

## Litigation Alert

November 2022

# Different Grounds to Terminate a Contract Will Give Rise to Different Results

A recent case decided by the Court of First Instance (CFI), *Able Engineering Company Limited v. Welmetal Resources Group Limited* [2022] HKCFI 2963, is a good reminder that although there are different grounds to terminate a contract, the results will differ depending on the grounds chosen.

## Background

Able Engineering Company Limited (as the buyer) and Welmetal Resources Group Limited (as the seller) entered into a contract for the sale and purchase of steel bars for a two-year period commencing May 1, 2020.

Clause 12 of the contract has the following terms:

**Payment** for each physical delivery is to be effected **within 30 days from the date of delivery**. Without prejudice to the [seller's] other remedies, if **payments are not received** within the stipulated period, the [seller] shall have the rights to **suspend** further delivery of Commodities under this Contract **and/or terminate** this Contract. [The seller] shall not be held any responsible for the suspended delivery of commodities.

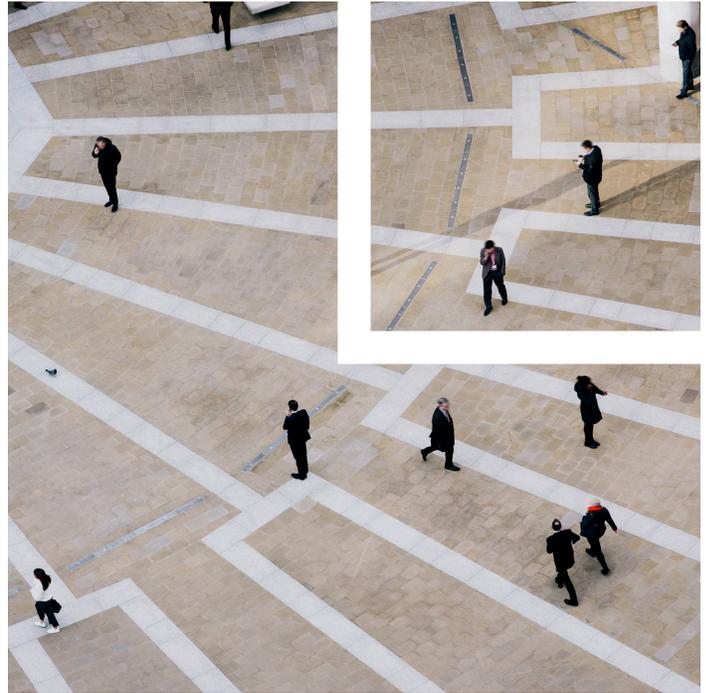
(Emphasis added.)

Between May 1, 2020, and May 27, 2021, the buyer placed 24 purchase orders with the seller.

In respect of 14 of the purchase orders, the buyer failed to make payment within 30 days from the date of delivery.

In May 2021, the seller sent various emails to the buyer demanding payment and threatening suspension and/or termination.

By May 27, 2021, the overdue payments exceeded \$2.9 million. The seller decided to exercise its right to terminate the contract, informing the buyer on the same day by



email and by letter of its decision, stating that the contract “shall, following the terms contained and agreed therein, be terminated with immediate effect.” The email was sent early that morning and the letter delivered by courier the same day.

In the afternoon of May 27, the seller received a request from the buyer to collect a check for the overdue payments, which the seller did later that afternoon and deposited it with the bank the following day.

## Buyer’s application

In early 2022, the buyer commenced court proceedings and made an application to the CFI to decide, among other issues, whether the seller was entitled to terminate the contract.

## Buyer’s arguments

The buyer admitted that it was in breach of its payment obligations under the contract. However, the buyer argued that the seller is entitled to terminate only if the term being breached amounted to a breach of a “condition” of the contract.

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Under Hong Kong law, there are different types of terms in a contract.

- The test is whether the relevant breach of the term deprives the aggrieved party of the entire benefit of the contract.
  - If yes, then the term is considered a condition, and would allow the aggrieved party to terminate the contract and/or claim damages.
  - If not, then the term is considered a warranty, and would allow the aggrieved party to claim damages, but not terminate the contract.
- If the term cannot be shown to be a condition or a warranty, the term is an innominate or intermediate term.
  - If an innominate or intermediate term has been breached, the aggrieved party may claim damages. However, the right to terminate would only arise if the breach were sufficiently severe.

On this basis, the buyer argued that clause 12 was an innominate or intermediate term and that the buyer's breaches were not severe for the following reasons:

- The contract was for the supply of 15,000 MTS over a two-year period.
- The commodities were to be supplied by partial deliveries within that period.
- The total value of the commodities was \$49 million.
- The buyer was obligated to make full payment of undrawn quantities on or before April 30, 2022.
- The buyer had less than 30 days from the date of delivery to make payment because of the time lag of several days between the date of delivery and the date of receipt of the invoice.
- On the occurrence of the specified event, the seller had an option to withhold delivery instead of terminating the contract. It could not have been the intention of the parties that the seller could resort to exercising the "nuclear option" of termination when it had the option of withholding deliveries.

### Court rejected the buyer's arguments

The court found that the contract clearly provided that payment is due within 30 days from the date of delivery.

The contract could have provided that payment be made within 30 days of the date of the invoice or the date of receipt of the invoice, but that was not what the parties had agreed.

The buyer's submissions disregarded the fact that clause 12 conferred an express right to terminate the contract on the occurrence of the specified event. The effect of exercising the express power to terminate puts an end to future performance obligations and also to claim the outstanding balances at the date of termination. It does not entitle the aggrieved party to claim damages for loss of bargain.

Had the obligation been a "condition," apart from its right of termination, the aggrieved party would be entitled to claim damages for loss of bargain. In the present case, the seller does not claim damages and the question of whether the obligation to make payment within the stipulated time amounts to a condition is irrelevant.

It is clear that a contract may provide for one party to terminate in circumstances that do not amount to a breach or failure to perform and that such provisions can also confer a right to terminate for some specified failure to perform.

### Takeaway

Different grounds to terminate a contract will give rise to different results.

First, an aggrieved party may terminate a contract pursuant to an express term in a contract, provided that the specified events occurred (in this case, the failure to make payment within 30 days from the date of delivery). The termination puts an end to future performance. However, termination pursuant to an express term by itself does not entitle the aggrieved party to claim damages.

Further, or in the alternative, an aggrieved party may terminate a contract if an innominate or intermediate term has been breached (provided that the breach is sufficiently severe) or if a condition has been breached (on the basis that the breach resulted in the aggrieved party being deprived of the entire benefit of the contract). The termination puts an end to future performance, and the aggrieved party is also entitled to claim damages. Breach of a warranty only give rise to a right for damages, but not termination.

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If the aggrieved party may terminate a contract on both of the above grounds, the aggrieved party should consider various factors in choosing which ground to use, including (1) whether it can be easily proven that the specified events occurred and thus gave rise to the right to terminate and (2) whether the right to claim damages should be preserved.

The party terminating the contract should bear in mind that if the grounds for termination are subsequently found to be invalid, the party will be liable for loss and damages as a result of wrongful termination. Accordingly, the right to terminate a contract should be exercised with great caution.

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