

Consequences of Breach of Contract

When does a breach of contract occur?

A breach of contract most commonly occurs when a party to a contract refuses to perform a material obligation of the contract. Material obligations may be express or implied. If one party to a contract makes it impossible for the other party or parties to perform their obligations, the contract will be frustrated. However, it is also possible that acts outside the parties' control may prevent performance. Under such circumstances, the contract may be suspended or terminated, without there being a breach. Termination without breach could also occur for personal contracts (e.g., employment and certain service contracts) if one of the parties dies, where the identity of the person is important to the performance of the contract.

What are the consequences of breach of contract?

If there is a breach of a material term of a contract, the party who is not in breach can choose whether or not to terminate the contract. In many contracts, this process and the corresponding timing is set out explicitly in the contract. For example, the contract may require notice of a breach to be given to the defaulting party, or that the defaulting party will have the opportunity to remedy the breach. If the breach is remedied then the contract cannot be terminated.

If the party chooses to maintain the contract after a breach occurs, in some circumstances, the non-breaching party can seek a court order to compel the breaching party to fulfil its obligations under the contract. This type of remedy is known as 'specific performance.'

If the non-breaching party decides to end the contract after the breach occurs, it must notify the breaching party immediately. The contract will terminate upon notification. Any obligations that arose before the notification will continue and can be enforced.

If the breaching party has breached only some of the terms of the contract, it may be difficult to determine whether the non-breaching party has the right to terminate the contract. Generally, a right to terminate only arises if the breach is serious and the unfulfilled term is essential or material.

If a party attempts to terminate a contract when there is no legal right to do so, a wrongful repudiation of the contract will occur, which itself constitutes a breach. This will give the other party the right to terminate the contract and to recover damages. For this reason, it is imperative to seek advice before terminating or refusing to perform your side of a contract.

Remedies for breach of contract

Informal remedies

If the breach involves defective goods or services, you may choose to contact the supplier. In so doing, you should state why the goods or services are defective and what you want the supplier to do to remedy the situation. You should put your concerns in writing. This simple approach may be effective.

Damages

Damages refers to the payment of money to compensate the non-breaching party for breach of contract. The basic principle behind an award of damages is to put the non-breaching party in the same position that it would have been in if the contract had been performed properly. An award of damages may include money to compensate you for any cost you have incurred as a result of the breach (e.g., the cost of repairs), or money for loss of profit.

When you go to court, damages are assessed on a 'once and for all basis'. This means that you will not be able to go back to court for a review if you suffer additional losses in the future. However, the non-breaching party has a duty to mitigate or minimise damages.

This means that if there is a reasonable action that you could take that would reduce the damage that you would otherwise suffer, you must take that action. If you fail to do so, the breaching party will not be required to pay you for the full amount of the loss that you actually incur.

Specific performance

Sometimes a non-breaching party will want the breaching party to actually do what it promised to do rather than to pay damages. This is called 'specific performance'. Several factors are relevant to whether a court will decide to order specific performance. For example:

- Damages must be an inadequate means of compensation. This determination will depend on the circumstances of the case. However, where an innocent party has purchased something unique (for example, land), the court is more likely to consider damages to be inadequate.
- A court will not order specific performance where there are ongoing obligations to be performed, because doing so would involve the court in continuous supervision of the contract.
- Specific performance will not be ordered if there has been a delay in initiating court proceedings and it would be prejudicial to the other party to grant specific performance.

Dispute resolution

In many contracts, the parties agree to a dispute resolution process that is outside of formal judicial proceedings. These 'alternative' dispute resolution processes may be particularly important for long-term contracts, where the parties foresee an ongoing relationship.

Alternative dispute resolution is also beneficial because it allows for continual performance of contractual obligations while the dispute is being resolved. These processes also provide for a way to resolve the dispute without incurring the high costs of litigation.

However, alternative dispute resolution clauses need to be very carefully drafted, to ensure that they are clear and enforceable. Consideration also needs to be given to the communication procedures that should be followed during contract performance, given that good communication is key to avoiding and resolving disputes.

Examples of alternative dispute resolution that contracts may recognise include informal negotiations, escalation through senior management, mediation, and arbitration.

The Australian Commercial Disputes Centre has drafted a number of model clauses that may serve as useful references. These clauses principally deal with mediation, expert appraisal, and expert determination. The Centre has also published guidelines that detail the procedures to be adopted when each form of dispute resolution is carried out. These model clauses and the other information provided by the Centre can provide guidance when drafting dispute resolution clauses.

In some jurisdictions, courts can require parties to a dispute to engage in some form of compulsory alternative dispute resolution, even if the contract did not contain alternative dispute resolution terms.

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