A Thorogood Special Briefing

Chapter 1
Introduction

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Introduction

The law on remedies for breach of contract is technical and complex, built mainly from legal precedent. This Report aims to provide advice, guidance and remedies for those who deal directly with contracts and contractual problems (in businesses and other organisations) as well as for those whose work is affected by the contents of a contract. It is relevant for drafting and negotiating contract terms as well as for problems arising from performance of the contract.

Contract breach and remedies

A breach of contract occurs when one of the parties to a contract fails to carry out its obligations as set out in the contract (in other words, it has broken the terms of what the parties agreed). The contract itself may contain terms entitling the defaulting party to put matters right by rectifying the breach, and it may choose to do this. If not, there are various legal 'remedies' available to the party injured by the breach, who may take legal action accordingly to obtain redress.

'Remedies are the law's response to a wrong (or, more precisely, to a cause of action).' [1]

Most frequently this will be to obtain financial compensation, but there are other remedies applicable in certain circumstances.

The remedies available, the kinds of damages that may be claimed, and the principles establishing how much compensation the innocent party is entitled to claim, have largely developed (and continue to develop) through precedents set by the courts from previous rulings. The current trend in the courts is to develop judgments according to the actual facts of the particular case rather than to develop and apply broad principles.

The principles are described in this Report, illustrated throughout by relevant cases, and sometimes with apposite quotations from the actual judgments.

1 Mr Justice Roth in Luxe Holding Ltd v Midland Resources Holding Ltd [2010] EWHC 1908 (Ch)

Contract or tort

The focus of this Report is on remedies available for breach of contract. Contractual obligations are entered into voluntarily by the parties. The law of tort, another category of law, imposes obligations on the parties without any option as to compliance. Tort covers a wide range of law, which is different from contract law, and in turn both of these categories are different from criminal law.

In tort, injury, loss or damage may be caused by breach of a legal duty or in contravention of a right conferred by law, other than through breach of contract, giving rise to a right to recover damages. There must be a legal right that has been infringed as well as damage suffered.

Remedies may be available in tort concurrently with contract. In some commercial claims the same set of facts may be argued on the basis either of tort or of contract. There may be tactical reasons for bringing a claim under one heading rather than another, where there are differences in the application of the law.

Lord Goff of Chieveley said: *'…given that tort duty is imposed by the general law, and the contractual duty is attributable to the will of the parties, I do not find it objectionable that the claimant may be entitled to take advantage of the remedy which is most advantageous to him'*.[2] In this case, the time limit within which the action had to be brought was longer for tort than for contract, and the parties therefore wished to sue for negligence, rather than in contract.

In the context of commercial contracts, the kinds of torts that may arise and cause loss or damage are:

- Negligence as legally defined
- Torts affecting goods – damage, destruction or misappropriation
- Torts affecting land – damage or deprivation of use
- Torts causing personal injury or death
- Economic torts – such as negligent misstatements that cause economic loss, or infringement of intellectual property rights, such as patents or trade marks
- Breach of a statutory duty imposed by legislation
- Misrepresentation

In some situations the duty in tort may be wider than in contract, and therefore a claim would be easier to prove in tort. For example, in a case on the tort

2 Henderson v Merrett Syndicates [1994] 3 All ER 506

of a negligent misstatement, it was stated that a duty of care would arise irrespective of any contractual relationship in certain circumstances.[3]

But generally under English law, breach of contract is easier to prove than negligence. In certain cases damages may be sought either under contract or in tort. For example, if goods are delivered and are of unsatisfactory quality and do not meet the agreed specification, there will be a claim in contract. There could also be a claim for negligence under the law of tort. The tendency recently in commercial litigation, where claims may be brought on either basis, is that the courts will focus on the similarities rather than the differences.

This Report

The cases discussed in this Report are principally commercial, and therefore between companies or other commercial organisations.

The claimant and defendant will normally be referred to neutrally, that is as 'it' rather than 'he' or 'she', unless there is an individual person concerned.

'Claimant 'has replaced 'plaintiff' in recent terminology. 'Claimant' will be the term normally used in this Report.

In the Chapters that follow:

- Chapter 2 discusses contractual and procedural alternatives to litigation.
- Chapter 3 considers how contracts may be terminated following certain kinds of breaches, and the basic principles involved in awards of damages for breach of contract.
- Chapter 4 looks at the factors concerned in assessing damages.
- Chapter 5 describes specific kinds of damages awards.
- Chapter 6 investigates other remedies for breach of contract.

3 By Lord Morris of Borth-y-gest in Hedley Byrne & Co v Heller & Partners Ltd [1964]AC 465 (HL)

Chapter 2
Alternatives to litigation for breach of contract

- Contractual alternatives to litigation
- Procedural alternatives to litigation

Chapter 2
Alternatives to litigation for breach of contract

In most cases a contract will be carried out or ended without any breach by either party. The most satisfactory conclusion to a contract is that each party carries out its obligations and receives its rights. For example, a supplier provides a single delivery of goods and its customer pays for them, as specified. The contract has been performed. It may continue for so long as the obligations and rights of the parties stay in force.

However, a contract may be brought to an end or, technically, 'discharged', in a number of ways: performance, expiry, further agreement, 'frustration', or by its contractual terms, as well as on account of certain types of breaches.

There may be a date set out in the contract itself fixing its duration, after which it will have expired and no longer be in effect, such as a contract for services to be provided over a period of time.

The parties may agree to end the contract. This agreement must be supported by 'consideration', one of the essential elements of a legal contract, that is to say that there is some bargain or reciprocity between the parties – a price paid by one party for a promise by the other. Where both parties still have rights and obligations to carry out, relinquishing those rights will constitute the consideration. But where one party has carried out its side of the bargain, and is releasing the other party from part or all of its obligations, it must be getting something out of the agreement, rather than making a gratuitous promise, for there to be consideration. Otherwise the release must be in the form of a deed.

A contract is said to be 'frustrated' if a supervening event makes performance of the contract impossible or radically different from what the parties originally anticipated. The event must be quite beyond what the parties intended in entering into the agreement, making it impossible to carry out. A contract will not be frustrated just because it has become more difficult to perform or because of hardship or inconvenience to either party.

The contract itself is likely to contain explicit provisions under which it may be brought to an end, under specified conditions at the option of one of the parties,

for instance if the other party becomes insolvent. The contract may also specifically permit a party to terminate the contract in the event of its breach by the other party, perhaps for particular kinds of breaches, which may be described as 'material' or 'major' or 'continuing' or 'multiple', to avoid termination for trivial defaults. This will be a contractual right of termination.

'Termination' means that the injured party is no longer required to perform its obligations under the contract. It is not that the contract is treated as if it had never existed. The latter is technically 'rescission' – the contract is rescinded.

Not all breaches allow the innocent party to terminate the contract. Breach of contract by one party that causes loss to the other party will entitle that other party to bring an action for damages – financial compensation for loss suffered – and possibly other remedies depending on the nature of the breach. If the breach consists of a condition – a term in a contract that is so fundamentally important that the whole transaction would be drastically affected if it is not carried out – then the contract may be treated as terminated by the injured party.

Contractual alternatives to litigation

If one party is in breach and there is no agreement on resolving the problem, the party not at fault may choose to litigate to obtain redress for the loss or damage suffered. However, provisions may be included in the contract to allow for management of any conflicts that arise during the contract relationship, in an attempt to avoid formal means of dispute resolution.

Indemnities

An indemnity is a promise by one party to pay for loss or damage or to keep the other party free from loss or damage in defined circumstances. The essence of an indemnity is taking on the liability to make good the loss. It is the foundation of the institution of insurance.

The party giving the indemnity takes responsibility for making good any loss caused by a particular obligation. A contractual indemnity may therefore provide for compensation in specific circumstances, sometimes but not always subject to upper financial limits. This often occurs where there is a risk that a third party will suffer loss. Thus if a provider is processing personal data on behalf of its customer, it may indemnify the customer in their agreement in respect of any

loss or damage caused to the data subjects whose personal data is being processed, for whom the customer has legal obligations. It is a contractual means of allocating the risk to the party giving the indemnity.

Compensation for performance failures

An advance estimate may be made of compensation for a foreseeable failure, to be paid by the party at fault. For example, for any delay in meeting a completion date for implementing a system, the supplier may agree that the contract should state that specific sums should be paid for each week of delay until actual completion, with an upper limit of amount or number of weeks. The sums are known as 'liquidated damages' and they are payable to the customer on account of the inconvenience and disruption caused. For this contractual purpose, they should also be limited in extent, by number of weeks allowable as delay, and/or a ceiling amount. The customer will not want to terminate the contract if completion will be delayed but achievable. But the customer must reserve the right to take more drastic action if the point is reached when the completion date moves ever further away, and the compensation is no longer adequate. Another example where compensation may be specified in advance is for service provision, where service level agreements may be negotiated for agreed levels of services and compensation in the event of failure to meet those key service levels. Liquidated damages are discussed further in Chapter 4.

Retention of title

In standard supply and purchasing agreements, provision is often made for title to the goods to pass on delivery, but English law on 'retention of title' effectively allows a supplier to hold on to title until payment for the products in question has been received in full, provided that the clause is clear and unequivocal. This concept is a reasonable form of security in return for extending credit payment terms. The risk is that the customer becomes insolvent before paying for the goods. And if title has passed, the supplier will have lost both the products and the payment for them.

The purpose of the retention of title clause in a contract is to enable goods to be repossessed if they are not paid for. The supplier wants to establish a position whereby it is not merely an ordinary unsecured creditor in respect of unperformed contractual obligations, and that its goods are not available for disposal by a receiver or liquidator.

Where a customer is a reseller or other distributor who has sold goods on for which the supplier has not been paid, the law gives innocent third party purchasers good title. Some suppliers then attempt to establish prior rights to the proceeds of such sales. This is legally possible, but it involves cumbersome administrative procedures, possibly including registration of interests at Companies House, and will not be practicable for many suppliers for their normal contractual situations.

Some retention clauses are extremely convoluted, and attempted enforcement of them has established a body of law based on the outcome of litigated cases. There are many areas of ambiguity, but suppliers who attempt to cover every possible contingency run the risk that the carefully constructed wording will fail for lack of clarity. It will often be commercially unrealistic to require resellers to keep products in their original packaging, and not to sell goods on until they have been paid for, or to require them to notify their end-user customers formally that, initially at least, prior title is vested in their own supplier.

A contractually agreed right is often included for the supplier to enter premises where products are kept in order to repossess them, but it is of limited value, because an entry cannot be forced without court authority.

Whatever the clause says, a receiver or a liquidator may well challenge it in the interests of seeking to retain possession of goods.

Repossession of goods is almost always a second-best result for a supplier. The supplier must be able to identify the products and relate them to specific invoices. There will not often be the opportunity to sell goods at the same price to another party unless they remain unopened. It is a means of mitigating losses, particularly as it is rare for a supplier to end up with full payment in a receivership.

In practice, the supplier must immediately notify the administrative receiver or liquidator of the defaulting customer. An administrator, however, has greater statutory protection from creditors. And if the products are recovered, VAT cannot be claimed on the bad debt. Sometimes a receiver or liquidator will be able to realise a better value for goods that incorporate the supplier's products and may elect to honour an outstanding contract, or at least to bargain a compromised price with the supplier. A receiver or liquidator will often seek a specialist supplier's help in disposing of highly technical products on a shared revenue basis.

Individual decisions on the approach to be taken should depend on the typical trading circumstances and the value of the average products being sold.

Good credit control is a much more practical and effective mechanism to minimise the risk of an insolvent customer. Sophisticated search and investigation facilities are readily available from credit control agencies, and these can be effective tools in helping suppliers to assess credit risks.

Force Majeure

The purpose of a force majeure clause is to allow suspension of the contract or even termination without liability for breach of contract where an unforeseeable event outside a party's control prevents performance of its obligations. It may simply cover events 'outside the reasonable control' of the parties, but it may specifically define certain agreed situations where there might otherwise be doubt: natural disasters or other Acts of God, fire, hurricanes, war, riots, impossibility of obtaining raw materials, delays by third parties such as sub-contractors, government intervention, industrial disputes – and so on.

Escalation

A contractual provision may require a dispute to be escalated up through the hierarchy of each party to the contract before formal legal action is initiated. Senior managers, perhaps at Board level, may well be remote from the day-to-day involvement of the staff dealing full-time with the services or products. They will not be so close to the details, and therefore are less likely to have reached an entrenched position or to have to defend themselves against any personal blame. They may also have the authority to be able to solve the dispute swiftly by making a practical decision, possibly with concessions on either side, in the interests of their organisation.

Time limits

A 'last chance' may be given. For example, there may be a provision for the contract to be terminated if the customer 'fails to pay the amounts due for a period of 30 days after written notice'. The supplier must formally advise the customer that the latter owes money under the contract, but that the final sanction will not take effect provided that payment is made immediately in response to the formal advice. By notification in writing, there is an opportunity to correct anything that has inadvertently gone wrong, perhaps administratively in the accounts department.

Expert determination

For determination of certain kinds of disputes of a technical nature, the contract wording may include the appointment of an agreed external independent technical expert (to act as expert, not as adjudicator). This must also be subject to agreement on the acceptance of the professional independence and expertise of the expert selected, and also agreement on what constitutes a dispute confined to technical issues. For example, this might be over what should be included in a particular technical definition, or whether a new release of software comprises a new version, upgrade or update, if these are differentially treated in the contract.

Procedural alternatives to litigation

If none of the alternatives discussed above is applicable or has been successfully effected, and if the party in breach has not rectified the breach, the innocent party may litigate by initiating formal legal proceedings. However, it may be agreed in the contract to go to arbitration instead of litigation, or to attempt an Alternative Dispute Resolution (ADR) procedure first, in order to resolve a contractual dispute.

Arbitration

An arbitration provision enables the parties to use arbitration procedures rather than court proceedings for resolving a dispute. Although the jurisdiction of the court cannot be excluded in a contract, the law permits arbitration to be specified as the method of adjudication. Arbitration is similar to litigation in being adversarial, but it is more flexible in that there is no obligation to conform to legal rules of evidence and procedure, and in the choices of timing and adjudicator.

The disputing parties choose a neutral person – or more than one – to resolve the dispute by the remedy of a binding and enforceable decision or award. For international trade, arbitration is often a preferred route for settling disputes.

Arbitration in the UK is governed by the Arbitration Act 1996. There can be greater flexibility in the legal rules of evidence and procedure, but the conduct of arbitration depends entirely on the nature of the agreement to arbitrate. The parties have much autonomy in deciding how the dispute should be resolved, subject to certain public interest safeguards. Statutory rules apply, unless there are other provisions in the agreement.

An arbitration hearing may be less formal than a court hearing. The arbitrator is required to act fairly and impartially. Evidence is often given in the form of documents, and it is sometimes possible to make an award based entirely on written submissions. A decision made by the arbitrator will normally be binding on the parties. There is an appeal to the courts from an arbitration award only in very limited circumstances. An arbitration award is therefore more final than a High Court decision. It is enforceable by the courts in exactly the same way as a court judgment.

Suppliers usually exclude payment of money due from the arbitration process, as there exist well-defined court procedures for debt collection. A claim for an agreed sum is discussed in Chapter 6.

Alternative Dispute Resolution (ADR)

Through the option of ADR, a framework is created for the parties themselves to negotiate a solution that they both find mutually satisfactory, with the assistance of a neutral third party, sometimes also with experts. The process is relatively informal, cheap, flexible and voluntary (although if it is unsuccessful, the costs will, of course, have been increased). There is no continuing obligation and it can be stopped at any time. The neutral third party's role is based on consent, and the process stays under the control of the parties. The costs are usually divided between the parties.

ADR changes the emphasis of the dispute from an outcome of 100 per cent success or failure to a co-operative process controlled by the parties themselves to achieve a workable settlement. Its success depends on the willingness of the parties being ready to resolve their dispute in a mutually satisfactory way. The mediator cannot impose a solution. The parties do not have to agree until both are satisfied.

Decisions are not binding, and should there not be an outcome on which both parties are happy to rely, any confidentiality agreed about the procedure will not have any effect if the matter subsequently proceeds to a court hearing.

The courts are required to encourage the use of ADR in appropriate cases as part of the litigation process, and to facilitate it through case management.

Skilled mediators may achieve remedies that are outside the scope of the courts to award, in reaching a practical resolution of a problem. For example, in a dispute between neighbours about a water supply pipe, the judges in the Court of Appeal were unanimous in finding it unsatisfactory that it had not been mediated.[4] A

4 Martin v Childs [2002] EWCA Civ 283

joint expert had reported that the best solution was for each property to be fed by its own pipes. The recommendation had not been followed.