When is a Breach "Material"?

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Contracts sometimes contain specific provisions entitling a party to terminate where a “material breach” has occurred. However, while the drafter may have intended this to provide recourse when things go wrong, in reality, without a clear definition, such wording often just leads to uncertainty and a dispute. This is because, under English Law, there is no legal definition of what constitutes material breach. Whether or not a breach of contract is serious enough to be “material” is something which will be dependent both on the specific facts of the case and the wording of the contract itself.

The recent decision in *RiverRock European Capital Partners LLP v Harnack* [2022] EWHC 3270 (Comm), sets out a useful overview of the law on what constitutes a “material breach” of contract, and is a salient reminder of the pitfalls that can befall the unwary should a breach be found not to be material enough to be acted upon.

The term “material breach” unfortunately occupies somewhat of a blurred middle ground between a “repudiatory” breach and a simple breach of contract. While the latter may permit a claim for damages, the former (being a breach which goes to the root of the contract or deprives the innocent party of substantially the whole benefit of the contract) will permit termination at common law regardless of any rights of termination agreed under the contract (unless, of course, the parties have effectively excluded such common law rights).

However, if a party purports to terminate a contract on the basis of a material breach in accordance with the relevant provisions of the contract but does so wrongly, the consequences can be severe, as the “innocent” party may then be entitled to claim this purported termination amounts to a repudiatory breach, terminate and claim damages itself.

In its decision in *RiverRock*, the High Court ultimately determined that, while there had been breaches of contract, these were not serious enough to be deemed “material”. The key facts of the case were as follows:

- RiverRock European Capital Partners Limited (“**RiverRock**”) are an investment firm who appointed Deutsche Real Estate Asset Management Limited (“**DREAM**”) under consultancy and other allied agreements to manage an investment fund (the “**DREAM Agreements**”). DREAM acted as RiverRock’s “Appointed Representative” for the purpose of providing FCA-regulated activities.
- Two individuals, Mr Harnack and Mr Moersdorf (the “**Defendants**”), acted as fund managers and undertook under certain guarantee deeds to meet the financial obligations of DREAM should the DREAM Agreements be terminated.
- RiverRock subsequently discovered that DREAM had been dissolved and struck off from Companies House because it had failed to file a confirmation statement as required by the Companies Act 2006.
- The DREAM Agreements provided that they could be terminated where a “material breach” had occurred. RiverRock claimed that the strike-off and dissolution of DREAM amounted to a

material breach and that, accordingly, it could terminate those agreements and claim from the Defendants repayment of fees amounting to €1,617,270 under the guarantee deeds.
- Ultimately the Court determined the breach was not material, as it was the consequence of a simple oversight which could easily have been remedied. It was also relevant that the evidence was RiverRock was not concerned by the dissolution and had, indeed, already been looking to replace the Defendants as fund managers.

Analysis

In its decision, the Court began by making clear that "*the concept of a "material" breach has not been easy to define*". In reviewing recent cases on the issue, context and consequences were the key determiners of materiality, and included: the breaching party's explanation for the relevant breaches; the consequence to each party of either the contract remaining in existence or being terminated; and the significance of the breaches in the context of the contract as a whole[1]. Fundamentally, as Jackson LJ, giving the principal judgment of the Court of Appeal in probably the leading case on material breach[2] stated, a material breach "*is more than trivial, but need not be repudiatory…The breach must be a serious matter, rather than a matter of little consequence*".

At paragraph 51 of its decision in *RiverRock*, the Court set out its conclusion on what amounted to a "material" breach for the purposes of the Dream Agreements:

"A repudiatory breach was not required (otherwise the term would add little since the Consulting Agreement could be terminated in the context of a repudiatory breach in any event at common law…) Instead what was needed was a substantial breach. It had to involve serious consequences for the innocent party, for which purpose I adopt the description of Neuberger J. in Glolite Ltd. v Jasper Conran Ltd.,The Times, 28 January 1998 of serious "…in the wide sense of having a serious effect on the benefit which the innocent party would otherwise derive from performance of the contract in accordance with its terms"".

In light of this reasoning, the fact that the breach was "*readily capable of remedy*[3]" and caused no loss to the fund or its investors, was strongly indicative that it was not material. In fact, there were no real practical consequences arising from the breach, other than the need to replace the fund managers, which the evidence showed RiverRock had been intending to do in any event.

In addition, as can be seen from the wording of this judgment, it is important to note that the line between a repudiatory breach and a material breach may be thin. If the former occurs where a breach "*deprives the other party of substantially the whole benefit of the contract*", and the latter where a breach has a "*serious effect on the benefit*" of that contract**,** a nuanced analysis of the specific facts and the factors set out above will be essential to determine the nature of the breach, and a party could easily find itself on the wrong side of that line.

Practical consequences

If parties wish to allow termination in the event of a "material breach" they would be wise to set out clearly what they mean by that phrase. If a certain event (such as dissolution of a company) is intended to create a right of termination, the safest course of action would be to expressly say so in the contract itself. Leaving materiality up for debate creates a level of uncertainty, and increased risk of litigation, which is in neither parties' interest.

However, where no such definition exists, care must be taken before seeking to claim "material breach" and consideration should be given to how to evidence the consequences of that breach. It is also wise to seek an explanation from the breaching party, or investigate any remedial actions which could be taken, before pulling the trigger and terminating the contract.

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[1] See *Dalkia Utilities Services Plc v Celtech International Ltd* .[2006] 1 Lloyd's Rep.599 for an overview of these factors.

[2] *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd* [2013] EWCA Civ 200

[3] While in this case this was simply due to the fact the breach could be easily fixed by sending the relevant form to Companies House, it is also an important reminder that clauses permitting remedy of a breach will also be key in assessing materiality.