basis as if the owner had wrongfully repudiated the contract.

Architect to give certificate

Q17 1. The architect must *promptly assess any claim made by the contractor under clause Q16 and must *promptly issue to the contractor and to the owner a certificate specifying the amount for payment to the contractor or the owner, as the case may be.

4. If a certificate is issued under this clause, it takes place of a final certificate under clause N11, and clause C9 applied.

If the contractor fails to meet a substantial obligation, the owner’s agent can provide a notice to remedy the defect within 10 days. If that period expires without the obligation being met, the “engagement” of the contractor can be terminated under clause Q2. This is clearly different from the termination of the whole contract. Given that common law rights are not excluded by this contract, the innocent party must proceed with even greater caution when about to terminate. The distinction is made more obvious by comparison
with the lop-sided nature of the termination right of the contractor under clauses Q13, 14 and 15. Clause Q15 requires the owner, after termination, to pay the contractor the amount the owner would have had to pay if the owner had wrongfully repudiated the contract. In other words, under clause Q15, the builder is given the remedies that apply to a common law termination but under clause Q2, the owner is given the remedies that apply under the remainder of the Q clause.

If the owner exercises a common law right to terminate rather than relying on clause Q2, the owner would be entitled to the common law remedies. However, the rights conferred under clause Q appear to offer practical steps towards completion of the project, such as assignment of subcontracts and the right to sell materials and equipment left on site.

The distinction between termination of the contract and termination of the engagement of the contractor is not the subject of comment in any Australian case I have found. The concept of termination of engagement is well established in England and in other international jurisdictions but not widespread in Australia.

The widely used Australian Standards construction contract AS4000-1997 imports the common law remedies into its termination clause by virtue of clause 39.10:

“If the contract is terminated pursuant to subclause 39.4(b) or 39.9, the parties' remedies, rights and liabilities shall be the same as they would have been under the law governing the Contract had the defaulting party repudiated the Contract and the other party elected to treat the Contract as at an end and recover damages”

The advantage of a “termination of engagement” clause is that the parties’ rights following termination are precisely governed by the contract terms as there is no debate that the contract remains on foot. One might observe that a contractor who is prepared to breach a substantial obligation of the contract and fail to remedy the default within 10 days might also prove recalcitrant when it comes to fulfilling the remaining obligations under the contract.

**Contract clauses that survive termination**

Contract clauses governing the resolution of disputes often include express provisions to the effect that the dispute resolution provisions survive early termination. Where the contract does not include such a provision and one party objects to the institution of expert determination or arbitration, instead preferring litigation through the courts, there is no clear authority as to whether the other party can insist on the contractual provisions notwithstanding the early termination. Australian courts have been reluctant to preclude parties from seeking redress through the Courts. There is more authority as to arbitration than other forms of dispute resolution. The legislative backing of arbitration through the *Commercial Arbitration and Industrial Referral Agreements Act 1986* explains this approach.
Arbitration clauses

In *Codelfa* Justice Stephen held that an arbitration clause akin to a *Scott v Avery* provision survives frustration of the contract. The Court said that frustration was in this sense the same as termination following repudiation. The doctrine applies to a contract that is valid but subsequently repudiated, but not to a contract that is void *ab initio*. The clause in that case was in the following terms:

"(1) Except as otherwise specifically provided in the Contract all disputes arising out of the Contract during the progress of the works or after completion or as to any breach or alleged breach thereof shall be decided by the Commissioner.

(4) Submission to arbitration shall be deemed to be a submission to arbitration within the meaning of the New South Wales Arbitration Act 1902 or any statutory modification thereof.

(5) No action or suit shall be brought or maintained by the Contractor or the Commissioner against the other of them to recover any money for or in respect of or arising out of any breach or alleged breach of this Contract by the Contractor of the Commissioner or for or in respect of any matter or thing arising out of this Contract unless and until the Contractor or the Commissioner shall have obtained an award of an Arbitrator appointed under this clause for the amount sued for."

It is established in relation to contracts that are not terminated early that an agreement in a contract that a party may refer any dispute to arbitration is a binding agreement to arbitrate should a party so elect. As a matter of logic it is difficult to see why the same principle would not apply to a contract that was terminated by repudiation where the contract terms complied with the requirements set out in *Codelfa*.

Clauses fixing liability

In *Holland v Wiltshire* the vendor of a property included the following clause in the sale contract:

“But if default shall be made in due payment of the said purchase money and interest or any part thereof respectively at the respective times aforesaid the Vendor may at his option without notice to the Purchaser sell the said property and rescind this contract and any moneys paid on account of the purchase shall then be forfeited to the Vendor as and for liquidated damages”

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44 *Codelfa Construction Pty. Ltd. v State Rail Authority of N.S.W.* (1982) 149 CLR 337.
45 *ab initio* is Latin for "from the beginning" – effectively a contract that is deemed to have never existed
46 *Codelfa* at para 62;
47 *PMT Partners Pty Ltd (In Liquidation) v Australian National Parks And Wildlife Service* (1995) 184 CLR 301
48 [1954] HCA 42; (1954) 90 CLR 409
A deposit of £2 was paid and the purchaser was then unable to complete the purchase. The vendor attempted to compel the purchaser to complete but eventually sold the property to another party and sued for the difference between the original contract price and the eventual sale price; £645. The purchaser tried various arguments to escape and ultimately went to the High Court where it agreed that the above clause operated to its benefit in limiting the damages of the vendor to moneys paid on account; £2.

The High Court rejected the argument, saying the limitation clause was for the benefit of the vendor and the vendor had not exercised his right under that clause. Rather, the vendor had communicated to the purchaser that it required completion and ultimately decided to sell the property after terminating the contract for breach. This case highlights the need for careful termination. Perhaps a different outcome would have resulted had the vendor relied on the clause to terminate.

The English position is set out in Photo Production Ltd v Securicor Transport Ltd. Lord Diplock there said that a contract includes primary and secondary obligations. The secondary obligations, such as limitations of damages, come into play when the primary obligations are breached. He expressed the view that the secondary obligations endure after the contract has been terminated for repudiation. Accordingly, the English position appears to support a view that, notwithstanding the termination of the contract, the defaulter can rely on any clauses in the contract that limit its liability in damages.

In my view, this appears inconsistent with the approach taken in Sopov v Kane discussed above where the Victorian Court of Appeal found the liability of the defaulting owner was not limited to the contract sum but was to be assessed on a quantum meruit basis. While one might contend that limitations on damages are expressly agreed with a view to breaches of the contract, the nature of the breach that results in termination is generally of a very different character. The High Court of Australia does not appear to have directly considered the approach taken by Lord Diplock in Securicor.

Conclusion

The law governing the early termination of a contract is complex and controversial. This brief foray has not dealt with many of the circumstances that arise from time to time and is by no means an exhaustive analysis. The number of successful appeals from decisions at first instance, and indeed successful appeals to the High Court from Courts of Appeal, bear witness to the complexity and difficulty of this area of the law.

Tom Grace
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