

### COMMERCIAL AGREEMENTS AND THE NEED FOR ADEQUATE TERMINATION RIGHTS

Michael Ball, Partner

Chris Peadon, Senior Associate

Allens Arthur Robinson, Sydney

#### IN BRIEF

A recent High Court decision highlights the need to consider prior to entering into a commercial agreement, the circumstances in which such an agreement may be terminated, and to ensure that appropriate termination rights are then included. The authors report that doing so may avoid protracted litigation.

This article identifies a number of matters you should consider when reviewing commercial agreements to determine whether you have appropriate termination rights.

#### INTRODUCTION

The 13 December 2007 decision of the High Court in *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* [2007] HCA 61 highlights the cost, inconvenience and uncertainty that may arise when an agreement does not expressly set out the circumstances in which each party may unilaterally terminate an agreement. This may have been avoided if the parties had considered the matters referred to below and included appropriate terms in the agreement.

#### FACTS OF THE CASE

The case concerned the purported termination of a joint venture agreement between the Land Council (the owner of the relevant land) and Sanpine (a property developer) for the development of the land. The joint venture agreement contained no provision expressly setting out the circumstances in which either party could unilaterally terminate the agreement.

For the development to proceed, the land needed to be rezoned. It became clear after considerable costs had been incurred by the joint venture that this would not occur in the near future, if at all.

An administrator was then appointed to the Land Council. The administrator sought information from Sanpine concerning the financial position of the joint venture, including details of the amount of the

borrowings secured against the land, which Sanpine was required to maintain. Sanpine was unable to provide that information.

The Land Council then purported to terminate the joint venture agreement on the basis of various alleged breaches by the developer. Sanpine commenced a proceeding seeking a declaration that the purported termination was invalid.

## THE DECISION

At first instance, Justice Campbell held that the termination was valid. On appeal, the New South Wales Court of Appeal held that it was not. The High Court unanimously reversed the Court of Appeal's decision and held that the termination was valid. It accepted the classification of contractual terms into three categories:

1. conditions: any breach of which entitled termination;
2. warranties: a breach of which did not give rise to a right of termination; and
3. intermediate terms: a breach of which may give rise to a right of termination depending on the seriousness of the breach.

The court held that a contractual term requiring the developer to render accounts had, among others, been repeatedly breached by Sanpine, that the term was an intermediate term, and that the breaches were sufficiently serious to give rise to a right to terminate the agreement.

## OBSERVATIONS

While the Land Council's termination was ultimately held to be valid, it took four years and three hearings in three separate courts for this to be finally determined. This no doubt involved considerable cost and inconvenience to the parties, and left the parties uncertain during that period as to their respective

rights, obligations and potential liabilities.

To reduce the risk of a purported termination being the subject of litigation, you should consider the following:

- Do you want to be able to terminate the agreement on notice without cause? This may protect you against unexpected changes in circumstances. Of course, it may be difficult to convince the other party to agree to such a term, especially if you do not want to grant the other party a reciprocal right.
- Do you want to be able to terminate if certain obligations are not satisfied within specified time periods? For example, should time be 'of the essence' in making certain payments, or should the agreement provide that a right to terminate arises if certain project milestones (eg procuring the land to be rezoned) are not achieved within a specified period. The latter example is likely to be relevant where you are required to make payments based on the passage of time, or meet certain liabilities as they accrue, irrespective of whether the objectives of the agreement are being met.
- Do you want the right to terminate if there are specified changes in circumstances? For example, the other party becomes insolvent, or the price of the product to be supplied sinks below a certain level making the project commercially unattractive.
- Are there breaches of obligations that you would allow the innocent party to be able to require the party in breach to remedy within a specified time prior to a right to terminate arising? This may be appropriate where the satisfaction of the obligation is not time critical, but it is important that it is done at some point.

- Are there breaches of obligations that you do not want to give rise to a right to terminate, but only give rise to a right to seek damages? This may be appropriate where the parties are comfortable that damages would be an adequate remedy.

Termination rights, like all other aspects of commercial agreements, are matters for negotiation. Whether a party would be able to negotiate all the termination rights they ideally require would depend on the circumstances. Nevertheless, as illustrated above, consideration before entering into an agreement of the circumstances in which you would like to be able to terminate, and when you would be willing to permit the other party to terminate, will minimise the risk of there being uncertainty about the validity of any purported termination. It should also reduce the likelihood of a party being put to the cost and inconvenience of litigating the issue.

---

Michael Ball and Chris Peadon's article was previously published in *Allens Arthur Robinson's Focus Commercial Litigation*—January 2008. Reprinted with permission.

---