

Termination for convenience in ICT contracts: It isn't always that convenient

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When ICT projects fail (and it has been reported in the past that two thirds of projects in New Zealand are failing) the customer's first reaction is often to look at terminating for breach. However, in practice, claims of breach can be expensive and time consuming to prove; the 'smoking gun' is often elusive, and breach claims are frequently let down by issues such as undocumented arrangements or where the customer's post-execution conduct has effectively muddied the waters.

In light of this, the customer may try to cut its losses and to seek to rely on a termination for convenience provision (where they have been included in the relevant contract). This may be a sensible and practical way to bring to an end a relationship that isn't working and stem any further project losses. Subject to any provisions that survive termination (eg indemnities or data and confidentiality provisions), termination for convenience usually relieves the parties of their further contractual obligations upon expiry of the relevant notice period. Accrued rights or liabilities as at the date of termination would survive termination (unless the contract provides otherwise).

Yet, termination for convenience provisions are not a magic bullet; ICT contracts often include minimum terms, lengthy termination notice periods and early termination charges to recover any sunk costs. In addition, while termination for convenience and damages claims are not mutually exclusive, it is worth considering the risk that the customer may limit the damages it could potentially recover by terminating for convenience rather than terminating for breach.

Specifically, termination for convenience may have the effect of limiting the customer's losses flowing from pre-termination breaches, depending on the particular facts. For example, one potential loss if an ICT project contract is terminated may be procuring a new supplier. If the customer terminates for breach, it may be able to recover those losses as damages. In contrast, if the contract is terminated for convenience, the supplier could argue the procurement costs arose because of the terminating party's choice to terminate rather than as a direct result of any breach. The procurement costs, and potentially other losses, may therefore not be recoverable where a contract is terminated for convenience.

Ideally, the contract will be clear about the consequences of termination for convenience, including the potential costs that can be recovered by the parties. However, in practice, the customer's ability to secure favourable termination provisions is dependent on the customer's leverage and it can be difficult (and sometimes impossible) to get a supplier to agree to a list of costs/losses that may be recoverable by the customer on termination.

An alternative approach would be to make it easier for the customer to terminate for breach. For example, rather than rely on the uncertain terminology of 'material breach' it may be helpful to include examples of what will constitute grounds for termination (such as repeated service level breaches or missed key milestones).

If favourable termination provisions cannot be secured, then, before jumping to a decision to terminate for convenience, the customer should consider its appetite to later pursue any potential damages.

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