

Terminating a contract: What steps do you need to take?

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Ending a contract can be a tricky task, especially when you do not know where to begin. Contracts can be lengthy, wordy and a puzzle at times. The good news is, whether you're dealing with a catering, cleaning or other goods/services contract, the approach to termination largely remains the same. This article highlights some key points to consider when thinking about termination.

What does termination mean?

Termination brings a contract to an end and generally releases the contracting parties from their contractual obligations. The exception is where the parties have agreed that certain obligations survive termination (e.g. confidentiality).

Why terminate a contract?

There are many reasons why you might want to consider terminating a contract:

- It is no longer profitable or commercially viable;
- A party is not adhering to the agreement;
- For convenience, without alleging fault;
- Where unforeseen circumstances (e.g. Covid-19 pandemic) render the contract impossible to perform;
- A party is insolvent;
- A party no longer requires the goods or services; or
- A party has come under new control or has been acquired by a competitor. Such a change in circumstances may reduce the benefit of the once commercially attractive agreement.

How to terminate a contract?

Prior to terminating a contract, it is crucial to consider whether you have legal grounds to terminate. This is to make sure that any termination is lawful and does not expose you (as the terminating party) to any liability for wrongful termination, which may allow the other party to bring a claim against you.

A right to terminate may arise as a result of:

- statute;
- common law; or
- a contractual term.

We briefly look at each route below.

Statute

Firstly, contracts can be terminated through operation of law; for example, by the death of either party, by merging one contract with another or by certain illegalities. The scope of this note does not extend to termination by operation of law.

Common law

Secondly, common law has long established that parties have the right to terminate on grounds of a 'serious' breach of contract. This is referred to as a 'repudiatory breach'. There is no set definition of what a 'serious breach' is; instead it is fact specific. A 'serious' breach can therefore be complicated to assess and that is why legal advice should be sought at an early stage, and in particular prior to termination, to clarify the position.

In practical terms, a 'serious breach' means a contracting party is not performing (or has said it will not perform) its main obligations. Often, the breach by one party of a fundamental term of an agreement that goes to the root of its obligations will allow the innocent party to terminate.

It is important to note that whilst such a breach might give you (as the aggrieved party) the right to terminate and claim damages, it does not automatically terminate the contract. If a right to terminate arises but you do not act upon it quickly by proceeding to terminate, then you can be deemed to have 'accepted' the breach, waived your right to do anything about it and affirmed the contract.

The practical consequences of termination can be broad and extend into commercial realms: for example, business disruption and impacts on budgets.

Contractual term

Thirdly, a contractual term may provide a party with a right to terminate for convenience or might require conditions to be met before termination can take place. For example, a contractual term may set out a circumstance which will give a party the right to terminate the contract. This can include conditions such as requiring a party to give notice of termination prior to a contract's end date to stop its automatic renewal, or to allow the party in breach a period of time to try to remedy the breach. In that latter case, it can be easy for the parties to get into a dispute about what the remedy looks like.

Even where the contract expressly provides a right to terminate, the interpretation of such terms can be complicated. For example, a 'break clause' may permit termination; however, before the term can be relied upon, there may be conditions that need to be met. If these terms are not interpreted correctly, they can also result in wrongful termination. As mentioned above, this may lead to a claim against you if the other party disputes your grounds for termination or if you get the mechanism of terminating wrong.

Notice

In general, whether terminating under common law or a contract term, a party is normally required to give notice to the other party of its intention to terminate the contract, via an unequivocal communication.

If a party is terminating in accordance with a contractual term, generally the term will also provide the process for how the termination notice is to be communicated to the other party. This may be via a minimum notice period (e.g. must give thirty days' notice), the form of the notice (e.g. must be in writing), or a medium of communication (e.g. must be served by post).

Complying with these requirements can be complex, and, if a party fails to get it right, there is a risk that the termination might be invalid which can then expose you to a claim for wrongful termination.

Summary

As discussed above, there are a number of reasons why you might wish to terminate a contract.

Looking at the other party's conduct and the contract itself is the right starting point and should help to identify whether you have the right to terminate and, if so, how you go about it.

We regularly deal with disputes which involve the termination of contracts, in particular where termination goes wrong. The consequences of terminating a contract wrongfully can be disastrous both financially and in terms of reputation, so it is important to seek advice prior to proceeding with termination.

This article is intended to highlight some of the key points to consider in relation to the termination of contracts. However, it should not be taken as legal advice and we would strongly recommend that specific legal advice is taken prior to the termination of any contract.

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