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Insights



Termination for Convenience clauses: Unintended and inconvenient consequences

14/08/2025

'Termination for Convenience' clauses in offshore energy contracts are not unusual, but their potential effects are often underestimated.

Such clauses typically provide that, in the event the Employer or Company invokes the clause, the Contractor is entitled to some remuneration for its performance of the contract up to the point of termination. Whether that remuneration covers only costs incurred to date, or also includes an element of profit, will usually have been a matter of commercial negotiation.

The Contractor's inability to claim its full expected profits on the contract as a whole is a significant concession. Nevertheless, this is a compromise Contractors commonly accept so that the Employer retains flexibility to terminate early under the mechanism.

However, Contractors should also be aware of another significant implication of a Termination for Convenience clause - namely, the ability for the Employer or Company to use it to effectively cap liability for their own breach.

In the case of *Comau UK Ltd v Lotus Lightweight Structures* [1], the Termination for Convenience clause was held to limit the damages the Contractor could recover for a material breach by the Employer. This outcome seemed particularly harsh because the clause provided that the Employer could only terminate for its own convenience if it was up to date with payments to the Contractor. On the facts, it was not; invoices were admitted as overdue.

The Court decided the case by applying the 'minimum performance' principle. This principle states that, when quantifying damages for breach of contract (with the aim of putting the innocent party in the position it would have been in had the contract been properly performed), the court will consider whether the defaulting party was entitled to perform the contract in a range of ways, and will assume that the defaulting party would choose the least onerous option. In other words, the Contractor could only expect, as damages, the amount it would have earned if the Employer had exercised its right to terminate for convenience - the least costly route for the Employer to discharge the contract.

On the facts of the *Comau* case, the innocent party did not seek to terminate for repudiatory breach before the Employer could invoke its immediate right to terminate. You might wonder whether this would make any difference to the analysis, and whether the minimum performance rule applies to an assessment of 'loss of bargain' damages. On one view, the defaulting party has no rights to perform the contract in a range of ways because the contract has already ended. On the other hand, the 'bargain' the innocent party has lost was always for a contract that its counterparty could end at its convenience.

The answer is "no." In *The Mihalis Angelos* [2], the charterers purported to cancel a charterparty on the grounds of force majeure. The owners accepted this as a repudiation and sought damages. On appeal, the majority found that the charterers were entitled to cancel,

but went on to say that even if they had been in repudiatory breach, damages would have been nominal because the charterers could - and would - have cancelled for convenience anyway, once that right arose a few days later.

In light of the foregoing, Contractors' claims against a Company may well be limited by reference to the early termination fee. There is also an additional risk Contractors should be mindful of: if it is convenient for an Employer or Company to terminate, a shrewd one may purport to do so on grounds that avoid any contractual termination fee, while still avoiding exposure beyond that fee if its grounds are later found to be unsound. In such circumstances, the Contractor could be left without the contract and forced to claim only its termination fee - or rather, damages equivalent to that same amount.

[1] Comau UK Ltd v Lotus Lightweight Structures Ltd [2014] EWHC 2122 (Comm)

[2] Maredelanto Compania Naviera SA v Bergbau-Handel GmbH ("The Mihalis Angelos") [1970] 2 Lloyd's Rep 43

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Author

Tom Adams

Partner

+44 (0)7825 123035

tom.adams@adamsmoorelaw.com