haynesboone

Wrongful termination in good faith: reconciling the authorities in the context of force majeure

July 2020

In the rush to seek relief under force majeure clauses following the devastating impact of the Covid-19 pandemic, it is likely that some claims were made incorrectly, albeit in good faith. Particularly in circumstances where force majeure relief is linked to a purported termination, the party seeking to terminate needs to comply with any contractual requirements and ensure that the event relied upon is capable of being caught by the force majeure clause. While a failure to do so may mean that it is, in principle, open to the other party to terminate the contract and claim damages, this may not be so in all circumstances.

1. Relief under force majeure clauses

It is not the intention of this paper to restate the English law approach to contractual provisions that seek to excuse a failure to perform following the occurrence of specified supervening events. These contractual provisions are often referred to as "force majeure" clauses and, for ease of reference, this is the terminology that we employ. However, and as the great number of articles on this topic in recent months make clear, there is no doctrine of force majeure under English law. The effect of such clauses on the rights and obligations of the parties depends upon the language used.

Whether or not a supervening event is sufficient to fall within a force majeure clause will not simply turn on the nature of the event itself, but the contract will often also require that the event was beyond the control of the relying party and that there is a clear causal link between the event and the failure to perform.

Most force majeure clauses will operate to suspend performance of the affected obligations under the contract until the end of the event. Other clauses will operate to excuse the liability of a party for non-performance or, say, for delay in performance in the context of contracts for the supply of goods or services. A further category of force majeure clauses will operate to bring the contract to an end either upon notice or, in some cases, automatically.

We are most interested in the final category because, where a party wrongfully terminates a contract in reliance upon a force majeure clause, this may amount to a "renunciation" of the contract permitting the innocent party to terminate and claim damages.

2. What is a renunciation of the contract?

Under English law, in the event of a breach by one party, the innocent party may be entitled to treat itself as discharged from its liability to (i) perform any further obligations and (ii) accept performance by the party in default, i.e. the innocent party may be entitled to terminate the contract thereby bringing it to an end from that point in time. Termination on this basis does not dismantle or set aside the contract retrospectively, as if it had never existed at all, in a way that may be open

© 2020 Haynes and Boone, LLP

to a party by reason of some ground of initial invalidity to the contact, such as mistake, fraud or lack of consent. Instead, the liability to perform future obligations is replaced[1] by a liability on the defaulting party to pay compensation for the loss sustained by the innocent party as a consequence.

However, while any breach will in principle give rise to a right to sue for damages, not all breaches will entitle a party to terminate the contract. There are, essentially, three sets of circumstances capable of giving rise to an entitlement to terminate. These include where the defaulting party renders it impossible to perform the contract, or where there has been a breach that is sufficiently serious to strike at the root, or essence, of the contract – the latter of which is commonly referred to as a "repudiatory" breach[2]. The third category, with which we are most interested for the purposes of this paper, is where the defaulting party by words or conduct demonstrates a clear intention not to perform, or expressly declares that it does not intend to perform, its obligations under the contract in some essential respect. This is generally referred to as a "renunciation" of the contract[3]. By its nature, renunciation can arise both before or at the time for performance, as distinct from a pure repudiatory breach (as defined above) which can really only occur at the time of performance of the relevant obligation.

Where the renunciation takes the form of a refusal by the defaulting party to perform its obligations, as would be the case where a party wrongfully terminates a contract in reliance upon a force majeure clause, it will be open to the other party to accept this as a renunciation and terminate the contract in the manner described above. In simple terms, and as set out by the Court of Appeal in *Valilas v Januzaj* (2014)[4], such a renunciation can be thought of as an "anticipatory repudiatory breach" in that the party has stated it will not be carrying out its obligations when they fall due, and so the other party may "accept" this breach and bring the contract to an end. Renunciation and repudiatory breach can therefore be seen as "*two sides of the same coin*" and case law with respect to both is relevant when assessing the legal position.

Difficulties can arise, however, where there is a genuine dispute as to the construction of the contract or, say, where a party has acted in good faith but on a mistaken understanding of the contract. The fact that a contractual notice of termination based on a force majeure event was made incorrectly, will not necessarily automatically amount to a renunciation. The relevant English law authorities do not give clear guidance as to the approach to be taken in these circumstances and, in some respects, the cases are

[1] Note that certain contractual provisions will survive termination, for example clauses limiting or excluding liability and clauses addressing governing law and jurisdiction.

[2] Examples of which include breach of a condition, serious breach of another (intermediate) term, or a pattern of breaches that collectively are sufficiently serious.

[3] Although somewhat confusingly, this category is often also referred to as "repudiatory breach", as explained further below.

[4] [2014] EWCA Civ 436

© 2020 Haynes and Boone, LLP

not always easy to reconcile. In the section that follows, we examine the current judicial thinking by reference to a party's wrongful termination in reliance upon a force majeure clause.

3. Wrongful termination in good faith

The legal position where a party mistakenly, perhaps because of erroneous legal advice, notifies the other that it is entitled to withhold performance, is, at first glance, straightforward. The relevant test is whether a reasonable person, considering matters objectively from the position of the innocent party, would consider the other party had declared its intention not to carry out the contract. Thus, the default position, following service of a wrongful termination in reliance upon a force majeure clause, would be that it amounted to a renunciation, which breach the innocent party could accept and bring the contract to an end. By analogy, in the House of Lords decision in *Federal Commerce & Navigation Co Ltd v Molena Alpha Inc, "The Nanfri"* (1979)[5], a refusal by a shipowner to issue pre-paid bills of lading on the basis of incorrect legal advice was held to amount to a repudiation.

However, there have been decisions over the years which have muddied the waters. These can be considered as falling into two groups: firstly, where there is a technical error with the termination notice itself; and secondly, where the error lies in the grounds for termination.

Technical errors within the notice

Where a legitimate force majeure event has occurred, but there has been a failure to properly follow the contractual machinery by the terminating party, there are a number of relevant English Law decisions.

In *Eminence Property Developments Ltd v Heaney* (2010)[6], solicitors for the seller of 13 flats incorrectly counted the deadline for payment by reference to consecutive days, rather than "working" days. As such, the seller's service of notices to complete under the contract contained an incorrect final date for completion and, when this date passed, its subsequent service of notices accepting the buyer's failure to complete as a repudiation, were premature. The buyer purported to accept these notices as a repudiatory breach, and the matter was ultimately considered by the Court of Appeal. It held that, taking into account all the circumstances and the seller's conduct, it was clear it had acted in a manner in accordance with a wish to enforce its contractual rights, rather than abandon them. The rescission notices showed an intention to terminate the contract in accordance with the contractual procedure and referred explicitly to the seller's exercise of its contractual remedies. Had the buyer's solicitors pointed out the date error, it is likely the seller's solicitors would have immediately corrected it.

[5] [1979] A.C. 757

[6] [2010] EWCA Civ 1168

© 2020 Haynes and Boone, LLP

This can be contrasted with the decision in *Regulus Ship Services Pte Ltd v Lundin Services BV* (2016)[7], where an ocean towage contract permitted a party to terminate after giving 48hrs notice. The tug boat owner served a notice of termination, which purported to start the notice period 48hrs before it was sent, meaning that termination happened immediately. This was found to amount to a repudiation as it was "*so obviously hopeless as…to put in question whether [the owner] was acting in good faith*". In addition, terminating the contract in the manner it did showed that the claimant was "*not in reality relying on the terms of the [contract], as sensibly understood*". It had therefore clearly evidenced an intention not to perform the contract, and a "*reasonable reader*" of the termination notice would understand that it would not continue to perform even if it was pointed out that it had made a mistake.

The relevance of this with respect of termination for force majeure is clear. Many contractual rights of termination following force majeure events have strict time periods with which the parties must comply. For example, Clause 34(b) of Supplytime 2017 states both that the relevant event must continue for more than 14 days following receipt of notice and, if it has not, then the notifying party may terminate within 3 days of that notice. If either of these requirements are not met, then the termination notice will be invalid. The decision in *Eminence* suggests that, if you are in receipt of a premature (or even tardy) notice, careful consideration should be given before simply using it as an opportunity to claim that the terminating party has renounced the contract. It is possible that the use of the contractual termination machinery by the terminating party would be viewed as incompatible with the claim that it was renouncing those rights. A key consideration will also be whether the terminating party has made clear it would much rather the contract continued and whether the mistake seems to be an innocent one.

Misunderstanding of the legal position

The second situation will arise where the notice has been correctly provided in accordance with the contractual requirements, but is based on an error in understanding how the relevant force majeure clause operates. As such, the right of termination does not actually exist. For example, there was, in fact, no causal link between the event and the adverse effect on performance or there was an alternative way to perform, but the terminating party failed to properly investigate this. Importantly, however, a key point here is that, despite this error, the party honestly believed it could terminate and would not have sought to terminate otherwise.

In *Woodar Investment Development v Wimpey Construction* (1980)[8], a purchaser wrongly exercised a contractual right to withdraw from a land deal based on a misunderstanding of the terms of the contract as it related to the timing of the commencement of compulsory purchase proceedings. The House of Lords – by a bare majority of 3:2 – held that this did not amount to a renunciation of the contract. In the majority's view, the circumstances did not manifest an intention on the part of the purchaser to refuse

[7] [2016] EWHC 2674

[8] [1980] 1 W.L.R. 277

© 2020 Haynes and Boone, LLP

further performance. Specifically, discussions between the parties had proceeded on the basis that the service of a notice terminating the contract would not be considered a "hostile" act; and that the entitlement (or not) to terminate would be determined by the courts, by whose decision both parties would abide. It is however a curious decision, given that the purchaser's termination notice was accompanied by a letter stating that the "*contract is now discharged by the enclosed notice*". If that does not evince a clear intention by the purchaser not to perform an essential obligation (i.e. to buy the land) under the contract, it is difficult to imagine what would.

Woodar can be contrasted with the decision in "*The Nanfri*" set out above, which would at first glance also fulfil these requirements but where, nevertheless, the actions of the party in default were held to amount to a repudiatory breach. The key distinctions appear to be that, in "*The Nanfri*", the impact on the innocent party was significant and the lack of time meant that there was no commercial window within which to resolve the problem. In *Woodar*, by contrast, there was time, for example, for the dispute to be referred to the courts for determination, and the purchaser made clear it would be bound by any such determination. It should also be noted that the courts have subsequently referred to the owner's behaviour in "*The Nanfri*" as "*cynical and manipulative*"[9] and this was clearly a relevant factor. Nevertheless, determining whether an action was "innocent" or "cynical" is evidently fraught with uncertainty.

Various subsequent decisions have distinguished *Woodar* based on its precise facts and, to some extent, it is now generally accepted as something of an exception. However, it does remain a binding decision of the most senior English court and authority for the proposition that, in certain limited circumstances, it may not be open to an innocent party to immediately terminate a contract on the basis of some serious infringement by the other party (such as a wrongful termination pursuant to a force majeure clause) where that infringement was made on a mistaken understanding of contractual rights.

Take it or leave it?

It is important to note that, in respect of either of the scenarios addressed above, the fact that the decision to terminate was based on incorrect legal advice is not determinative; as cases on both sides had such errors at their root. What is, however, apparently key, is whether the terminating party makes clear it is terminating as a last resort and would prefer the contract to continue. If the terminating party has stated it is not adopting a "take it or leave it" stance and is willing to continue to perform if its termination is shown to be incorrect, this *might* mean that the conduct does not amount to a renunciation. However, where there is not time for the parties to resolve the matter and if the consequences of failing to perform are significant, the service of a wrongful notice of termination for force majeure is likely to amount to a renunciation.

[9] Per Etherton LJ in *Eminence*

© 2020 Haynes and Boone, LLP

4. Consequences for the innocent party

In the current climate, one can see that mistakes will almost certainly be made when attempting to terminate a contract in reliance upon a force majeure clause. But whether a wrongful termination in this context will amount to a renunciation of the contract may be heavily fact dependent. How the terminating party purported to exercise its termination right, and precisely what was said between the parties at the time, could be crucial in determining its proper effect. This is perhaps particularly so in the scenario where a party wrongly terminates a contract before the works or services the subject of the contract have even commenced. That could be the case where offshore vessels have been chartered for future use, but meanwhile there is time and (perhaps) a willingness by the terminating party to have the issues in dispute determined by a third party.

As is evident from the cases discussed above, great care needs to be exercised by the innocent party. In each case, the background facts – including discussions between the parties – need to be carefully assessed before any action is taken. If the innocent party reacts too quickly in terminating the contract, this could itself amount to a renunciation, i.e. if it is later found by a court or tribunal that the initial (wrongful) termination notice did not itself amount to a renunciation of the contract. It would then be open to the other party to accept *that* renunciation, with the result that the innocent party (who was not initially in breach) finds itself facing a claim for damages[10].

Depending upon the circumstances, and if time permits, the most sensible approach may be to seek clarification of the terminating party's intent before the innocent party itself terminates. However, care does need to be taken during this interim period. It has been said that a renunciation or repudiatory breach is a "*thing writ in water*" until it is accepted[11] and, meanwhile, the contract remains alive so to speak. Thus, there is a risk that the renunciation could be overtaken by other events – for example if the party in default starts to perform its obligations again or if the innocent party itself renounces or repudiates the contract. Admittedly there may be reduced scope for either such scenario in the context of a wrongful termination, but the point stands. What amounted to a renunciation at the time the relevant termination notice was sent, may no longer be sufficient once the innocent party determines that it wishes to accept that breach and bring the contact to an end. In short, the context will always be key.

[10] A number of recent cases highlight the problem, including the Court of Appeal's judgment in *Telford Homes (Creekside) Ltd v Ampurius Nu Homes Holdings Ltd* [2013] EWCA Civ 577

[11] Per Rix LJ in *Stocznia Gdanska SA v Latvian Shipping Company* [2002] EWCA Civ 889, paragraph 87

© 2020 Haynes and Boone, LLP

haynesboone

CONTACT DETAILS

Andreas Dracoulis, Partner

andreas.dracoulis@haynesboone.com
T +44 (0)20 8734.2846

Jonathan Morton, Associate

jonathan.morton@haynesboone.com
T+44 (0)20 8734.2863

Haynes and Boone CDG, LLP
1 New Fetter Lane
London EC4A 1AN

www.haynesboone.com

Haynes and Boone CDG, LLP is a Limited Liability Partnership registered in England and Wales under Partnership Number OC 317056 with its registered office and principal place of business at 1 New Fetter Lane, London, EC4A 1AN, United Kingdom. It is authorised and regulated by the Solicitors Regulation Authority. A list of members of the LLP together with a list of non-members designated as partners is available at the address shown above.

This paper has been prepared for information purposes only, highlighting issues of general interest and importance. It is not intended to and does not constitute legal advice and shall not be considered or passed off as legal advice in whole or in part. The paper is not intended to create (and receipt of it does not constitute) a lawyer-client relationship. Readers must in all circumstances take professional legal advice on any relevant contract or matter. A past performance or prior result is no guarantee of a similar future result in another case or matter. This publication shall not be reproduced, distributed or modified (in whole or in part) without the permission of Haynes and Boone CDG, LLP.

© 2020 Haynes and Boone, LLP