



## LEGAL BRIEFING

### *DRC Distribution Ltd v Ulva Ltd*

High Court of Justice (Queen's Bench Division), Flaux J [2007] EWHC 1716

#### ***The Facts***

This was the hearing of a preliminary issue. DRC Distribution Ltd ("DRC Distribution") and DRC Polymer Products Limited ("DRC Polymer") were sister companies. In 2003 DRC Distribution and Ulva Ltd ("Ulva") entered into a long-term supply agreement for 100% of Ulva's requirements for an insulation cladding system. DRC Distribution did not have a manufacturing facility and so the cladding supplied to Ulva was manufactured by DRC Polymer.

From October 2005, Ulva began sourcing its requirements from another supplier as well as DRC Distribution. Ulva admitted at the hearing that this was a breach of the supply agreement that required DRC to take 100% of its products from DRC Distribution.

Under the terms of the distribution agreement, Ulva was given a 60-day credit period after the date of any invoice in which to pay that invoice. Ulva frequently paid invoices late. In May 2006, DRC Polymer's insurers reduced the permitted credit limit for transactions for Ulva to nil on the grounds that its financial statements indicated a deteriorating financial position and that losses had been sustained by Ulva. In June 2006, DRC Distribution informed Ulva that it was no longer prepared to supply Ulva on credit terms.

On 14 June 2006, Ulva gave a notice to terminate the supply contract with effect from 14 December 2006. DRC Distribution replied stating that until the expiry of the notice it expected that all Ulva's supplies would continue to be supplied by DRC Distribution and that unless the position in relation to credit terms was resolved the agreement would terminate after 30 days. After further correspondence on 1 August 2006 DRC Distribution terminated the agreement with immediate effect for material breaches including the sourcing of supplies from an alternative manufacturer.

#### ***The Issues***

The following three issues were to be decided:

1. The extent to which Ulva was in breach of its agreement with DRC Distribution;
2. Whether DRC Distribution had suffered any loss; and
3. Whether DRC Distribution could recover, in principle, the loss suffered by DRC Polymer.

#### ***The Decision***

Ulva's breach of the supply agreement was deliberate as Ulva had obtained supplies from another source. This breach was almost certainly committed because Ulva had discovered that material which would satisfy Ulva's customers' needs could be supplied more cheaply by the other supplier than by DRC Distribution. Ulva's preference to pay its new supplier rather than DRC Distribution was a breach of the supply agreement.

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DRC Distribution were also in breach of the supply agreement as they had attempted to impose new payment terms (by refusing credit) in breach of the terms allowing for credit in the supply agreement. There was no basis for implying a term into the supply agreement that the provision of credit was linked to the continuance of credit insurance. However, there was no express or implied term of the supply agreement that excused Ulva's continuing breach by continuing to obtain supplies from other sources.

Under the terms of the supply agreement, DRC Distribution was deemed to have incurred the costs of manufacture and the acts of DRC Polymer were deemed to be the acts of DRC Distribution. Therefore DRC Distribution was entitled to claim its substantial losses.

***Comment***

A company entering into exclusive supply agreements for a lengthy period of time must ensure that it continues to obtain its supplies from its chosen supplier for the length of the agreement, even if a better or cheaper product is later available on the market. If this occurs and the company wishes to use the new product, then the company must terminate the agreement in accordance with the termination provisions of the agreement. If a company fails to do so, they will be at risk of paying damages for breach of the supply agreement.

***Charlene Linneman***  
***October 2007***

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