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When can you terminate for breach of contract?

This article focuses on one of the key Court of Appeal cases of 2019: *Ark Shipping Company LLC v Silverburn Shipping (IOM) Ltd (The "Arctic")* [2019] EWCA Civ 1161. Stephenson Harwood acted for the successful appellant, Ark Shipping.

This judgment is of particular significance as it clearly sets out the factors that the English court will take in to account if it is asked to determine whether a particular term in a contract should be treated as a condition, the breach of which entitles the innocent (non-defaulting) party to lawfully terminate the contract.

3 types of terms in a contract

English law recognises three different types of contractual terms: (1) conditions; (2) innominate terms; and (3) warranties. The classification of these terms is fundamental, as it affects the rights the innocent (non-defaulting) party can exercise following a breach of contract.

The three categories of contractual terms can be summarised as follows:

Condition

A major term of the contract which is so important that it goes to the root of the transaction. Breach of a condition entitles the innocent (non-defaulting) party to terminate the contract and claim damages for any loss it suffers.

Warranty

A warranty is a minor term in the contract, usually an assurance or promise in a contract, the breach of which may give rise to a claim for damages only.

Innominate/Intermediate term

A term that cannot be defined as either a "condition" or a "warranty". The remedy for breach of an innominate term will depend on the effect of the breach at the time that it happens. If the effect of the breach substantially deprives the innocent party of the whole of the benefit of the contract, it will be deemed a serious breach of the term and the remedy will be the same as if it had been a breach of condition. If the effect of the breach is less serious, the remedy will be the same as if it had been a breach of a warranty.

The facts

In the "Arctic", a dispute arose between the owner of the vessel "Arctic" (Silverburn) and the charterer (Ark Shipping) as to whether a term of their charterparty was a condition or an innominate term. The charterers of the vessel argued that the specific term was an innominate term whereas the owners of the vessel argued that it was a condition (which, in the event of a breach, would entitle the owners to lawfully terminate the charterparty and re-possess the vessel for their own benefit).

The Court of Appeal in a unanimous decision, held that the relevant term was not a condition but in fact an innominate term. Full details of the facts surrounding the "Arctic" decision can be found at: <https://www.shlegal.com/news/maintenance-of-unexpired-class-is-not-a-contractual-condition>

What does this case tell us?

The Court of Appeal provided helpful guidance on the questions that must be considered when determining whether a contractual term is a condition or an innominate term:

1. Is the term expressly labelled as a condition in the contract?
2. Is the term a 'time clause' within the meaning of the case of *Bunge v Tradax*?
3. Is the term a condition precedent?
4. What is the type of breach that arises from a breach of that term and how much weight should this be given when compared to other relevant factors?
5. Where is the term to be found in the contract?
6. Is the labelling of the term as a condition a viable proposition by way of contractual construction?
7. What are the consequences of a breach of that term?

What does this mean for you?

The "Arctic" further demonstrates the English Courts' reluctance to readily identify terms as contractual conditions, in particular when there is a risk of disproportionate consequences as a result of a breach. Care should therefore be taken when negotiating and preparing contracts to ensure that in the event of a breach of a contractual term, the remedy the parties intended is available (or not, as the case may be).

Particular attention should be given to the drafting of terms the parties consider as material and which they intend to be treated as conditions (a breach of which would allow the innocent party to terminate the contract). Taking into account the Court of Appeal's guidance in "The Arctic", if there is potential for ambiguity regarding the classification of the term, we would recommend that the wording should expressly state the parties' intention for the term to be a condition.

If you require any assistance with the interpretation and drafting of contracts, please do not hesitate to get in touch with us.

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