Understanding repudiatory breach

The basic principles of repudiatory breach are commonly misunderstood both in terms of the nature of this type of breach and its effect. Definitions of the term often refer to ‘immediate’ or ‘automatic’ termination. For reasons discussed in more detail below, such definitions are misleading.

A repudiatory breach is a breach that the law regards as sufficiently serious to justify termination. The terms of the contract themselves may also entitle a party to terminate in the event of a breach that would not otherwise be regarded by law as a repudiatory breach.

While it is true that the rights and obligations of the innocent party do fundamentally change at the point of breach, it does not follow that the only possible outcome from that point is that the contract is brought to an end.

Two recent cases, which will be discussed in further detail below: (Cook v MSHK Ltd & ors [2009] and North Eastern Properties Ltd v Coleman & anor [2009]), provide useful examples of the importance of parties understanding their rights and obligations in this context. This article aims to outline the key aspects of repudiatory breach and to highlight the serious consequences that can arise as a result of a party’s failure to properly grasp its basic principles.

What are the effects of a repudiatory breach?

The key to understanding repudiatory breach and its effects, and therefore to appreciate the necessary steps that an innocent party must take to ensure that their position is protected, is to clearly identify the two changes that occur as the result of a repudiatory breach:

1. the innocent party gains a right to elect whether to affirm or to terminate the contract; and
2. the innocent party gains the right to claim damages (and will retain that right regardless of the result of their election).

Recognising that there is an election to be made by the innocent party following a repudiatory breach is vital.

Election to Affirm

In simple cases the innocent party will make its election and expressly communicate that election to the other party. In the case of an election to affirm, the effect of the breach is therefore that the rights and obligations of both parties under the contract remain unchanged but the innocent party will retain their right to claim damages for the breach. However, where a choice is not expressly communicated, an election can be implied. For an election to affirm to be implied two conditions must be present:

1. the innocent party must have knowledge of the facts giving rise to the breach; and
2. they must also have knowledge of their legal right to choose between the alternatives open to them.
If these two conditions are present and the innocent party then acts or communicates in some way, an intention or wish for the contract to continue, they will be deemed to have affirmed the contract. As a general rule affirmation, once elected, is irrevocable. However, the court may make an exception in circumstances where an innocent party has put pressure on the party in breach to perform the contract (which could, depending on the circumstances, be seen as an election to affirm), but the party in breach continues to be in breach. In these circumstances, it would be unfair for the innocent party to be held to have ‘made its bed’ by urging performance. The court justifies a different approach in such circumstances because it views the act of the party at fault as a ‘continuing repudiation’. An innocent party faced with a continuing repudiation should make it very clear (preferably in writing) that they are revoking their affirmation due to a continuing repudiation to ensure that the revocation is valid.

**Loss of Right to terminate**

If the decision of the innocent party is to terminate, the key element here is not to delay in making that decision known to the other party in the form of a clear and unequivocal communication (preferably written). Case law has shown that there is definitely a danger that if sufficient time passes without the innocent party making an election, they will be deemed to have affirmed the contract. As one would expect there are no hard and fast rules about the length of time that the innocent party can take in making its decision but what is clear is that they should do so as soon as possible.

**Recent Case Law**

Two recent cases of *Cook v MSHK Ltd & ors [2009]* and *North Eastern Properties Ltd v Coleman & anor [2009]* provide neat examples of the importance of a proper understanding of the effect of a repudiatory breach on the rights and obligations of the contracting parties and the serious consequences that can arise out of a misunderstanding of those rights and obligations.

**Facts of Cook**

Ben Cook was a former head of the ‘artists and repertoire’ division at dance record label Ministry of Sound (MOS). Cook’s employment contract imposed post-termination restrictions on soliciting MOS’s artists, but did not prevent him from competing. Cook accepted an offer of employment from one of MOS’s competitors, and resigned with six months’ notice. During his notice period, MOS allegedly discovered that Cook would be working on competing projects at his new label, and decided to remove him from sensitive commercial work and restrict his computer access. Cook was then absent with work-related stress, but returned to work out the rest of his notice period. He was then dismissed for gross misconduct and breach of fiduciary duty, as MOS believed that Cook had lied when asked directly what work he would be carrying out in the future.

MOS issued a claim for a declaration that Cook’s dismissal had been lawful and sought damages for the loss of revenue caused by Cook’s failure to work out his full notice period. Cook sought summary judgment and the judge agreed that MOS had not treated Cook’s conduct as repudiatory, but had instead affirmed his contract of employment. The result was that MOS could not rely on the allegations of breach to justify Cook’s dismissal.
Decision

The judge found that during the weeks following the known commission by Cook of conduct that constituted a repudiatory breach, MOS had given no indication to Cook that it was disposed to bring disciplinary proceedings against him, and had repeatedly made it clear that it regarded him as bound by his contract to work to the end of his notice period. The judge had been fully entitled to find that, on the admitted facts, MOS had affirmed Cook’s contract in the face of the known commission of breaches. Based on MOS’s own pleadings, it was clear that the company knew of Cook’s intention to compete (ie the breach) for over two months before his dismissal. Once MOS knew that the breach had occurred, it had to decide what to do about it. It had decided to affirm the contract and invite Cook back to work.

Facts of North Eastern Properties

In North Eastern Properties the High Court looked at whether an innocent party has the right to make an election prior to the repudiatory breach. This was a dispute involving the sale and purchase of land. The sale of the property had been delayed due to problems with the completion of construction work. The purchaser sought to rely on a letter sent together with notices to complete to the vendor as notification of an election to terminate the contract. The letter stated:

‘Accordingly unless the properties are ready for occupation with final building regulation certificate and premier guarantee certificate within no later than ten working days from the date of this letter then our clients will deem your clients in breach of contract and will consider themselves discharged from the contract and entitled to the return of their deposit with interest.’

The purchaser sought to rely on this letter as evidence of an election to terminate the contract. The judge agreed with the vendor’s argument that there is no authority to support the right to make an election prior to the repudiatory breach. Instead the judge viewed the letter as a simple statement of intention. The result was that the contracts remained in force.

COMMENTS

Faced with a breach of contract, an innocent party has some tough choices to make. First, whether the breach is sufficiently serious to justify termination. Wrongly treating a contract as terminated could itself be a breach of contract. Secondly, once satisfied that the breach is sufficiently serious to constitute a repudiatory breach then an election must be made as to whether to terminate or to treat the contract as continuing. To avoid pitfalls, this election should be made without unreasonable delay and in a clear and unequivocal manner. Cook and North Eastern Properties provide good examples of the very serious consequences that can result from an innocents party’s failure to act promptly and properly when faced with a repudiatory breach.

At-a-glance GUIDE
The effect of a repudiatory breach is that the innocent party gains the right to choose whether to either affirm the contract or to terminate.

If the innocent party elects to terminate they are released from performance of their obligations under the contract and from any obligation to accept further performance by the party in breach.

If the innocent party elects to affirm the contract, they remain obliged to perform their duties under the contract, but can seek damages.

Prior to making their election the innocent party must continue to perform their part of the contract.

Affirmation may be express or implied.

Affirmation is generally irrevocable.

It is possible for an innocent party to lose the right to terminate (for example by acceptance of goods or passage of time).

Cook v MSHK Ltd & ors [2009] EWCA Civ 624

North Eastern Properties Ltd v Coleman & anor [2009] EWHC B18 (Ch)