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Termination Rights in UK IT Contracts--Use Them or Lose Them

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by [Alan Owens](#), [Michael Swinson](#)

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Overview:

A recent decision of the UK Court of Appeal illustrates the dangers of failing to address contract breaches and other disputes in a timely manner.

In technology contracts, parties sometimes shy away from breach of contract situations because the underlying causes of default can often be complex—and the parties' focus is typically on achieving successful delivery or roll-out. But, by ignoring a breach by the other party and instead continuing to perform the contract in a "business-as-usual" fashion, a party may find that it is later prevented from enforcing its contractual rights. In particular, if the contracting party is found to have affirmed the contract, it may lose rights that it would otherwise have had to terminate the contract for breach.

Further when later seeking to rely on the "lost" right to terminate, the party not in breach may find itself in even more hot water because the notice of termination may be deemed to be an "anticipatory renunciation" of the agreement, giving rise to substantial claims against it.

Background:

The case in question is *Tele2 International Card Company v Post Office*.

Tele2 supplied phone cards to the UK Post Office. However, the Post Office was concerned about Tele2's financial viability and, therefore, required Tele2 to provide a letter guarantee from its parent company. The guarantee was to be renewed seven days before the start of each calendar year (*i.e.*, by 24 December of the previous year). The agreement between the parties provided that any failure by Tele2 to provide a parent guarantee letter would be a material breach and would trigger a right for the Post Office to terminate the agreement.

At the end of 2003, Tele2 did not provide a parent guarantee letter for 2004. Notwithstanding Tele2's failure to do so, the Post Office continued to perform the agreement as normal. However, on 1 December 2004, the Post Office decided that it had had enough and notified Tele2 that it was terminating the agreement for material breach. Tele2 challenged the purported termination, claiming that by continuing to perform the agreement for the previous eleven months, the Post Office had elected to affirm the agreement and, therefore, was no longer entitled to terminate for breach.

Decision and implications:

The Court of Appeal agreed with Tele2 and found that the Post Office had affirmed the agreement. As such, the termination notice issued by the Post Office was not valid and, in fact, amounted to a wrongful repudiation of the agreement by the Post Office. Tele2 was entitled to seek damages for the Post Office's repudiation—although, on the facts of the case, Tele2 had suffered no loss and so no damages were found to be payable.

The key point of interest from this case is the Court of Appeal's finding that the continued performance of an agreement by a party who is entitled to terminate the agreement may amount to an affirmation of the agreement. The Post Office clearly did have a right to terminate the agreement, because Tele2 failed to provide the required parent guarantee letter. However, by continuing to perform its obligations under the agreement for the next eleven months, the Post Office had effectively chosen to affirm the agreement and abandon its termination right. The Post Office was not entitled to go back on that choice.

Interestingly, the agreement did include a "no waiver" clause, which provided that a delay in exercising a contractual right was not to be taken as a waiver of that right. However, the Court of Appeal said that this did not help the Post Office, as this was not a case where the exercise of a termination right had been delayed. Rather, the Post Office had actively decided not to exercise that right by affirming the agreement. The "no waiver" provision did not entitle the Post Office to reverse this decision.

Use it or lose it

The clear message from this case is that a contracting party with a contractual termination right must "use it or lose it". If it continues to perform its obligations under the agreement as if nothing were wrong, then it may be taken to have affirmed the agreement. In this case, the termination right may be lost and any "no waiver" provisions in the agreement may not help to restore it.

Furthermore, if there is a disagreement over the meaning of certain contractual terms and one party agrees to proceed on the basis of the other party's interpretation, this may give rise to an estoppel situation (*i.e.*, the first party may be prevented from later challenging the other party's interpretation of the contract). This again illustrates the risk of a contractual dispute to "drift".

Importance of Contract Monitoring

In the context of a long-term strategic relationship such as an IT services contract or an outsourcing, it is critical to have an effective contract management function that will quickly be able to: (1) identify any breach that might give rise to termination or other rights; and (2) decide on a strategy for dealing with the breach that will not compromise those rights (this will usually involve formal notifications drafted in accordance with the contractual dispute resolution mechanism and an express reservation of rights pending firm decisions being made). This will usually involve careful but swift liaison between the legal and commercial functions. The longer that the parties continue with "business-as-usual" in spite of a breach, the greater the risk that any consequent termination right will be lost.