

TERMINATION OF CONTRACTS

Contracts exist in many different forms and are used in many different areas of life. Signing a loan agreement or an employment contract are some of the many ways we encounter contracts in our everyday lives. In some situations, however, you may wish to exit the contract.

This article will cover some ways in which you may be able to terminate a contract.



There are three main reasons that a contract may be terminated:

- The parties used an express power in the original contract to terminate;
- The parties entered into a subsequent agreement to terminate the contract; or
- One of the parties breached or repudiated the contract.

A. TERMINATION BY EXPRESS POWERS

Sometimes, the original contract may contain provisions dealing with termination. These provisions could specify when and how the contract may be terminated. These may encompass:

- Rights for one or both parties to terminate;
- The right to terminate after providing a certain amount of notice;
- The right to terminate the contract at will;
- Events that will trigger a right to terminate, such as breach of the contract; and
- A fixed period of time, after which the contract will come to an end.

Employment contracts, for example, usually contain the first and second kinds of provisions. In Australia, employers cannot simply terminate your employment at will, and cannot include at-will provisions in your employment contract. Instead, employment contracts usually specify a notice period that your employer must give if they wish to terminate your employment. The National Employment Standards mandate a minimum period of notice. On the other hand, your employment contract will usually state that if you want to resign, you must provide a certain amount of notice. Thus, both parties to employment contracts have the right to terminate but must provide notice prior to doing so.

B. TERMINATION BY SUBSEQUENT AGREEMENT

The following hypothetical scenario illustrates how a contract may be terminated by subsequent agreement.

Say, for example, that you and your business partner X enter into a contract. However, you and X get into a disagreement and are unable to resolve it. You and X mutually decide that it is best to terminate the contract, however the contract states that it will go on for two more years. You and X can execute a new agreement to terminate the contract regardless of what the original agreement said.

Thus, parties to a contract do not always need to worry about being 'locked in' for a fixed amount of time. It is relatively easy to make a subsequent agreement to terminate because the agreement can be oral as well as written.¹ However, if you wish to vary rather than terminate the contract, for example to give some of X's responsibilities to someone else, your new agreement will need to be in writing.²

¹ *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1956) 98 CLR 93.

² *Suttor v Gundowda Pty Ltd* (1950) 81 CLR 418.



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Now, let's look at a different scenario that illustrates how varying the contract by subsequent agreement may terminate it.

Imagine that you and X arrived at a different solution; you would remain as business partners in the same venture, but you would change some of the arrangements. You and X drafted a new written agreement but did not specify how this new agreement would interact with the original contract. A court may find that your new agreement stands as a new contract, and results in the termination of the old one.³

However, this will depend on how drastically your new agreement differs from the original, and how comprehensive the new agreement is.⁴

C. TERMINATION FOR BREACH OF CONTRACT

Breach of contract occurs when one of the parties fails to perform at the time or to the standard required by the contract. Breach of a condition will give rise to a right to terminate; however, not all terms of the contract are conditions.

A condition is an 'essential promise' in the contract.⁵ The court will examine the contract and its surrounding circumstances to determine what the parties intended. A term will be essential if the promise is so important to the promisee that they would not have entered into the contract without assurance of strict or substantial performance of that promise.⁶ Breach of some non-essential promises may also give the innocent party a right to terminate.⁷ However this will depend on how serious the breach was, or whether it 'deprives' the innocent party of

'substantially the whole benefit' that the contract intended to give them.⁸

D. TERMINATION FOR REPUDIATION

Repudiation occurs when one of the parties demonstrates an unwillingness or inability to perform their contractual obligations.⁹ If one party repudiates, the other can terminate the contract and sue them for damages.

For example, A owns a convenience store but strongly dislikes his employee, the manager Z. A decides to reduce Z's pay by 50% and forces him to mop the floors and clean the public toilet instead of managing the store clerks.

In this scenario, A has repudiated the contract; the significant reduction in status, pay and responsibilities without consulting Z demonstrates that A no longer intends to be bound by the employment contract, which stated that Z would be hired as a manager and not a janitor.

E. CONCLUSION

The law surrounding termination of contracts ensures that you can exit a contract where the other party fails to, or chooses not to, fulfil their end of the agreement.

However, it is important to seek legal advice before terminating a contract; wrongful termination could expose you to costly and time-consuming legal action.

For more information on contracts generally, refer to our article titled 'Contract Law' (click [here](#)).

Comasters Law Firm can assist you in drafting agreements and in litigation against individuals and companies.

³ *Wallace-Smith v Thiess Infracore (Swanston) Pty Ltd* (2005) 218 ALR 1.

⁴ *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1956) 98 CLR 93.

⁵ *Tramways Advertising Pty Ltd v Luna Park (NSW)* (1938) 38 SR (NSW) 632, 641.

⁶ *Ibid.*

⁷ *Associated Newspapers v Bancks* (1951) 83 CLR 322 HCA.

⁸ *Hongkong Fir Shipping Co v Kawasaki Kisen Kaisha* [1962] 2 QB 26.

⁹ *Carr v JA Berriman Pty Ltd* (1953) 89 CLR 327.

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