

Getting Out of a Contract

By SM Shanmugam & Shona Anne Thomas

“Optimism doesn’t wait on facts. It deals with prospects.” — Norman Cousins



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In the world of commerce, optimism of business success drives individuals and companies to make deals and enter various contracts. Sometimes, however, it may be necessary to reassess the wisdom of continuing with a business partner. A good example is where a business partner continuously defaults on performing its services or in delivering goods as per specification or on making timely payments. Though some roadblocks and setbacks can be overcome by way of negotiations, supplementary agreements and second chances, certain scenarios may be too difficult to resolve.

Breach of contractual terms

At the outset, it may be tempting to immediately terminate the contract, but one should not jump the gun.



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To start with, determine whether your business partner is in breach of condition or warranty as it does make a difference. A *“breach of condition”* entitles the innocent party to repudiate the contract and put an end to the parties’ respective obligations, whereas a *“breach of warranty”* only entitles the innocent party to sue for damages.¹ The reasoning for this has been elaborated by the Court of Appeal² as follows:

“Where the term that has been flouted is fundamental to the contract, the innocent party is entitled to treat himself as being discharged from further obligations under it. But where the obligation that has been breached is only subsidiary or minor in nature, the innocent party may not treat himself as being free of his obligations under the contract, although he may sue and recover damages for the non-performance of the subsidiary term. The rules that operate in this area of the law of obligations produce a further consequence. A party who terminates a contract or treats it as having come to an end in reliance upon the breach of a non-fundamental term is himself guilty of a breach of a contract.

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¹ *Tan Chong & Sons Motor Company (Sdn) Berhad v Alan McKnight* [1983] 1 MLJ 220 (FC)
² *Ching Yik Development Sdn Bhd v Setapak Heights Development Sdn Bhd* [1996] 3 MLJ 675 (CA)



“If the breach is of such a nature that it goes to the root of the contract, then the term broken is fundamental in nature. On the other hand, if the consequences of the breach complained of are not serious in the sense that they do not go to the root of the contract, then the term in question is a subsidiary one entitling the innocent party to recover damages but not to treat the contract as being at an end.”

Termination governed by contract

Regardless of the circumstances (whether there is a breach or not), if termination seems to be the solution to the problem faced, do check whether the contract has a termination clause. The manner in which this clause is drafted dictates how to go about termination. In most instances, the clause either caters for the contract to be terminated by way of notice or upon occurrence of a specific event such as insolvency, failure to perform or breach of the contract terms.

Where the contract expressly provides for termination upon the occurrence of certain events, the contract cannot then be terminated in some other way not specified under the contract. In the case of *Tan Hin Leong*,³ the Singapore Court of Appeal held that since the parties had clearly expressed their intention regarding termination of the agreement in a particular manner, termination by notice was not applicable, and would be plainly against the express wording of the agreement. Further, when interpreting an agreement, the courts will generally be slow to depart from the consensus reached between parties and will choose to be bound by the four corners of the agreement.⁴ Of course, as with any general rule, there are exceptions where the courts are willing to imply terms into a contract and such exceptions turn on the facts of each case.

Typically, contracts that have termination clauses will specify how notice of termination is to be given to the other party. Thus, the contractual provisions must be thoroughly checked to ensure:

- type of notice;
- form of notice;
- notice period;

³ *Tan Hin Leong v Lee Teck Im* [2001] 2 SLR 27 (SGCA)

⁴ *Silver Concept Sdn Bhd v Brisdale Rasa Development Sdn Bhd (formerly known as Ekspidisi Ria Sdn Bhd)* [2005] 4 MLJ 101 (CA); *The Pacific Bank Bhd (sued as guarantor) v Kerajaan Negeri Sarawak* [2014] 6 MLJ 153 (FC)



- the correct address and person the notice should be issued to; and
- whether prior notice of default must be given for the breach to be remedied.

The decision to terminate should never be rushed as the consequences of an unlawful or premature termination are likely to be detrimental. This is because a wrongfully terminated business partner can sue for damages, as indicated in the following decisions:

- The Privy Council took the view that where it is clear that the plaintiff has suffered substantial loss but the evidence does not enable it to be precisely quantified, the court will assess the damages as best as it can on the available evidence.⁵
- The Federal Court took the view that breach of the agreement may give rise to damages for loss of profit pursuant to s 74 of the Contracts Act 1950.⁶

Author's remarks

Amidst the enthusiasm of striking a new deal with a potential business partner, much time is usually spent on the substantive terms of the contract while little to no attention is paid to boilerplate clauses such as the termination clause. In our view, the termination clause is your exit plan when the agreement with your business partner goes south. Hence, due consideration should be given to this contractual provision from the get-go.

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⁵ *Tai Hing Cotton Mill Ltd v Kamsing Knitting Factory* [1979] AC 91

⁶ *SPM Membrane Switch Sdn Bhd v Kerajaan Negeri Selangor* [2016] 1 MLJ 464 (FC)

