

'Dealing with a breach of contract. What are the options for the innocent party when the contract is broken? Can they walk away from the deal, when and how?'

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Introduction

1. I have been asked to talk this afternoon about breach of contract, specifically what strategies can be adopted in the event that one party fails to complete under the terms of the contract. What are the options for escaping the contract or, alternatively, for forcing the other party to complete?
2. The first point to make is that, of course, every contract is different. When and how any contract can be determined will obviously depend primarily on any specific terms which it contains dealing with circumstances and methods for termination.
3. Often terms are standardised and the most important standard terms in the property context are the Standard Conditions of Sale, now in their 5th edition and (in the commercial context) the Standard Commercial Property Conditions. These are regularly incorporated into agreements for sale and are commonly encountered in practice. I will touch on them further later.
4. Plainly, when considering the consequences of breach, however, there is never any substitute for careful reading of the contract and any terms incorporated into it. However, this talk is intended to be a general overview of what steps are available in the event of a breach of contract. In the property context the paradigm case is an agreement for sale of land, though much of what I will say also applies to other types of contracts such as development agreements or agreements for lease.
5. As a final preliminary point, I am not discussing the termination of a lease in this talk. Although a lease is of course a contract, as you all know very specific and different

rules apply to the termination of a lease because a lease also creates a legal estate in land, which is not generally the case with a contract for sale.

Overview

6. So what are the consequences of a failure by one party to comply with the contractual terms? The answer might seem obvious; the innocent party can terminate the contract and claim damages. However, the practicalities of bringing the contract to an end or enforcing compliance are frequently far from straightforward.
7. In simple terms, the innocent party has two options. First, if they wish to end the contract they must rescind the contract (or, more accurately, terminate for breach), assuming that they are entitled to do so. Depending on the circumstances they may then also be able to take further steps such as forfeiting the deposit, claiming interest or costs and, in some cases, claiming damages for the loss of the bargain.
8. Second, if the innocent party still wishes to keep the contract alive, they can elect to waive any repudiatory breach and, if the contract breaker still appears unwilling to perform, bring a claim for specific performance.
9. I will deal with rescission first and then consider specific performance.

Rescission

10. As we all know from contract law classes, where there is a repudiatory breach of contract, the innocent party is put to their election as to whether or not to treat the contract as at an end. If they wish to end the contract they must give notice to the contract breaker of their decision to accept the breach and rescind the contract.
11. So far so simple. The real difficulty of course lies in assessing whether or not a breach can properly be regarded as repudiatory so as to trigger the right to rescind.

12. Only a breach of a condition will always entitle the innocent party to treat the contract as at an end. A condition is a term of the contract which goes:

“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.” (Wallis, Son & Wells v Pratt & Haynes [1910] 2 KB 1003, per Fletcher Moulton J).

13. A well drafted, modern property contract will usually specify which terms are conditions in this sense of the word by expressly providing that a failure to comply entitles the innocent party to terminate the agreement.

14. Other terms of the contract, which are not so fundamental, are called innominate or intermediate terms. Whether or not a breach of an innominate term entitles the innocent party to rescind the contract depends upon the actual consequences of the breach. In the well-known passage from the judgment of Diplock L.J. in Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd [1962] 2 QB 26:

“There are...many contractual undertakings of a more complex character which cannot be categorised as being ‘conditions’ or ‘warranties’...Of such undertakings all that can be predicated is that some breaches will and others will not give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended he should obtain from the contract; and the legal consequences of a breach of such undertaking, unless provided for expressly in the contract depend upon the nature of the event to which the breach gives rise and do not follow automatically from a prior classification of the undertaking....”

15. In practice, in the property context, questions of whether or not a term of the contract is a condition or an innominate term so beloved of contract law tutors, rarely seem to arise. Usually the parties will have dealt with this expressly in the agreement by specifying the consequences of a breach of a particular term.
16. Far more frequently, the issue that arises in practice is whether a failure by the contract breaker to meet a contractual deadline is sufficient to entitle the innocent party to terminate.
17. Where a party to the contract has failed to comply with a deadline, the first question is always whether or not time is of the essence in respect of the particular clause which has been breached.
18. The common law traditionally regarded stipulations as to time in a contract as conditions which had to be strictly complied with. Equity took a more relaxed view and equity has prevailed since s. 41 of the Law of Property Act 1925 provides:
- “Stipulations in a contract, as to time or otherwise, which according to rules of equity are not deemed to be or to have become of the essence of the contract are also construed and have effect at law in accordance with the same rules.”*
19. It follows that any contractual stipulations as to time are not regarded as essential, unless the parties have expressly specified that this is the case or where necessary implication dictates; see United Scientific Holdings Ltd v Burnley Borough Council [1978] AC 904.
20. It is not, however, necessary for the contract to state in terms that time is of the essence of a particular clause (although when drafting an agreement, this is of course the surest way to ensure that the consequences of a breach are clear). Depending on the context and the other terms of the contract it may be enough for the parties to specify that the performance of the clause within a specific time is a “condition” or a “condition precedent”.

21. Where the parties have failed to specify the precise consequences of a delay in performance, difficult questions of construction can arise. However, as a general rule the courts lean firmly against making time provisions of the essence. So, for example, in Touche Ross & Co v Secretary of State (1983) 46 P&CR 187, a rent review clause required the landlord to serve a rent review notice and if the parties could not agree the rent the question should be referred to a surveyor “*as soon as practicable and in any event not later than three months after the service of the said notice.*” The Court of Appeal held that this wording was not sufficient to make time of the essence, so that a reference to the surveyor made after the expiry of the three-month period was effective.

22. It should be noted at this point that a very different position pertains in the case of a unilateral contract or option. In accordance with the general principle that the terms of an option must be strictly complied with, time is of the essence of option agreements. Similarly, where a conditional contract of sale fixes a date by which a condition must be fulfilled in order for the agreement to become binding, the date is of the essence of the contract. As Lord Nicholls put it in Valentines Properties Ltd v Huntco Corp Ltd, in these situations:

“Inherent in a time limit is the notion that the parties are drawing a line. Once the line is crossed, a miss is as good as a mile.”

23. It follows that in the most commonly encountered case of a contract for sale of land, time will not be of the essence. Therefore, if there is a delay in completion that will not, by itself, entitle the innocent party to treat the contract as at an end. In order to achieve that result, the innocent party must serve a notice making time of the essence.

24. Where the contract incorporates either the commercial or standard conditions of sale, there is incorporated into the contract the well-known concept of the notice to complete.
25. So, by clause 6.8 of the 5th Edition of the Standard Conditions of sale, at any time on or after the date set for completion either party who is ready, able and willing to complete may give the other notice to complete. If so, by clause 6.8.2, the parties are to complete within 10 working days and for these purposes time is of the essence. It is not uncommon for the parties to incorporate these conditions, but then expressly vary the period of the notice to complete or otherwise tailor the standard conditions to their own requirements.
26. A word of warning. Where time is of the essence (either following service of notice to complete or otherwise) time limits are very strict indeed. Any delay, however short, entitles the innocent party to rescind.
27. The clearest indication of the severity of this principle is Union Eagle Limited v Golden Achievement Limited [1997] 2 WLR 341. The purchaser pursuant to “*an entirely commonplace*” contract for sale was a mere 10 minutes late in tendering performance. The Privy Council not only refused to grant specific performance, but also refused to exercise the inherent equitable discretion to grant relief from forfeiture of the deposit, which I am going to turn to shortly.
28. It should be kept in mind however, that even where the contract does not incorporate the standard terms, it is open to the innocent party to serve a notice making time of the essence. Where the contract does not expressly make time of the essence the other party may give notice requiring performance of the contract within a reasonable time. Notice can be served at the moment the time for performance has passed, but the notice must give a reasonable period for completion. What is reasonable will depend on all the facts and circumstances of the case, although the period of 10 days specified in the standard conditions may well provide a useful guide in a straightforward case.

29. The ability to serve notice making time of the essence is, of course, a very useful, indeed essential, tool for the innocent party. Whenever there is any doubt about whether or not time is of the essence and the innocent party may wish to seek to terminate, it is sensible to serve a notice making time of the essence as soon as possible, even if the innocent party may ultimately wish to complete. Even after the notice to complete has expired, the innocent party still has an election; if they wish to complete then they can do so. The notice making time of the essence does not have the effect of creating a 'drop dead' date. Early service of a notice does, however, advance the point at which the innocent party can effectively walk away from the deal.
30. Even after the service of a notice to complete (or where time is expressly of the essence) it is important to make sure that any decision to rescind the contract is effectively communicated to the contract breaker. The contract will remain alive until the election to rescind is made.
31. There are no particular formalities prescribed by the general law for the form of a rescission. This is the case even where there are (as will usually be the case in property contracts) formality provisions applying to the contract itself. Again the contract may step in and specify how notice is to be given and, if it does, those requirements must of course be complied with.
32. In the absence of specific provision, however, it is sufficient if the innocent party does something which is inconsistent with the subsistence of the contract. The only requirement is that acceptance of a repudiation must be clear and unequivocal. Mere inactivity or silence will there not generally be enough.
33. Accordingly, it is important that as soon as a final decision has been reached to terminate the contract following a breach, this is communicated to the defaulting party

in clear terms as soon as possible. Until that election is made, the contract remains alive.

34. Furthermore, it is possible for the innocent party to affirm the contract following a breach. Affirmation may be express or implied and it will be implied if, with knowledge of the breach and of his right to choose to end the contract, the innocent party does some unequivocal act from which it may be inferred that he intends to continue with performance of the contract. Plainly there is ample scope for arguments to arise that particular actions constitute affirmation. It is all too easy, particularly within large organisations, for invoices to be sent, letters to be written or other steps taken which can be seized upon to assert affirmation.
35. It follows that the longer matters are left to run before an express notice of rescission is sent, the greater the risk that something will happen which will entitle the defaulter to argue that the contract remains alive because the innocent party has affirmed or waived the breach.
36. Assume that an innocent party has, or is about to, rescind the contract. What are the other consequences that might follow from this decision?
37. One commonly encountered problem is the issue of whether or not the innocent party is obliged to return a deposit paid by the defaulter at the time the contract was entered into. Whether or not the vendor is entitled to retain the deposit might well play a considerable role in deciding whether or not to rescind.
38. Generally speaking a contract for sale will provide that if the contract is rescinded due to default by the purchaser, the deposit is forfeited to the vendor.
39. However, by s. 49 (2) of the Law of Property Act 1925:

“Where the court refuses to grant specific performance of a contract, or in an action for the return of the deposit, the court may if it thinks fit, order the repayment of any deposit.”

40. Given the ubiquity of the practice of taking a deposit, there is surprisingly little authority as to the circumstances in which the court will exercise this discretion. The following is clear enough, however. The jurisdiction will only be exercised in exceptional circumstances. Furthermore, the fact that the vendor is able to re-sell the property at a higher price and therefore has suffered no loss is not, in itself, a good enough reason to order the return of the deposit. These propositions emerge from the leading judgment on the discretion conferred by s. 49 (2), Midill (97PL) Ltd v Park Lane Estates Ltd [2009] 1 W.L.R. 2460, where Carnwath LJ said:

“...the deposit is “an earnest for the performance of the contract”, which can be retained by the seller if the buyer defaults, without any necessary regard to the question of actual loss or its amount. That principle, as the Privy Council made clear [in Bidaisee v Sampath (1995) 46 WIR 461] is not “overruled” by section 49(2). There needs to be “something more”; or, as other judges have said, something special or exceptional to justify overriding the ordinary contractual expectations of the parties.”

41. When advising an innocent party faced with a failure to complete, it is important not to assume that it will be entitled to retain the deposit, even if that is what the contract specifically provides. To provide an example from my own practice, I have a case concerning a contract for sale of commercial property. The contract, made at auction, provided for completion to take place within 21 days and a deposit of 10% of the purchase price was paid. The purchaser was unable to complete in that timescale and the vendor’s solicitors served notice to complete. The time expired and the vendor rescinded the contract and sought to retain the deposit. The purchaser disputed the validity of the rescission on the grounds of estoppel and claimed the recovery of the deposit under s. 49 (2).

42. The purchaser's argument was that the property had been re-sold at a considerably higher price. Furthermore, the delay in completion was due to matters beyond its control because its bank had taken longer than advised to transfer the completion monies to a UK bank account. Significantly, the purchaser had been in a position to complete the day after the notice to complete expired. The purchaser argued that this was sufficient to make the case exceptional.
43. Master Teverson rejected that argument and held that the vendor was entitled to retain the deposit. However, the purchaser has appealed, permission has been granted and that appeal is to be heard by a single judge of the High Court in two weeks. So watch this space.
44. This case serves to demonstrate that even in a case where the matters appear straightforward from the point of view of the innocent party, there is a prospect of a claim to recover the deposit. Even if the innocent party is ultimately successful in resisting the claim, there is a prospect of becoming embroiled in litigation and, if the purchaser has taken the step of entering a unilateral notice, that might frustrate the innocent party's plans for it. It is worth bearing all of that in mind when advising a party contemplating the rescission of a contract in circumstances where the other party is still keen to complete.
45. As well as forfeiting the deposit, the innocent party may well also have a claim for damages for breach of contract. The circumstances in which a damages claim might arise are infinitely various and beyond the scope of this talk. The basic proposition is that the innocent party is entitled to damages which put them in the position they would have been in had the contract been performed.
46. However, it is worth noting one general point. The retention of the deposit does not necessarily preclude a claim for damages. Since the deposit is regarded as an earnest of performance and not an estimate of the vendors' loss should the sale fall through, it would seem to follow that the vendor should be entitled to both retain the deposit and

claim damages in respect of any consequential loss, subject to the usual rules about remoteness and causation. This is reflected in clause 7.4.2 of the standard conditions of sale, which provides expressly that if the buyer fails to comply with the notice to complete the seller may rescind the contract, forfeit and keep any deposit and accrued interest, resell the property and claim damages.

Specific Performance

47. The second alternative for the innocent party is to elect to keep the contract alive. In the first instance, of course, this does not require the innocent party to take any particular steps (unless of course the contract expressly so provides). As we have seen, the contract is not automatically rescinded following a breach, even a failure to comply with a notice to complete.
48. If it becomes apparent that the defaulter is not voluntarily going to complete the contract or perform the contractual step in question, then the innocent party's remedy is to apply to court for the specific performance of the contract.
49. Before looking at the procedure for seeking specific performance, it is worth mentioning the need to protect the innocent party's position pending the outcome of any claim. Where the innocent party is the purchaser under a contract for sale, they are plainly at risk that the property will be sold by the vendor to a third party (perhaps for a higher price) and be left with their claim for damages, which may or may not be a valuable remedy.
50. In the case of registered land, the appropriate step to take is to enter a unilateral notice against the registered title to the property in question. This will prevent any disposition of the property which is the subject of the dispute from being registered unless consent is given or the vendor successfully applies to discharge the notice, whereupon the purchaser will be given an opportunity to object.

51. Whilst the protection of the purchaser's interest in the property by the entry of a unilateral notice will often be an obvious step to take (and failure to do so could be disastrous) some caution must be exercised. The Land Registry will not (or at least should not) scrutinise the validity of an application for a unilateral notice beyond checking that it protects a recognised interest.
52. However, because there is little a registered proprietor can do to prevent the entry of a unilateral notice, the Land Registration Act 2002 contains a remedy for improper use of this mechanism. By s. 77 (1) (b) of the Act, a person must not exercise the right to enter a unilateral notice without reasonable cause. A breach of that duty sounds in damages and accordingly, it is important to consider carefully the basis for making applying for the notice before doing so.
53. The ingredients which must be made out before a claim for specific performance can succeed are well known. The first requirement is that damages will be an inadequate remedy for the innocent party. Fortunately for property lawyers, the law has long taken the view that the purchaser of a particular piece of land cannot obtain a satisfactory substitute. Accordingly, specific performance is always available both to a vendor and a purchaser in the case of a breach of a contract for sale. In the case of other types of contract, however, it will always be necessary to first consider whether or not the innocent party would be adequately compensated by an award of damages.
54. In recognition of the fact that specific performance is the primary remedy in cases of breach of a contract for sale of land, the CPR makes specific provision for an application for summary judgment in cases of this type.
55. Paragraph 7 of the Practice Direction to CPR Part 24 provides that where a claimant seeks specific performance of an agreement for the sale, purchase, exchange, mortgage or charge of any property or for the grant or assignment of a lease or tenancy of any property they are entitled to apply for summary judgment. The distinction is that in this type of case the claimant may make that application at any

time after the claim form has been served, whether or not any particulars of claim have been served and before the defendant has acknowledged service or the time for doing so has expired. This truncates the procedure because normally the claimant cannot apply for summary judgment until after the defendant has filed an acknowledgment of service or a defence.

56. On any application for summary judgment the usual standard applies. Accordingly, the claimant must show that the defendant has no real prospect of successfully defending the claim.
57. Specific performance is an equitable remedy and, therefore, discretionary, albeit that in a standard case of a failure to complete on a contract for sale of land, specific performance is likely to be granted almost as a matter of course. Factors which might persuade a court to decline to grant specific performance despite the existence of a valid contract include exceptional hardship and delay.
58. Such factors are, by their very nature, highly specific to the case in question. But one example where the court refused specific performance in a case of this nature is Patel v Ali [1984] Ch 238. In that case a claim for specific performance of a contract for the sale of a house was refused. A four year delay had occurred (for which neither party was responsible) and in the meantime the vendors circumstances had changed disastrously as a result of her husband's bankruptcy and an illness which had left her disabled. At the other end of the spectrum, mere pecuniary difficulties do not afford a defence and the purchaser will not be denied specific performance merely because in a rising market the vendor will find it difficult to acquire alternative accommodation with the proceeds of sale (see Mountford v Scott [1975] Ch 258).

Conclusion

59. To summarise, when advising the innocent party, the first matter to consider is always whether they wish to salvage the agreement, if possible. If they wish to end the agreement, the first question to consider is whether or not the breach which has

occurred gives rise to the right to rescind (either because of its seriousness or because it is a breach of a time stipulation which either is, or has been made, of the essence).

60. If a decision is taken to rescind, this should be communicated to the defaulting party swiftly and clearly. If there is a dispute about whether or not the rescission is effective then a specific procedure for summary judgment is available, provided that the contract is for the sale of land.
61. If, on the other hand, the innocent party wishes to keep the contract on foot, then steps should be taken to protect their interest by entering an appropriate form of unilateral notice (assuming their interest under the contract is not already protected by registration). Specific performance will usually be available in contracts concerning property and, again, a summary procedure is available if the innocent party wishes to pursue it.

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