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Pitfalls and Risks That May Arise From Giving an Inadequate Notice of Termination Under English Law

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Kwangkyu Park

This article explains some aspects of the English contract law of termination. The focus of this article is on the recent decision of Andrew Baker J of the Commercial Court in London in Phones 4U Limited (in administration) v EE Limited [2018] EWHC 49 (Comm) (the Phones 4U case), which involved the question whether an innocent contractual party who has served a notice of termination in reliance upon an express contractual right of termination would necessarily be entitled to damages for loss of bargain resulting from the termination? The author also explains in the final section of the article the type of situations where the law does not allow the innocent party to exercise both his express contractual right of termination and his right to terminate at common law at the same time (especially without indicating that one of them is only exercised in the alternative in case he should be wrong in exercising the other).

The essence of Andrew Baker J's decision in the *Phones 4U* case was that, regardless of whether or not Phones 4U was in repudiatory breach at the time of EE's termination of the relevant contract, EE could not recover "loss of bargain" damages for repudiatory breach at common law because the language of EE's notice of termination was such that, objectively, EE relied solely upon an express contractual right of termination and not upon any right to terminate for repudiatory breach.

As explained in the Commentary section of this article, however, there may be cases where the language of the relevant notice of termination is not the only factor that will be considered by the court in determining the legal implications of the notice. In exceptional situations, in serving a notice of termination, the innocent might be required to make a firm election between his common-law right of termination and his contractual right of termination.

The Facts

In the *Phones 4U* case, the dispute arose from the termination of a trading contract between the parties (the Agreement), which occurred as a result of EE serving a notice of termination on 17 September 2014 pursuant to a contractual right of termination set out in clause 14.1.2 of the Agreement.

In the notice of termination, EE said that it was terminating the relevant Agreement with immediate effect "*in accordance with clause 14.1.2 of the Agreement*", and that "*nothing herein shall be deemed to constitute a waiver of any default or termination event, and EE hereby reserves all rights and remedies it may have under the Agreement*…" Clause 14.1.2 was a standard insolvency termination clause and entitled EE to terminate in the event of Phones 4U appointing administrators. Such appointment of administrators had occurred shortly before the service of the notice of termination. It was common ground that the appointment of administrators was not a breach of contract, but did entitle EE to terminate the contract under clause 14.1.2.

EE brought a couple of counterclaims. Its primary counterclaim was for recovery of damages for alleged loss of bargain resulting from the termination of the Agreement. In this regard, as the Agreement did not provide for such damages for termination under clause 14.1.2, EE had to rely on the allegation that Phones 4U had been in repudiatory breach (i.e. a breach that the law regards as serious enough to entitle the innocent party to terminate) at the time of the notice of termination. For this purpose, EE relied on the fact that a couple of days before the notice of termination, Phones 4U's retail shops and outlets did not open for business and online trading was suspended. In fact, the cessation of trading had turned out to be permanent. As to the question of repudiation, a major issue in the proceedings was whether at the time of the notice of termination, the cessation of trading was permanent or was likely (and if so how likely) to be or become permanent. Phones 4U denied that it had been in repudiatory breach at that time.

Further, Phones 4U denied liability for such damages *regardless of any such breach*, and submitted an application for summary judgment dismissing EE's primary counterclaim on the grounds that EE did not have any realistic prospects of success subsequently at the trial. The essence of Phones 4U's argument was as follows: In the notice of termination, EE only relied upon its contractual right of termination under clause 14.1.2 in terminating the Agreement and did not purport to rely on any repudiatory breach on the part of Phones 4U. Therefore, EE's primary counterclaim should fail regardless of whether or not Phones 4U had been in repudiatory breach at the time of the notice of termination.

Andrew Baker J found in favour of Phones 4U, summarily dismissing the primary counterclaim.

Interesting Aspects of the Decision

Shortly before examining the relevant authorities, the judge explained the basic legal principles of damages for loss of bargain at common law. As he noted at §73, where a repudiatory breach has occurred, the innocent party normally has an election to make between two alternative courses of action in responding to the repudiation. He has the option either to *affirm* the contract (i.e. keep the contract alive), or to *accept* the repudiation (i.e. terminate the contract in the sense of treating the repudiation as having released him from further performance of the contract). In either case, the innocent party has the right to claim damages for the breach.

On the application for summary dismissal of the primary counterclaim, the starting point the judge noted was that damages for repudiatory breach are or include any loss of bargain and are recoverable only if the relevant loss has resulted from the breach (§73). As regards the question of causation for loss of bargain, the judge explained that there would be two different types of situations.

The judge noted that there would be cases of repudiatory breach, of which the present case was *not* one, where the nature of the relevant contract is such that the cause of claim for the loss of bargain has nothing to do with any action or decision (such as notification of termination for the breach) taken by the innocent party in response to the breach (§73). By way of example, he said, where a contract for sale of goods provides for delivery of the goods within a certain period and provides that time is of the essence of the contract for that purpose, the seller's failure to deliver the goods within that period would, in itself, create a cause of claim for damages for non-delivery.

As regards cases such as the present one, however, the judge held that "*the necessary causation for loss of bargain damages to be recoverable is created by the innocent party choosing to treat itself as discharged from further performance of the bargain and communicating that choice to the guilty party*" (§73). In such situations, as the judge noted (§75), the law still treats the repudiatory breach itself (rather than the innocent party's election to terminate the contract rather than to keep it alive) as the cause of the loss of bargain.

In either type of those cases, the ultimate question is whether the alleged loss of bargain has been caused by a repudiatory breach.

The judge held (§121) that it is correct in principle to suggest that:

> "*…if a termination letter communicates clearly a decision to terminate only under an express contractual right to terminate that has arisen irrespective of any breach, then it cannot be said that the contract was terminated for breach and so a claim for damages for loss of bargain at common law cannot run.*"

Therefore, in the present case, EE's primary counterclaim was to fail at the trial unless it was able to prove both that Phones 4U had been in repudiatory breach (independent of its appointment of administrators) at the time of the notice of termination and that the notice of termination constituted a communication of its intention to accept that repudiation.

It was indicated by the judge in effect (§76, §121 and §126) that, where a party exercised an express contractual right of termination (as opposed to a common law right of termination) by serving a notice of termination referring to certain facts as the reason for termination, if those facts constitute the very repudiatory breach subsequently complained of by the other party, then there might be room for the argument that the notice of termination should not be treated as a notice of intention to rely solely on the express contractual right of termination.

The judge also implicitly indicated (§130, based on his observations set out in §109) that, even if EE were to be unable to prove that the notice of termination constituted a communication of its intention to accept a repudiatory breach, it might not in itself necessarily have been fatal to its counterclaim for loss of bargain if the counterclaim had been based on an allegation that Phones 4U's appointment of administrators had been caused by a breach of its obligations under the Agreement although such appointment itself was not a breach of contract.

As there was no such allegation by EE, the issue was simply one of proper construction of the notice of termination. The judge held:

> "*131 … the issue is one of the construction of EE's termination letter. Upon the analysis I have set out above, the relevant issue of construction is whether by its termination letter EE purported to exercise a common law right to terminate for the repudiatory breach and/or renunciation now alleged. EE requires an affirmative answer…*"

As a matter of proper construction of the notice of termination, the judge held that EE could not receive such an affirmative answer. He said:

> "*132 I find EE's termination letter as sent entirely clear … It communicated unequivocally that EE was terminating in exercise of, and only of, its right to do so under clause 14.1.2, a right independent of any breach. Phones 4U was not accused of breach. EE made clear it was not to be taken as waiving any breach that might exist, any rights in respect of which were reserved. But a right merely reserved is a right not exercised. EE can still sue upon any breach of contract committed by Phones 4U prior to termination. For any such breach, it may pursue all remedies that may be available to it bearing in mind that the contract was terminated under clause 14.1.2 and not for breach. But what EE cannot do is re-characterise the events after the fact and claim that it terminated for breach when that is simply not what it did. Nor can it say that it treated Phones 4U's renunciation (as now alleged) as bringing the contract to an end when that, again, is just not what actually happened.*"

This finding meant that EE had no real prospect of success at the trial on its primary counterclaim, as it was bound to fail even on the assumption that Phones 4U had been in repudiatory breach (independent of its appointment of administrators, which was not in itself a breach) at the time of the notice of termination. Therefore, the judge summarily dismissed the counterclaim for loss of bargain.

Interestingly, EE referred to the well-known principle, established in *Boston Deep Sea Fishing & Ice Co v Ansell* [1888] 39 Ch D 339, that a party that terminates a contract for a bad reason may subsequently defend itself against a claim for wrongful termination by reference to a good reason extant at the time of termination, whether or not then known to that party. It means that a defendant in an action for wrongful termination can rely upon a reason which was not referred to in his notice of termination. EE then submitted that, where there is both a contractual right to terminate and a common law right to terminate for repudiatory breach, the starting point is that generally, there is no inconsistency between exercising the contractual right and terminating for breach, so that a party can generally elect to exercise both rights together (see *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689). Further, EE suggested that it is not clear on the authorities how the court is to determine whether a termination notice referring only to the contractual termination right should be taken to have exercised both rights, and that the correct approach was to ask whether objectively the notice of termination conveyed that the innocent party had elected "to exercise only its contractual right to terminate and to forego its rights at common law."

The judge held, however, that the *Boston Deep Sea Fishing* principle was not applicable to the present case. In this regard, the key aspect of the facts in the present case was that, when terminating the Agreement, EE did not purport to rely on a repudiatory breach (if any) on the part of Phones 4U.

Commentary

The Moral of Andrew Baker J's Decision

As suggested by Andrew Baker J himself (§131), there appears to have been no prior English authority applicable precisely on the facts of the *Phones 4U* case. Therefore, his decision is a new development on the English law of contractual termination.

It is a decision of which people who are involved with drafting contractual termination notices under English law could be unaware at their peril.

It is noteworthy that the judge identified a couple of the types of situations on which his decision would not be a direct authority.

He said (§124): "*The present case does not concern a (purported) termination of a contract where no basis for terminating is communicated.*" He left this question open.

He also said (§125): "*This case also does not concern a termination of a contract expressed to be for a repudiatory breach or renunciation that existed and gave rise to a contractual right of termination where only the contractual right is cited as justifying the termination.*" He indicated (§§ 125 and 126) that in such a case of termination, except where the innocent party only had the contractual right (as a result of its common law right having been excluded or replaced, not merely supplemented), the innocent party might succeed on its claim for damages for loss of bargain.

In light of (*inter alia*) the judge's observations in §§ 125 and 126, it seems that it is *not necessarily* a pre-requisite to a successful claim for damages for loss of bargain at common law, that the innocent party should have notified the party in breach specifically at the time of termination that he is terminating for a repudiatory breach. It seems likely that the ultimate test is whether objectively, regardless of the precise language of the notice of termination, the innocent party relied upon a repudiatory breach on the part of the other party in terminating the contract. In other words, the ultimate test is probably one of causation.

This does not, however, affect the importance of the moral from the decision in the *Phones 4U* case, namely, that, where a party to a contract wishes to serve a notice of termination pursuant to and in reliance upon an express right of termination, if it would be important for him to claim damages at common law for his loss of bargain resulting from the termination, it would normally be advisable for him to say in his notice of termination that he is also relying upon his right to terminate at common law, unless (as explained in detail below) the situation is such that the law requires him to choose between such two different rights of termination.

Election Between Termination Rights Necessary in Exceptional Situations

In many situations, the innocent party may be entitled to exercise both an express contractual right of termination and a right to terminate at common law at the same time.

Nevertheless, for the purpose of serving a notice of termination, there may be situations where the innocent party must choose between such rights and cannot purport to exercise both rights (unless he indicates that one of them is only exercised in the alternative in case he should be wrong in exercising the other). Such situations would arise particularly where the innocent party has both rights at the relevant time but the express contractual remedies for the innocent party arising from his exercise of the express contractual right of termination are materially different from those that would be available to him at common law for repudiatory breach: see *Dalkia Utilities Services plc v Celtech International Ltd* [2006] 1 Lloyd's Rep 599 and *Shell Egypt West Manzala GMBH v Dana Gas Egypt Limited* [2010] EWHC 465 (Comm) (the Shell Egypt case). Moore-Bick LJ held in *Stocznia Gdynia SA v Gearbulk Holdings Ltd* [2010] QB 27 at §44: "*If the contract and the general law provide the injured party with alternative rights which have different consequences, as was held to be the case in Dalkia Utilities v Celtech, he will necessarily have to elect between them and the precise terms in which he informs the other party of his decision will be significant, but where the contract provides a right to terminate which corresponds to a right under the general law (because the breach goes to the root of the contract or the parties have agreed that it should be treated as doing so) no election is necessary.*"

It was suggested by Leggatt J in *Newland Shipping and Forwarding Ltd v Toba Trading FZC* [2014] EWHC 661 (Comm) (the Newland Shipping case) that the test is not merely whether the express contractual remedies and the remedies at common law are *different* from each other, but whether there is *inconsistency* between the former and the latter. Where the rights are inconsistent, even where the court might otherwise have declared that the innocent party relied upon both the express contractual right of termination and his right of termination at common law, the court is likely to be reluctant to find that the innocent party relied upon both of such rights in terminating the contract, and would probably be inclined normally to find that the innocent party made an election between those rights. If the court should find that the innocent party failed to make a proper election, the court might declare that he failed to terminate the contract.

Leggatt J further held (albeit only in passing) in the *Newland Shipping* case that, if he were wrong to have declared that Newland Shipping were entitled at the time of its initial notice of termination to exercise both its express contractual right of termination and its right to terminate at common law, as they purported in that notice to exercise both of those rights, Newland Shipping would have failed to validly exercise either of those rights by that notice in the sense that the notice had "no legal effect" (§67). It remains to be seen whether that dictum is to be followed by the English courts. In such cases, in the author's view, it is not inconceivable that the court would declare that the innocent party validly terminated the contract by the notice of termination but is not be entitled to any other remedies.

The Best Way to terminate a Contract Under English Law

Exactly what would constitute the best way to prepare a notice of termination depends upon the circumstances of the case. The relevant factors would include: (a) whether it is certain that the innocent party is entitled to exercise an express right of termination; (b) whether the other party is clearly in repudiatory breach at the same time; (c) whether the contract and the common law provide the innocent party with alternative rights which have different consequences, and (if so) how different they are from each other; (d) whether the innocent party is more interested in legitimately terminating the contract than in remedies to which he might be entitled following termination; and (e) whether the innocent party is more interested in remedies at common law (especially damages for loss of bargain resulting from termination) than in express contractual remedies (if any) that would be available to him as a result of contractual termination.

There may be a situation where the innocent party definitely wishes to terminate and believes that he certainly has an express right of termination but he might or might not have a right to terminate at common law. In such a situation, if the express contractual remedies are inconsistent with the remedies that would be available at common law for any repudiatory breach by the other party, the innocent party would have to make an election between the express right of termination and the potential right to terminate at common law. If termination is the innocent party's top priority but he is particularly interested in the potential remedies at common law, he might wish to serve a notice stating that he accepts the repudiatory breach as terminating the contract but, alternatively, in case he should be wrong in asserting the existence of repudiatory breach, exercises the express contractual right. (This form of notice was mentioned as possible at §34 of the decision in the *Shell Egypt* case.)