

Chapter

# 6

## Contract law

## 6.1 Contract law

A contract is a legally binding agreement between parties. It is made by consenting parties and is recognised by the law as enforceable.

The main elements that are needed for a **simple contract** (made through any form being oral, written or inferred by action of parties) are:

- **Intention to create legal relations** – both parties must have clearly indicated that they wanted to create a legally binding contract. Meeting a friend to go out for the night is not normally a contract.
- **Agreement** – both parties have agreed by way of one party making an offer and the other accepting. (i.e. offer + acceptance = agreement)
- **Consideration** – there must be a “bargain” meaning a value given by one party in exchange for the other parties’ provision or obligation. (i.e. there must be 2 sides).

Examples of simple contracts are buying a newspaper at corner shop, buying a bus ticket from the bus driver, buying groceries at the supermarket or buying a pencil from stationery shop.

Sometimes the above are not enough to show a valid contract and therefore the following elements would validate all contracts:

- **Form** – the contract must be in a particular form to be valid e.g. in writing. Some contracts must be in “**deed**” (e.g. credit agreements, sale of land, transfer of company shares) meaning they are in writing, signed by both parties witnessed and also delivered.
- **Capacity to contract** – most people have the capacity to enter into a contract except for minors or companies which may be restricted to their constitution.
- **Legal nature of contract** – it must be a contract for a legal act to be enforceable.
- **Reality of consent** – if one party agreed to the contract based on the other’s misrepresentation then the contract can be rescinded.

### Subject to contract

Sometimes a contract is not valid despite having all the elements needed to make one binding, this is because it may contain the term “subject to contract”. This term means that both parties are still in negotiations even though they may have agreed terms. Both parties can withdraw from the agreement without liability or penalty.

## 6.2 Intention to create legal relations

This is the intent by both parties to create a legally binding relation and must be present for a contract to be legally bound. Two areas here:

**Social and domestic agreements** – these are generally not intended to be legally bound contracts, however there are some exceptions.

In *Balfour v Balfour (1919)* husband was working abroad and promised maintenance of £30 a month to wife in UK. The marriage ended and the wife sued for maintenance which was no longer paid.

*Held:* Informal agreement between husband and wife was not intended to be legally binding

In *Merritt v Merritt (1970)* husband went off to live with another woman and then husband and wife met after and agreed that husband would pay £40 a month which she would use to pay the mortgage on the house. They signed an agreement to these terms and transfer of house to wife on final payment of mortgage. Husband refused to transfer house over when mortgage was paid off.

*Held:* Agreement was intended to be legally binding and was created after the marriage had broken down.

**Commercial agreements** – these are generally intended to be legally bound contracts, however there are some exceptions.

- By statute.
- By express declaration – “gentlemen’s agreement” or “binding in honour”. (*Rose and Frank v Crompton Bros (1925)* where expressly mentioned in the commercial agreement was an “honourable pledge” clause stating the agreement was not legal. The agreement was terminated. It was held that it was not legally binding as there was no obligation to fulfil contract.)
- By a without prejudice clause.

## 6.3 Agreement

We need an offer and an acceptance for there to be an agreement.

### Offer

A definite statement to be bound by specific terms. It can be expressed or implied and if accepted will be legally bound. It may be made to a person or more than one person or to the public at large and only the person or person receiving this offer can accept it.

In *Carlill v Carbolic Smoke Ball Company (1893)* the company's advert said that whoever used the smoke ball as directed and contracted influenza would be given £100 reward. The company further said that they deposited £1,000 in a bank to show that they are committed to this promise. Carlill bought the smoke ball, used it as directed and caught influenza.

*Held:* It was an offer made to the public at large and could be accepted by anyone. The smoke ball failed to do as per the advert's promise and therefore did not fulfil the contract and therefore found in favour of Carlill.

### **Invitation to treat**

This is distinguished as not an offer. It is invitation for persons to make offers to himself. It is not something that a person can accept to make a binding legal relation because it is still part of negotiations. Examples are items in a shop or shares prospectus.

In *Fisher v Bell (1960)* a shop keeper was prosecuted for displaying a flick knife for sale under the offensive weapons act, however it was held that it was an invitation to treat and not an offer and it was up to the customer to make an offer. The shop keeper was not in infringement of the law.

In *Pharmaceutical Society of Great Britain v Boots Cash Chemist (1952)* it was held that the drugs on display in the shop which needed pharmacist supervision would be given at the cashdesk point. There was only an invitation to treat up until this point and at the point where the customer wanted to pay for the items there would be adequate trained supervision.

Usually all adverts in the paper are invitations to treat:

In *Partridge v Crittenden (1968)* there was an ad in the paper stating "Bramblefinch cocks and hens, 25s each". It was held that this was an invitation to treat and not an offer the advert stated animals for sale but that he would sell to all who came.

In *Harris v Nickerson (1873)* there was an advert stating that an auction would take place at a certain time, date and location with certain items. The auction took place but without those items. The auctioneer was sued for expenses and damages saying that there was an acceptance of an offer. It was held that the advert was merely a statement and therefore an invitation to treat and not an offer to be accepted.

A mere statement of price is an invitation to treat:

In *Harvey v Facey (1893)* the claimant telegraphed the defendant stating "Will you sell us Bumper Hall Pen, telegraph lowest price", the defendant telegraphed back "lowest price for Bumper Hall Pen £900", the claimant telegraphed back "We agree to buy Bumper Hall Pen for £900 as asked by you". There was no further reply. The claimant claimed there was a contract. *Held:* No contract this was a mere statement of price if there was a sale. It was only an invitation to treat. Not an offer than could be accepted.

### Example 6.1

Tommy sees a colouring book for sale at £4.99. But when he takes it to the checkout point it turns out that the label was wrong and is actually £49.99. Tommy maintains that he should only pay £4.99. What is the situation under contract law?

### Termination of offer

An offer can be terminated as follows:

- **Lapse of time** – an offer expires after a reasonable amount of time if a time limit is not stated. In *Ramsgate Victoria Hotel v Montefiore (1866)* the defendant made an application for shares with a deposit. Five months later an acceptance was sent with allotment of shares and request for final payment. Defendant argued that the offer had expired. It was held that a reasonable time had passed and the offer has lapsed.
- **Failure to meet condition**
- **Death of one of the parties** – if the offeror or offeree dies then the contract is lapsed. An exception to this is if it is a contract not for personal services and the offeror dies without prior notice to offeree then the offeree can enforce the contract.
- **Rejection** – terminates the offer or counter-offer also terminates the original offer. In *Hyde v Wrench (1840)* a property was offered at £1,000 but counter-offered with £950. The counter-offer was rejected. After which the original offer was accepted by the claimant. It was held the original offer was terminated once the counter-offer was made.
- **Revocation** –
  - **an offer can be withdrawn at any time before acceptance.** In *Routledge v Grant (1828)* a horse was offered for sale and six weeks was given to make a decision as to whether to accept or reject. The offer was revoked within six weeks. It was held that there was no acceptance and therefore entitled to revoke offer.
  - **only effective if it has reached the offeree and original offer not been accepted.** In *Byrne v Van Tienhoven (1880)* the defendant posted an offer to claimant in New York and asked for a cable reply. Offer was received by claimant and acceptance was cabled. But in the meantime the defendant had sent a letter revoking offer which was received by the claimant after he had accepted offer. It was held that revocation was not effective as it had arrived after acceptance was sent to defendant in the format requested.
  - **can be communicated by reliable third party.** In *Dickinson v Dodds (1976)* property was offered for sale until a certain deadline. The property was sold to someone else before this deadline and the intermediary between defendant and

claimant had told the claimant that the offer was revoked. The claimant put in acceptance of the offer before the end of the deadline. It was held that the revocation was effective as a reliable third party had informed the claimant inside the deadline and before acceptance by claimant.

### Exceptions to revocation

- **Collateral contract** – If part payment is made by the offeree to the offeror, to keep the offer open then this would create a collateral contract. The original offer cannot be revoked and to do so would be a breach of the collateral contract. Damages would usually be sought by the offeree in this situation.
- **Unilateral contract** – Much like in the case of the carbolic smoke ball an offer made to the whole world, it would be almost impossible to notify everyone who saw the offer a revocation. In addition if the offeree has begun performing his part of the contract, then it would not be fair to revoke the offer.

### Acceptance

This is agreeing unconditionally to an offer made to you and thus entering into legally binding relations.

- **Acceptance can be made through oral, written or conduct by the offeree, but not through silence or in action.** In *Felthouse v Bindley (1862)* there was an offer to buy a horse for a sum of money and added “if I hear no more about him, I consider the horse mine” There was no reply to this offer. It was held that there was no contract as silence is not an act to accept an offer.
- Acceptance must be done through the **stipulated format as prescribed by the offer.** If no such format is given in the offer then a reasonable method is acceptable.
- **Acceptance is only effective when it is communicated or received.** In *Entores v Miles Far East Corporation (1955)* an offer was sent by telex which was received and an acceptance of this offer was sent back by telex. A breach of contract was claimed soon after and now the claimant wants to issue a writ. It was held that a contract was made as acceptance took place as soon as it was printed out at the defendants telex machine. A writ can be served.
- **Postal rule** – is an exception to the above, because under this rule acceptance is effective from the moment it was posted not when the offeror has received it or not. This is the case as long as:
  - **Both parties have stipulated this as being acceptable.**
  - **The acceptance is properly addressed stamped and posted.** In *Household Fire Insurance v Grant (1879)* Grant applied for shares in a company, and the shares were posted to Grant. Grant never received the shares. The company went bust and Grant was sued for the outstanding amount on the shares allotted to him. It was held that the postal rule applied and acceptance was effective from posting of letter to Grant. Grant was liable.

- **Offeror does not stipulate that the “postal rule” does not apply.** In *Holwell Securities v Hughes (1974)* there was an option given to offeree to buy some property. Option was to be exercised by “notice in writing”. The offer was accepted and a reply was sent in writing in good time of intention to exercise option. This was lost in the post. It was held that “notice in writing” meant that the letter would have to be received by the offerer for it to have effective acceptance and thus binding contract. In this instance the postal rule did not apply.

## 6.4 Consideration

Consideration has been defined as:

“A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.” *Currie v Misa (1875)*

	Buyer	Seller
Gain	Goods	Cash
Loss	Cash	Goods

- **Executed consideration – means an act in exchange for a promise.** For example the offer of doing a day’s work (act) in a coal mine in exchange for money after the day’s work (promise).
- **Executory consideration – means a promise in exchange for a promise.** For example if Sir Bobby intends to sell his house to Mr Souness, and Sir Bobby intends to buy Sven’s house. All these acts are in the future and yet to be carried out.
- **Past consideration is not enforceable** – something that already has been done and a promise to pay for this work done. In *Re McArdle (1951)* husband left house to wife and children. One of the son’s came to live in the house with mother. Son’s wife made improvements to the house and afterwards the other children agreed to compensate her for her efforts. The payment was never made. It was held that this was past consideration, house improvements made before the agreement, and therefore the promise is unenforceable.
- **Consideration must be sufficient** – there must have been a loss incurred by the promisor and the promisee must be obtaining a gain.
- **If the promisee is bound by law anyway to do a certain task this will not be seen as consideration.** In *Collins v Godefroy (1831)* Godefroy subpoenaed Collins and promised to pay him for giving evidence on Godefroy’s behalf. It was held that there was no consideration for this promise money. Collins was already going to appear in court due to legal duties.

This is different to *Glasbrook Bros Ltd v Glamorgan County Council (1925)* where the police provided special guard service for a company who agreed to pay for this extra service. The company did not pay as the police were performing a public duty. It was held that the police had provided an extra service which was beyond normal public duty and therefore there was a consideration.

- If you have **promised to pay extra for services which you have already contracted** with someone, then this is binding as long as the services performed are **outside the existing contractual duties**. In *Williams v Roffey Bros and Nelson Contractors (1990)* Roffey Bros had been contracted to do some work for Williams but got behind slightly. Williams offered extra pay to make sure they finished on time. They completed on time and requested payment. Williams refused to pay. It was held that they were entitled to the extra pay as if they did not complete on time, Williams would have had to pay penalties to Nelson a third party. There was consideration given to Williams.

## 6.5 Misrepresentation

**Void contract** – is not a contract at all although there has been offer and acceptance. It was as if the contract never existed. All property and monies are returned to their original owners as if it they never left even if these items had been passed on to innocent parties.

**Voidable contract** – is a contract which can be avoided by one party. The party can recover all goods so long as they have not passed on to an innocent third party. If this has occurred then it is said that “good title has passed” and any kind of compensation must be with the person in the original contract. Rescission is the usual way a contract is avoided which restores one’s original position.

**Misrepresentation is a false material fact used by one party to induce the other party into making a legal contract.** Misrepresentation would make a contract voidable.

**A statement of fact** – In *Edgington v Fitzmaurice (1885)* a company issued a prospectus requesting the public to buy debentures. The prospectus described the purpose of the loans was to purchase items for the business; however the monies were used to pay off creditors. It was held that this was a material misstatement by the directors in obtaining monies for the debentures.

**Opinion** – doesn’t normally form part of misrepresentation but actionable if implies underlying knowledge of fact. In *Esso Petroleum v Mardon (1975)* a representative for Esso stated that a garage will sell 200,000 gallons over 3 years. The station hadn’t been used before. It didn’t sell 200,000 gallons. It was held that although the statement was opinion, Esso were experts in this field and can be reasonably believed that this was based on fact therefore it was actionable.

**Silence** – is not deemed as misrepresentation except for the following situations:

- **Where the information is incomplete (half-truth).** In *R v Kylslant (1931)* a company’s prospectus stated that dividends had been paid over a number years. However didn’t mention that they have been paid out of reserves and not profits. Big losses occurred in those years.



- **A statement is true to begin with but becomes false before the completion of the contract.** In *With v O'Flanagan (1936)* a doctor was to sell his practice which has an income of £2,000 a year. The doctor fell ill shortly after and the annual income suffered substantially and it was worth a lot less at time of sale. It was held that his illness had affected the value of the practice and had made his earlier representation untrue. His silence was misrepresentation as he should have corrected his earlier statement. The sale was voidable.
- **Utmost good faith contracts (*uberrimae fidei*)** where you must disclose all material facts known. The contract is voidable if there is non-disclosure. Examples are insurance agreements where you must disclose all or the agreement is voidable and solicitors/client relationship.

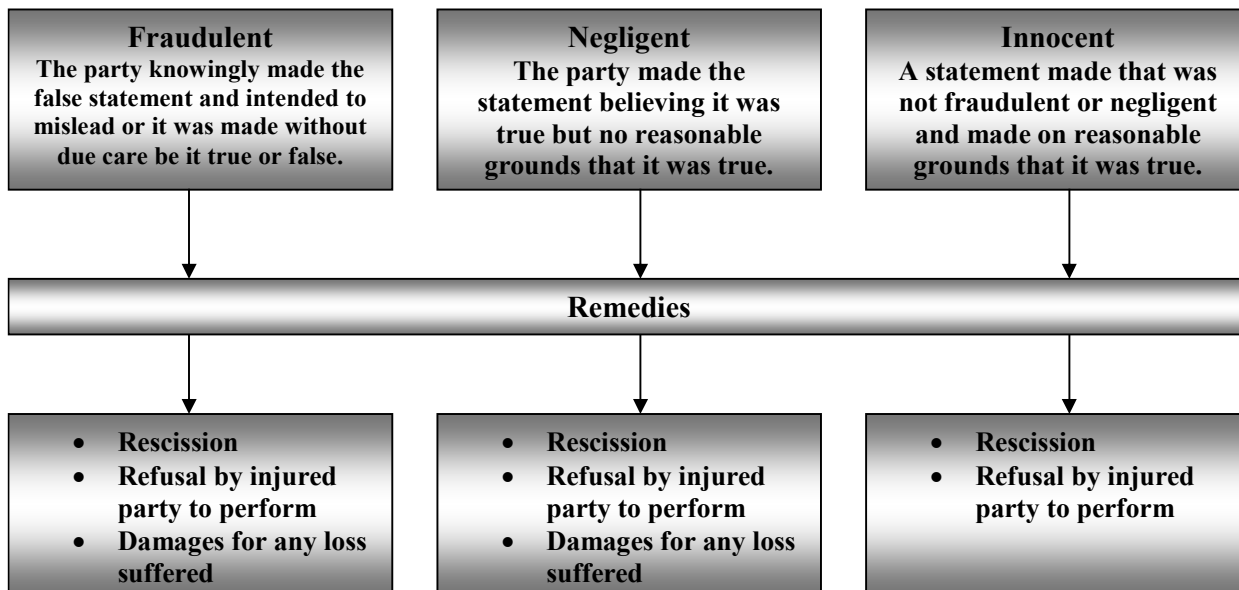
**Inducement to enter into contract** has taken place if:

- There was knowledge of inducement
- Occurred before the contract was completed
- It affected judgement
- Unaware of truth

In *Redgrave v Hurd (1881)* a solicitors practice was purchased on the value given by the seller. The buyer had the chance to examine the accounts but did not, relying on the seller's statement. Had the accounts been examined the truth would have been uncovered. It was held that this was a misrepresentation.

In *Attwood v Small (1838)* a gold mine sold by an individual had made several claims about the levels of gold. The buyer had carried out a surveyor's inspection before the contract was complete. It was held that the mine was bought on the reliance of the surveyors report and not the seller, therefore there was no misrepresentation.

## Types of misrepresentation:



Rescission may not occur under the following circumstances:

- The injured party has taken a benefit from the contract e.g. accepting a dividend from a company.
- Lapse of time is too great. In *Leaf v International Galleries* a painting was bought from a gallery which was innocently misrepresented. Five years later the problem was uncovered. The contract tried to be voidable but it was held lapse of time was too great.
- Parties cannot be restored to original positions because good title has passed on to a third party.

## 6.6 Contract terms

These are the items which have been agreed upon by both parties, where the terms of the offer are the terms of the contract because acceptance is unqualified and absolute.

**Conditions** = major terms, expressed or implied, so important that its breach or non-performance will destroy the contract. If broken would entitle the injured party to discharge the contract and claim damages.

**Warranties** = minor terms, expressed or implied, if broken the injured party must continue and may claim damages for loss suffered.

In *Poussard v Spiers (1876)* Poussard was due to appear on 28/11/1874 for an opera show but appeared on 04/12/1874. Spiers had managed to find a substitute but in order to secure this singer he had to give the entire contract. Poussard's services were refused when she turned up. Poussard sued for breach of contract. It was held that Poussard's non-appearance until the 4<sup>th</sup> was a condition in the contract which was breached and therefore Spiers was entitled to discharge the contract.

In *Bettini v Gye (1876)* Bettini, opera singer, was contracted to do a series of performances but also was contracted to come to the rehearsals. He couldn't come to the rehearsals because he was ill but arrived just before his contracted performances. His services were refused. It was held that the rehearsal was a warranty in the contract and not a condition therefore there was a breach of contract by Gye. But Gye could make a claim for damages for any loss suffered.

**Innominate terms** = when it is not clear whether it is a condition or warranty. Courts must then decide whether breach has caused the injured party to lose most of the benefit he would have received from the contract. Then this would be a breach of condition.

**Express terms** = these are mentioned expressly as part of the contract be it in writing or orally.

**Implied terms** = these are not expressly mentioned in the contract but are used to fill in the gaps of presumed intention and protect the weaker party.

Implied terms may be as follows:

- Custom – parties entering in to a contract subject to customs in trade.
- Statute – these are in law and used to protect. E.g. the Sale of Goods Act 1979.
- Previous dealings – courts will recognise a term which has been implied in regular transactions with two parties.
- Business efficacy – something which is so obvious is implied by the courts. In *The Moorcock (1889)* a ship was moored alongside a wharf to unload its cargo. It is known by all that at low tide the ship would be grounded next to this wharf. The ship was grounded and got damaged. It was held that the ship owners should have taken reasonable care to ensure the ship does not get damaged at low tide as it well known.

## Key summary of chapter

### Contract law

A contract is a legally binding agreement between parties. It is made by consenting parties and is recognised by the law as enforceable.

The main elements that are needed for a **simple contract** (made through any form being oral, written or inferred by action of parties) are:

- **Intention to create legal relations** – clear indication by both parties.
- **Agreement** – there must be an offer and acceptance.
- **Consideration** – there must be value given by both parties.

The following elements would validate all contracts:

- **Form** – the contract must be in a particular form to be valid.
- **Capacity to contract** – most people have the capacity to enter into a contract except for minors or companies which may be restricted to their constitution.
- **Legal nature of contract** – it must be a contract for a legal act to be enforceable.
- **Reality of consent** – if one party agreed to the contract based on the other's misrepresentation then the contract can be rescinded.

**Social and domestic agreements** –generally not intended to be legally bound contracts.

**Commercial agreements** –generally intended to be legally bound contracts.

### Offer

A definite statement to be bound by specific terms. It can be expressed or implied and if accepted will be legally bound. It may be made to a person or more than one person or to the public at large and only the person or person receiving this offer can accept it.

**Invitation to treat** – is an invitation for persons to make an offer and not an offer that can be accepted (*Fisher v Bell 1960*).

**Termination of offer:**

- Lapse of time (*Ramsgate Victoria Hotel v Montefiore 1866*).
- Failure to meet conditions
- Death of one of the parties
- Rejection (*Hyde v Rensch 1840*).
- Revocation (*Routledge v Grant 1828*), (*Byrne v Van Tienhoven 1880*).

**Acceptance:**

- Acceptance can be made through oral, written or conduct by the offeree.
- Not through silence or inaction (*Felthouse v Bindley 1862*).
- Stipulated format as stated by the offer.
- Only effective when it is communicated or received (*Entores v Miles Far East Corporation 1955*).
- Postal rule.

### **Consideration:**

- Past consideration is not enforceable (*Re McArdle 1951*).
- Consideration must be sufficient.
- Bound by law to do a task anyway (*Collins v Godefroy (1831)*).
- Promised to pay for extra services outside contractual duties (*Williams v Roffey Bros and Nelson Contractors 1990*).

### **Misrepresentation**

**Void contract** – is not a contract at all although there has been offer and acceptance.

**Voidable contract** – is a contract that can be avoided by one party.

Misrepresentation is a false material fact used by one party to induce the other party into making a legal contract.

Misrepresentation would make a contract voidable.

### **Types of misrepresentation:**

#### **Fraudulent**

The party knowingly made the false statement and intended to mislead or it was made without due care be it true or false.

#### Remedies

- Rescission.
- Refusal by injured party to perform.
- Damages for any loss suffered.

**Negligent**

The party made the statement believing it was true but no reasonable grounds that it was true.

**Remedies**

- Rescission.
- Refusal by injured party to perform.
- Damages for any loss suffered.

**Innocent**

A statement made that was not fraudulent or negligent and made on reasonable grounds that it was true.

**Remedies**

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**Contract terms**

**Conditions** = major terms, expressed or implied, so important that its breach or non-performance will destroy the contract.

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Implied terms maybe as follows:

- Custom
- Statute
- Previous dealings
- Business efficacy

## **Solutions to lecture examples**



## Chapter 6

### **Example 6.1**

Tommy sees a colouring book for sale at £4.99. But when he takes it to the checkout point it turns out that the label was wrong and is actually £49.99. Tommy maintains that he should only pay £4.99. What is the situation under contract law?

This is an invitation to treat by the shop and not an offer *Fisher v Bell (1961)*. The shop has the right to accept or reject the customers offer.