STEPHENSON HARWOOD

September 2021

Termination for "material breach" – what exactly is "material"?

Contracts for the international sale of goods often contain provisions entitling one of the parties to terminate the contract for "material breach". If the parties have expressly defined what they mean by material breach, then this should not give rise to much uncertainty if the crunch comes, and one party wishes to terminate. This article considers what happens if "material breach" is left undefined, as it is a question which we have been asked by traders quite often in recent times.

As those familiar with English contract law will know, a breach which goes to the root of the contract, or deprives a party of substantially the whole benefit of the contract, will entitle the innocent party to terminate for what is known as repudiation. A contractual right to terminate for "material breach" allows the innocent party to terminate for a breach which is not quite as serious as that. But where on the sliding scale of seriousness does any particular breach fall? The decision in *Dalkia Utilities Services PLC v Celtech International Limited [2006] EWHC 63 ("Dalkia")* contains some very helpful guidelines about what constitutes a material breach.

Whether a breach is material is a question of fact. Defined generally by the English High Court as a breach that has "a serious effect on the benefit which the innocent party would otherwise derive"[1], the common denominator in every case analysis is that a material breach must be substantial.

1. Considerations in Dalkia v Celtech

The facts

The claimant, Dalkia Utilities Services Ltd, entered a 15-year contract to provide energy services to the defendant, Celtech International Ltd. Payment under the contract was to be made in monthly instalments, known collectively as the "*Charges*".

The contract contained a clause that provided, "In the event of the client (Celtech) being in *material breach* of its obligations to pay the Charges, the company shall have the right to terminate this Agreement immediately." There was also a clause that made a Termination Sum payable by Celtech if the contract ceased because of Celtech's breach.

Celtech then failed to pay 3 monthly instalments consecutively. Dalkia sought to terminate the contract and claim a Termination Sum from Celtech.

Celtech argued that this failure to pay 3 monthly instalments, out of over a hundred payments, was not "material". These non-payments, they claimed, were small in proportion to the total amount payable. The issue in this case was whether Celtech's non-payment of 3 monthly instalments in a 15-year contract amounted to a material breach of the contract.

The decision

The High Court ruled in favour of the Claimant, Dalkia. Celtech, having failed to pay three consecutive monthly instalments, had committed a material breach of its obligations to make payment under the contract.

The total amount of the instalments combined was "neither trivial nor minimal"[2], as they formed a quarter of the current year's payments and Celtech was on the brink of insolvency.

Christopher Clarke J laid down the following (non-exhaustive) factors in assessing the materiality of a breach[3]:

1. The nature of the contract and the specific obligations involved;

[1] *Dalkia Utilities Services PLC v Celtech International Limited [2006] EWHC 63 ("Dalkia")* at 99.

[2] *Dalkia* at 102.
[3] *Dalkia* at 102.

2. What the breach consists of and its impact on the innocent party; and
3. The circumstances in which the breach arises, including any explanation given or apparent as to why it has occurred.

Due to the fact-sensitive nature of the inquiry, the High Court considered the specific material breach clause in a commercial context.[4] It held that such a clause was "*designed to protect a client [from termination] where the default is minimal or inconsequential or (even if it is not) is accidental or inadvertent*" but to allow the contractor to terminate in all other cases. Celtech's default in this case was not minimal or accidental, as Celtech did not have sufficient funds to make the payments.

2. Clauses allowing time to remedy a material breach

Even if a given breach is found to be material, termination of a contract may not be granted by the courts if the breach is remediable; and if the consequences of the termination would lead to a serious imbalance, benefit-wise, between the parties.[5]

Parties to the contract may therefore consider inserting a clause allowing the party in breach to remedy the breach before a right to termination can be exercised. Lord Reid has clarified that "remedy" refers to actions to be taken by the breaching party to "put [matters] right for the future."[6]

The English Court of Appeal, in the recent case of *Bains v Arunvill Capital Limited* [2020] EWCA Civ 545, held that *actual performance* of the contract is required to remedy a material breach. A mere indication of intention to perform does not constitute a remedy.

3. Concluding comments

Whether a breach is material depends to a very large degree on the specific factual matrix of each case. The *Dalkia* factors provide guidance in determining whether a particular breach is material, but the ultimate decision on a right to terminate hinges on specific contextual details and considerations about whether the breach can be remedied. Parties can reduce the potential for uncertainty by defining what they mean by "material breach" in their contracts.

Contact us

John Simpson
Partner, Singapore, London
T: +65 6622 9565
E: john.simpson@shlegal.com

[4] *Dalkia* at 102.
[5] *Phoenix Media Limited v Cobweb Information Limited* [2000] 5 WLUK 424
[6] See *Lewison on Interpretation of Contracts*, Chapter 17, at 17.119: *FL Schuler AG v Wickman Machine Tool Sales Ltd* [1974] A.C. 235.

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