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‘Better late than never’ – Saving defective termination notices

By Ryan Deane

Introduction

In the recent case of *Topalsson* v *Rolls-Royce Motor Cars Ltd* [2023] EWHC 1765 (TCC), the Technology and Construction Court provided useful guidance on the circumstances in which a failure to complete by contractual deadlines entitles the innocent party to terminate a contract. It also illustrates the dangers of terminating a contract for the wrong reasons, and shows how the negative consequences of such a mistake can still be avoided in the nick of time.

Termination of a contract

Before looking at what happened in *Topalsson* v *Rolls-Royce*, a general reminder of the law surrounding termination of a contract will help to put the issues in dispute in context. Stating the obvious, a breach of contract always gives the innocent party the right to claim damages. However, the innocent party may in certain circumstances also have the option of bringing the contract to an end because of the other party’s breach. Under English common law, termination of a contract can occur in two main sorts of cases.

First, due to a breach of a term of the contract. In particular, any breach of a ‘condition’ or a serious breach of an ‘innominate term’ allows the innocent party to terminate. This begs the question of what a condition and innominate term are.

Historically, the meaning of a ‘condition’ was an obligation that you must perform fully before I have to perform at all, such that performance of my obligation was *conditional* on performance of yours. This approach is exemplified by the observation by Sir George Jessel in the 1878 case of *Re Hall v Barker*:

> “*If a shoemaker agrees to make a pair of shoes, he cannot offer you one shoe and ask you to pay half the price*”

The modern meaning has become divorced from this sense of the order of performance. Instead, the courts will simply ask: did the parties intend that any breach of the term in question would allow the innocent party to terminate?

Unsurprisingly, the Courts are reluctant to find that the parties’ intention is for even the most minor of breaches to bring a contract to an end unless it is obvious from the words used. Just using the word ‘condition’ to label a term is not sufficient. The most common true contractual conditions are those implied by statutes, such as the conditions for quality and ownership implied by statute in contracts for the supply of goods.

Time is of the essence

The other main example, which is of particular relevance to *Topalsson* v *Rolls-Royce*, are ‘time of the essence’ provisions. If a clause makes ‘time of the essence’ for performing a duty by a clear deadline, then even a small delay gives the aggrieved party the right to terminate.

The most famous case in which a time of the essence provision allowed the innocent party to terminate is *Union Eagle Ltd* v *Golden Achievement Ltd* [1997] UKPC 5. It involved a contract to buy a flat in Hong Kong, completing

by 5.00 pm on 30 September. The contract expressly made time of the essence for this deadline, and stated that any breach by the buyer of any contract term would lead to forfeiture of the deposit and allow the seller to end the contract. The buyer tendered the purchase price ten minutes late. The seller declared the deposit forfeit and the contract at an end. The court confirmed the seller's right to do so.

Repudiatory breaches leading to termination

If a clause in a contract is not a condition then it is an 'innominate term'. In *Hong Kong Fir Shipping* [1962] 2 QB 26, Lord Justice Diplock held that only breaches of such terms that "*will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract"* allow the innocent party to terminate. Other judges have asked whether the breach "*goes to the root of the contract*" or whether it is "*fundamental*". In addition to termination due to any breach of a true condition (such as 'time being of the essence' clauses), such serious breaches of innominate terms are the second way a contract can be terminated at common law - through repudiation.

A contract can be repudiated where one party expressly or by implication states that he will not perform his outstanding obligations. This is called an 'anticipatory' breach (the breaching party is saying that they will not perform their future obligation) or a renunciation. Sometimes, a contracting party will rely on the other party's actions as justification for adopting that stance. A party may purport to terminate the contract because they erroneously think they are entitled to do so because of the other party's serious breach. This action might very well amount to a repudiation itself, as that party is now indicating that he will not perform his outstanding obligations. The same is true if a contracting party purports to cancel pursuant to an express cancellation clause in the contract, but for some reason is not entitled to do so. Care must therefore be taken before pulling the termination trigger, because if you get it wrong, the other party can accept a wrongful termination as a repudiation of the contract and terminate the contract themselves to claim damages.

The facts of the case

Turning to the facts of the case with these principles in mind, Topalsson is a company that provides specialist digital twin engine and configurator software for the automotive industry. Their software allows prospective customers to configure the car they are interested in and see what it will look like. Rolls-Royce is of course the famous manufacturer of luxury cars, now a subsidiary of BMV.

In October 2019, Rolls-Royce contracted Topalsson to create a digital visualisation software for its new Rolls-Royce Ghost model launch in Spring 2020. Engineers were to create a computer model of the car, expressed both in geometrical and mathematical terminology. The model was to be converted into a visual representation of the car by a process known as rendering.

Under the agreement, Topalsson was obliged to meet milestone dates contained in an agreed implementation plan, which gave a high-level breakdown of the original project programme. As is not uncommon in software development projects, it soon became evident that the original programme dates could not be achieved. A revised plan was agreed, with later delivery dates for the key milestone '*Technical Go-Live*', the term used for completion of the project.

Topalsson missed the deadlines in the revised programme and blamed Rolls-Royce for impeding the work. Rolls-Royce on the other hand, accused Topalsson of misrepresenting its expertise and inadequately resourcing the project, leading to significant delays and poor performance.

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In April 2020, Rolls-Royce purported to terminate the Agreement at common law on the basis that Topalsson had failed to achieve set milestone dates. Topalsson rejected that first termination notice, claiming, amongst other points, that the milestones at issue had never been agreed, and affirmed the agreement as continuing in force rather than purporting to accept Rolls-Royce's wrongful termination.

Later in April 2020, Rolls-Royce sent a second termination notice, without prejudice to their first termination notice, purporting to terminate at common law or alternatively under the Agreement on the grounds that the milestone dates had not been met. Topalsson again claimed that the second termination notice was not effective and so Rolls-Royce's wrongful termination meant that it was in repudiatory breach of the Agreement. This time Topalsson elected to accept the alleged repudiatory breach and stopped work in May 2020.

The key issues before the court

After that second volley of termination notices, Topalsson issued proceedings, claiming damages for unlawful termination and lost profits, alternatively payment for work carried out and/or invoiced as at the termination date. Rolls-Royce counterclaimed for damages flowing from the alleged repudiatory breach, claiming substantial losses of €20 million for software replacement costs, lost profits, and other related damages. Both parties agreed, however, that under the agreement the contractual claims were capped at €5 million.

Mrs Justice O'Farrell, giving the judgment of the court, summarised the key issues to be considered as follows:

- whether Topalsson were under any obligation to deliver and install the software in line with an agreed programme or within a reasonable time;
- whether Topalsson achieved any of the agreed milestone dates or carried out its obligations in a reasonable time;
- whether Topalsson was impeded in its performance, or prevented from performing its obligations by Rolls-Royce; and
- whether Rolls-Royce was entitled to terminate under the Agreement or at common law on the ground of Topalsson's repudiatory or anticipatory breach, or whether Rolls-Royce was itself in repudiatory breach by giving the notices of termination.

The importance of clear and express deadlines

The relevant terms of the agreement that governed Topalsson's obligations included the following:

> "*5.3.7 In performing this Agreement* [Topalsson] *shall … complete the Services and deliver the Deliverables on time and in full and by any applicable milestone date or delivery date, if delivery dates or milestones are not specified, within or by any reasonable delivery date or time period that is specified by* [Rolls-Royce].
>
> *5.8 Time shall be of the essence regarding any date for delivery by the Supplier of any good or service specified in this agreement and the Completion Date.*"

The only document that formed part of the contract which could be said to contain any "milestones" was the original programme. This had activity bars for each mandatory stage with symbols indicating the end of each time period. However, O'Farrell J held that this original programme did not contain any true contractual "milestones" or "delivery dates". It was simply too "*high-level*" in nature and not sufficiently detailed to impose contractual deadlines that would be of crucial importance (especially since 'time was of the essence'). The document contained no specific dates. Instead, as the judge found, the activity bars shown on the programme were only

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indicative of when an activity would finish relative to other activities. Further, the agreement itself defined it as an "*Anticipated Timeline*" and not a fixed programme, further undermining the suggestion that a failure to perform in accordance with it would be the guillotine that could immediately bring the contract to an end. Pausing here, this is a useful reminder that simply inserting technical or programming documents as part of the contract documents, without reflecting their (intended) content in clear, properly drafted terminology in the main body of the agreement, can backfire. As the contract stood, Topalsson could therefore not have been 'in breach of' the original programme because it was not detailed enough to contain contractual milestones and Clauses 5.3.7 and 5.8, set out above, did not apply to it.

A different conclusion was reached for the revised programme, which was produced a few months after the agreement, when it had become clear that the project was in delay. It was more detailed and had been prepared by Topalsson themselves and was approved by a Rolls-Royce Steering Committee. Both parties had in fact used the revised programme as the agreed timeline against which subsequent discussions regarding progress and delay had taken place. In the Technology and Construction Court, Rolls-Royce argued that Clause 5.8 of the agreement operated to make time of the essence in relation to the revised programme dates, such that they were entitled to terminate the contract for any breach, no matter how insignificant. Topalsson countered that Clause 5.8 did not apply to the revised programme because it was not "*specified in this agreement*" as required by the clause but was instead agreed between the parties after the Agreement was made.

The judge agreed with Rolls-Royce, finding that the words "*specified in this agreement*" only applied to the words "*goods and services*" mentioned immediately prior, and not any "*date for delivery*". In addition, the agreement required development work to be carried out to finalise the scope, timing and sequencing of the deliverables and so the parties anticipated that further programmes would be made. The relevant clauses in the Agreement therefore applied to the Revised programme and time was of the essence in relation to those dates.

Neither was Topalsson able to demonstrate that Rolls-Royce was responsible for the delay to the project in any significant way. The court accepted Topalsson's case that some initial delay was caused by the late start of the project, but (i) that did not exonerate Topalsson from its obligation to meet the agreed milestones, and (ii) the Revised programme took that delay into account.

The judge concluded:

> "*The most likely reason for the delay to progress was the lack of appropriately skilled resources, either because Topalsson took on a project that simply was beyond its capabilities, or because it struggled to recruit and retain the necessary staffing levels.*"

It followed that Topalsson was in breach of its obligation to meet the dates for delivery set out in the revised programme and that, because time was of the essence, and Rolls-Royce was entitled to terminate the agreement for even the smallest breach of that programme.

Saving a defective termination notice?

That would have been the end of the matter, except that Rolls-Royce had made a mistake when issuing the first termination notice. In the notice, Rolls-Royce had relied on Topalsson's repudiatory breach by reference to its failure to meet the original programme dates. That was erroneous because Rolls-Royce had by that point agreed to the revised programme and in any event, as the judge had found, no contractual milestones were contained in the original programme. Rolls-Royce, as a result, was not entitled to rely on breaches of the original programme as a repudiation of the contract by Topalsson.

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As mentioned above, terminating a contract on the wrong grounds gives the opportunity for the other party to claim that this was a repudiation in and of itself, and claim damages against the party purporting to terminate. However, in order for that to happen, the other party must accept the repudiation and treat the contract as at an end. Here, Topalsson had failed to do that. After the first termination notice was issued, it simply rejected the effect of the notice and affirmed the agreement, treating the parties as still being bound by their obligations. As the well-known statement from *Howard* v *Pickford Tool Co Ltd* [1951] 1 KB 417 goes "*An unaccepted repudiation is a thing writ in water*", and Rolls-Royce's wrongful termination disappeared like ripples in a pond.

Upon Topalsson affirming the contract, the potential repudiation of the first termination notice disappeared, as if it had never occurred at all. This allowed the second termination notice issued by Rolls-Royce to be considered on a clean slate. That notice correctly referred to Topalsson's failure to meet the milestones contained in the revised programme. O'Farrell J held that, in her judgment, the second termination notice validly terminated the agreement. The revised programme was binding on the parties. The express terms of the agreement made time of the essence. Topalsson failed to meet the delivery dates set out in the revised programme. That failure amounted to a breach of condition, entitling Rolls-Royce to terminate the agreement at common law for repudiatory breach.

In the alternative, Rolls-Royce was also entitled to terminate under the express termination provisions in the agreement, which stated:

> "*If in the reasonable opinion of [Rolls-Royce] [Topalsson] fails to perform the Services in accordance with this Agreement or to deliver Deliverables by the applicable delivery dates or milestone dates or if [Rolls-Royce] rejects the Deliverables, without limitation to any other of its rights or remedies, [Rolls-Royce] shall have the following rights:*
>
> *… 13.11.3 to terminate this Agreement in whole or part with immediate effect by giving written notice to [Topalsson].*"

This was not a condition and so would not entitle Rolls-Royce to terminate for any breach, no matter how trivial or inconsequential, but only for a significant or substantial one. On the facts, before Topalsson stopped working it had delivered an important milestone 11 days late, which the court found to be a material breach which went to the root of the contract. Rolls-Royce had therefore validly terminated the Agreement under both the express terms of the contract and at common law. Topalsson was therefore liable for the resulting damages.

Comment

While the court's decision does not break any new ground, such cases of 'termination tennis' demonstrate the application of the well-established principles relating to termination of contracts. There are also practical lessons to be learned. Crucially, parties should ensure that any key requirements or deadlines are clearly recorded in the contract (or that it provides clear mechanisms for agreeing them later) in order to avoid subsequent disputes arising as to whether deadlines are binding and when they have been achieved.

Parties seeking to terminate for repudiatory breach or based on a contractual right should, in the notice of termination, take care to rely on valid legal and factual bases to do so, or else risk being in repudiatory breach themselves. For example, if contractual timelines or scope have been varied by agreement, failure to meet the original requirements may no longer justify termination.

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Parties should also take care when receiving termination notices and take legal advice from the outset. Carefully consider any termination notice you receive with your legal team. Choosing whether to accept a repudiatory breach is an important, potentially costly, decision that has a fundamental impact on the operation of the contract, and usually has to be taken very quickly.

Similarly, involve legal advisers when you draft a termination notice. Serving an invalid termination notice and wrongly treating the contract as repudiated can leave you vulnerable to repudiating the contract yourself. A party alleged to have repudiated a contract by purporting to terminate at common law, but relying on an improper ground, can subsequently rely on another ground to defend what would otherwise be an unlawful termination (per Lord Denning in *The Mihalis Angelos* [1971] 1 QB 164), but it is much safer to get it right the first time.

While a minor breach of a condition may be enough for termination, breaches of other contractual terms giving rise to an express right to terminate still need to be sufficiently serious in the circumstances to warrant termination. Consider, therefore, which terms in your contracts should be conditions, and ask your lawyers to ensure that the contractual language achieves this aim.

In particular, consider whether time is expressed to be of the essence in the contract. Making time of the essence for performance is sufficient to render any delay (even if only by a few hours) repudiatory. If time is to be of the essence, include a clearly drafted provision in the agreement and make sure that it is consistent with your termination clause (do not, for example, include a grace period to rectify).

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