

# The Yin & Yang of English contracts

& Bird & Bird

Howard Rubin & Chris Holder

Partners

London

# Contents

- Why Yin & Yang?
- Conditions & Warranties
- Repudiatory & Material Breach
- Direct, indirect & Consequential Loss
- Liquidated damages & Penalties
- Waiver & Estoppel

# Why Yin & Yang?

"Yin & Yang", is used to describe how seemingly opposite or contrary forces are interconnected and interdependent in the natural world; and, how they give rise to each other as they interrelate to one another.

# Warranties

A warranty is an express term in a contract and

“one of the most ill-used expressions in the legal dictionary”

Mr. Justice Ramsey in

*BSkyB and anor. –v- HP Enterprise Services UK Limited and ors. [2010] EWHC 86 (TCC)*

# Warranties

- A ‘warranty’ as drafted into a contract is a term of that contract, the breach of which gives rise to a claim in damages but does not allow the innocent party to terminate the agreement for breach.
- “‘Warranty’ means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.”

S.6(1) Sale of Goods Act 1979

# Conditions

- 'go so directly to the substance of the contract or, in other words, are so essential to its very nature that their non-performance may fairly be considered by the other party as a substantial failure to perform the contract at all.'

**'Intermediate' or  
'innominate' terms**

# The starting point: a 'breach' jargon-buster.....

Concept		Analysis
1.	<b>Right to terminate for 'repudiatory breach'</b>	<ul style="list-style-type: none"><li>• This is a <b>common law right</b></li><li>• It arises where the breach goes "to the root" of the contract, or "deprives the innocent party of the whole benefit" – "repudiatory breach" is <b>not</b> the same as "material breach"</li><li>• One case has held that 'substantial' breach means the same as 'repudiatory' breach</li></ul>
2.	<b>Right to terminate for 'any' breach</b>	<ul style="list-style-type: none"><li>• The expression cannot always be taken literally</li><li>• It must be interpreted in a way that is "commercially sensible" – see the cases below</li></ul>
3.	<b>Right to terminate for 'material breach'</b>	<ul style="list-style-type: none"><li>• This is a right which is provided for <b>under a contract</b></li><li>• It is a breach which has, or is likely to have, a "serious effect" on the benefit enjoyed under the contract by the innocent party</li></ul>

# Professional instinct and the courts

Most businessmen and advisers would instinctively say that 'material breach' means a breach 'going to the root' i.e. a breach that is repudiatory...but that is *not* the legal position...

It is common ground [among the QCs involved in this case] that 'material breach' does not mean a repudiatory breach. If 'material' was synonymous with 'repudiatory', the clause would add nothing to Dalkia's remedies at common law

- *Clarke J, Dalkia v Celtech, 2006 (para 92)*

# Repudiatory breach.....



# What is 'repudiatory breach' in common law?

A breach which deprives the innocent party of substantially the whole benefit  
(*Hong Kong Fir v Kawasaki, 1962*)

A breach which "affects the very substance of the contract"  
(*Wallis v Pratt, 1910*)

A breach which goes "to the root of the contract"  
(*Davidson v Gwynne, 1810*)

A breach which "frustrates the commercial purposes of the venture"  
(*Tarrabochia v Hickie, 1856*)

# Termination for 'material breach'.....



# Colman J's formulation of 'material breach'

A material breach is one which is wholly or partly remediable and is or, if not remedied, is likely to become, serious in the wide sense of having a serious effect on the benefit which the innocent party would otherwise derive....

- *Colman J, National Power v UGC, 1998*

- Bird & Bird comment: this form of words consciously defines 'material breach' as being less severe than 'repudiatory breach'
- This is a very frequently quoted soundbite

# Termination for 'material breach' clauses

- The parties' contract will very often provide for a right to terminate for 'material breach'... and usually provide a 'cure period' at a fixed amount of time (eg of 30 days) for the defaulting party to remedy those breaches which are "capable of being remedied"

## Advantages of this clause include

It is serious-sounding, yet unspecific

It gives the parties the ability to get out of the contract with justification later down the line if the other party breaches

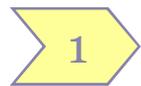
## Drawbacks

If expressed in purely general terms, it is a fudge

The law on the meaning of the phrase is not straightforward

# How practice has evolved

- Several techniques have evolved which adapt a plain 'material breach' clause. These include:



**1** Defining the expression 'material breach'



**2** **Cross-referring to other clauses** breach of which is to be considered "material" (eg lengthy delay in payment by customer)



**3** Including a 'material breach' schedule, which is typically **a non-exhaustive list of events** which constitute 'material breach'

Note: business acquisition agreements often contain material adverse change mechanisms; loan agreements always contain a list of Events of Default

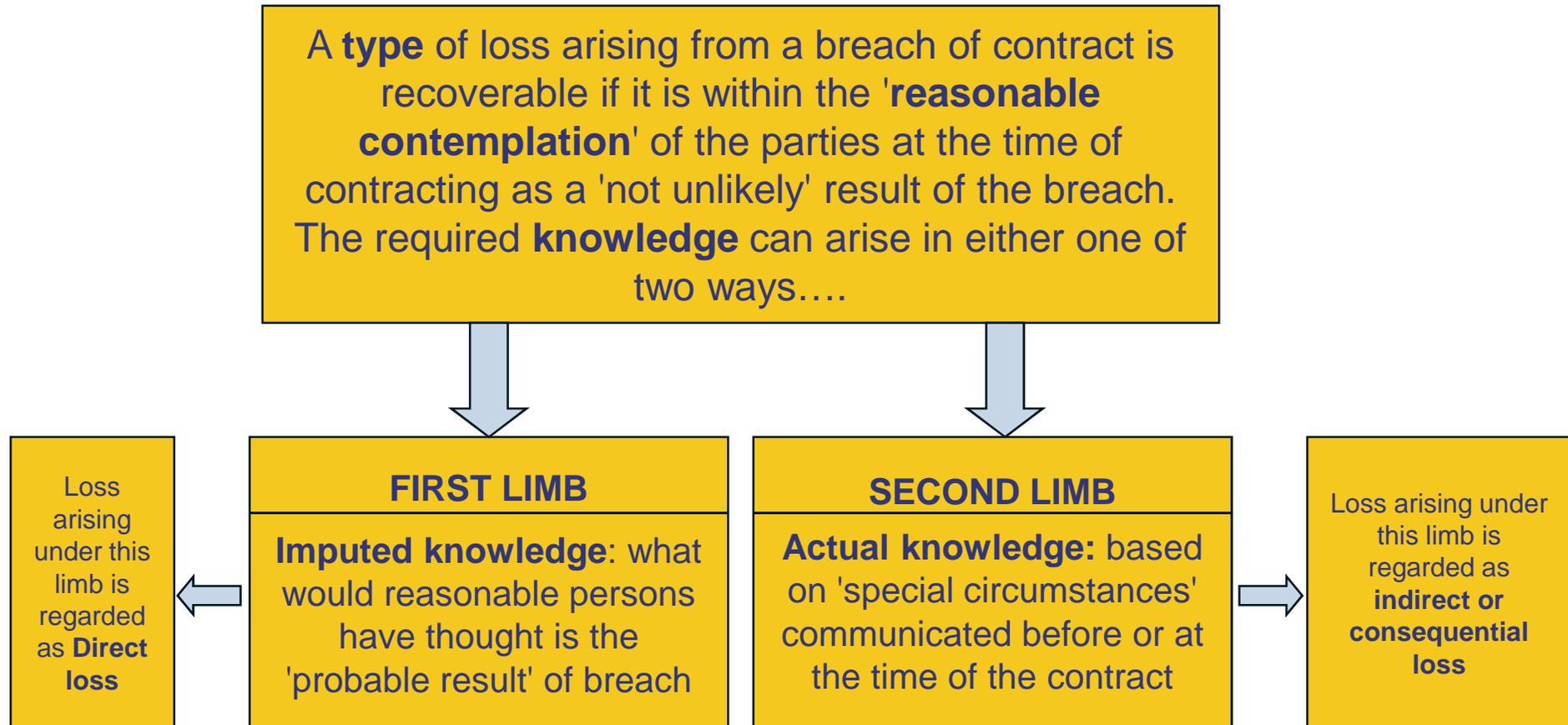
# Interpreting 'material breach' clauses

1. Right to terminate for '**material breach of any obligation**' - this means that as long as the factual breach is material, it can be exercised in relation to a trivial clause
2. Right to terminate for '**breach of any material obligation**'. On its natural and ordinary meaning this means that as long as the *obligation* is material the factual breach can be *trivial* – therefore a one day payment delay could result in 'hair-trigger' termination
3. Right to terminate for '**material breach**' – on its natural and ordinary meaning *both* the *obligation* and the *breach* must be material, but the inherent danger is, what is 'material' to one party may not be material to the other.

# Conclusions and key messages

- ✓ It is vital that an innocent party understands its rights in face of breach by the other ... but the common law is complex
- ✓ The expressions 'any breach', 'substantial breach' and 'material breach' have only rarely been explored in Court
- ✓ We have tried to extract general themes – using the fact-specific cases as illustrations
- ✓ As we have seen, the expression 'material breach' is not the same as 'repudiatory breach'.
- ✓ In a possible termination scenario, always remember: what are the ultimate goals of the business?

# A summary of loss under the rule of *Hadley v Baxendale*....



# How to define direct & indirect loss within *Hadley v Baxendale*

The line between direct and indirect or consequential losses is drawn along the boundary between the first and second limbs of *Hadley v Baxendale*....

- **Rix J** in *BHP v British Steel* (1999)

It is common ground [*among the QCs in this case*] that the words "directly" and "indirectly" refer respectively to the first and second limb of the rule in *Hadley v Baxendale*....

- **Field J** in *GB Gas Holdings v Accenture* (2009)

# What constitutes 'direct' loss?

- There's no mystique about it – many types of loss suffered by the customer can on the facts be regarded as 'direct' eg:
  - Loss of profits (British Sugar v NEI)
  - Anticipated savings by customer (PwC v Keele)
  - Payments made by customer to third parties (Ferryways v ABP)
  - Knock-on financial losses (GB Gas v Accenture)
- Losses arising from a breach can be 'direct' loss under the first limb of Hadley v Baxendale, even if those losses are caused by a chain reaction of events
- Sometimes, 'loss of profit' can be partly 'direct' and partly 'indirect' (eg in Victoria Laundry v Newman, or Pegler v Wang)

# Milestone 'direct loss' cases

Case	What was 'direct loss'?
<i>Millar v David Way</i> (1934)	Additional labour cost
<i>Croudace v Cawoods</i> (1978)	Workers left idle
<i>British Sugar v NEI</i> (1997)	Loss of profits
<i>Deepak Fertiliser v Davy McKee</i> (1998)	Fixed factory costs incurred during plant interruption; increased operating costs after operations resumed
<i>Hotel Services v Hilton</i> (2000)	Loss of profits
<i>Pegler v Wang</i> (2000)	Loss of anticipated profit
<i>University of Keele v PwC</i> (2004)	Loss of anticipated savings
<i>Ferryways v ABP</i> (2008)	Payments to third parties
<i>GB Gas Holdings Ltd v Accenture (UK) Limited</i> (2010)	Various knock-on financial losses
<i>McCain v EcoTec</i> (2011)	Lost revenue

# What is 'consequential' loss.....?

The word "consequential" is not very illuminating, as all damage is in a sense "consequential" ....

- **Atkinson J** in *Saint Lines v Richardson* (1940)

- Consequential losses are only those which are not within the first 'limb' of *Hadley v Baxendale*
- Many contracting parties have discovered this the hard way
- Business parties are assumed to know the **legal** meaning of "consequential loss": this idea is an application of *Spencer v Secretary of State* (2012)
- **Note: English law now treats the phrases 'indirect' and 'consequential' as the same in this context**

# Some drafting lessons for a supplier

- A supplier **should not rely** on the generic words 'indirect and consequential loss' as a primary category of excluded loss
- Rather, it should exclude its liability for customer 'loss of profit' or other business losses **upfront and explicitly**
- The supplier will often list extensively the customer business losses which it wishes to exclude
- It is not a solution for a supplier to say that it excludes '*...consequential loss including loss of profit...*'. That will not exclude the customer's right to recover 'direct' loss of profit
- The phrase 'consequential loss' can be used in the supplier's clause, but as a *residual category* of loss, and *relegated* in the drafting – also, supplier should be wary of excluding specific types of loss and then add "**other**" before "consequential loss"

# Loss from a customer's perspective....

- Customers may wish to benefit from gaps in supplier drafting
- They will not highlight the issue if they feel they could claim damages for losses of business benefit, despite the supplier clause
- In addition, for many customers it is commercially unacceptable that their direct losses of business benefit are treated as excluded liabilities
- Many customers nowadays are in the driving seat, and table 'recoverable loss' clauses
- Alternatively, customers often 'chip away' at supplier drafting, and wish to treat direct loss of their profit and other direct economic losses as 'recoverable losses' (perhaps subject to a supplier cap)

# Applying loss in a commercial context...

In which business sectors could this be most relevant?

Financial services – trading platforms

Travel and leisure – hotel/airline bookings

Media – advertising revenues

Utilities – British Gas

# Liquidated damages & Penalties

- Basis of damages award in English law
- Liquidated Damages are a genuine pre-estimate of the damage which will be suffered by a party for a breach a Penalty is a sum payable regardless of the breach.
- Liquidated Damages are enforceable Penalties are void.
- Courts are reluctant to find a penalty

# The genuine pre-estimate test

*Murray v Leisureplay Plc [2005] EWCA Civ 963*

- (i) To what breaches of contract does the contractual damages provision apply?
- (ii) What amount is payable on breach under that clause in the parties' agreement?
- (iii) What amount would be payable if a claim for damages for breach of contract was brought under common law?
- (iv) What were the parties' reasons for agreeing to the relevant clause?
- (v) Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed *in terrorem*,

# The penalty test

*Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC79*

- (a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.
- (b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.
- (c) There is a presumption (but no more) that it is penalty when “a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage”.

## On the other hand:

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility.

# The penalty shoot out

What about  
Delay Payments?

Are Service  
Credits a  
penalty?



# Waiver & Estoppel

- Estoppel an equitable remedy which prevents a party from alleging or denying a given fact.
- Examples; promissory estoppel, proprietary estoppel
- Waiver a failure to enforce a contractual right
- Examples; waiver by election, waiver by estoppel.
- No waiver clause
- Waiving the no waiver clause - *Tele2 International Card Co SA v Post Office Ltd 1990*

Thank you! **& Bird & Bird**

Chris Holder, Partner,  
[chris.holder@twobirds.com](mailto:chris.holder@twobirds.com)  
+44 (0)20 7982 6457

Howard Rubin, Partner,  
[howard.rubin@twobirds.com](mailto:howard.rubin@twobirds.com)  
+44 (0)20 7415 6187

Bird & Bird LLP ist eine Partnerschaft mit beschränkter Haftung nach englischem Recht, eingetragen im Companies House of England and Wales unter der Nummer OC340318. Der Name Bird & Bird bezeichnet eine internationale Anwaltssozietät, bestehend aus Bird & Bird LLP und ihren verbundenen Sozietäten. Bird & Bird praktiziert in den nachfolgend angegebenen Standorten. Die Gesellschafter der LLP werden von Bird & Bird als Partner bezeichnet. Counsel, Senior European Consultants und Of-Counsel sind nicht Partner oder Gesellschafter der LLP. Weitere Informationen finden Sie auf unserer Homepage [www.twobirds.com](http://www.twobirds.com)