Law Angels

LAW OF CONTRACT

SQE 1 PREP

LAW ANGELS

CONTRACT LAW

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LAW ANGELS

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PREFACE

Contract law is the bedrock of commerce and daily life, governing the agreements that underpin everything from complex corporate mergers to simple online purchases. It is a discipline of logical principles and nuanced application, where the precise meaning of a promise can determine rights, obligations, and remedies. This textbook is designed to be your guide through this foundational area of law, providing a clear and analytical pathway from formation to breach.

Our approach is built on a simple belief: to master contract law, you must understand not just what the rules are, but how they interact to resolve disputes and give effect to the intentions of the parties. We have therefore structured this text to do more than present legal doctrine. It deconstructs the lifecycle of a contract, breaking down each element, from offer and acceptance to consideration and intention, and illustrating how they operate in real-world scenarios. You will find a consistent focus on the interpretation of terms, the vitiating factors that undermine agreements, and the strategic assessment of remedies for breach.

The SQE1 assessment requires a deep and application-based knowledge. This book is tailored to that challenge. We integrate pivotal cases and statutory provisions, such as the *Sale of Goods Act 1979* and the *Consumer Rights Act 2015*, not as isolated facts, but as the essential tools for constructing and analysing legal arguments. Clear examples, flowcharts tracing the path of contractual analysis, and scenario-based problems are woven throughout to transform your understanding from passive reception to active application.

Our goal is to equip you with a formidable and practical command of contract law. Whether you are drafting a clause, advising a client on the enforceability of an agreement, or seeking a remedy for breach, the following pages will provide the clarity, logical rigour, and analytical depth you need to succeed.

Welcome to the study of contract law. The principles are timeless, and their mastery is indispensable for any aspiring solicitor.

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ACKNOWLEDGEMENTS

The development of this textbook was a significant endeavor, and we extend our sincere gratitude to the collective efforts that made this publication possible.

At Law Angels, we are fortunate to be supported by a dedicated team whose commitment to legal education and excellence is the cornerstone of our work. The collaborative spirit, legal expertise, and tireless effort of our entire organization were instrumental in shaping this text from concept to completion.

We also extend our appreciation to the broader legal community. The insightful feedback from our academic and practitioner reviewers greatly enhanced the accuracy and clarity of the material. Their contributions, offered in a spirit of scholarly collaboration, have been invaluable in ensuring this resource meets the rigorous demands of the SQE curriculum.

We are also thankful for the unwavering support from our personal networks, whose understanding provided the foundation that allowed this project to thrive.

It is our privilege at Law Angels to contribute to the education of future solicitors, and we hope this text serves as a reliable guide for the next generation of legal professionals.

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GLOSSARY OF KEY TERMS

A

Acceptance: An unqualified expression of assent to the terms of an offer, made in the manner specified or indicated by the offeror.

Accord and Satisfaction: An agreement (accord) to discharge an existing obligation by providing different consideration (satisfaction).

Anticipatory Breach: A breach of contract that occurs when one party clearly indicates, before the time for performance is due, that they will not perform their obligations.

Auction: A process of selling goods where an offer is made by a bidder and accepted by the fall of the auctioneer's hammer.

B

Battle of the Forms: A conflict that arises when two parties each try to incorporate their own standard terms into a contract, often through competing documents like purchase orders and acknowledgements.

Breach of Contract: The failure, without a lawful excuse, to perform any part of a contract when it falls due.

Business Efficacy: The principle that a term may be implied into a contract to make it work as the parties must have intended.

C

Capacity: The legal ability of a person or entity to enter into a binding contract (e.g., minors, corporations, and mentally disordered persons have limited capacity).

Certainty: The requirement that the terms of an agreement must be clear and complete enough for a court to be able to enforce them.

Condition: A major term of a contract which goes to the root of the agreement. Breach of a condition gives the innocent party the right to terminate the contract and claim damages.

Consideration: The price paid for a promise. It is something of value (e.g., a payment, an act, or a forbearance) given by one party to another in exchange for a promise.

Contra Proferentem Rule: A rule of interpretation which states that any ambiguity in a clause (especially an exemption clause) should be construed against the party who sought to include it.

Contract: A legally binding agreement between two or more parties that creates enforceable rights and obligations.

Counter-offer: A response to an offer which varies its terms. It operates as a rejection of the original offer and the creation of a new offer.

D

Damages: A monetary award intended to compensate the innocent party for the loss suffered as a result of a breach of contract.

Duress: A vitiating factor where a party is forced into a contract by illegitimate pressure, such as threats to person, goods, or economic interests.

E

Economic Duress: Illegitimate commercial pressure which coerces a party into entering a contract, rendering the contract voidable.

Exemption Clause: A term in a contract which seeks to exclude or limit the liability of one party for breach of contract or negligence.

Express Terms: Terms of a contract that are explicitly stated by the parties, whether orally or in writing.

F

Frustration: An event, occurring after the formation of the contract, which is beyond the control of the parties, renders the contract impossible, illegal, or radically different from what was agreed, and discharges the parties from further performance.

Fundamental Breach: A breach of contract so serious that it deprives the innocent party of substantially the whole benefit of the contract.

G

Guarantee: A secondary agreement where one party (the guarantor) promises to answer for the debt or default of another (the principal debtor).

I

Illegality: A contract is illegal if it involves committing a crime or tort, or is contrary to public policy. Such contracts are typically void and unenforceable.

Implied Terms: Terms that form part of a contract without being expressly stated. They can be implied by fact, by custom, by common law, or by statute.

Indemnity: A promise to compensate another party for a specific loss or damage they may suffer.

Injunction: A court order requiring a party to do (mandatory injunction) or refrain from doing (prohibitory injunction) a particular act.

Innocent Misrepresentation: A false statement made honestly and without negligence, which induces the other party to enter the contract.

Innominate Term: An intermediate term of a contract where the consequences of a breach, rather than the nature of the term itself, determine the remedy. If the breach deprives the innocent party of substantially the whole benefit, they may terminate; otherwise, only damages are available.

Intention to Create Legal Relations: The presumption that the parties intended their agreement to be legally binding. This is strong in commercial contexts but rebuttable in social/domestic ones.

Invitation to Treat: An expression of willingness to negotiate, which is not an offer but an invitation for others to make an offer (e.g., goods on a supermarket shelf).

L

Liquidated Damages: A genuine pre-estimate of the loss that would be caused by a breach of contract, agreed by the parties in the contract itself.

Limitation Clause: A term in a contract that seeks to limit, rather than exclude, the liability of one party (e.g., capping the amount of damages payable).

M

Misrepresentation: A false statement of fact or law made by one party (the representor) to the other (the representee) which induces the representee to enter into the contract.

Mistake: An erroneous belief held by one or both parties at the time of contracting about some fact fundamental to the agreement. The law on mistake is narrow and can render a contract void (*void ab initio*) in limited circumstances.

Mitigation (Duty to Mitigate): The obligation on the innocent party to take reasonable steps to minimise the loss they suffer as a result of the other party's breach.

N

Negligent Misrepresentation: A false statement made without reasonable grounds for belief in its truth, which induces the other party to enter the contract. Actionable under *s.2(1) Misrepresentation Act 1967* or at Common Law.

O

Offer: A definite promise to be bound on specific terms, made with the intention that it becomes binding upon acceptance.

Offeror: The person who makes an offer.

Offeree: The person to whom the offer is made.

P

Parol Evidence Rule: A rule which prevents a party from presenting extrinsic evidence (oral or written) that would add to, vary, or contradict the terms of a written contract intended to be the entire agreement.

Penalty Clause: A clause that stipulates a sum payable on breach that is not a genuine pre-estimate of loss but is intended to punish the breaching party. It is unenforceable at common law.

Performance: The fulfilment of a contractual obligation, which discharges the party from their duty.

Postal Rule: An exception to the rule on communication of acceptance, stating that an acceptance by post is effective from the moment the letter is posted, provided it was reasonably contemplated by the parties.

Privity of Contract: The doctrine that a contract cannot confer rights or impose obligations arising under it on any person except the parties to it.

Promissory Estoppel: An equitable doctrine that may prevent a party (the promisor) from going back on a promise, even without consideration, if it was intended to be binding, relied upon, and it would be inequitable to allow them to renege.

Q

Quantum Meruit: A claim for a "reasonable sum" for work done or goods supplied, often arising where a contract has been discharged or is unenforceable.

R

Remoteness of Damage: A legal principle that limits the recoverability of losses. Damages can only be claimed for losses which were reasonably foreseeable as liable to result from the breach at the time the contract was made.

Repudiation: A breach of contract which is so serious that it indicates the breaching party's intention to no longer be bound by the contract, giving the innocent party the right to terminate.

Rescission: An equitable remedy that aims to restore the parties to the position they were in before the contract was made. It is available for vitiating factors like misrepresentation.

Restitution: The law of gains-based recovery, aimed at preventing unjust enrichment, often by requiring the defendant to give back a benefit they have received at the claimant's expense.

S

Specific Performance: A discretionary equitable remedy which orders a party to perform their contractual obligations, typically granted where damages are an inadequate remedy (e.g., for the sale of unique goods like land).

Standard Form Contract: A pre-prepared contract where one party sets the terms and the other has little or no ability to negotiate them.

T

Term: A provision of a contract that creates a contractual obligation.

U

Undue Influence: A vitiating factor where one party abuses a position of trust or authority over another to secure an agreement. It can be actual or presumed.

Unfair Contract Terms Act (UCTA) 1977: A UK statute that imposes limits on the extent to which liability for breach of contract, negligence, or other breaches of duty can be avoided by exclusion clauses.

Unilateral Contract: A contract where one party (the offeror) makes a promise in exchange for an act from the other party (the offeree). Acceptance occurs only upon full performance of the act (e.g., reward offers).

Unjust Enrichment: The principle that a person should not be allowed to profit at another's expense without there being a legal reason for doing so. It is the foundation for restitutionary claims.

V

Vitiating Factor: A defect in the formation of a contract (such as misrepresentation, mistake, duress, or undue influence) which undermines its validity and may make it void or voidable.

Void Contract: A contract that has no legal effect from the outset, as if it never existed. No rights can be transferred under it.

Voidable Contract: A contract that is initially valid but can be set aside (rescinded) at the option of one of the parties due to a vitiating factor.

W

Warranty: A minor term of a contract, collateral to the main purpose. Breach of a warranty only gives the right to claim damages, not to terminate the contract.

1

THE NATURE AND FOUNDATION OF A CONTRACT

Imagine a world where a simple promise meant nothing. If David agreed to sell his car to Chloe for £5,000, Chloe could take the car and refuse to pay, or David could keep the £5,000 and refuse to hand over the keys, with no consequences. Commerce and daily life would be chaotic because people could not rely on each other's word. The Law of Contract is the legal framework that prevents this chaos. It is the set of rules that determines which promises the law will enforce, and what happens when they are broken. In essence, contract law is the foundation of all market economies and our daily interactions, from buying a coffee to signing an employment contract. It provides the certainty and security that allows us to plan for the future and trust in our dealings with others.

1.1 Definition and Essential Elements of a Valid Contract

So, what exactly is a contract? A simple definition is: A legally binding agreement. This means it is more than just a casual promise; it is a promise that a court will recognise and enforce.

For an agreement to become a legally binding contract, it must contain five essential ingredients. Think of these as the five pillars that hold up a contract. If any one of these pillars is missing, the agreement will not be legally enforceable. The five pillars are:

1. **Agreement**: This is achieved through an offer made by one party and an acceptance of that offer by the other. For example, Sarah offers to sell her laptop to Ben for £300, and Ben says, "Yes, I'll buy it."

2. **Consideration**: This is the price paid for the promise. Each party must give something of value to the other. It can be money, an item, or an act. In our example, Sarah's consideration is the laptop, and Ben's consideration is the £300. A one-sided promise, like "I promise to give you my watch," without you giving anything in return, lacks consideration and is not a contract.

3. **Intention to create legal relations**: The parties must have intended for their agreement to be legally enforceable. The law presumes that in business agreements, this intention exists. In social or domestic arrangements, like a promise between friends to meet for dinner, the presumption is that there is no such intention.

4. **Certainty**: The terms of the agreement must be clear and complete enough for a court to understand what it is supposed to enforce. An agreement where David agrees to sell his car to Chloe "for a reasonable price" might be too uncertain if they cannot agree on what "reasonable" means.

5. **Capacity**: The parties must have the legal ability to enter a contract. Most adults have full capacity, but there are special rules for minors (those under 18), people who are mentally incapacitated, and companies.

1.2 The Objective Test of Agreement

How do we prove that two people had a meeting of the minds? We cannot look inside their heads. Instead, the law uses an objective test. This means we do not ask, "What did Sarah truly believe in her mind?" We ask, "How would a reasonable person, looking at what was said and done, interpret Sarah's actions and words?"

The famous case of ***Smith v Hughes*** [1871] LR 6 QB 597 illustrates this. Mr. Smith believed he was selling old oats to Mr. Hughes, and Mr. Hughes believed he was buying new oats. The court did not try to figure out who was secretly right. It looked at their outward conduct. If a reasonable person in Mr. Smith's position would have believed Mr. Hughes was agreeing to buy the old oats that were on offer, then a contract for old oats existed.

For example, if Tom jokingly tells his neighbour, "I'll sell you my house for £1!" and the neighbour, knowing it's a joke, says "Done!", a court would not enforce this. A reasonable person would see that Tom did not objectively intend to make a real offer. The objective test ensures that contracts are based on reliable, external evidence, not on hidden thoughts.

1.3 Distinction between Contract, Tort, and Restitution

Contract law is one area of civil law, but it is not the only one. It is crucial to distinguish it from two other key areas: Tort and Restitution.

Contract

Contractual duties are voluntarily undertaken by the parties through their agreement. If David contracts to paint Chloe’s house, his duty to do so comes from his promise. The main remedy for breach of contract is damages to put the innocent party in the position they would have been in if the contract had been performed.

Tort

Tortious duties are imposed by law, regardless of any agreement. The duty not to be negligent is owed to everyone in society. If David is driving carelessly and crashes into Chloe’s car, he has committed the tort of negligence. The remedy is damages to put Chloe back in the position she was in before the wrong occurred.

Restitution (or Unjust Enrichment)

This area of law prevents one person from being unjustly enriched at the expense of another. It does not depend on a promise or a wrong. If David accidentally pays £100 into Chloe’s bank account, Chloe has been unjustly enriched. The law of restitution will force her to pay that £100 back, even though there was no contract and she did nothing wrong. A common claim is for *quantum meruit* (a "reasonable sum"), for example, if Ben does work for Sarah expecting to be paid, but no formal contract is ever signed, a court may order Sarah to pay a reasonable amount for the benefit she received.

1.4 The Principle of Freedom of Contract

The guiding principle of English contract law is Freedom of Contract. This means that the law respects the right of individuals and businesses to freely negotiate and enter into any agreements they choose, on whatever terms they see fit. The courts see their role as enforcing the bargain the parties have made for themselves, not in rewriting a bad deal.

This principle has two main aspects:

1. **Freedom to contract**: You are free to choose with whom you wish to make a contract.

2. **Freedom of contract terms**: You are free to agree on any terms you like.

However, this freedom is not absolute. Parliament and the courts have intervened to protect weaker parties and uphold fairness. Key statutes that limit freedom of contract include:

- **The *Unfair Contract Terms Act (UCTA) 1977***: This Act controls the use of exclusion clauses that try to limit liability for negligence or breach of contract.
- **The *Consumer Rights Act 2015***: This provides strong protection for consumers against unfair terms in contracts with businesses.

So, while David and Chloe are generally free to agree to any price for the car, a business cannot use a hidden, unfair term in a standard contract to exploit a consumer. Freedom of Contract is the starting point, but it is balanced by the need for justice and consumer protection.

1.5 Conclusion

In summary, contract law is the essential machinery that turns simple promises into legally enforceable agreements. By understanding its five essential elements, its objective nature, how it differs from other legal obligations, and its core principle of freedom, you have built the foundational knowledge needed to explore the more detailed rules in the chapters to come.

2

THE FORMATION OF A CONTRACT I: AGREEMENT AND CERTAINTY

Every binding contract begins with a simple, powerful concept: agreement. But in the eyes of the law, a mere handshake or a feeling of mutual understanding is not enough. To be enforceable, an agreement must be proven through a clear, mechanical process. This chapter delves into the first and most critical stage of contract formation, breaking down the legal blueprint that turns a simple promise into the foundation of a binding contract.

We will explore the two essential components of agreement: the offer, a definitive promise that sets the terms, and the acceptance, an unqualified "yes" that seals the deal. You will learn to distinguish a true offer from a mere invitation to negotiate, understand the precise moment a contract is formed through various forms of communication, and grasp the crucial requirement that the agreement must be certain and complete. Mastering these fundamental principles is the first and most important step in your journey through contract law.

2.1 The Requirement of Agreement: Offer and Acceptance

At the heart of every contract is an agreement. Think of it as a meeting of two minds, where both parties consent to the same thing. But how do we prove this meeting of the minds happened? The law simplifies this by breaking down agreement into two clear, mechanical steps: Offer and Acceptance.

One party, the offeror, must make a definite promise. The other party, the offeree, must give a final and unqualified "yes" to that exact promise. It is like a key turning in a lock; the offer is the key, and the acceptance is the turn that opens the door to a binding contract. This chapter will examine both the key and the turn in detail.

2.2 The Doctrine of Offer

2.2.1 Defining an Offer

An offer is a clear and definite statement of the terms on which the offeror is willing to be bound. It must demonstrate an intention to be legally bound as soon as it is accepted by the person it is addressed to. It is not a vague expression of interest; it is the starting pistol for a potential contract.

Example: Sarah sends an email to Ben stating: "I will sell you my 2020 Ford Fiesta, registration AB12 CDE, for £7,000. This offer is open to you until Friday." This is a clear offer. The terms are specific, and it shows Sarah is ready to be bound if Ben agrees.

2.2.2 Distinguishing Offers from Invitations to Treat

This is one of the most important distinctions in contract law. An invitation to treat is not an offer. It is an invitation for others to make an offer. It is the first step in negotiations, not the final step. Why is this distinction so crucial? Because the person who makes the offer is the one in control; they can choose whether to accept or reject the offers they receive.

The law has developed clear rules for common situations:

1. **Goods Displayed in a Shop**

   The display of goods on a shelf, in a shop window, or online is generally an invitation to treat, not an offer. In ***Pharmaceutical Society of Great Britain v Boots Cash*** **Chemists** [1953] 1 QB 401, Boots operated a self-service pharmacy. The law required the sale of certain drugs to be supervised by a pharmacist. The Society argued that when a customer picked up the drug from the shelf, that was an offer, and the sale was complete at that point, away from the pharmacist. The Court of Appeal held that the display of goods was an invitation to treat. The customer makes the offer at the cash desk, and the shop accepts or rejects that offer at the cash desk, where the pharmacist could supervise. This gives the shop the right to refuse a sale (e.g., to a minor).

2. Advertisements

Generally, an advertisement is an invitation to treat, inviting people to make an offer.

Example: An online ad by "David's Gadgets" saying "Brand new smartphone, only £299" is an invitation to treat. When you click "buy now," you are making the offer. David's Gadgets can then accept it (by confirming the order) or reject it (if they are out of stock).

3. Auctions

At an auction, the auctioneer's request for bids is an invitation to treat. Each bid from the audience is an offer. The auctioneer's hammer fall is the acceptance, finalising the contract between the seller and the highest bidder. The case of ***Payne v Cave*** [1789] 100 ER 502 established that a bidder (the offeror) can withdraw their offer at any time *before* the auctioneer's hammer falls. The auctioneer is also free not to accept any bid.

4. Tenders

If a company, "Chloe's Construction," invites contractors to tender for a building project, that invitation is an invitation to treat. The bids submitted by the contractors are offers. Chloe's Construction can then choose which offer to accept.

However, there is a key exception. An advertisement can be a unilateral offer if it is a promise to pay a reward in return for an act. The case of ***Carlill v Carbolic Smoke Ball Company*** [1893] 1 QB 256 is foundational. The company advertised a "smoke ball" product and promised to pay £100 to anyone who used it and still caught influenza. They even said they had deposited £1,000 in the bank to show their sincerity. Mrs. Carlill used the ball and caught the flu. The court held the advertisement was a unilateral offer made to the whole world. It could be accepted by anyone who performed the required act (using the ball and catching the flu). By performing the act, Mrs. Carlill had accepted the offer and was entitled to the £100.

2.2.3 Communication and Termination of an Offer

An offer must be communicated to the offeree. You cannot accept an offer you don't know exists.

Once made, an offer does not last forever. It can be brought to an end in several ways:

1. **Revocation**

   The offeror can revoke (cancel) the offer at any time before it is accepted. The revocation must be communicated to the offeree. It does not take effect until the offeree knows about it. In ***Byrne v Van Tienhoven*** [1880] 5 CPD 344*,* a company in Cardiff posted an offer to a company in New York on October 1st. They posted a letter of revocation on October 8th. The offeree in New York received the offer on October 11th, telegraphed their acceptance, and received the revocation on October 20th. The court held that the revocation was not effective until October 20th. The acceptance on October 11th was valid, creating a binding contract. The postal rule did not apply to revocations.

   Example: Sarah offers to sell her book to Ben on Monday. On Tuesday, she sends Ben a text saying, "I withdraw my offer." Ben reads the text immediately. The offer is revoked. If Ben had accepted the offer on Monday before the text was sent, a contract would exist.

2. **Rejection**

   If the offeree rejects the offer, it is terminated. A counter-offer (a new offer with different terms) also counts as a rejection. In the case of ***Hyde v Wrench*** [1840] 49 ER 132, Mr. Wrench offered to sell his farm to Mr. Hyde for £1,000. Mr. Hyde said, "I will give you £950." This was a counter-offer, which *rejected* the original £1,000 offer. When Mr. Hyde later said, "Okay, I'll give you £1,000 after all," the court held this was a *new* offer, which Mr. Wrench was free to reject. There was no contract.

3. **Lapse of Time**

   An offer will lapse if it is not accepted within a specified time. If no time is specified, it lapses after a reasonable time. What is "reasonable" depends on the context (e.g., an offer to sell perishable goods lapses quickly).

Example: David offers to sell his concert tickets to Chloe "for the next 24 hours." If Chloe does not accept within 24 hours, the offer automatically ends.

4. **Death**

If the offeror dies, the offer terminates, but only if the offeree knows of the death before acceptance. The same generally applies to the offeree's death, as the offer is personal.

2.3 The Doctrine of Acceptance

2.3.1 Unqualified Assent to the Offer

Acceptance is the final and unqualified agreement to all the terms of the offer. It must mirror the offer exactly. This is known as the mirror image rule. Any change to the terms is a counter-offer, not an acceptance.

Example: Sarah offers to sell her car to Ben for £7,000. Ben says, "I accept, and you must also give me a year's insurance." This is not acceptance. It is a counter-offer, which rejects Sarah's original offer.

2.3.2 Communication of Acceptance: The General Rule and Exceptions

The general rule is that acceptance must be communicated to the offeror. Silence cannot amount to acceptance. In ***Felthouse v Bindley*** [1862] EWHC CP J35, a man named Felthouse was negotiating to buy a horse from his nephew. He wrote, "If I hear no more about him, I consider the horse is mine at £30." The nephew did not reply. The court held that no contract existed. The uncle could not impose a contract by silence. The nephew was under no obligation to speak.

However, there are certain exceptions to this rule:

1. **The Postal Rule**

This is a famous exception. Where it is reasonable, intended, or requested that acceptance be sent by post, then acceptance is complete as soon as the letter of acceptance is posted, even if it is lost or delayed in the post. In ***Adams v Lindsell*** [1818] EWHC KB J59, the defendants offered to sell wool to the plaintiffs by post, asking for a reply "in course of post." The offer letter was delayed. The plaintiffs posted their acceptance immediately upon receipt. Due to the delay, the defendants, thinking no reply was coming, sold the wool to someone else. The court held that a contract was formed the moment the plaintiffs posted their acceptance. The defendants were in breach of contract.

The rationale behind this principle is that the offeror chooses the method of communication (post), so they bear the risk of delays. The moment the offeree posts the letter, they have done all they can to finalise the deal.

The postal rule only applies to acceptance. Revocation and rejection must be received to be effective.

2. Unilateral Contracts

In a unilateral contract (like ***Carlill***), acceptance is not through a promise but through full performance of the act. Notification of acceptance is not usually required unless the offer specifies it.

Example: David puts up a poster: "£100 reward for the return of my lost dog, Rover." Chloe does not need to call David and say, "I accept your offer." By finding and returning the dog, she accepts the offer through her actions.

3. Silence in the Context of Conduct

While silence alone cannot accept, conduct can. If the offeror says, "If you agree, just start the work," and the offeree starts the work, their conduct constitutes acceptance.

2.3.3 Acceptance in Instantaneous Communication

For modern, instantaneous methods of communication like email, texting, or live chat, the courts have generally applied a "receipt rule" rather than the postal rule. The acceptance is effective when it is received by the offeror on their system. It does not matter if they have not actually read it yet.

The case of ***Entores Ltd v Miles Far East Corporation*** [1955] 2 QB 327 concerned a telex (an old-fashioned instant message). The court held that acceptance by an instantaneous communication takes effect where and when it is received. If the line fails and the message is garbled, there is no contract, as the acceptance was not properly communicated.

The same logic applies to emails. An email acceptance is likely effective when it arrives at the offeror's server, making it their responsibility to check their emails.

2.3.4 Battle of the Forms

In business, deals are often done using standard forms; a purchase order from the buyer and an order confirmation from the seller. Each form has its own set of terms, often conflicting. This is the "battle of the forms."

The legal question is: whose terms win? The courts apply the traditional offer-and-acceptance analysis to find the last shot fired.

The "Last Shot" Doctrine

The party who fires the "last shot", that is, the last to send a document stating their terms before performance begins without objection, is often held to have their terms incorporated into the contract.

In ***Butler Machine Tool Co Ltd v Ex-Cell-O Corporation (England) Ltd*** [1979] 1 WLR 401 (CA) Butler offered to sell a machine on their terms, which included a price variation clause. Ex-Cell-O "accepted" but on their own terms, which had no price variation clause. They also included a tear-off slip for Butler to sign, stating agreement to Ex-Cell-O's terms. Butler signed and returned the slip. The court held that by returning the slip, Butler had accepted Ex-Cell-O's counter-offer. The contract was on Ex-Cell-O's terms, and the price variation clause was not included.

To win the battle, a business must ensure its terms are the last ones acknowledged by the other party before the contract is formed.

2.4 Certainty of Agreement

2.4.1 The Principle that Agreements must be Certain

For a contract to be enforceable, its terms must be clear and complete. A court cannot enforce a deal if it does not know what the parties agreed to. The agreement must have a clear, objective meaning.

In the case of ***Scammell v Ouston*** [1941] 1 AC 251, the parties agreed to buy a lorry "on hire-purchase terms." There were many different kinds of hire-purchase terms in the industry. The House of Lords held the agreement was too vague to enforce because a court could not determine which specific set of terms the parties intended.

2.4.2 Mechanisms for Resolving Uncertainty

The courts will strive to uphold agreements where possible. They have several tools to save an agreement that appears uncertain.

1. The court will look at the words the parties used and try to give them a reasonable meaning.
2. **Implication of a reasonable term**: If a term is missing (e.g., the price), the court may imply a term that the goods or services be supplied for a reasonable price. *Section s.8(2)* of the *Sale of Goods Act 1979* provides that, "Where… the price is not determined… the buyer must pay a reasonable price."
3. **Severance**: If one part of the agreement is uncertain but the rest is clear, the court may sever (cut out) the uncertain part and enforce the rest.
4. **Custom or previous dealing**: The court may look at the parties' previous dealings or trade custom to clarify a vague term.

2.4.3 Agreements to Agree

An agreement to agree in the future is not a binding contract. The law requires a concluded bargain, not an agreement to make an agreement later.

In ***May & Butcher v The King*** [1934] 2 KB 17, the parties agreed to sell tentage at prices to be agreed from time to time. The court held this was unenforceable. They had left a fundamental term (the price) to be settled in the future, and there was no mechanism to determine it if they failed to agree.

However, if the agreement contains a clear mechanism for determining a missing term (e.g., "at a price to be fixed by a named third-party valuer"), it may be enforceable.

2.5 Conclusion

In conclusion, the formation of a valid contract depends on a clear offer and acceptance that demonstrates mutual consent. An offer is a definite promise capable of acceptance, while an invitation to treat is merely an invitation to negotiate. Offers can lapse, be revoked, or terminated by rejection, and acceptance must be a clear and unconditional agreement communicated to the offeror, except in specific cases like the postal rule, where acceptance takes effect once posted.

Ultimately, contract law ensures certainty and fairness by enforcing only those agreements where the parties have genuinely reached consensus. While courts often strive to uphold agreements through interpretation and gap-filling, they cannot enforce vague arrangements or “agreements to agree.” The goal remains to uphold commercial certainty while respecting the autonomy of contracting parties.

3

THE FORMATION OF A CONTRACT II: CONSIDERATION AND INTENTION

In the previous chapter, we explored the crucial first step in forming a contract: achieving a clear agreement through offer and acceptance. However, not every agreement results in a legally binding contract. If David agrees to meet Chloe for coffee, and Chloe fails to show up, David cannot typically sue her for breach of contract. The law requires two further pillars to support the structure of a binding agreement: Consideration and Intention to Create Legal Relations.

This chapter delves into these two foundational doctrines. Consideration is often described as the "price of a promise," the element of exchange that distinguishes a binding contract from a mere gift. Alongside it, the doctrine of intention to create legal relations acts as a filter, separating social and domestic agreements from those made in a commercial context where the parties are presumed to want legal consequences. Together, these principles ensure that the law of contracts enforces only those promises that are part of a genuine bargain and are intended to be legally binding.

3.1 The Doctrine of Consideration

3.1.1 Definition: "Something of Value in the Eye of the Law"

Consideration is the essential element of a bargain. It is what each party brings to the agreement. The classic definition is from the case of ***Currie v Misa*** [1875] LR 10 Ex 153, which described consideration as "some right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility given, suffered or undertaken by the other."

In simpler terms, consideration is the price paid for the other party's promise. For a contract to be enforceable, both parties must provide consideration. This is known as the principle of mutuality.

Example: Sarah promises to sell her car to Ben for £5,000.

- Sarah's consideration: The car (a benefit to Ben, a detriment to Sarah).
- Ben's consideration: The £5,000 (a benefit to Sarah, a detriment to Ben).

This exchange of promises creates a binding contract. If Sarah had simply promised to *give* Ben the car, and Ben promised nothing in return, there would be no consideration from Ben, and the agreement would be a gratuitous promise, legally unenforceable.

3.1.2 Executed, Executory, and Past Consideration

Consideration can be categorized based on its timing relative to the promise:

1. **Executory Consideration**

   This is a promise given in exchange for a promise. It is a commitment to do or give something in the future. This is the most common type in bilateral contracts.

   Example: On Monday, Sarah promises to deliver her car to Ben next Friday, and Ben promises to pay £5,000 on the same day. Both parties' consideration is executory. A binding contract exists from Monday.

2. **Executed Consideration**

This is an act performed in response to a promise. The act itself is the consideration. This is common in unilateral contracts.

Example: David offers a £100 reward for the return of his lost dog. Chloe's consideration is the act of finding and returning the dog. Her act is executed consideration, which accepts the offer and completes the contract.

3. **Past Consideration**

This is an act that was completed before any promise was made. Past consideration is not valid consideration. The act must be done at the promisor's request and in the context of a pre-existing understanding that payment would be made. In the case of ***Roscorla v Thomas*** [1842] EWHC QB J74, after the sale of a horse, the seller promised the buyer that the horse was "sound and free from vice." The horse turned out to be vicious. The court held that the promise was made after the sale was complete. The consideration for the sale was in the past, and the promise regarding the horse's temperament was unsupported by new consideration and therefore unenforceable.

The case of ***Lampleigh v Brathwait*** [1615] EWHC KB J 17 established an exception. Past consideration *can* be valid if the act was done at the request of the promisor, and both parties understood that the act would be remunerated. The subsequent promise is seen as fixing the amount of a payment that was always intended.

3.1.3 The Rule: Consideration must be Sufficient but need not be Adequate

This is a crucial principle. Sufficiency means the consideration must have some identifiable value, however small, in the eyes of the law. Adequacy refers to whether it is a fair or equal price in economic terms. The courts do not concern themselves with whether the bargain is a good one; that is for the parties to decide.

Sufficient but Inadequate

The law will enforce a contract even if the consideration is grossly inadequate.

Example*:* If Sarah agrees to sell her brand-new car to Ben for £1, the court will see £1 as sufficient consideration (it has legal value), even though it is grossly inadequate. The contract is binding.

Insufficient

Some things are deemed insufficient as consideration because they hold no legal value. These include:

- **Performance of an existing public duty**: A police officer cannot claim extra reward money for doing what they are already legally obliged to do (e.g., arresting a criminal).
- **Performance of an existing contractual duty owed to the promisor**: This is a complex area, explored in detail below.

3.1.4 Consideration must Move from the Promisee

The promisee (the person seeking to enforce the contract) must have provided the consideration themselves. A stranger to the consideration cannot sue on a contract.

Example: David promises Sarah that he will pay £500 to her friend, Chloe, if Sarah paints his fence. Sarah paints the fence. Here, consideration has moved from Sarah (the promisee) to David. Sarah can enforce the promise against David. Chloe, who provided no consideration, cannot sue David, even though the promise was for her benefit. This links directly to the doctrine of privity of contract.

3.2 Performance of an Existing Duty

The question of whether doing something you are already legally obliged to do can count as valid consideration is a central and evolving area of contract law. The courts have drawn careful distinctions based on who the existing duty is owed to, recognising that the context of the duty fundamentally changes the nature of the bargain.

3.2.1 Existing Public Duty Imposed by Law

The general rule is that performing a public duty you are already legally required to perform does not amount to fresh consideration for a new promise. The logic is that a citizen should not be able to demand extra payment for simply obeying the law. For instance, a witness who is served with a subpoena, a legal order to testify in court, is under a public duty to attend.

If someone promises the witness a payment for their testimony, the witness cannot enforce that promise because they have given nothing beyond what the law already demands of them. This was the situation in ***Collins v Godefroy*** [1831] EWHC KB J18, where the court held that a promise of payment to a subpoenaed witness was unenforceable, as the witness provided no consideration beyond his existing legal obligation.

However, the law recognises an important exception: if a person goes above and beyond their public duty, they provide fresh consideration. A classic example involves the police. While they have a general public duty to prevent crime and uphold the law, they are not required to provide specific, dedicated services to a private company beyond their normal patrols.

In ***Glashrook Bros Ltd v Glamorgan County Council*** [1925] AC 270, a mine owner, fearing theft and unrest, requested that police officers be stationed physically on their property, a level of protection the police chief believed was unnecessary. The mine owner promised to pay for this service. The court held that by providing this special, dedicated security detail, the police had done more than their public duty required. This extra service constituted valid consideration, making the mine owner's promise to pay legally enforceable.

3.2.2 Existing Contractual Duty Owed to a Third Party

This scenario arises when a person who is already contracted to do something for one party (Party B) makes a new promise to a different party (Party C) concerning the same performance. The law here is more flexible. Performing an existing duty owed to a third party can be valid consideration for a promise from that new party. The reason is that the new party (Party C) receives a benefit from the performance of the duty that they were not previously entitled to.

This was established in the case of ***Scotson v Pegg*** [1861] EWHC Exch J2. Here, one party was already under a contract to deliver coal to a specific person. They then made a new agreement with a different party to deliver the same coal to them. The court enforced this new agreement, ruling that the delivery of the coal to the new party was a valid benefit and therefore constituted good consideration, even though the seller was already obliged to deliver it to someone else. The new promisee gained a legal right to the coal they did not have before.

3.2.3 Existing Contractual Duty Owed to the Promisor

This is the most complex and contentious scenario. If you are already contractually bound to do something for a person, can your promise to do that exact same thing be consideration for a new promise from them, such as extra pay? The traditional answer was a strict "no."

This traditional view is famously illustrated in ***Stilk v Myrick*** [1809] EWHC KB J58. Two sailors deserted a ship in the middle of a voyage. The captain, unable to replace them, promised the remaining crew that he would divide the deserters' wages among them if they worked the ship home short-handed. When the ship arrived, the captain refused to pay.

The court held that the sailors were already bound by their original contracts to meet the normal emergencies of the voyage, which included dealing with desertion. By simply doing what they were already obliged to do, they provided no new consideration for the captain's promise, which was therefore unenforceable. This rule was designed to prevent parties from holding each other to ransom mid-performance.

However, the modern approach has significantly softened this harsh rule. The courts now look for a "practical benefit" that the promisor receives. The landmark case of ***Williams v Roffey Bros & Nicholls (Contractors) Ltd*** [1991] 1 QB 1 revolutionized this area. Roffey Bros was a contractor hired to refurbish a block of flats. They subcontracted the carpentry work to Williams for a fixed price. Williams got into financial difficulty and fell behind schedule.

This was a problem for Roffey Bros because their main contract has a penalty clause for late completion. To avoid this penalty, Roffey Bros promised Williams extra money to finish the job on time. Williams completed the work but was not paid the extra amount. The Court of Appeal held that Roffey Bros' promise was enforceable. The court found that by securing

Williams's continued performance, Roffey Bros obtained a practical benefit: they avoided having to pay a penalty for delay, and they saved the time, trouble, and expense of finding a new subcontractor.

This practical benefit constituted valid consideration, even though Williams was technically only doing what he was already bound to do. It is important to note that ***Stilk v Myrick*** is not overruled; it still applies where a promise is extracted under duress or economic blackmail. However, where a promise to pay more is made voluntarily to secure a genuine commercial advantage, as in ***Williams v Roffey***, it will be binding.

3.3 Part-Payment of a Debt and Promissory Estoppel

A common and very practical problem arises when a debtor is unable to pay a debt in full and the creditor agrees to accept a smaller sum as full and final settlement. Can the creditor later change their mind and sue for the outstanding balance? The common law and equity provide conflicting answers.

3.3.1 The Rule in *Pinnel's Case* and the Principle in *Foakes v Beer*

The traditional common law rule is strict and comes from the old case of ***Pinnel's Case*** [1602] 5 Co Rep 117. It states that payment of a lesser sum on the day it is due cannot be satisfaction for the whole debt. This is because the debtor is only doing what they are already legally obliged to do, and thus the creditor receives no consideration for their promise to waive the balance. This principle was famously affirmed by the House of Lords in ***Foakes v Beer*** [1884] UKHL 1. Dr. Foakes owed Mrs. Beer a sum of money from a court judgment.

She agreed that if he paid the principal sum in instalments, she would not take any further action on the judgment. After Dr. Foakes paid the principal, Mrs. Beer sued for the interest that had legally accrued on the judgment debt. The House of Lords held that her promise not to claim the interest was not binding because Dr. Foakes had provided no consideration for it; he had only paid what he was already legally obliged to pay. She was entitled to the interest.

There are, however, established exceptions to this rule where the part-payment is considered good satisfaction. For example, if the debtor provides something different in addition to the part-payment, such as paying early, paying at a different location, or providing a "peppercorn" (something of trivial intrinsic value but sufficient in law), this can constitute the necessary consideration.

3.3.2 The Doctrine of Promissory Estoppel: Principles and Requirements

To prevent the injustice that can result from the strict rule in ***Foakes v Beer***, the courts of equity developed the doctrine of promissory estoppel. This principle can stop a promisor from going back on their word, even in the absence of fresh consideration.

The modern foundation of this doctrine was laid in the seminal case of ***Central London Property Trust Ltd v High Trees House Ltd*** [1947] KB 130. In 1937, the plaintiffs leased a block of flats to the defendants at an annual rent of £2,500. During the Second World War, the flats could not be fully let, so in 1940 the plaintiffs agreed in writing to reduce the rent by half. This arrangement was intended for the duration of the war. In 1945, with the war over and the flats full again, the plaintiffs sought to return to the original rent.

They also questioned whether they could recover the unpaid half of the rent for the war years. The court held that the full rent was payable from 1945 onwards. However, Lord Denning famously stated that the promise to accept lower rent was binding for the war years. The landlord was estopped from claiming the full rent for that period because the tenant had relied on the promise to its detriment.

For promissory estoppel to apply, several conditions must be met:

1. A clear and unequivocal promise or assurance was made by one party, intending to affect their legal relationship.
2. The promisee relied upon this promise, either by acting or refraining from acting.
3. It would be inequitable for the promisor to go back on their promise, meaning it would be unfair to allow them to enforce their strict legal rights after the promisee has relied on the promise.

It is crucial to understand the limitations of promissory estoppel. It operates as a shield, not a sword. This means it can be used as a defence to a claim (e.g., "You cannot sue me for the full debt because you promised not to"), but it cannot be used to create a new cause of action. Furthermore, it generally suspends rights rather than extinguishes them. The promisor can usually revert to their original strict rights by giving reasonable notice.

3.3.3 The Relationship between Promissory Estoppel and Consideration

Promissory estoppel does not replace or abolish the doctrine of consideration. Instead, it acts as a mitigating principle to prevent injustice. Consideration remains the fundamental basis for the formation of a contract. Promissory estoppel is an equitable doctrine that intervenes to prevent a party who has made a promise, which was intended to be relied upon and was in fact relied upon, from insisting on their strict legal rights where it would be unjust to allow them to do so. It is a safety valve for the legal system, ensuring that the rigid rules of common law, like that in ***Foakes v Beer***, do not lead to unfair outcomes.

3.4 Intention to Create Legal Relations

For an agreement to be a legally binding contract, the parties must not only have reached an agreement supported by consideration, but they must also have intended that agreement to be legally enforceable. This is the final, crucial filter that separates a contract from a mere social promise or a statement of intention. The law applies rebuttable presumptions to determine this intention, meaning it starts with a default position that can be overturned by clear evidence to the contrary. These presumptions differ sharply depending on whether the agreement was made in a commercial or a social/domestic context.

3.4.1 The Presumption in Commercial Agreements

In the world of business and commerce, the law operates on a strong presumption that the parties do intend to create legal relations. This presumption provides the certainty and security necessary for trade and commerce to function. When two businesses or individuals enter into a commercial arrangement, the law assumes they are not merely exchanging pleasantries but are making a serious commitment that they expect to be upheld in a court of law if necessary.

This principle is robust, as seen in the case of ***Edwards v Skyways Ltd*** [1969] 1 WLR 349. Here, an employer, while making an employee redundant, promised an "*ex gratia*" payment. The term "*ex gratia*" translates to "as a favour" and might suggest a payment made without admission of legal liability. However, the court held that in the context of a business negotiation, the use of this phrase was not enough to rebut the strong presumption of an intention to be legally bound. The promise was made in a serious commercial setting, and the employer was therefore held to its word.

This presumption also applies to collective agreements between employers and trade unions. While these agreements are often not intended to be immediately legally binding between the union and the employer, the individual terms they contain, such as pay scales and working hours, are presumed to be intended for incorporation into the individual contracts of employment of the union members. This ensures that the commercial realities of the workplace are legally enforceable for each employee.

The strength of this presumption means that a party wishing to argue that a commercial agreement was not intended to be binding bears a very heavy burden of proof. They would need to provide clear evidence, such as an explicit "honour clause" stating "this agreement is not intended to be legally binding," or by showing that the agreement was merely a statement of future intent or was too vague to be enforced.

3.4.2 The Presumption in Social and Domestic Agreements

In stark contrast to the commercial world, agreements made within a family or between friends in a social context are presumed not to be intended to create legal relations. The law treats these spheres as private realms where promises are based on affection, mutual trust, and social responsibility, not on legal obligation. The courts are generally reluctant to intervene in domestic disputes, fearing that doing so would undermine family harmony and create litigation over everyday social interactions.

The classic authority for this principle is ***Balfour v Balfour*** [1919] 2 KB 571. A husband who worked overseas promised to pay his wife a monthly allowance while she remained in England for medical reasons. When the relationship broke down and the husband stopped the payments, the wife sued. The Court of Appeal held that there was no contract. The agreement was a domestic arrangement between a husband and wife, made in the context of a happy marriage, and the parties did not intend for it to be scrutinized by a court of law. The presumption against legal intention prevailed.

Similarly, casual arrangements between friends, such as agreeing to share the cost of a meal, a taxi, or a holiday, typically fall within this presumption. The law views these as social agreements, where the parties rely on mutual goodwill rather than legal enforcement.

3.4.3 Rebutting the Presumptions: Express and Implied Intentions

The presumptions of intention are not iron-clad rules; they are starting points that can be rebutted by evidence demonstrating what the parties truly intended. The key is the context in which the agreement was made.

The presumption against legal intention in domestic agreements can be overturned if the circumstances show that the parties were, in fact, dealing with each other in a serious, business-like manner. The leading case that demonstrates this is ***Merritt v Merritt*** [1970] 1 WLR 1211. Here, a husband and wife had separated. While they were separated, they made a written agreement stating that the husband would pay the wife a monthly sum, and if she paid the mortgage out of this money, he would transfer the house into her sole name.

The wife paid off the mortgage, but the husband refused to transfer the house. The court held that the agreement was legally binding. The context was not one of a happy domestic relationship but of a separation. The parties were no longer relying on mutual trust and affection; they were making a clear, written agreement to settle their financial affairs, much like parties in a commercial negotiation. The serious nature of the context and the formality of a written agreement successfully rebutted the usual presumption.

Other factors that can rebut the presumption in a domestic setting include the sheer seriousness of the subject matter or if the parties have acted on the agreement to their detriment, showing that they clearly took it as a binding commitment.

Conversely, the strong presumption in favour of legal intention in commercial agreements can also be rebutted. This is often done by an express statement. For example, if a commercial document is labelled "Subject to Contract" or includes a clause stating "This arrangement is binding in honour only," it may successfully negate the intention to create legal relations. However, as ***Edwards v Skyways*** shows, the courts will look at the substance of the agreement and the context, not just the labels. The phrase "letter of comfort," often used in banking, is a common example where a company might assure a bank of its support for a subsidiary's loan without intending to create a legally binding guarantee. Whether such a letter is binding depends on the precise wording and the surrounding circumstances.

In conclusion, the doctrine of intention to create legal relations ensures that the law of contract intervenes only where it is wanted and needed. By applying these sensible presumptions, the law respects the sanctity of social and family life while providing the firm foundation of enforceability that is essential for the world of commerce.

3.5 Conclusion

The journey from a simple agreement to a legally binding contract requires more than just offer and acceptance. The two pillars of Consideration and Intention to Create Legal Relations are essential.

Consideration is the element of exchange, the "price" of the promise. It must be sufficient but need not be adequate, and it must move from the promisee. The rules on performance of an existing duty have evolved, with the modern focus on whether a practical benefit has been conferred (*Williams v Roffey*). The harsh common law rule on part-payment of debt (*Foakes v Beer*) is mitigated by the equitable doctrine of promissory estoppel (*High Trees*), which can prevent a party from going back on a promise if it would be inequitable to do so.

Intention to Create Legal Relations acts as a final filter, with strong presumptions that commercial agreements are intended to be binding, while social and domestic agreements are not, unless the contrary is proven.

With these principles in place, we have now fully explored the essential elements required for the formation of a valid contract. The next part of this book will examine the content and meaning of the promises made within that contract.

4

THE PARTIES TO THE CONTRACT: PRIVITY AND THIRD-PARTY RIGHTS

Having established how a contract is formed, we now turn to a fundamental question: who can enforce it? The traditional answer, embodied in the doctrine of privity of contract, is simple: only a person who is a party to the contract can sue or be sued on it. This principle seems logical; if you did not sign the deal, you should not be bound by it or able to claim its benefits. However, this can lead to unfair and commercially inconvenient results. Imagine if David contracts with a builder, Chloe, to install a new heating system in his mother's house as a gift. If Chloe does a shoddy job, under the strict privity rule, David's mother cannot sue Chloe because she was not a party to their contract, even though she is the one who suffered the loss.

This chapter explores the common law doctrine of privity and its historical exceptions before examining the revolutionary statutory change brought by the *Contracts (Rights of Third Parties) Act 1999*. This Act significantly reformed the law, allowing third parties to enforce contract terms in certain circumstances, thereby solving many of the practical problems created by the old rule.

4.1 The Common Law Doctrine of Privity of Contract

The doctrine of privity of contract stipulates that a contract cannot confer rights or impose obligations upon any person except the parties to it. This means that only those who have provided consideration for a promise can enforce it.

4.1.1 The Basic Rule: Only a Party can Enforce a Contract

The classic case that firmly established this principle is ***Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*** [1915] UKHL 1. Dunlop sold tyres to a wholesaler, Dew & Co, with a clause stating that Dew would not sell the tyres below a listed price and would require its customers, like Selfridge, to make the same promise. Selfridge agreed but then sold the tyres below the price. Dunlop sued Selfridge for breach of contract. The House of Lords held that Dunlop could not succeed. There was no contract between Dunlop and Selfridge. Dunlop had given no consideration to Selfridge; the consideration had flowed between Dew and Selfridge. Therefore, Dunlop, as a third party to the contract between Dew and Selfridge, could not enforce a term of that contract.

This case underscores a core principle: a stranger to the contract is a stranger to the consideration. This ensures that the law only enforces bargains between those who have actually bargained with each other.

4.1.2 The Relationship between Privity and Consideration

The privity rule is intimately linked to the doctrine of consideration. As we saw in ***Dunlop v Selfridge***, for a promise to be enforceable, the promisee must have provided consideration for it. A third party who has not provided any consideration to the promisor cannot enforce the promise, even if the contract was specifically intended for their benefit. This link reinforces the bilateral nature of a contract as a private bargain between two parties.

4.2 Common Law Exceptions and Circumventions

The strict application of the privity doctrine often produced results that were commercially inconvenient and manifestly unjust. The common law, in its characteristic fashion, gradually developed several methods to circumvent the harshest effects of the rule. While these exceptions did not overturn the fundamental principle of privity, they created important pathways for third parties to gain rights in certain limited circumstances.

4.2.1 Agency

The agency exception is the most significant and straightforward common law circumvention of the privity rule. An agency relationship exists when one person (the agent) is authorized to act on behalf of another (the principal) in legal dealings with third parties. The very purpose of agency is to create a legal relationship between the principal and the third party, even though they have not directly dealt with each other.

When an agent, acting within their actual or apparent authority, makes a contract with a third party, the contract is deemed to be between the principal and the third party. The agent, having fulfilled their role, generally drops out and acquires neither rights nor liabilities under the contract. This means the principal can sue the third party for breach, and the third party can sue the principal, despite the absence of direct contact or consideration between them.

Example: Sarah is a purchasing manager for "Global Products Ltd." She signs a contract with Ben, a supplier, to buy raw materials for the company. Sarah is acting as an agent for her principal, Global Products Ltd. If Ben delivers defective materials, it is Global Products Ltd., not Sarah, that must sue Ben for breach of contract. The privity of contract exists between Global Products Ltd. and Ben.

This exception is crucial for the functioning of all corporate commerce, as companies can only act through human agents.

4.2.2 Trusts of a Promise

This equitable exception is more conceptual but was historically a key tool for lawyers. A trust exists when one person (the trustee) holds property or a right for the benefit of another (the beneficiary). The courts extended this concept to contractual rights. If a promisee in a contract could be construed as holding the benefit of a promise made for a third party *on trust* for that third party, then the third party, as the beneficiary, could sue to enforce the promise.

The leading case is ***Les Affréteurs Réunis SA v Leopold Walford (London) Ltd*** [1919] AC 801. A shipbroker (Walford) negotiated a charterparty between a shipowner and a charterer. The contract included a clause stating that a commission was payable to the broker. When the shipowner refused to pay, the broker sued. The House of Lords held that the charterer, as the promisee of the commission clause, was acting as a trustee of that promise for the broker. Therefore, the broker, as the beneficiary of the trust, could enforce the promise directly against the shipowner.

However, the courts have been reluctant to widen this exception, requiring clear evidence of an intention to create a trust. It is not enough that a contract simply benefits a third party; the parties must have intended the promisee to be a trustee of the promise. In modern practice, this exception has been largely superseded by the *1999 Act*, but it remains a viable, if uncertain, argument in cases falling outside the statute's scope.

4.2.3 Restrictive Covenants

This is a property law exception with limited application in general contract law. A restrictive covenant is a promise made in a deed concerning land, which restricts how that land can be used (e.g., a promise not to build commercial properties on a plot of residential land). The unique feature of a valid restrictive covenant is that it "runs with the land." This means the burden of the promise (the restriction) can bind subsequent owners of the land, and the benefit can be enforced by subsequent owners of the neighbouring land that benefits from the restriction.

Example: David sells part of his estate to Chloe, and in the deed, Chloe promises that no fences over six feet will be built. David later sells the rest of his estate to Ben. If Chloe builds a high fence, Ben, as the new owner of the benefited land, can enforce the covenant against Chloe, even though he was not a party to the original contract between David and Chloe.

This exception is highly technical and depends on strict rules, but it demonstrates the common law's ability to create pragmatic solutions where a continuous obligation attached to land is necessary.

4.3 The Contracts (Rights of Third Parties) Act 1999

Recognizing the inadequacies and complexities of the common law exceptions, Parliament introduced the *Contracts (Rights of Third Parties) Act 1999*, which came into force in 2000. This Act represents the most significant reform to the privity rule in English legal history, providing a clear, direct, and comprehensive statutory right for third parties to enforce contract terms in defined situations.

4.3.1 When a Third Party can Enforce a Term

Section 1 of the Act provides two clear, alternative tests for determining when a third party has a right of enforcement. A third party may enforce a term of the contract if:

1. The contract expressly provides that he may. This is the simplest scenario. The contract can explicitly state: "It is agreed that [Third Party's Name] shall have the right to enforce clause 5 of this agreement against [Promisor's Name]." Such a clause leaves no room for doubt.

2. The term purports to confer a benefit on him. This is the more common and significant test. It applies if a term of the contract appears to give a benefit to the third party. For example, a construction contract between David (homeowner) and a builder might state: "The builder warrants that all roofing work will be carried out to a standard sufficient for a 20-year guarantee for the benefit of the current and any future owner of the property." This "purports to confer a benefit" on a future owner.

However, this second test has a safeguard; the third party has no right "if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party." This means that even if a term clearly benefits a third party, the courts will look at the contract as a whole to see if the parties actually intended for that third party to have a direct right of action. The burden is on the contracting parties to expressly opt-out if they do not want the Act to apply.

The third party must also be expressly identified in the contract by name, as a member of a class, or by a particular description (e.g., "the tenants of Flat 2B"), but need not be in existence when the contract was made (allowing for unborn children or future companies to benefit).

4.3.2 Variation and Rescission of the Contract

A major concern with granting third-party rights was that it would "freeze" the contract, preventing the original parties from varying or rescinding (cancelling) their own agreement. The Act provides a balanced solution in *Section 2*.

The general rule is that the parties to the contract can vary or rescind it without the third party's consent. However, this right is lost once the third party's rights have crystallized. This happens when:

- The third party has communicated their assent to the relevant term to the promisor (e.g., by sending a letter accepting the benefit).
- The promisor is aware that the third party has relied on the term.
- The promisor could reasonably be expected to have foreseen that the third party would rely on the term, and the third party has in fact relied on it.

Once one of these events occurs, the original parties can no longer cancel or alter the third party's right without their written consent. This is a vital protection that gives the third-party certainty once they have acted upon the promise made for their benefit.

4.3.3 Available Defences and Remedies

If a third party brings a claim under the Act, the position is designed to mirror what would have happened if the original promisee had brought the claim. *Section 3* states that the defendant (the promisor) can raise any defence or set-off that would have been available to them if the claim had been brought by the original promisee. This includes defences arising from the contract itself or from any unrelated dealings between the promisor and the promisee.

Example: Using the construction example, if the builder sues David for the final payment, David could raise a set-off for the cost of repairing defective work. If the future owner then sues the builder under the *1999 Act* for the same defective work, the builder can raise the same set-off—namely, that he has already effectively "paid" for the defect by having his final payment reduced in the earlier lawsuit with David.

The remedies available to the third party are the same as those available to a party to the contract, such as damages, injunctions, and specific performance.

4.3.4 Relationship with Other Exceptions and Excluded Contracts

The *1999 Act* is not a total replacement for the old law. *Section 7(1)* explicitly preserves the common law exceptions. This means that a third party who cannot claim under the Act (for instance, because they are not sufficiently identified) may still be able to sue via the doctrines of agency or trust.

Furthermore, the Act does not apply to all contracts. *Schedule 1* lists specific exclusions, including:

- Contracts of employment (to prevent employees being sued by third parties).
- Bills of exchange and other negotiable instruments.
- Articles of association of companies.

The *Contracts (Rights of Third Parties) Act 1999* has brought clarity and justice to this area of law. It allows contracting parties to confer enforceable rights on third parties with certainty, while providing a clear framework that balances the rights of all involved: the promisor, the promisee, and the intended third-party beneficiary.

4.4 Conclusion

The law governing who can enforce a contract has evolved significantly. The traditional common law doctrine of privity strictly limited enforcement to the parties who provided consideration. While exceptions like agency and trusts provided some relief, they were often uncertain.

The *Contracts (Rights of Third Parties) Act 1999* represents a major and welcome reform. It provides a clear, statutory right for identified third parties to enforce contract terms that are intended to benefit them, while including sensible safeguards to protect the original parties' rights until the third party has relied on the promise. This Act brings the law into alignment with commercial reality and common sense, ensuring that a person for whose clear benefit a contract was made is not left without a remedy.

5

THE TERMS OF THE CONTRACT I: EXPRESS AND IMPLIED TERMS

Once a contract is formed, the next critical question is: what exactly have the parties agreed to? The rights and duties of the parties are defined by the terms of the contract. Not everything said during negotiations becomes a binding term, and sometimes, terms are included even though they were never explicitly discussed. This chapter explores how contract terms are established, categorized, and incorporated into the agreement.

We will examine the difference between mere representations and binding terms, how written terms become part of a contract, and the various ways in which courts will imply terms into an agreement to give it efficacy or to reflect the presumed intentions of the parties. Understanding the content of a contract is fundamental to determining whether it has been performed correctly or breached.

5.1 Express Terms

Express terms are the specific provisions that the parties have explicitly agreed upon, whether orally or in writing. They form the core of the contractual agreement.

5.1.1 Distinguishing Terms from Mere Representations

A key distinction must be made between a term (a binding promise) and a mere representation (a statement that induces a party to enter the contract but is not itself a promise). The courts use several tests to distinguish between them:

1. **The Importance of the Statement**

If the statement is so important that the offeree would not have contracted without it, it is likely a term. In ***Bannerman v White*** [1861] 142 E.R. 685, a hop grower explicitly told a buyer that no sulphur had been used in growing the hops. The buyer said he would not even bother to ask the price if sulphur had been used. The court held this was a term of the contract.

2. **Special Knowledge or Skill**

If the maker of the statement has special knowledge or skill relative to the other party, the statement is more likely to be a term. In ***Dick Bentley Productions Ltd v Harold Smith (Motors) Ltd*** [1965] 1 WLR 623, a car dealer stated that a car had done only 20,000 miles since a new engine was fitted. This was held to be a term because the dealer was in a far better position to know the truth than the buyer.

3. **The Timing of the Statement**

Statements made during the heat of negotiations are more likely to be representations. If a statement is made and then a significant time passes before the contract is formalized, it is less likely to be a term. Conversely, if a statement is repeated and then incorporated into a written contract, it is clearly a term.

Example: Sarah is selling her car to Ben. During negotiations, she says, "This car has never been in an accident." If this is a decisive factor for Ben and Sarah, as the owner, is in the best position to know, this is likely a term. If she casually remarks, "I think it probably gets about 40 miles per gallon," this is likely a mere representation.

5.1.2 The Parol Evidence Rule and its Exceptions

The parol evidence rule states that when a contract is put in writing, that written document is presumed to contain all the terms of the agreement. extrinsic evidence (evidence outside the document, such as oral promises or earlier written correspondence) is generally not admissible to add to, vary, or contradict the written terms.

Example: David and Chloe sign a detailed, written contract for the sale of David's business. During negotiations, David orally promised to not open a competing business for two years. If this promise is not in the final written contract, the parol evidence rule would generally prevent Chloe from adducing evidence of the oral promise to try to enforce it.

However, the rule is not absolute and has several important exceptions. Extrinsic evidence is admissible to:

1. **Show that the contract is not yet in force**: For example, to prove the contract was conditional on another event.
2. **Clarify an ambiguous term**: To explain the meaning of a word or phrase.
3. **Establish a custom or trade usage**: To show that words in the contract have a special meaning in a particular trade.
4. **Prove a collateral contract**: A separate, oral agreement that is supported by its own consideration and which exists alongside the main written contract.
5. **Rectify the contract**: To show that the written document does not reflect the true agreement of the parties and should be corrected.

5.1.3 The Effect of Entire Agreement Clauses

To reinforce the parol evidence rule and provide certainty, commercial contracts often include an entire agreement clause. This clause states that the written contract represents the entire understanding between the parties and supersedes all prior discussions, representations, and agreements.

Example of Entire Agreement Clause: "This agreement constitutes the entire agreement between the parties and supersedes all prior representations, agreements, negotiations, and discussions, whether oral or written, between the parties."

While such clauses are generally effective, they are not a complete shield. They cannot exclude liability for fraudulent misrepresentation, and the courts will interpret them strictly. They prevent prior statements from becoming terms, but they do not necessarily prevent a party from claiming they were induced to enter the contract by a misrepresentation.

5.2 Incorporation of Written Terms

For a written term, particularly one in a standard form contract or a set of written standard terms, to be binding, it must be properly incorporated into the contract. This can happen in three main ways.

5.2.1 Incorporation by Signature

The rule is simple and strict: if a party signs a document, they are bound by its terms, whether they have read them or not. This is based on the objective principle that a signature signifies assent.

In ***L'Estrange v F Graucob Ltd*** [1934] 2 KB 394, Ms. L'Estrange bought a cigarette vending machine and signed a sales agreement which contained an exemption clause in small print. She did not read it. When the machine failed, she sued. The court held she was bound by the clause because she had signed the document. The only exceptions are if the signature was obtained by fraud or misrepresentation.

5.2.2 Incorporation by Reasonable Notice

If a document is not signed, its terms can still be incorporated if one party took reasonable steps to bring the terms to the other party's attention before or at the time the contract was made.

The key case is ***Olley v Marlborough Court Ltd*** [1949] 1 KB 532. A couple booked a hotel room and paid at the reception. In their room was a notice excluding the hotel's liability for lost or stolen items. The court held this notice came too late; the contract was formed at the reception desk. The notice was not incorporated.

The test for "reasonable notice" depends on:

The nature of the term: The more unusual or onerous a term (like an exclusion clause), the greater the degree of notice required. In ***Thornton v Shoe Lane Parking Ltd*** [1971] QB 163, a clause excluding liability for personal injury was held to be so onerous that it required explicit mention.

The steps taken: Were the terms available? Were they referenced on a ticket or sign? Was the other party directed to them?

5.2.3 Incorporation by a Previous Course of Dealing

If the parties have a consistent and regular course of previous dealings, terms may be incorporated into the current contract by virtue of that history, even if they were not specifically mentioned on this occasion.

In the case of ***J Spurling Ltd v Bradshaw*** [1956] 1 WLR 461, the parties had done business for many years, with the contract notes always containing an exemption clause. On one occasion, the note was sent after the contract was made. The court held the clause was still incorporated because of the long and consistent course of dealing.

For this to apply, the previous dealings must be regular, consistent, and recent. A few sporadic transactions are not enough.

5.3 Terms Implied by the Courts

When a contract is silent on a particular matter, the courts may step in to fill the gap by implying a term. This is not a power the courts exercise lightly; they cannot rewrite a contract to make it fairer. The implication of a term is a process of giving effect to what the contract *must*, as a matter of logic and necessity, be taken to include. The basis for implication falls into three distinct categories, each with its own rigorous test.

5.3.1 Terms Implied in Fact (Business Efficacy and Officious Bystander Tests)

These are terms implied to give effect to the specific, but unexpressed, intention of the parties to the particular contract. The focus is on what these specific individuals must have intended. The courts have developed two classic tests for this, which are often used in tandem.

1. The Business Efficacy Test

This test, established in the foundational case of ***The Moorcock*** [1889] 14 PD 64, asks whether the term is necessary to make the contract work as the parties must have intended. The court will imply a term without which the contract would be commercially unworkable or futile. In ***The Moorcock***, the owners of a wharf contracted for a ship to dock and unload. Both parties knew the ship would ground at low tide. The court implied a term that the riverbed would be safe for the ship to sit on. Without this term, the entire commercial purpose of the contract, enabling the ship to dock and unload safely would be defeated. The term was not merely reasonable; it was necessary for business efficacy.

2. The Officious Bystander Test

This is a more vivid, practical test famously articulated by *MacKinnon LJ* in ***Shirlaw v Southern Foundries (1926) Ltd*** [1939] 2 KB 206. It posits that a term will be implied if, while the parties were negotiating, an "officious bystander" (a nosy onlooker) had suggested including the term, both parties would have replied, "Oh, of course!" The test is objective and focuses on the parties' presumed common intention. It is not enough that one party would have agreed; it must be what both parties would have unquestionably assented to. For example, in a contract where a singer is employed to perform, it is an obvious implication that they must turn up and be capable of singing. If an officious bystander had asked, "Shall we write down that you have to actually sing?" both parties would have given a testy, affirmative reply.

The modern approach, as confirmed by the Supreme Court in ***Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd*** [2015] UKSC 72, has tightened these tests. The court emphasized that a term will only be implied if it meets a high threshold of obvious necessity. It must be so obvious it goes without saying, and it must be capable of clear expression. Reasonableness alone is not enough; the term must be necessary to give effect to the parties' intended meaning.

5.3.2 Terms Implied by Custom or Usage

A contract does not exist in a vacuum. It operates within a specific commercial or local context. Therefore, a term can be implied if it is established by a custom or usage that is so well-known and certain that everyone in that trade or locality is taken to have contracted with reference to it.

For a custom to be implied, it must satisfy the following criteria:

1. It must be certain and well-established.
2. It must be reasonable.
3. It must be notorious, meaning it is so well known that anyone in that field would be aware of it.
4. It must be consistent with the express terms of the contract; it cannot contradict what the parties have written down.

Example: In the case of ***Hutton v Warren*** [1836] EWHC Exch J61, a tenant argued that he was entitled to an allowance for seeds and labour he had expended on the farm, even though the lease was silent on the matter. The court agreed, finding that it was a universal custom in the country for a quitting tenant to receive such an allowance. The contract was deemed to have been made within the context of this custom.

5.3.3 Terms Implied in Law

Unlike terms implied in fact, which focus on the specific parties' intentions, terms implied in law are imposed by the court as a matter of legal policy for an entire category of contractual relationships. The court is not asking, "What did these parties intend?" but rather, "What legal obligations are necessary for this type of relationship to function properly?"

These terms are based on broader considerations of fairness, public policy, and the nature of the relationship itself. The most significant examples are found in employment and landlord-tenant law.

Employment Contracts

The courts have implied a mutual duty of trust and confidence into every contract of employment. This means the employer must not, without reasonable and proper cause, conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence with the employee. Examples of breach include making false accusations of theft, constant bullying, or undermining an employee in front of their staff. Conversely, the employee has an implied duty of good faith and fidelity.

Landlord and Tenant Agreements

The courts imply a covenant for quiet enjoyment, meaning the tenant shall have the right to use the property without substantial interference from the landlord or anyone claiming under the landlord.

Other relationships: A similar duty of care is implied in contracts between professional advisors and their clients, requiring the advisor to act with reasonable skill and care.

5.4 Terms Implied by Statute

While parties are generally free to agree on their own terms, Parliament has intervened to create a safety net of mandatory protections, particularly for consumers. These statutory implied terms automatically form part of certain types of contracts, regardless of what the parties have actually agreed. They are designed to establish basic standards of fairness and to redress the imbalance in knowledge and bargaining power that often exists between businesses and consumers. For SQE1 candidates, understanding these statutory terms is crucial, as they form the basis of a huge number of everyday legal disputes.

5.4.1 Sale of Goods Act 1979

The *Sale of Goods Act (SOGA) 1979* is a cornerstone of commercial and consumer law. It implies key terms into every contract for the sale of goods, which are classified as conditions (fundamental terms whose breach allows the innocent party to terminate the contract and claim damages) unless otherwise stated.

The Implied Term as to Title (*s.12*)

This is the most fundamental term. It implies that the seller has the right to sell the goods. If this term is breached, the buyer is entitled to a full refund of the price, even if they have used the goods for some time.

Practical Example: David buys a second-hand car from a dealer. It later emerges that the car was stolen and the dealer had no legal title to it. This breaches *s.12*. David can terminate the contract and recover the full purchase price from the dealer, as he never legally owned the car.

Goods Sold by Description (s.13)

Where goods are sold based on a description, the goods must correspond with that description. This applies both to goods the buyer has not seen and to goods the buyer has seen but which are still purchased based on a descriptive label or advertisement.

Practical Example: Chloe orders a new "king-size" bed frame online. The product description specifies the dimensions as 180cm x 200cm. When delivered, the frame measures 150cm x 200cm (queen size). The goods do not correspond with their description, breaching *s.13*. Chloe can reject the bed and get her money back.

Satisfactory Quality (s.14(2))

When goods are sold in the course of a business, they must be of satisfactory quality. This standard is assessed from the perspective of a reasonable person, considering the price, description, and all other relevant circumstances. The term "quality" includes:

- Fitness for all common purposes: A toaster must toast bread.
- Appearance and finish: A new sofa should not have scratches or stains.
- Freedom from minor defects: A new book should not have missing pages.
- Safety: A child's toy must not have sharp edges or loose, small parts.
- Durability: A washing machine should last for a reasonable length of time.

Practical Example: Ben buys a new smartphone from a high-street retailer. The screen has a cluster of dead pixels, and the battery drains in two hours. The phone is not of satisfactory quality. Ben can reject it for a full refund.

Fitness for Particular Purpose (s.14(3))

If the buyer makes known to the seller (expressly or by implication) any particular purpose for which the goods are being bought, the goods must be reasonably fit for that purpose. This applies even if that purpose is not the usual one for the goods. The buyer must have relied on the seller's skill and judgment.

Practical Example: Sarah goes to a specialist running shop and tells the assistant, "I need running shoes that will provide strong ankle support for trail running on uneven ground." The assistant recommends a specific model. If those shoes, used for trail running, provide no ankle support and Sarah twists her ankle, the shoes are not fit for that particular purpose, breaching *s.14(3)*.

Sale by Sample (s.15)

Where there is a contract for sale by sample, the bulk of the goods must match the sample in quality, and the buyer must have a reasonable opportunity to compare the two. The goods must also be free from any latent (hidden) defects that would not be apparent on a reasonable examination of the sample.

Practical Example: A fashion designer agrees to buy 100 rolls of silk from a supplier after inspecting and approving a small sample swatch. When the full order arrives, the colour is noticeably different from the sample. This breaches *s.15*.

5.4.2 Supply of Goods and Services Act 1982: Implied Terms as to Care and Skill, Time, etc.

This Act complements the *SOGA* by covering contracts where goods are not sold but are transferred (e.g., hire, exchange) or where services are provided.

For Contracts Where Goods are Transferred

The Act implies terms virtually identical to those in *SOGA* regarding title, description, quality, and fitness for purpose. This ensures that whether you hire a carpet cleaner or rent a car, the goods provided must meet the same basic standards as if you had bought them.

For Contracts for Services (e.g., builders, solicitors, mechanics, decorators)

- *Section 13* provides that the supplier must carry out the service with reasonable care and skill. This is the core obligation in any service contract. A breach of this term is a breach of a condition.

Practical Example: David hires a qualified electrician to rewire his house. The electrician does the work carelessly, leading to faulty wiring and a fire. The electrician has failed to exercise reasonable care and skill, breaching s.13.

- *Section 14* provides that if no time for performance is fixed by the contract, the supplier will carry out the service within a reasonable time. What is "reasonable" is a question of fact, depending on the nature of the service.

Practical Example: Chloe hires a gardener to landscape her garden, with no specific completion date agreed. If the gardener, without good reason, takes 12 months to complete a job that should take 3 months, this is likely a breach of s.14.

- *Section 15* provides that if no consideration is fixed by the contract, the party contracting with the supplier must pay a reasonable charge. This prevents a service provider from performing work and then demanding an extortionate fee that was never agreed.

5.4.3 Consumer Rights Act 2015: Key Provisions

The *Consumer Rights Act (CRA) 2015* represents a major overhaul of consumer law, consolidating and strengthening protections for consumers in their dealings with traders (anyone acting for purposes relating to their business). It repeals the relevant parts of *SOGA* and *SGSA* for consumer contracts, replacing them with a single, comprehensive regime. The key innovation is the creation of a clear hierarchy of consumer remedies.

1. Goods must meet the following standards (similar to *SOGA*):

- Satisfactory Quality.
- Fit for a Particular Purpose.
- As Described.
- Match any model seen or examined.

2. **The Tiered Remedies for Faulty Goods**

- **Short-term right to reject**: If the goods are faulty, the consumer has a right to reject them and claim a full refund within 30 days of delivery. This is a powerful new right.
- **Right to repair or replacement**: After the initial 30 days, if the goods are faulty, the consumer can demand a repair or a replacement. The trader must do this within a reasonable time, without significant inconvenience, and at their own cost.
- **Right to a price reduction or final right to reject**: If the repair or replacement is unsuccessful, impossible, or not provided within a reasonable time, the consumer can demand a price reduction (keeping the goods) or exercise a final right to reject (return the goods for a refund, which may be subject to a deduction for use).

3. **Digital Content**

The *CRA* was the first statute to specifically regulate digital content (e.g., apps, software, music downloads). It must be of satisfactory quality, fit for a particular purpose, and as described. If it fails to meet these standards, the consumer has the right to a repair, replacement, or price reduction.

4. **Services**

The *CRA* implies terms that services will be performed with reasonable care and skill, for a reasonable price, and within a reasonable time. If a service is not provided with reasonable care and skill, the consumer is entitled to a re-performance of the service or a price reduction.

In summary, statutory implied terms create a non-negotiable foundation for fairness in contracts for goods, services, and digital content. While the *SOGA* and *SGSA* remain relevant for business-to-business transactions, the CRA provides a robust, consumer-focused framework that dictates the quality standards traders must meet and the remedies available to consumers when those standards are not fulfilled. For any contract, the first step is to identify which statutory regime applies and what terms it implies.

5.5 Conclusion

The content of a contract is made up of express terms (both oral and written) and implied terms. Determining the express terms requires distinguishing binding promises from mere representations and understanding how written terms are incorporated. When the contract is silent, the courts will imply terms to reflect the parties' presumed intentions (in fact), established practice (custom), general legal policy (in law), or to comply with mandatory statutory protections, particularly for consumers under the *Sale of Goods Act 1979* and the *Consumer Rights Act 2015*. Identifying all the relevant terms is the essential first step in assessing the rights and obligations of the contracting parties.

6

THE TERMS OF THE CONTRACT II: EXEMPTION CLAUSES AND INTERPRETATION

Having established what the terms of a contract are, we must now confront a critical reality; not all terms are created equal. Some terms are designed not to define the core promise, but to limit the consequences of breaking it. These are known as exemption clauses. Their use is widespread in standard-form contracts, from parking tickets to multi-million-pound construction projects. This chapter explores the legal "arms race" that has developed around these clauses. We will examine the common law rules that courts have crafted to restrict their scope and the powerful statutory controls, primarily the *Unfair Contract Terms Act 1977* and the *Consumer Rights Act 2015*, that police their fairness.

Furthermore, we will delve into how courts classify contractual terms to determine the consequences of their breach. Understanding this landscape is essential for advising both the party seeking to rely on an exemption clause and the party seeking to challenge it.

6.1 Exemption and Limitation Clauses: Definition and Function

An exemption clause is a contractual term that purports to exclude or restrict the liability of one party for breach of contract, negligence, or other wrongs. It is crucial to distinguish between two types:

1. **Exclusion clause**: A term that seeks to exclude liability entirely. For example, "The company shall not be liable for any loss or damage whatsoever to vehicles or their contents."
2. **Limitation clause**: A term that seeks to limit liability to a specified amount. For example, "The company's total liability for any loss or damage shall not exceed £100."

The function of these clauses is to manage and allocate commercial risk. A business may use them to cap its potential losses, obtain insurance more easily, and offer lower prices by limiting its exposure to claims. However, their potential for abuse, particularly against consumers, has led to intense judicial and parliamentary scrutiny.

6.2 Incorporation of Exemption Clauses

Before a court will even consider the validity or meaning of an exemption clause, it must be satisfied that the clause has been properly incorporated into the contract. The rules here are strict, building upon the general principles of incorporation covered in Chapter 5.

6.2.1 By Signature

The rule from ***L'Estrange v F Graucob Ltd*** [1934] 2 KB 394 applies with full force. If a party has signed a document containing an exemption clause, they are bound by it, regardless of whether they read or understood it. The only exceptions are fraud or misrepresentation.

6.2.2 By Notice

For unsigned documents like tickets, receipts, or notices, the party seeking to rely on the clause must prove they took reasonable steps to bring it to the other party's attention *before* the contract was made. In ***Olley v Marlborough Court Ltd*** [1949] 1 KB 532, a notice in a hotel bedroom excluding liability for theft was not incorporated because the contract was formed at the reception desk, before the guests saw the notice.

The "Red Hand" Rule

The more unusual or onerous the clause, the greater the steps required to bring it to notice. In ***J Spurling Ltd v Bradshaw*** [1956] 1 WLR 461, *Lord Denning* famously remarked that "some clauses would need to be printed in red ink with a red hand pointing to it before the notice could be held to be sufficient."

6.2.3 By Course of Dealing

A consistent and regular course of previous dealings between the parties can lead to the incorporation of a term, even if it was not specifically brought to notice on the particular occasion. The course of dealing must be sufficient to lead a reasonable person to believe that the terms were intended to apply routinely.

6.3 Interpreting Exemption Clauses

Once incorporated, the court must interpret the clause to see if it covers the breach that has occurred. The courts have developed a set of strict, often hostile, rules of construction.

6.3.1 The Contra Proferentem Rule

This is the golden rule of interpreting exemption clauses. Any ambiguity or lack of clarity in the clause will be construed against the party who seeks to rely on it (the *proferens*). In ***Andrews Bros (Bournemouth) Ltd v Singer & Co Ltd*** [1934] 1 KB 17, a contract for "new Singer cars" contained a clause excluding all "conditions, warranties, and liabilities implied by statute." The court held this ambiguous clause did not cover a breach of the *express* term "new," and the sellers were liable for delivering a used car.

Practical Example: A clause stating "we are not liable for loss or damage to goods" could be interpreted as covering only direct physical damage, not consequential financial loss, due to the ambiguity.

6.3.2 Fundamental Breach and the Scope of the Clause

Historically, there was a doctrine that a party could not exempt themselves from liability for a "fundamental breach", that is, breach that went to the root of the contract. While this is no longer a rule of law, it remains a potent rule of construction.

The House of Lords in ***Photo Production Ltd v Securicor Transport Ltd*** [1980] UKHL 2 held that there is no special rule of law preventing the exclusion of liability for fundamental breach. Whether such a clause applies is a matter of interpreting the contract. However, the courts will require very clear and unambiguous words to find that a party intended to exempt themselves from the core obligations of the contract.

Example: A security company's contract stated it was not liable for damage caused by its employees' negligence. If a guard deliberately sets fire to the factory, this may be so fundamental an act that it falls outside the scope of the clause, which was only intended to cover negligent acts, not deliberate destruction.

6.4 Statutory Control of Unfair Terms: *The Unfair Contract Terms Act (UCTA) 1977*

Imagine a small business owner, Sarah, who needs to buy a delivery van. She goes to a large vehicle dealership and signs their standard contract, which includes a clause saying: "The seller is not responsible for any mechanical defects after delivery." A week later, the engine seizes up completely. Can the dealership hide behind this clause? This is where the *Unfair Contract Terms Act (UCTA) 1977* comes into play.

UCTA is Parliament's main tool for policing exemption clauses in business-to-business (B2B) contracts and in some business-to-consumer situations. It doesn't ban all exemption clauses, but it subjects them to strict controls, primarily through the "reasonableness test."

6.4.1 The Reasonableness Test

The heart of *UCTA* is the requirement that many clauses must be reasonable to be enforceable. Under *s.11(1),* a contract term is valid only if it is “fair and reasonable” in light of what was known, or ought reasonably to have been known, by the parties at the time the contract was made, not at the time of breach. The party relying on the clause (usually the bigger, more powerful business) has the burden of proving it is reasonable.

What makes a clause reasonable? The court looks at all the circumstances at the time the contract was made. *Schedule 2 of UCTA* gives helpful guidelines, including:

- **Bargaining power**: Were the parties of equal strength? Could Sarah have negotiated the clause, or was it "take it or leave it"?
- **Inducements**: Did Sarah get a discount for agreeing to the clause?
- **Knowledge**: Should Sarah, as a businessperson, have known about the clause and its implications?
- **Practicality**: If the clause requires Sarah to notify the dealer of defects within 3 days, was that practically possible?

In ***St Albans City & District Council v International Computers Ltd*** *[1996] 4 All ER 481,* a software company supplied defective software to a local council. The contract limited the company's liability to £100,000, but the council's actual loss was over £1 million. The court held the clause was unreasonable. The parties had unequal bargaining power, the supplier was a large multinational with insurance, and the £100,000 limit was tiny compared to the potential loss. The clause failed the reasonableness test, and the supplier was liable for the full loss.

6.4.2 Liability for Negligence

This section deals with clauses that try to exclude liability for carelessness.

- **The absolute ban (s.2(1))**: Any clause that tries to exclude or restrict liability for death or personal injury caused by negligence is VOID. It is completely unenforceable. For example, a gym membership form says: "The gym is not responsible for any injuries, including those caused by our faulty equipment." If a treadmill breaks due to poor maintenance (negligence) and a member is injured, this clause is void. The gym is fully liable.
- **The reasonableness test (s.2(2))**: A clause that tries to exclude liability for other losses (like property damage or financial loss) caused by negligence must satisfy the reasonableness test. For example, the same gym clause says it is not liable for lost or stolen property. If a member's locker is broken into because the gym failed to fix a broken lock (negligence), this clause would only be valid if the gym could prove it was reasonable.

6.4.3 Liability for Breach of Contract

These sections control clauses that try to dodge liability for breaking the contract itself.

- **Written standard terms of business (s.3)**: This section applies when one party is dealing on the other's standard written terms (like a pre-printed form contract) or as a consumer. In these cases, a clause that allows them to render a contractual performance substantially different from what was reasonably expected, or render no performance at all is only enforceable if it satisfies the reasonableness test.
  Using the example in the introductory paragraph, the van dealership's clause excluding liability for mechanical defects is in their standard terms. For it to be enforceable against Sarah, the dealership would have to prove it was a reasonable term.
- **The core statutory rights in sale of goods (s.6)**: This section protects the fundamental implied terms we learned about in Chapter 5; *ss.12-15 SOGA 1979*.
  - **Against a consumer**: You CANNOT exclude or restrict liability for the goods having a good title, corresponding with their description, being of satisfactory quality, or being fit for their purpose. Any attempt to do so is VOID.
  - **In other cases (B2B)**: You can exclude these liabilities, but only if the clause satisfies the reasonableness test.

6.5 Statutory Control in Consumer Contracts: *The Consumer Rights Act (CRA) 2015*

While *UCTA* still applies to some consumer situations, the *Consumer Rights Act 2015* is now the primary and much stricter law for business-to-consumer (B2C) contracts. It gives consumers even greater protection.

6.5.1 The Core Test and the "Grey List"

The CRA introduces a powerful, general test for unfairness.

The Unfairness Test (s.62)

A term is unfair if, "contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations... to the detriment of the consumer." If a term is unfair, it is not binding on the consumer. The rest of the contract continues if it can without the unfair term.

The "Grey List" (Schedule 2)

This is a long list of 20 types of terms that may be regarded as unfair. It's a warning list for traders. Examples include:

- Terms that allow the business to unilaterally change the terms of the contract.
- Terms that lock consumers into long contracts while allowing the business to cancel at any time.
- Terms that impose hidden fees or charges.

Example: An online streaming service includes a term saying, "We may change the price of your subscription at any time by giving you 24 hours' notice." This would likely be an unfair term under the *CRA*. It creates a significant imbalance (only the business can change the price) and lacks good faith (24 hours is not enough time for a consumer to reasonably react).

6.5.2 The "Black List" and Core Rights

This is the CRA's nuclear option. Certain things are so fundamental that they cannot be excluded.

The "Black List" (s.31)

A trader cannot exclude or restrict their liability for failing to meet the statutory standards regarding:

- Goods (satisfactory quality, fit for purpose, as described).
- Digital Content (satisfactory quality, fit for purpose, as described).
- Services (reasonable care and skill).

Any term that even tries to exclude these core consumer rights is automatically void. The consumer keeps their full statutory rights.

Example: A used car salesman sells a car to Ben, a consumer. The receipt says: "Sold as seen, no refunds." The next day, the brakes fail. The "sold as seen" clause is trying to exclude the obligation that the car be of satisfactory quality and fit for purpose. Under the *CRA*, this clause is void. Ben can still reject the car and demand a full refund under his statutory rights.

6.6 Classification of Contract Terms

Not all broken promises are the same. The consequence of a breach depends on the importance of the broken term. The law classifies terms into three categories.

6.6.1 Conditions, Warranties, and Innominate Terms

Think of it like a hierarchy of promises:

1. **Condition**

   A VIP Promise. This is a term that is so fundamental to the contract that if it's broken, the innocent party should be allowed to walk away. Breach of a condition is like a deal-breaker.

   Example: Ben orders a specific, rare vintage wine for his wedding. The supplier delivers a different, common wine. The term about the specific type of wine is a condition. Ben can terminate the contract, send the wine back, and get his money back.

2. **Warranty**

   A Minor Promise. This is a less important term that is collateral to the main purpose. Breaking it is annoying, but not a deal-breaker. The contract must go on, but the injured party can claim compensation.

   Example: The same wine is delivered a day later than promised. The delivery date is likely a warranty. Ben can't cancel the whole wedding wine order, but he can claim damages for the inconvenience of the late delivery.

3. **Innominate Term**

   A "Wait and See" Promise. Some terms are hard to classify upfront. The law looks at the consequences of the breach to decide the remedy. Was the breach serious enough to destroy the whole contract?

In ***Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*** [1962] 2 QB 26, a ship was hired for 2 years. A term required it to be "seaworthy." The ship was unseaworthy and spent 20 weeks in repairs. The breach was so serious it deprived the hirer of a substantial part of the 2-year charter. The court held this allowed the hirer to terminate.

However, if the unseaworthiness had only caused a 2-day delay, the breach would not have justified termination. The hirer would be limited to a claim for damages.

6.7 Conclusion

The legal treatment of contract terms is a battle between freedom of contract and the need for fairness. The journey of an exemption clause is perilous: it must first be incorporated into the contract, then interpreted strictly by the courts, and finally survive the powerful statutory controls of *UCTA 1977* (for B2B contracts) or the *CRA 2015* (for B2C contracts). Alongside this, the classification of terms as conditions, warranties, or innominate terms determines the remedies available for their breach. A comprehensive understanding of these principles is essential for drafting enforceable contracts, advising clients on their rights and liabilities, and navigating disputes effectively.

7

VITIATING FACTORS: MISREPRESENTATION AND MISTAKE

Up to this point, we have assumed that contracts are formed by parties who have freely and knowingly reached an agreement. But what if one party's consent was based on a lie, a misunderstanding, or a threat? The law recognises that a contract is not truly consensual if it was entered into under certain defective conditions. These defects are known as vitiating factors; they can undermine the contract making it either void (treated as if it never existed) or voidable (valid until the innocent party chooses to set it aside).

This chapter explores the first two of these factors: Misrepresentation and Mistake. Misrepresentation occurs when one party is induced to contract by a false statement. Mistake deals with situations where the parties are fundamentally at cross-purposes from the outset. Understanding these doctrines is crucial for determining when a contract can be unwound due to an unfair or flawed formation process.

7.1 Misrepresentation

A misrepresentation is a false statement of fact or law made by one party (the representor) to the other (the representee) which induces the representee to enter into the contract. It is not a breach of a term of the contract, but rather a flaw in the pre-contractual negotiations that taints the entire agreement.

7.1.1 Elements of Misrepresentation

For a statement to be a misrepresentation, it must satisfy four key elements:

1. It must be a statement of fact or law, not mere opinion, intention, or sales puffery.
2. It must be false.
3. It must be made by one party to the other.
4. It must induce the other party to enter the contract.

The landmark case that established the modern approach to misrepresentation is ***Carlill v Carbolic Smoke Ball Company*** [1893] 1 QB 256. While this case is famous for unilateral contracts, it also illustrates a representation. The company's advertisement that the smoke ball would prevent influenza was a statement of fact. Mrs. Carlill relied on this statement (the inducement) and acted on it, forming the contract.

7.1.2 Distinguishing from Mere Puff, Opinion, and Terms of the Contract

It is vital to distinguish a misrepresentation from other types of statements:

1. **Puffery (or Sales puff):** These are vague, exaggerated claims that no reasonable person would take literally. For instance, a car salesman says, "This is the best car on the market!" This is a puff, not a misrepresentation.
2. **Statement of opinion**: A belief about something, not a statement of fact. An opinion is only a misrepresentation if the person stating it does not genuinely hold that opinion. In ***Bisset v Wilkinson*** [1927] AC 177, a seller, who had never farmed the land before, stated his opinion that a piece of land could support 2,000 sheep. This was held to be an honest opinion, not a statement of fact, and therefore not a misrepresentation.
3. **Statement of future intention**: A promise about what one will do in the future. This is not a statement of fact. However, if a person makes a statement about their future intention while having no present intention to fulfil it, that is a false statement of their current state of mind (a fact).

4. **Term of the contract**: As discussed in Chapter 5, a term is a promise that becomes part of the contract itself. A misrepresentation is a false statement that induces the contract but is not part of it. The remedies are different.

7.2 Types of Misrepresentation

Think of buying something based on what the seller tells you. Later, you discover what they said wasn't true. The law calls this misrepresentation. But not all false statements are treated the same. The law looks at the seller's state of mind - were they lying, careless, or honestly mistaken? This distinction is crucial because it determines what you can do about it.

7.2.1 Fraudulent Misrepresentation: The Deliberate Lie

This is the most serious type of misrepresentation. It happens when someone makes a statement they know is false, or they don't care whether it's true or false. The key element here is dishonesty.

- What makes it fraudulent? The person knows the statement is false.
- They don't believe the statement is true.
- They make the statement recklessly, without checking if it's true.

Example: David is selling his car. He knows the car was in a major accident and had its frame damaged. He repairs the visible damage and tells Chloe, "This car has never been in any accidents. It's in perfect condition." Chloe buys the car based on this statement. This is fraudulent misrepresentation because David knowingly lied about the car's history.

In ***Derry v Peek*** [1889] UKHL 1, a company said they had permission to use steam-powered trams. They actually didn't have final permission yet, but they believed they would get it. The court said this was not fraudulent because the directors honestly believed what they said. They were careless, but not dishonest.

Fraud requires proof of dishonesty. It's not enough that the statement was wrong; you must show the person knew it was wrong or didn't care.

7.2.2 Negligent Misrepresentation: The Careless Statement

Negligent misrepresentation is a key concept in contract law, particularly in business transactions where false statements can lead to significant financial losses. It occurs when someone makes a false statement without reasonable grounds for believing it is true, causing another party to rely on it and suffer harm. Unlike fraudulent misrepresentation, where the statement-maker deliberately lies, negligent misrepresentation involves carelessness.

Think of it as a mistake that could have been avoided with proper care. This section explores the two primary ways to claim for negligent misrepresentation: under *s.2(1)* of the *Misrepresentation Act 1967*, and at common law under the ***Hedley Byrne v Heller*** rule.

What is Negligent Misrepresentation?

Negligent misrepresentation happens when a person makes a false statement of fact, not because they intend to deceive, but because they didn't take reasonable care to ensure its accuracy. This false statement must induce the other party to enter a contract or take some action, leading to loss. In business, this is one of the most common types of misrepresentation because deals often rely on information like financial projections, valuations, or assurances about goods or services. For example, a seller might carelessly overstate a company's profits, leading a buyer to overpay. The law provides remedies to protect the innocent party, either through statutory provisions or common law principles.

Statutory Negligent Misrepresentation

The most straightforward and commonly used method to claim for negligent misrepresentation is under *s.2(1)* of the *Misrepresentation Act 1967*. This statute makes it easier for the innocent party to seek redress because it shifts the burden of proof, placing responsibility on the statement-maker to prove they were not careless. Let's break down how it works:

Key Requirements Under *Section 2(1)*

Under *s.2(1)* of the *Misrepresentation Act 1967*, a claim for negligent misrepresentation succeeds if:

1. **A false statement of fact** is made by one party to another.
2. **The statement induces** the other party to enter a contract.
3. **The statement causes loss** to the party who relied on it.
4. **The statement-maker cannot prove** they had reasonable grounds to believe, and did believe up to the time the contract was made, that the statement was true.

The critical feature of *s.2(1)* is the reversed burden of proof. Unlike fraud, where the claimant must prove deceit, or common law negligence, where the claimant must prove carelessness, *s.2(1)* assumes negligence unless the statement-maker can show they had reasonable grounds for their belief. This makes it a powerful tool for claimants, as it puts pressure on the defendant to justify their statement with evidence, such as documents, records, or professional checks.

Practical Example

Imagine Sarah is selling her bakery business to Ben. During negotiations, Sarah tells Ben, "Our annual profits are consistently around £500,000," based on a quick glance at old accounts without verifying recent figures. Ben, trusting this statement, buys the business for £2 million. After the purchase, Ben discovers the profits were only £300,000 due to declining sales. Under section 2(1), Sarah is liable for negligent misrepresentation unless she can prove she had reasonable grounds for her claim, perhaps by showing audited accounts or financial reports that supported the £500,000 figure. If Sarah relied on outdated or unverified information, she was careless, and Ben can claim damages for his loss (e.g., the overpayment). In practice, Ben's solicitor would demand evidence from Sarah, like accounting records, to test her defense.

This example highlights why *s.2(1)* is claimant-friendly. Ben doesn't need to prove Sarah was negligent; Sarah must prove she wasn't.

Legal Basis and Case Law

The *Misrepresentation Act 1967* was designed to simplify claims for misrepresentation, building on common law principles but easing the claimant's burden. A key case illustrating *s.2(1)* is ***Howard Marine and Dredging Co Ltd v A Ogden & Sons (Excavations) Ltd*** [1978] QB 574. Here, a company misrepresented the capacity of barges during contract negotiations, relying on incorrect shipping registers instead of accurate manufacturer documents. The court held the company liable under *s.2(1)* because it failed to prove reasonable grounds for its mistaken belief. The case underscores that "reasonable grounds" require objective evidence, not just good faith.

Another relevant case is ***Royscot Trust Ltd v Rogerson*** [1991] 2 QB 297, which confirmed that damages under *s.2(1)* are calculated similarly to fraud, covering all losses flowing from the misrepresentation, not just foreseeable ones. This makes the remedy generous, as claimants can recover substantial losses, including consequential damages.

Common Law Negligent Misrepresentation: The *Hedley Byrne v Heller* Rule

While the *Misrepresentation Act 1967* is the go-to for contractual misrepresentations, negligent misrepresentation at common law, established in ***Hedley Byrne & Co Ltd v Heller & Partners Ltd*** [1964] AC 465, applies in broader contexts, including when no contract exists. This rule is particularly relevant when professional advice or information is given carelessly, causing loss to someone who relies on it. It's rooted in the law of tort (negligence) rather than contract, making it versatile but harder to prove than a *s.2(1)* claim.

Key Requirements Under *Hedley Byrne*

The ***Hedley Byrne*** rule applies when:

1. **A special relationship** exists between the parties, creating a duty of care. This typically involves someone with expertise (e.g., a professional) giving advice or information to someone who foreseeably relies on it.

2. **The statement is false** and made carelessly (negligently).

3. **The recipient reasonably relies** on the statement, suffering loss as a result.

4. **No valid disclaimer** excludes liability.

A "special relationship" arises when the statement-maker has, or claims, special skill or knowledge, and it's foreseeable that the recipient will rely on the statement. Unlike section 2(1), the claimant must prove the statement-maker was negligent, which involves showing a breach of the duty of care (e.g., failing to check facts).

Legal Basis and Case Law

In ***Hedley Byrne & Co Ltd v Heller & Partners Ltd*** [1964] AC 465, an advertising agency asked a bank for a credit reference about a client company. The bank carelessly stated the company was financially sound, but included a disclaimer ("without responsibility"). The agency relied on the reference, entered a contract, and suffered losses when the company became insolvent. The House of Lords held that a duty of care could arise in a special relationship, but the disclaimer prevented liability. This case expanded tort law to cover negligent statements, not just physical harm.

Subsequent cases clarified the scope. In ***Smith v Eric S Bush*** [1990] 1 AC 831, a surveyor negligently valued a house, knowing the buyer would rely on the report. The court found a special relationship because the surveyor's expertise and the buyer's reliance created a duty of care. Similarly, in ***Caparo Industries plc v Dickman*** [1990] 2 AC 605, the court emphasized that a duty requires proximity, foreseeability, and fairness, limiting liability to specific recipients, not the public at large.

Disclaimers can defeat claims, but they must be reasonable under *s.2* of the the *Unfair Contract Terms Act 1977*, which restricts excluding liability for negligence. In ***Smith***, an unreasonable disclaimer did not protect the surveyor.

Practical Example

Consider Rachel, an architect, inspecting a house for James, a potential buyer. Rachel says, "The foundation is completely sound," after a quick visual check without proper tests. James buys the house, relying on Rachel's professional expertise, but later discovers severe foundation damage, costing £50,000 to repair. Under ***Hedley Byrne***, a special relationship exists because Rachel, as a professional, knew or should have known James would rely on her statement. If Rachel was careless (e.g., didn't conduct proper surveys), she's liable for James's losses unless she used a valid disclaimer. James's solicitor would argue that Rachel breached her duty of care, seeking tort damages.

Contrast this with a non-professional scenario. If Rachel, a friend with no expertise, casually says, "The house looks solid," no special relationship arises, and James cannot claim under ***Hedley Byrne***. This distinction is crucial for SQE candidates to identify in scenarios.

Comparing the Two Routes

Section 2(1) of the *Misrepresentation Act 1967*, and ***Hedley Byrne*** serve different purposes:

- **Section 2(1)** applies only to statements inducing a contract, with a reversed burden of proof, making it easier for claimants. Damages are generous, akin to fraud (***Royscot Trust Ltd v Rogerson***).
- ***Hedley Byrne*** applies to any negligent statement causing loss, even without a contract, but the claimant must prove negligence. It's common in professional advice cases.

Practical Example

If Thomas, an accountant, carelessly tells Lucy, an investor, "This company's accounts show £1 million profit," and Lucy invests, suffering loss when the profit was lower:

- If Thomas's statement led to a contract, Lucy can use section 2(1), forcing Thomas to prove reasonable grounds.
- If no contract exists (e.g., advice given informally), Lucy relies on ***Hedley Byrne***, proving Thomas's negligence and a special relationship.

7.2.3 Innocent Misrepresentation: The Honest Mistake

This occurs when someone makes a false statement but had reasonable grounds for believing it was true. There's no dishonesty and no carelessness, it's simply an honest error.

What makes it innocent?

- The person genuinely believed their statement was true.

- They had proper reasons for this belief.
- A reasonable person in their position would have made the same mistake.

Example

Tom sells a painting to Lisa, saying: "This is an original work by a local artist." Tom bought the painting from a reputable gallery that certified it as authentic. He has documentation showing it's genuine. Later, experts determine the painting is a forgery.

This is innocent misrepresentation because Tom had reasonable grounds for his belief (the gallery's certification) and genuinely thought he was telling the truth.

However, it is noteworthy that while you can still get the contract set aside for innocent misrepresentation, your options for claiming financial compensation are more limited compared to fraudulent or negligent misrepresentation.

7.3 Remedies for Misrepresentation

The type of misrepresentation directly controls the remedies available to the innocent party. The two main remedies are rescission and damages.

7.3.1 Rescission: The Remedy and its Bars

Rescission is an equitable remedy that aims to put the parties back into the position they were in before the contract was made. It involves unwinding the contract completely e.g returning goods, refunding money, etc.

It is available for all types of misrepresentation: Fraudulent, Negligent, and Innocent. If you bought a car based on a misrepresentation, rescission would mean:

1. You return the car to the seller.
2. The seller returns your money to you.

However, rescission is a powerful remedy, and the courts have established that it can be lost (or "barred") in several ways:

1. **Affirmation**: The innocent party, after discovering the misrepresentation, decides to continue with the contract. For example, Chloe discovers the car she bought was misrepresented, but she gets it repaired and continues to drive it for six months. By her actions, she has affirmed the contract and can no longer rescind.

2. **Restitution impossible**: It is impossible to give back what was received under the contract. For example, the subject matter of the contract has been consumed, destroyed, or substantially altered. If the misrepresentation was about a vintage wine and you have already drunk it, you cannot give it back.

3. **Third-party rights**: A third party has acquired rights in the subject matter for value and without notice of the misrepresentation. For example, David sells a car to Chloe based on a misrepresentation. Chloe then sells the car to Ben, who is an innocent purchaser who knows nothing of the misrepresentation. David can no longer rescind the contract with Chloe because it would unfairly take the car away from Ben.

4. **Lapse of time**: A long delay (even if not affirmation) may bar rescission, particularly for non-fraudulent misrepresentations.

7.3.2. Damages: Measure and Availability for each Type

Damages are a monetary award to compensate for loss. Their availability and calculation differ:

For Fraudulent Misrepresentation

- **Availability**: Yes. The claim is for the tort of deceit.
- **Measure of damages**: The aim is to put the claimant in the position they would have been in had the misrepresentation never been made. This is known as the "tort measure" or the "reliance loss." The claimant can recover all losses directly flowing from the fraud, even if they were not foreseeable.

Example: You buy a business for £200,000 based on a fraudulent statement of its profits. Its true value is only £150,000. You can claim the £50,000 difference. You may also be able to claim consequential losses, such as loans you took out that you wouldn't have otherwise.

For Negligent Misrepresentation (*s.2(1) of the 1967 Act*)

- **Availability**: Yes. This is a statutory claim.
- **Measure of damages**: The courts have decided that the measure should be the same as for fraud, the "tort measure." This is a huge advantage for claimants, as it is often more generous than standard contractual damages.

For Innocent Misrepresentation

- **Availability**: Damages are not available as of right.
- **The Court's discretion**: Under *s.2(2)* of the *Misrepresentation Act 1967*, the court has a discretion to award damages in lieu of rescission (instead of rescission). This allows the court to uphold the contract but compensate the injured party for their loss.

Example: In the painting example, if it's too late to rescind, the court might order the seller to pay the buyer the difference in value between an original and a forgery, allowing the buyer to keep the painting.

7.4 Common Mistake: When Both Parties Get It Wrong

Imagine both you and the person you're dealing with sign a contract, but you're both completely wrong about a fundamental fact that the entire agreement is built upon. This is what lawyers call common mistake. It occurs when both parties share the same mistaken belief about a crucial fact at the time they make the contract. The key question becomes: is the contract still valid if it was based on this shared error?

The legal effect of a common mistake can be dramatic. If the mistake is sufficiently fundamental, the contract may be declared void *ab initio*, that is, it is treated as if it never existed in the first place. This is different from a contract being voidable (which can be set aside by one party). When a contract is void for common mistake, it's invalid from the very beginning for everyone involved.

Let's explore the three main situations where common mistake can make a contract void.

7.4.1 Mistake as to the Existence of the Subject Matter (*Res Extincta*)

This is the clearest and most straightforward category of common mistake. It applies when the subject matter of the contract does not exist at the time the contract is made, and neither party knows this.

The legal principle: If the thing you're contracting about has already ceased to exist, there is nothing to contract about. The agreement is based on a false premise from the very beginning.

The case of ***Couturier v Hastie*** [1856] UKHL J3 is the foundational case for this principle. A contract was made for the sale of a specific cargo of corn that was being shipped from the Mediterranean to England. Unknown to both the buyer and seller, the corn had already gone bad during the voyage, and the ship's captain had sold it to someone else at an intermediate port. The House of Lords held that the contract was void. The subject matter of the sale, that specific cargo of corn, no longer existed when the parties made their agreement.

Modern example: Sarah agrees to buy a specific vintage car from Ben. The car is stored in a garage that neither has visited recently. Unknown to both Sarah and Ben, the garage burned down yesterday, and the car was completely destroyed. When they signed the contract, they were both mistaken about the car's continued existence. The contract is void for common mistake.

7.4.2 Mistake as to Title (*Res Sua*)

This less common situation occurs when a person accidentally agrees to buy something they already own.

The legal principle: You cannot buy what you already own. If both parties believe the buyer needs to purchase the property, but the buyer already owns it, the contract is void.

Practical example: David inherited a large estate from his grandfather but has never properly reviewed all the legal documents. He visits part of the estate that's been managed by a caretaker and, not realizing he already owns it, agrees to buy that same piece of land from the caretaker. Both David and the caretaker are mistaken about who owns the land. This contract would be void for common mistake.

7.4.3 Mistake as to a Fundamental Quality

This is the most complex and controversial category of common mistake. It deals with situations where the subject matter physically exists, but both parties are mistaken about some essential characteristic that makes it fundamentally different from what they thought they were dealing with.

The legal test: The courts are very cautious about using this category. The mistake must go to the very essence of what was being contracted for. It's not enough that the thing is worth less than the parties thought, or that it has some different qualities. The mistake must be so fundamental that the thing is essentially different in nature from what the parties believed it to be.

The Restrictive Approach

The case of ***Bell v Lever Bros Ltd*** [1932] AC 16 shows how difficult it is to establish this type of common mistake. Lever Brothers paid two senior directors substantial compensation to end their employment contracts early. Later, Lever Brothers discovered that the directors had committed serious breaches of duty that would have allowed the company to fire them without any compensation. Lever Brothers argued there was a common mistake about the directors' contracts being valid and enforceable.

The House of Lords held there was no common mistake. The employment contracts still existed; they were valid legal agreements. The fact that they were less valuable to Lever Brothers because of the undiscovered misconduct didn't make them fundamentally different in nature. The quality was different, but the essential subject matter (the employment contracts) was exactly what the parties thought it was.

Where it Might Succeed

The case of ***Associated Japanese Bank (International) Ltd v Credit du Nord SA*** [1989] 1 WLR 255 shows the narrow circumstances where a quality mistake might succeed. A bank entered into a leaseback agreement for four specific machines, with a guarantee from Credit du Nord. It turned out the machines never existed - the whole transaction was a fraud. The court held the guarantee was void for common mistake.

The key difference from ***Bell v Lever Bros*** was that the existence of the machines was a fundamental assumption underlying the entire transaction. Without the machines, there was nothing to lease and therefore nothing to guarantee. The mistake wasn't just about quality or value - it went to the very existence of the subject matter of the guarantee.

Practical Examples That Would Likely FAIL

- Buying a painting both parties believe is by Picasso, but it turns out to be a forgery
- Buying land both parties believe has planning permission, but it doesn't
- Buying a car both parties believe is rare and collectible, but it's actually common

In these cases, the contracts would likely still be valid because the physical things (painting, land, car) still exist and are what the parties thought they were, even if their value or qualities are different.

Practical Examples That MIGHT SUCCEED

- Buying a "pregnancy test" that turns out to be a novelty item with no actual testing capability
- Buying a "diamond" that is actually made of glass
- Buying a "house" that is actually just a film set facade with no interior

In these extreme cases, the items are so fundamentally different from what the parties believed they were contracting for that common mistake might apply.

7.5 Conclusion

Vitiating factors protect the integrity of contractual consent. Misrepresentation deals with false statements that induce a contract. The type of misrepresentation (fraudulent, negligent, or innocent) dictates the remedies, which can include rescission and/or damages. The

Misrepresentation Act 1967 is a key statute, particularly *s.2(1)*, which makes it easier to claim for negligent misrepresentation.

Mistake concerns fundamental errors made at the time of contracting. A common mistake shared by both parties can render a contract void if it relates to the very existence of the subject matter. A unilateral mistake, where one party is mistaken and the other knows it, can also render a contract void, but only if the mistake is as to identity, not merely attributes. Understanding these distinctions is essential for advising clients on whether a contract is binding, void, or can be set aside.

8

VITIATING FACTORS II: DURESS, UNDUE INFLUENCE, AND ILLEGALITY

This chapter examines three additional vitiating factors that can render a contract unenforceable: duress, undue influence, and illegality. While the previous chapter focused on defects in agreement formation through misrepresentation and mistake, this chapter addresses situations where consent is compromised by external pressure or where the contrat's purpose contravenes legal principles. These doctrines serve as crucial safeguards to ensure contractual relations remain founded on genuine consent and public policy considerations.

8.1 Duress

Duress occurs when one party's consent to a contract is obtained through improper pressure, rendering their agreement involuntary. The common law has developed to recognize three principal categories of duress, each addressing different forms of coercive pressure that undermine contractual freedom.

8.1.1 Duress to the Person

Duress to the person involves actual or threatened violence against an individual or their immediate family members to induce contractual agreement. This represents the most direct and historically recognized form of duress, where physical safety concerns override free will in contractual decision-making.

The legal principle governing this area establishes that any agreement obtained through threats or actual violence is voidable at the instance of the coerced party. The threatened party retains the option to either affirm or rescind the contract, providing crucial protection against agreements made under physical compulsion.

Consider a scenario where a business owner is threatened with physical harm unless they sign over their company shares at a substantial undervalue. Despite the apparent agreement evidenced by their signature, the law recognizes the fundamental absence of true consent. The threatened party may subsequently apply to the court to have the contract set aside, with the burden resting on them to demonstrate the coercive circumstances that vitiated their consent.

8.1.2 Duress to Goods

This category addresses situations where wrongful detention of, or threats to, property are used to extract contractual concessions. The doctrine acknowledges that economic pressure through property deprivation can be as coercive as direct physical threats in certain circumstances.

The legal test requires establishing that the pressure applied through property detention was illegitimate and that the complainant had no reasonable alternative but to submit to the demanded terms. The key distinction lies between legitimate assertion of contractual rights and improper exploitation of situational advantage.

In ***The Siboen and The Sibotre*** [1976] 1 Lloyd's Rep 293, the court examined circumstances where charterers threatened to blacklist a ship unless owners agreed to reduce charter rates. While establishing the theoretical possibility of economic duress, the court ultimately found the pressure applied in this instance did not reach the requisite threshold of illegitimacy, highlighting the careful balance courts maintain between protecting against coercion and preserving commercial certainty.

8.1.3 Economic Duress

Economic duress represents the most complex and frequently litigated category, particularly in commercial contexts. It addresses situations where improper economic pressure, rather than physical threats or property detention, undermines contractual freedom.

The Modern Legal Framework

The contemporary test for economic duress derives from ***Pao On v Lau Yiu Long*** [1980] AC 614 and requires establishing three key elements:

1. The pressure applied must be illegitimate.
2. The pressure must leave the victim with no reasonable alternative.
3. The pressure must actually induce the victim to enter the agreement.

Not all commercial pressure constitutes duress. The courts distinguish between hard bargaining, which remains legally permissible, and illegitimate pressure that crosses into coercive territory. Factors indicating illegitimacy include:

- Threats to breach existing contractual obligations;
- Exploitation of monopoly positions;
- Taking advantage of known vulnerability or emergency situations;
- Employment of unlawful means to exert pressure.

The case of ***Atlas Express Ltd v Kafco Ltd*** [1989] QB 833 demonstrates the application of economic duress principles. Kafco, a small business, secured a valuable contract with Woolworths and engaged Atlas Express for distribution services. After commencing performance, Atlas demanded significantly increased rates, threatening to cease deliveries immediately unless Kafco agreed.

The court found economic duress established because:

- Atlas threatened wrongful breach of their existing contract.
- Kafco faced business destruction if deliveries ceased before Christmas.
- No practical alternatives existed given time constraints.

- Kafco's agreement was directly caused by this coercive pressure.

Distinguishing Legitimate Pressure

Commercial reality requires recognizing that not all forceful negotiation constitutes duress. Legitimate pressure may include:

- Insisting on contractual rights;
- Refusing future business on unsatisfactory terms;
- Adjusting prices for new contracts in response to market changes;
- Taking lawful steps to protect commercial interests.

The distinction lies in the legitimacy of the pressure applied and the availability of reasonable alternatives for the pressured party.

Evidentiary Considerations

Courts examine several factors when assessing economic duress claims:

- Whether the victim protested at the time of agreement;
- The availability of practical alternatives to submission;
- The receipt of independent legal advice;
- The timeliness of any legal challenge;
- The proportionality between pressure applied and concessions demanded.

The doctrine of economic duress continues to evolve, particularly in recognizing more subtle forms of commercial coercion while maintaining necessary commercial certainty. Recent cases have emphasized the importance of contextual analysis, examining the relative bargaining positions, industry practices, and the practical realities facing the pressured party.

8.2 Undue Influence

8.2.1 Actual Undue Influence

Actual undue influence occurs when one party can prove that the other exerted improper pressure or influence that directly caused them to enter into a contract against their free will.

Unlike presumed undue influence, this category requires affirmative evidence of coercive behavior in the specific transaction being challenged.

Elements of Actual Undue Influence

To establish actual undue influence, the claimant must demonstrate three key elements:

1. The influencer exerted pressure or influence over the claimant.
2. This influence was "undue", meaning it was improper or unacceptable.
3. The influence actually caused the claimant to enter the contract.

Forms of Undue Influence

Actual undue influence can manifest in various ways, including:

- Constant pestering or harassment until the victim gives in;
- Emotional manipulation using guilt, fear, or obligation;
- Exploitation of known vulnerabilities or dependencies;
- Deliberate isolation from friends, family, or professional advisors;
- Creating a sense of emergency or crisis to force quick decisions.

In ***BCCI v Aboody*** [1990] 4 All ER 955, a wife signed guarantees for her husband's business debts. The court found actual undue influence because the husband had systematically pressured his wife over many years, creating a pattern of domination and control that destroyed her independent judgment.

Consider an elderly parent who is constantly told by their adult child that they will be placed in a nursing home unless they sign over their house. The parent, fearing abandonment and loss of independence, signs the transfer documents. This would likely constitute actual undue influence due to the emotional manipulation and exploitation of vulnerability.

Challenges in Proving Actual Undue Influence

- The influence is often subtle and occurs in private.
- Victims may be reluctant to testify against family members.

- There may be no physical evidence of coercion.
- The influenced party might initially appear to cooperate willingly.

8.2.2 Presumed Undue Influence

Presumed undue influence operates differently from actual undue influence. Instead of proving specific acts of coercion, the law presumes that certain relationships are so likely to involve undue influence that the burden shifts to the stronger party to prove the transaction was fair.

Category 2A: Automatic Presumption Relationships

Certain relationships automatically give rise to the presumption of undue influence. These include:

- Solicitor and client;
- Trustee and beneficiary;
- Doctor and patient;
- Religious advisor and congregant;
- Parent and child (particularly with young children).

In these relationships, the law recognizes the inherent vulnerability of one party and the natural influence held by the other.

Category 2B: Relationships Where Trust and Confidence is Proven

This category includes relationships where, although not automatically presumed, one party has in fact placed trust and confidence in the other. The claimant must first prove the existence of this relationship of trust before the presumption applies.

Examples include:

- Husband and wife (in some circumstances);
- Adult children and aging parents;
- Long-standing financial advisor relationships;
- Caregiver and care recipient;

- Close family friendships where financial dependence exists.

In ***Allcard v Skinner*** [1887] 36 Ch D 145, a woman joined a religious order and gave all her property to the mother superior. The court found a relationship of trust and confidence existed, and the presumption of undue influence applied because the transfer was not explained to be permanent, and the woman received no independent advice.

8.2.3 Rebutting the Presumption

When presumed undue influence is established, the burden shifts to the stronger party to prove the transaction was fair and that no undue influence occurred. This can be achieved through several means:

1. **Independent Legal Advice**

   The most effective way to rebut the presumption is to show that the vulnerable party received competent, independent legal advice. The advisor must:

   - Be truly independent from the influencer.
   - Fully understand the transaction and its implications.
   - Adequately explain the risks and consequences to the client.
   - Ensure the client is acting freely and voluntarily.

2. **Substantive Fairness**

   The stronger party must demonstrate that the transaction was substantively fair, including:

   - Adequate consideration was given.
   - The terms were commercially reasonable.
   - No gross imbalance of benefits existed.
   - The transaction made sense in the context of the relationship.

3. **Free and Informed Consent**

   Evidence must show that the vulnerable party:

   - Understood the nature and effect of the transaction.

- Entered into it voluntarily.
- Had the mental capacity to make the decision.
- Was not acting under any misapprehension or pressure.

In ***Inche Noriah v Shaik Allie Bin Omar*** [1929] AC 127, an elderly woman transferred property to her nephew. Although a relationship of trust existed, the presumption was rebutted because she had received independent legal advice and understood the transaction completely.

8.2.4 Undue Influence by Third Parties

The doctrine of undue influence by third parties represents one of the most complex and commercially significant areas of contract law, addressing situations where improper influence is exercised not by the contracting party themselves, but by someone closely connected to the transaction. This scenario most commonly arises in financial contexts where family members provide guarantees or security for business debts, creating a legal triangle that involves the lender, the borrower, and the vulnerable guarantor.

The fundamental legal problem in third-party undue influence cases stems from the separation between the party exercising influence and the party seeking to enforce the contract. When a wife guarantees her husband's business loan, and the husband exerts undue influence over his wife to obtain her signature, the bank faces a difficult situation.

It may have acted entirely properly throughout the transaction, yet it risks being unable to enforce the guarantee if the husband's conduct is found to constitute undue influence. The legal system has evolved sophisticated principles to balance the competing interests of protecting vulnerable parties from relational exploitation while maintaining the practical enforceability of commercial agreements.

The modern law in this area was substantially shaped by the landmark case of ***Royal Bank of Scotland v Etridge (No 2)*** [2001] UKHL 44, where the House of Lords heard eight consolidated appeals involving similar fact patterns of wives challenging guarantees they had provided for their husbands' business debts. The resulting guidelines established a comprehensive framework that imposes specific responsibilities on both lenders and legal advisors in these sensitive transactions.

For lenders, the ***Etridge*** principles create a duty to take reasonable steps to ensure that the guarantor enters the agreement freely and with full understanding of the risks involved. This typically requires the lender to insist that the guarantor receives independent legal advice before signing any documents, and to provide the advising solicitor with sufficient financial information about the borrower's circumstances to enable meaningful advice to be given.

The role of solicitors in this process is particularly crucial and carries significant professional responsibilities. When advising a potential guarantor in circumstances where third-party influence might be present, the solicitor must conduct a private meeting with the client without the potential influencer being present, thoroughly explain the nature and legal effect of the proposed guarantee, discuss the specific financial risks including the possibility of total loss, and confirm that the client appears to be acting voluntarily without any apparent coercion. The solicitor must then provide written confirmation to the lender that these duties have been properly discharged, creating an evidential record that helps protect the lender's position if the guarantee is later challenged.

The consequences for lenders who fail to comply with these protective requirements can be severe. If a bank proceeds with a guarantee transaction without ensuring that proper independent advice has been given, and undue influence is later established, the guarantee may be declared unenforceable even if the bank had no direct knowledge of the improper conduct.

This principle was firmly established in the earlier case of ***Barclays Bank v O'Brien*** [1994] 1 AC 180, where the House of Lords held that financial institutions could be "fixed with constructive notice" of undue influence or misrepresentation in cases where the relationship between the borrower and guarantor was non-commercial in nature, such as between married couples or cohabiting partners.

Practical Application

The practical application of these principles requires careful attention to procedural details. When a bank is asked to take security from someone who stands in a close relationship to the primary debtor, it should immediately implement protective measures including sending the security documents directly to the guarantor's own solicitor rather than through the borrower, providing the solicitor with comprehensive information about the borrower's financial position and the extent of existing indebtedness, and refusing to complete the transaction until receiving satisfactory written confirmation that the guarantor has received proper advice and understands the risks involved. These steps create a crucial paper trail that demonstrates the lender's compliance with its equitable duties.

The scope of relationships triggering these protective measures has expanded beyond the traditional marital context to include various domestic and relational situations where influence might be exercised. Modern courts have applied the principles to unmarried cohabiting partners, adult children providing guarantees for parents, elderly parents providing security for children's business ventures, and other close personal relationships where the dynamics may create vulnerability to undue influence. In each case, the essential question remains whether the nature of the relationship is such that the lender should recognize the possibility of influence and take corresponding protective measures.

The evolution of this area of law reflects a careful balancing act between competing policy objectives. On one hand, there is a clear public interest in protecting vulnerable parties from being pressured into assuming financial obligations they don't properly understand and wouldn't undertake voluntarily. On the other hand, commercial certainty requires that lenders can reasonably rely on security documents properly executed by apparently competent adults.

The ***Etridge*** framework represents a pragmatic compromise that allocates responsibilities among the various parties: potential influencers must refrain from improper conduct, lenders must implement reasonable protective procedures, solicitors must provide competent independent advice, and guarantors must take responsibility for decisions made after receiving proper advice.

In practice, the effectiveness of these safeguards depends heavily on the professionalism and diligence of legal advisors. A solicitor providing independent advice must be truly independent, which means they should not be the same solicitor acting for the borrower or the lender in the transaction.

They must take sufficient time to ensure the guarantor genuinely understands the transaction, and they should be alert to any signs of reluctance, confusion, or pressure that might indicate the client is not acting freely. The advisor should also document the advice given and the client's responses, creating a contemporaneous record that may become crucial evidence if the transaction is later challenged.

8.3 Illegality and Public Policy

8.3.1 Contracts Illegal by Statute

Contracts that are expressly or impliedly prohibited by statute are considered illegal and generally unenforceable. The statutory prohibition may be explicit, where legislation specifically states that certain types of agreements are unlawful, or implicit, where the contract violates the general purpose or spirit of the legislation even without an express prohibition.

Express Prohibition

Some statutes explicitly state that certain contracts are illegal. For example, the *Competition Act 1998* specifically prohibits agreements that prevent, restrict, or distort competition. Similarly, the *Gambling Act 2005* regulates and restricts certain types of gambling contracts. When a statute contains such explicit prohibitions, courts will not enforce contracts that clearly violate these provisions.

Implied Prohibition

More commonly, courts must determine whether a contract is implicitly prohibited by reading the statute as a whole and considering its underlying purpose. The key question is whether allowing the contract to be enforced would frustrate the statute's objectives. In ***Re Mahmoud and Ispahani*** [1921] 2 KB 71, a contract for the sale of linseed oil violated regulations requiring both parties to hold licenses. Although the buyer falsely claimed to have a license, the court held the contract unenforceable by either party because the statutory purpose was to protect public interest through comprehensive licensing.

Licensing Requirements

Contracts made in violation of licensing statutes present particular difficulties. The courts distinguish between:

- **Revenue-raising licenses**: Where the main purpose is to generate government income.
- **Regulatory licenses**: Where the purpose is to protect the public by ensuring competence or proper standards.

A contract made without a required regulatory license is typically unenforceable, while a contract made without a revenue-raising license may still be enforceable, depending on the statutory interpretation.

8.3.2 Contracts Illegal at Common Law

Even without statutory prohibition, contracts may be illegal at common law if they are contrary to public policy. The courts have identified several categories of contracts that are considered inherently harmful to society.

1. **Contracts to Commit Crimes or Civil Wrongs**

   Any agreement to commit a criminal offence or civil wrong (tort) is illegal. This includes contracts to commit fraud, assault, or damage property. In ***Everet v Williams*** [1725] 2 Pothier on Obligations 3, famously known as the "highwayman's case," one robber sued another for not sharing proceeds from their robberies. The court refused to enforce the agreement, with the plaintiff's lawyers reportedly being fined for bringing the claim.

2. **Contracts Corrupting Public Life**

   Agreements that tend to corrupt public officials or interfere with public justice are illegal. This includes:

- Bribery of public officials;
- Agreements to stifle criminal prosecutions;
- Contracts to use improper influence on public officials;
- Agreements to pay witnesses for testimony.

3. **Contracts in Restraint of Trade**

While some restraint of trade agreements is permissible, they must be reasonable between the parties and not contrary to the public interest. The courts examine:

- The legitimate business interests being protected;
- The geographical scope of the restriction;
- The duration of the restriction;
- The overall reasonableness in context.

In ***Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co*** [1894] AC 535, the House of Lords established that restraint of trade clauses are valid if they are reasonable in the interests of the parties and the public.

4. **Contracts Promoting Sexual Immorality**

Historically, contracts related to prostitution or other "immoral" purposes were automatically illegal. The modern approach is more nuanced, focusing on whether the contract involves exploitation or other harmful consequences rather than moral judgment alone.

8.3.3 The Effects of Illegality: The General Rule and Modern "Range of Factors" Approach

The Traditional Approach

The historical common law position was straightforward but harsh: illegal contracts were void and unenforceable, and courts would not assist either party. This was known as the *ex turpi causa* doctrine, which means that no cause of action arises from disgraceful conduct. The court would refuse to hear the case, leaving the parties as it found them, regardless of how unfair the result might be.

The Modern Flexible Approach

The Supreme Court in ***Patel v Mirza*** [2016] UKSC 42 fundamentally reformed the law of illegality, replacing the rigid traditional rules with a flexible, principled approach. The case involved Mr. Patel who paid £620,000 to Mr. Mirza for insider trading that never occurred. When Mr. Mirza refused to return the money, the court had to decide whether the illegal purpose prevented recovery.

The Supreme Court established a three-stage test:

1. Consider the underlying purpose of the prohibition. Why did the law make the conduct illegal?

2. Consider any other relevant public policies. Are there other policy considerations that should be taken into account?

3. Deny enforcement only if it would be proportionate. Would allowing the claim harm the integrity of the legal system?

Applying the *Patel* Test

In ***Patel***, the court allowed recovery of the money because:

- The purpose of insider trading laws was to protect market integrity, which wasn't harmed by returning the money.
- There were strong public policy reasons to prevent unjust enrichment.
- Denying recovery would have been a disproportionate response.

Contrast with Pre-*Patel* Approach

Before ***Patel***, the case would likely have been decided differently under the "reliance test" from ***Tinsley v Milligan*** [1994] 1 AC 340, which focused on whether the claimant needed to rely on the illegality to establish their claim.

8.3.4 The Doctrine of Severance

When part of a contract is illegal but other parts are lawful, courts may sometimes sever (remove) the illegal portions and enforce the remainder. However, severance is only permitted in limited circumstances:

Requirements for Severance

1. **The illegal part must be separate**: The illegal provisions must be distinct from the main contract and not affect its fundamental character.
2. **The contract must remain coherent**: Removing the illegal part must not require rewriting the entire agreement.
3. **The parties' intentions must be clear**: The court must be satisfied the parties would have made the contract without the illegal terms.

Examples of Successful Severance

- In ***Goldsoll v Goldman*** [1915] 1 Ch 292, an overly broad restraint of trade clause was severed to make it reasonable and enforceable.
- In ***Attwood v Lamont*** [1920] 3 KB 571, the court refused severance because the illegal provisions were too intertwined with the main contract.

Limitations on Severance

Severance is not permitted when:

1. The illegal term goes to the heart of the contract.
2. Severance would fundamentally change the nature of the agreement.
3. The entire contract was made for an illegal purpose.
4. The illegal elements cannot be precisely identified and removed.

8.3.5 Practical Applications and Modern Developments

The Changing Approach to Illegality

The law of illegality has evolved significantly from rigid rules to flexible principles. The ***Patel*** decision represents a fundamental shift towards greater judicial discretion; focus on the underlying policy reasons, proportionality in remedies, and avoidance of unjust enrichment.

Emerging Areas

Contemporary courts are grappling with new forms of potential illegality, including:

- Contracts involving new technologies that may violate privacy laws.
- International contracts that may violate sanctions.
- Environmental regulations and their impact on commercial agreements.
- Data protection and cybersecurity requirements.

Risk Management Strategies

- Conduct thorough due diligence on regulatory compliance.
- Implement robust compliance programs.
- Maintain clear documentation of lawful purposes.
- Seek specialist advice for regulated industries.
- Consider the potential for changing regulations.

The modern approach to illegality recognizes that not all contracts involving unlawful elements should be treated equally. Instead of automatic unenforceability, courts now balance multiple factors to achieve just outcomes that respect legislative purposes while avoiding disproportionate consequences. This flexible approach better serves the interests of justice in complex modern commercial environments while maintaining the fundamental principle that courts will not assist those who engage in seriously illegal conduct.

8.4 Conclusion

The doctrines of duress, undue influence, and illegality represent essential mechanisms for preserving contractual integrity. They ensure that enforceable agreements reflect genuine consent while maintaining alignment with public policy objectives. As commercial and personal relationships evolve, these doctrines continue to develop, balancing freedom of contract with necessary protections against coercion, exploitation, and illegality. Understanding these principles remains fundamental to effective legal practice and ethical commercial conduct.

9

DISCHARGE OF A CONTRACT I: PERFORMANCE, BREACH, AND FRUSTRATION

The discharge of a contract marks the point at which parties are released from their contractual obligations, either through fulfilment, mutual agreement, breach, or the intervention of external events. It is a fundamental aspect of contract law that balances certainty with fairness, ensuring that parties who have performed as agreed are duly protected, while also providing just remedies when unforeseen circumstances or misconduct intervene. This chapter examines the various methods by which a contract may be discharged; by performance, agreement, breach, or frustration, tracing their evolution through key cases and statutory provisions. Each mode reflects the law's attempt to uphold commercial reliability while tempering strict doctrine with equitable considerations

9.1 Discharge by Performance

9.1.1 The General Rule: Complete and Exact Performance

The fundamental principle governing contractual discharge through performance is that parties must precisely fulfil their obligations as specified in the contract. This doctrine, often summarized as "the contract must be performed in its entirety," requires that a party completes all promised duties exactly as agreed before they can claim performance from the other party. The traditional approach, established in ***Cutter v Powell*** [1795] 101 ER 573, demonstrates the strict application of this rule, where a sailor who died during a voyage was denied any payment for the substantial work completed because he had not fulfilled the entire contractual obligation. This case established that for entire contracts; for which complete performance is a condition precedent to payment, substantial but incomplete performance does not trigger the payment obligation.

The rationale behind this strict approach lies in maintaining contractual certainty and respecting the parties' original bargain. When parties negotiate contracts, they agree on specific terms with the understanding that performance will be judged against those exact standards. The courts have consistently held that it is not their role to rewrite contracts or adjust performance standards after the fact, as doing so would undermine the predictability essential to commercial dealings. However, the potential harshness of this rule has been tempered by several important exceptions that have developed through common law evolution.

9.1.2 Exceptions: Substantial Performance, Divisible Contracts, and Acceptance of Partial Performance

The common law has developed several significant exceptions to mitigate the potential injustice of the strict performance rule, recognizing that commercial realities often require more flexible approaches to contractual performance.

Substantial Performance Doctrine

The landmark case of ***Hoenig v Isaacs*** [1952] 2 All ER 176 established that where a party substantially performs their contractual obligations, they remain entitled to the contract price, subject to a deduction for any defects or incomplete elements. In this case, an interior decorator had completed work on a flat except for minor defects, including a faulty bookshelf and wardrobe. The court held that there had been substantial performance and awarded the contract price less the cost of remedying the defects. The key elements for establishing substantial performance include: the party must have undertaken to perform the contract in its entirety; they must have substantially completed the main contractual obligations; any defects or omissions must be relatively minor; the benefit of the performance must have been substantially received by the other party; and the defects must be capable of being remedied by financial compensation.

Divisible Contracts

Some contracts are structured as a series of separate obligations, with payment due upon completion of each distinct part. For example, in a construction contract providing for stage payments, completion of each stage triggers the payment obligation for that stage, regardless of whether subsequent stages are completed. The characteristics of divisible contracts include: the contract specifies separate payments for distinct portions of work; each portion represents a separate agreed consideration; performance of one portion does not depend on completion of others; and the obligations are clearly severable in nature. This approach recognizes that many commercial arrangements are essentially sequential rather than unitary in nature.

Acceptance of Partial Performance

When one party offers partial performance and the other party voluntarily accepts it, the accepting party becomes liable to pay a reasonable sum for the benefit received. This operates under the principle of *quantum meruit* ("as much as he deserved"). The requirements for establishing this exception include: the performance must be offered and accepted voluntarily; the circumstances must indicate that payment was expected; the accepting party must have had the option to reject the partial performance; and the benefit must have been actually received. This principle prevents unjust enrichment by ensuring that parties cannot retain benefits received without providing appropriate compensation.

9.2 Discharge by Agreement

9.2.1 Bilateral Release

Bilateral discharge, also known as mutual release, occurs when both parties to a contract agree to release each other from their future obligations under the contract. This represents the cleanest and most straightforward method of contractual discharge, as it represents a complete meeting of minds regarding the termination of the contractual relationship.

The elements required for a valid bilateral release include mutual assent, where both parties must clearly agree to terminate the contract; consideration, with each party's promise to release the other from obligations serving as consideration for the other's reciprocal promise; compliance with formal requirements, where if the original contract was required to be in writing, the discharge should similarly be documented; and intention to create legal relations, with the parties intending their discharge agreement to be legally binding.

In practice, bilateral discharge is typically evidenced by a written agreement, often called a "mutual release" or "termination agreement." This document should clearly identify the original contract, specify the effective date of termination, address any outstanding obligations, and include comprehensive release language covering all potential claims arising from the contract.

Common scenarios for bilateral discharge include early termination of lease agreements by mutual consent, settlement of ongoing contractual disputes, termination of commercial agreements where both parties recognize the arrangement is no longer beneficial, and conclusion of fixed-term contracts before their natural expiration. The legal consequences of effective bilateral discharge are significant: all primary obligations under the original contract cease, though secondary obligations may survive if specified; parties cannot bring new claims for breaches that would have occurred after discharge; and existing accrued rights may be preserved or extinguished depending on the agreement's terms.

9.2.2 Accord and Satisfaction

Accord and satisfaction represent a specialized form of discharge by agreement where parties settle an existing obligation through a new agreement involving different performance. This mechanism is particularly useful for resolving disputes about the original contract or dealing with situations where strict performance has become difficult or impossible.

The legal definition comprises two elements: the accord, which is the agreement to accept alternative performance in discharge of an existing obligation; and the satisfaction, which is the actual performance of the new agreement. The accord essentially functions as a new contract that replaces the original obligation, with the satisfaction providing the consideration that makes the new contract binding.

The traditional rule from ***Pinnel's Case*** [1602] 5 Co Rep 117 established that payment of a lesser sum cannot satisfy a debt for a greater sum. However, the practical application of this principle has been significantly modified by exceptions and the modern approach to consideration.

The modern applications and exceptions include the practical benefit doctrine following ***Williams v Roffey Bros & Nicholls (Contractors) Ltd*** [1991] 1 QB 1, where a promise to accept less may be binding if it provides practical benefit to the creditor; the provision of additional elements, where if the debtor provides something additional such as early payment or collateral benefit, this can constitute valid consideration; settlement of disputed claims, where a genuine dispute about the amount owed makes settlement for a lower sum binding; and third-party payment, where acceptance of payment from a third party can discharge the original debt. This flexible approach recognizes that commercial realities often require pragmatic solutions to contractual difficulties while maintaining the essential requirement of consideration.

9.3 Discharge by Breach

9.3.1 Actual Breach: Repudiatory and Non-Repudiatory

An actual breach occurs when a party fails to perform their contractual obligations at the required time or to the required standard. The legal consequences of a breach depend fundamentally on whether it is classified as repudiatory or non-repudiatory. This distinction determines whether the innocent party is merely entitled to claim damages or has the additional right to terminate the contract and treat themselves as discharged from future performance.

A repudiatory breach is one that goes to the root of the contract, substantially depriving the innocent party of the benefit they expected to receive. The test, established in ***Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd*** [1962] 2 QB, is whether the breach substantially deprives the innocent party of the whole benefit of the contract. In this landmark case, the shipping vessel's mechanical problems and resulting unseaworthiness were held to be a breach of contract, but not necessarily a repudiatory one. The court introduced the concept of innominate terms, where the consequences of the breach determine whether it is repudiatory rather than the nature of the term breached itself.

Categories of Repudiatory Breach

1. **Breach of condition**: Terms expressly classified as conditions in the contract, or those which statute deems to be conditions (e.g., terms implied by the *Sale of Goods Act 1979*).
2. **Fundamental breach of innominate term**: Where the effect of the breach is so serious that it undermines the entire contractual relationship.
3. **Renunciation**: Where a party demonstrates an intention not to perform their obligations, either through express statement or conduct.
4. **Impossibility created by one party**: Where a party's actions make further performance impossible.

In contrast, a non-repudiatory breach is one that, while technically a failure to perform, does not substantially deprive the other party of the contract's benefits. For such breaches, the innocent party is limited to claiming damages and must continue with their own performance obligations. The distinction is crucial because wrongfully treating a non-repudiatory breach as repudiatory can itself amount to a repudiatory breach, entitling the other party to terminate.

9.3.2 Anticipatory Breach: Definition and the Innocent Party's Election

Anticipatory breach occurs when, before performance is due, one party clearly indicates an intention not to perform their contractual obligations. This doctrine, established in ***Hochster v De La Tour*** [1853] EWHC J72, allows the innocent party to take immediate action rather than waiting for the actual time of performance. In that case, a courier was engaged to begin work in May, but in April the employer informed him he would not be needed. The court held that the courier could sue immediately for breach of contract rather than waiting until May.

Forms of Anticipatory Breach

1. **Express renunciation**: Clear statement of intention not to perform.
2. **Implied renunciation**: Conduct making future performance impossible or fundamentally different.
3. **Voluntary incapacity**: Actions that destroy the party's ability to perform.

When faced with an anticipatory breach, the innocent party has a critical election between two courses of action. They may either "accept" the repudiation, treating the contract as discharged and suing immediately for damages, or "affirm" the contract, keeping it alive and continuing to demand performance. This election was comprehensively analysed in ***White and Carter (Councils) Ltd v McGregor*** [1962] A.C. 413, where the House of Lords held that if the innocent party can perform their obligations without the cooperation of the repudiating party, they may affirm the contract, complete performance, and claim the full contract price.

The consequences of this election are significant. If the innocent party accepts the repudiation, both parties are discharged from future obligations, and the innocent party can claim damages immediately. The measure of damages is generally the difference between the contract price and the market price at the time performance was due. If they affirm the contract, they must remain ready and willing to perform, and the contract continues in existence for the benefit of both parties. However, the affirming party takes the risk that supervening events may frustrate the contract or otherwise affect their rights.

The limitations on the right to affirm were established in ***Clea Shipping Corp v Bulk Oil International Ltd (The Alaskan Trader)*** [1984] 1 All ER 129, where the court recognized that in some circumstances, the innocent party may have a duty to mitigate their loss by accepting the repudiation rather than affirming the contract. This is particularly relevant where affirmation would be wholly unreasonable or wasteful.

9.4 Discharge by Frustration

9.4.1 The Doctrine: When a Supervening Event Renders Performance Impossible, Illegal, or Radically Different

The doctrine of frustration operates to discharge a contract when, without fault of either party, a supervening event occurs that makes performance impossible, illegal, or radically different from what the parties contemplated. The modern test, established in ***Davis Contractors Ltd v Fareham UDC*** [1956] AC 696, asks whether the supervening event has created a situation "so that the thing undertaken would, if performed, be a different thing from that contracted for."

The philosophical basis for frustration lies in the implied term theory or, more commonly today, the theory of radical change in obligation. As *Lord Radcliffe* explained in ***Davis Contractors***, frustration occurs "whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract."

Essential Elements for Frustration

1. There must be a supervening external event beyond the parties' control.
2. The event must not have been foreseeable or provided for in the contract.
3. The event must render performance impossible, illegal, or radically different.
4. Neither party must be at fault for the event occurring.

The courts apply the doctrine sparingly, recognizing that commercial contracts often allocate risks between parties, and frustration should not lightly be allowed to unravel carefully negotiated agreements. In ***Tsakiroglou & Co Ltd v Noblee Thorl GmbH*** [1961] 2 WLR 633, the closure of the Suez Canal was held not to frustrate a contract for the sale of goods, as alternative routes were available, albeit more expensive and time-consuming.

9.4.2 Frustrating Events

The courts have recognized several categories of events that may frustrate a contract, though each case turns on its precise facts and the terms of the particular contract.

1. **Destruction of Subject Matter**

   If the specific subject matter of the contract is destroyed without fault of either party, the contract is frustrated. In ***Taylor v Caldwell*** [1863] 3 B&S 826, the burning down of a music hall frustrated a contract for its use. The court held that the contract contained an implied condition that the hall would continue to exist, and its destruction discharged both parties.

2. **Supervening Illegality**

   If performance becomes illegal due to changes in law after contract formation, the contract is frustrated. In ***R v International Trustee for the Protection of Bondholders AG*** [1937] A.C. 500, contracts involving payment in gold became illegal following US legislation abrogating gold clauses, frustrating the payment obligations.

3. **Death or Incapacity**

   Personal service contracts are frustrated by the death or permanent incapacity of the person whose performance is essential. In ***Condor v The Barron Knights*** [1966] 1 WLR 87, a drummer's mental breakdown frustrated his contract with a band, as his continued performance required good health.

4. **Fundamental Change of Circumstances**

   In some cases, events that fundamentally change the nature of the contractual obligation may cause frustration. In ***Krell v Henry*** [1903] 2 KB 74, the cancellation of the coronation procession frustrated contracts for rooms along the procession route, as the coronation was the foundation of the contract.

9.4.3 Limits: Foreseeability, Self-Induced Frustration, and Express Provision

Several important limitations restrict the application of the frustration doctrine, ensuring it remains a narrow exception rather than a general escape route from bad bargains.

1. **Foreseeability**

   If an event was foreseeable, the courts are reluctant to find frustration, as the parties should have provided for it in their contract. In ***Amalgamated Investment & Property Co Ltd v John Walker & Sons Ltd*** [1977] 1 WLR 164, the listing of a building was held not to frustrate a contract for its purchase, as the possibility of listing was foreseeable.

2. **Self-Induced Frustration**

   A party cannot rely on frustration if the supervening event resulted from their own conduct or choice. In ***Maritime National Fish Ltd v Ocean Trawlers Ltd*** [1935] AC 524, a company was unable to claim frustration when it failed to obtain necessary licenses, as it had chosen which vessels to license.

3. **Express Provision**

   Parties may include force majeure clauses that expressly provide for supervening events. Such clauses typically specify the consequences of particular events and will generally prevail over the common law doctrine of frustration.

9.5 Effects of Frustration

9.5.1 Common Law Position

At common law, the effect of frustration is automatic and immediate: the contract is terminated from the moment of the frustrating event, and future obligations are discharged. However, the common law position created significant injustice through the application of the rule in ***Chandler v Webster*** [1904] 1 KB 493, which held that losses lay where they fell at the time of frustration. This meant that money paid before frustration could not be recovered, and money due before frustration remained payable.

The harshness of this rule was mitigated in ***Fibrosa SA v Fairbairn Lawson Combe Barbour*** [1943] AC 32, where the House of Lords established that money paid under a frustrated contract could be recovered if there had been a total failure of consideration. However, this created its own injustices, as it allowed recovery even if the payee had incurred expenses in preparation for performance.

9.5.2 The Law Reform (Frustrated Contracts) Act 1943

The *1943 Act* fundamentally reformed the common law position, creating a statutory scheme for allocating losses when contracts are frustrated. The Act applies to most contracts frustrated after its enactment, though it excludes specific categories including contracts for the carriage of goods by sea, insurance contracts, and contracts containing express provisions for frustration.

Key Provisions

1. ***Section 1(2)***: Money paid before frustration is recoverable, and money payable ceases to be payable.
2. ***Section 1(3)***: The court may allow a party who has incurred expenses before frustration to retain or recover money to cover those expenses.
3. ***Section 1(4)***: Where one party has obtained a valuable benefit before frustration, the court may require them to pay a just sum for that benefit.

The application of these provisions requires careful analysis of the facts in each case. In ***BP Exploration Co (Libya) Ltd v Hunt (No 2)*** [1983] 2 AC 352, the court established a structured approach to calculating the "just sum" under *s.1(3),* considering the benefit obtained and the expenses incurred.

The *1943 Act* represents a pragmatic attempt to distribute losses fairly between innocent parties when contracts are frustrated, recognizing that both may have incurred expenses or conferred benefits before the frustrating event occurred. Its flexible approach allows courts to achieve just results in diverse circumstances while respecting the general principle that parties should not be unjustly enriched by frustration.

9.6 Conclusion

The discharge of a contract represents the culmination of the contractual relationship, governed by both rigid legal rules and pragmatic exceptions designed to ensure fairness. Whether through complete performance, mutual consent, breach, or frustration, the law seeks to balance the sanctity of contract with justice in changing circumstances. The gradual development of doctrines such as substantial performance, accord and satisfaction, and frustration illustrates the courts' effort to reconcile strict legal principles with commercial realities. Ultimately, discharge operates not merely as a procedural endpoint but as a vital mechanism for maintaining trust, certainty, and equity in contractual dealings.

10

DISCHARGE OF A CONTRACT II: RESTITUTION AND UNJUST ENRICHMENT

This area of law operates not to enforce promises, as contract law typically does, but to correct situations where one party has been unjustly enriched at the expense of another. Imagine a builder who has started work on a house but the contract is then terminated due to the other party's breach. Should the builder be paid for the work done, even though the full contract was not completed? Or consider a situation where you pay for a holiday that is then cancelled due to a government travel ban (frustration). Can you recover your money?

The answer to these questions lies in the law of restitution. This chapter will guide you through the core principles, the key claims for a *quantum meruit* and *quantum valebant*, and how restitution interacts with termination for breach and frustration. Understanding this is vital for any solicitor advising a client on what remedies are available when a contract has gone awry.

10.1 The Principle of Restitution to Prevent Unjust Enrichment

At its heart, the law of restitution is not about punishing a wrongdoer but about preventing a defendant from being unjustly enriched at the claimant's expense. It is an independent body of law that sits alongside contract and tort. For a claim in restitution to succeed, three key elements must be established:

1. **The defendant has been enriched**: This enrichment is typically, but not always, financial. It could be the receipt of money, goods, or the benefit of services performed.

2. **The enrichment was at the claimant's expense**: The claimant must have provided the enrichment directly, for example, by paying the money or performing the services.

3. **The enrichment was unjust**: This is the most critical and complex element. The law recognises specific "unjust factors" that make the enrichment unjust. Common unjust factors include:

- **Failure of consideration**: The basis upon which the benefit was conferred has failed. This does not mean the contract is void for lack of consideration, but that the *purpose* for which the payment or service was made has not been fulfilled.
- **Mistake**: A benefit conferred under a fundamental mistake of fact.
- **Duress**: A benefit conferred under illegitimate pressure.
- **Necessity**: A benefit conferred in a situation of necessity to protect the defendant's interests.

The seminal case that firmly established this principled approach is ***Lipkin Gorman v Karpnale Ltd*** [1991] 2 AC 548. Although a case involving stolen money, the House of Lords explicitly recognised a general right to recover money on the ground of unjust enrichment. Lord Goff stated that the recipient must have received a benefit, at the claimant's expense, in circumstances which make it unjust for them to retain it.

It is important to understand that restitution is not a backdoor to enforcing a failed contract. If a valid contract governs the parties' relationship, its terms will usually dictate their rights and remedies. Restitution steps in where there is no valid contract, or where a contract has been set aside, terminated, or discharged, and justice demands that a party should not be left out of pocket for a benefit they have conferred.

10.2 Quantum Meruit and Quantum Valebant Claims

The most common forms of restitutionary claims in a contractual context are *quantum meruit* and *quantum valebant*. These are not causes of action in themselves, but are forms of action seeking a restitutionary remedy.

Quantum Meruit means "as much as he deserves". It is a claim for the reasonable value of services rendered.

Quantum Valebant means "as much as they are worth". It is a claim for the reasonable value of goods supplied.

These claims can arise in several distinct scenarios, which you must carefully distinguish.

Scenario 1: Where there is no Contract

A claim in *quantum meruit* can arise where services are rendered without a contract ever being concluded. If one party performs services at the request of the other, but the parties never finalise the terms, the law will imply a promise to pay a reasonable sum for the work done.

Example: A property developer asks an architect to draw up some preliminary plans for a new building, saying "we'll agree a fee later." The architect spends 50 hours on the plans. The developer then uses the plans but refuses to pay because no final fee was agreed. The architect can sue on a *quantum meruit* for the reasonable value of their 50 hours of work.

The case of ***British Steel Corp v Cleveland Bridge and Engineering Co Ltd*** [1984] 1 All ER 504 is a classic illustration. The parties were in negotiation for a contract for the manufacture of steel nodes. They had not agreed on crucial terms like price, delivery dates, or liability. At the request of Cleveland Bridge, British Steel commenced and completed manufacture. No final contract was ever signed. British Steel successfully claimed a reasonable sum on a *quantum meruit* for the nodes supplied. The court held that while there was no contract, the request for the work gave rise to an obligation to pay a reasonable remuneration.

Scenario 2: Where the Contract is Void or Unenforceable

If a contract is void for mistake or unenforceable for lack of formality (e.g., failure to meet the requirements of the Law of Property (Miscellaneous Provisions) Act 1989 for a contract for the sale of land), a party who has provided services or goods under it can still claim a reasonable sum on a *quantum meruit*.

The leading case is ***Craven-Ellis v Canons Ltd*** [1936] 2 KB 403. The claimant was appointed managing director by a contract that was void because he and the directors who appointed him had not obtained the necessary qualification shares. He performed services for the company. The Court of Appeal held he was entitled to a *quantum meruit*. The void contract could not be sued upon, but the company had received a benefit from his services and it would be unjust for it to retain that benefit without payment.

Scenario 3: Where the Contract does not Fix the Remuneration

Sometimes, parties enter into a contract that is silent on the price or remuneration. In such cases, the court will imply a term that a reasonable price is to be paid. The claim, while often called a *quantum meruit*, is actually a contractual claim for the reasonable sum implied by law.

This is governed by *s.8(2), Sale of Goods Act 1979*, which states: "Where the price is not determined... the buyer must pay a reasonable price." Similarly, for services, *s.15* of the *Supply of Goods and Services Act 1982*, implies a term that a reasonable charge will be paid.

Example: You take your watch to a jeweller for repair. You do not agree on a price beforehand. When you collect the watch, the jeweller presents a bill for £200. If this is a reasonable price for the work done, you are obliged to pay it.

10.3 Restitution following Termination for Breach

This is one of the most important practical applications of restitution for a solicitor. When a contract is terminated for one party's breach, the primary remedy for the innocent party is damages. However, there are situations where a claim for a *quantum meruit* can be a more advantageous alternative.

The key question is: can the innocent party, who has partially performed before the contract was terminated by the breach, sue for the value of the work done, rather than suing for damages for loss of profit on the entire contract?

The traditional rule was that if a party had only partially performed their obligations, they could not sue on the contract unless the other party had accepted the partial performance as performance of the contract. This was a harsh rule. The modern approach, developed through case law, is more flexible.

The landmark case is ***Planché v Colburn*** [1831] 8 Bing 14. The claimant author agreed to write a book on costume and ancient armour for a series published by the defendant. He was to be paid £100 on completion. After he had done substantial research and written a portion of the book, the defendants abandoned the series. The claimant sued. He could not sue for the £100 contract price, as he had not completed the book. Instead, he successfully brought a claim on a *quantum meruit* for the value of the work he had done. The court held that the defendants' abandonment of the project prevented the claimant from completing his performance, and it was therefore just to allow him to claim for the value of the services rendered.

The modern position was authoritatively restated by the Court of Appeal in ***Miles v Wakefield Metropolitan District Council*** [1987] AC 295 and confirmed in ***Sumpter v Hedges*** [1898] 1 QB 673. The principle is as follows:

- A claimant can claim a *quantum meruit* for work done if the other party has voluntarily accepted the benefit of the partial performance.
- However, if the benefit is conferred inevitably because the work is done on the defendant's land or property, this is generally not considered a voluntary acceptance.

Sumpter v Hedges is the classic cautionary tale. A builder agreed to build two houses and a stable for a lump sum. He did about half the work, ran out of money, and abandoned the site. The defendant owner then completed the buildings himself using materials left by the builder. The builder sued for a *quantum meruit* for the value of the work he had done. The Court of Appeal held he could not recover. He had only partially performed an entire obligation (to complete the buildings) and the defendant had no true choice but to accept the benefit of the incomplete buildings on his own land. The builder's only remedy was for any items where the defendant had a genuine choice to accept or reject (e.g., the materials), which constituted a separate contract.

10.4 Restitution following a Frustrated Contract (Link to LR(FC)A 1943)

When a contract is frustrated, it is automatically discharged from the point of frustration. The common law position was notoriously harsh. In ***Appleby v Myers*** [1867] LR 2 CP 651, the claimants agreed to install machinery in the defendant's factory for a lump sum. After part of the work was done, the factory and machinery were destroyed by fire. The contract was frustrated. The common law rule was that losses lay where they fell; the claimants could not recover for the work done, and the defendant, who had paid nothing, did not have to pay. This was clearly unjust.

To remedy this, Parliament passed the *Law Reform (Frustrated Contracts) Act 1943*. This Act provides a statutory scheme for restitution following frustration. It is a key piece of legislation for the SQE.

Key Provisions of the *LR(FC)A 1943*

***Section 1(2);* Money Paid or Payable before Frustration**

- Money paid before frustration is recoverable.
- Money payable before frustration ceases to be payable.

Example: Alex pays Betty a £5,000 deposit for a venue for a wedding on 1st July. On 1st June, the venue is destroyed by fire, frustrating the contract. Under s 1(2), Alex can recover the £5,000 deposit he paid.

***Section 1(3)*; A Just Sum for Benefits Received**

This is the most important operative section. It allows a party who has conferred a "valuable benefit" on the other party before the date of frustration to recover "such sum (if any) as the court considers just".

The court must consider:

1. The value of the benefit conferred on the other party.
2. Any expenses incurred by the benefited party in connection with the performance of the contract (e.g., preparatory costs).

The case of ***BP Exploration Co (Libya) Ltd v Hunt (No 2)*** [1979] 1 WLR 783 provides the definitive guidance on how to calculate the "just sum" under *s.1(3)*. *Lord Brandon* set out a two-stage process:

- **Stage 1**: Identify the Valuable Benefit. The benefit is valued at the date of frustration, not the cost to the claimant of conferring it. It is the end-product benefit received by the defendant.
- **Stage 2**: Calculate the Just Sum. The court has a broad discretion. The starting point is the proportionate part of the contract price, but this can be adjusted to ensure justice is done, taking into account the expenses incurred by the defendant.

In ***BP Exploration Co (Libya) Ltd v Hunt (No 2)*** [1979] 1 WLR 783, Hunt had an oil concession in Libya. BP agreed to finance the exploration and development of the oil field in return for a half-share in the concession and a proportionate share of any oil produced. Oil was found and produced. Then, the Libyan government nationalised the oil field, frustrating the contract. At the time of frustration, Hunt had received substantial benefits (the oil produced and the retained half-share in the concession). BP claimed a just sum for the money it had spent.

The court valued the benefit to Hunt at the date of frustration and then awarded BP a just sum that represented a fair proportion of the total contract price, effectively reimbursing BP for a significant portion of its expenditure.

Limitations of the Act

The Act does not apply to:

1. Contracts for the carriage of goods by sea (charterparties).

2. Contracts of insurance.
3. Contracts for the sale of specific goods that perish before risk has passed to the buyer (these are covered by s.7 Sale of Goods Act 1979).

10.5 The Relationship between Contractual and Restitutionary Remedies

A final, critical point for any solicitor is understanding how contractual and restitutionary remedies interact. The key principle is that a claimant cannot use restitution to escape a bad bargain.

If a valid contract exists and governs the situation, the claimant is generally limited to their contractual remedies. They cannot "opt out" of the contract and sue in restitution simply because it would be more profitable. This is known as the doctrine of prevention of evasion of contract.

The House of Lords made this abundantly clear in ***Cobbe v Yeoman's Row Management Ltd*** [2008] UKHL 55. Mr. Cobbe had a gentleman's agreement with a property owner that if he obtained planning permission for her land, she would sell it to him. He spent considerable time and money and successfully obtained planning permission. The owner then refused to go through with the sale. Mr. Cobbe could not sue on the contract because it was not in writing as required by the *Law of Property (Miscellaneous Provisions) Act 1989*. He also failed in a claim for unjust enrichment. The House of Lords held that he was a seasoned property developer who knowingly took a risk by proceeding without a formal contract. His remedy, if any, lay in proprietary estoppel, not in restitution, as the contract (albeit unenforceable) defined the scope of the intended enrichment.

Similarly, in ***MacDonald Dickens & Macklin v Costello*** [2011] EWCA Civ 930, the Court of Appeal reiterated that a *quantum meruit* claim is not available where the parties have a contract that provides for remuneration, simply because the claimant later regrets the price they agreed to.

When can Contract and Restitution Co-exist?

1. **After termination for breach**: The innocent party often has an election between suing for damages for breach of contract or claiming a *quantum meruit* for the value of work done.
2. **Following frustration**: The *LR(FC)A 1943* provides a statutory restitutionary scheme that operates precisely because the contractual obligations have been discharged.
3. **Where a contract is set aside**: If a contract is voidable for misrepresentation, duress, or undue influence and is subsequently rescinded, restitutionary claims for the return of money or property transferred under the contract become available.

10.6 Conclusion

Restitution aims to prevent unjust enrichment by stripping away a benefit received at another's expense where it is unjust to retain it. The main claims are *quantum meruit* (for services) and *quantum valebant* (for goods), which seek a reasonable remuneration. These claims can arise where there is no contract, a void contract, or where a contract does not fix the price.

Following termination for breach, a *quantum meruit* is available if the other party has voluntarily accepted the benefit of part performance. The *Law Reform (Frustrated Contracts) Act 1943* provides a statutory scheme for restitution when a contract is discharged by frustration, allowing for the recovery of money paid and the award of a "just sum" for benefits conferred. Essentially, restitution cannot be used to subvert a valid contract. Where a contract governs the relationship, its terms will generally prevail.

11

REMEDIES FOR BREACH OF CONTRACT I: DAMAGES AND MITIGATION

A contract is not merely a promise; it is a legally enforceable agreement. When one party fails to perform their obligations, the law does not leave the innocent party empty-handed. This chapter and the next explore the remedies available for a breach of contract. Here, we focus on the most common remedy: an award of damages. We will dissect the principles that underpin an award of damages, the rules that limit its scope, and the critical duty placed on the innocent party. Understanding these rules is fundamental for any solicitor, whether you are advising a client on their potential liability or on the compensation they can claim.

11.1 The Purpose and Principle of Contract Damages

When a contract is breached, the primary purpose of the court is not to punish the wrongdoer but to compensate the innocent party for the loss suffered. The fundamental principle is to put the innocent party, so far as money can do it, in the same position they would have been in if the contract had been performed. This is often referred to as the "compensatory principle."

It is imperative to distinguish contract damages from damages in tort. Tort damages aim to put the claimant in the position they would have been in if the wrong (e.g., the negligent act) had never occurred. Contract damages, by contrast, look forward to the promised future and aim to fulfil the claimant's expectations from the bargain they struck.

To achieve this, the law recognises three primary "interests" that a claimant may seek to protect.

11.1.1 Compensation for Loss: The Expectation Interest

The expectation interest is the most frequently claimed and represents the core purpose of contract damages. It protects the benefit of the bargain itself; the profit or advantage the claimant expected to gain from the contract's performance.

The classic statement of this principle comes from ***Robinson v Harman*** [1848] 1 Ex 850; "The rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed."

Example 1: The Sale of Goods

A manufacturer contracts to buy a specialised machine for £50,000. The seller fails to deliver. The manufacturer finds an identical machine from another supplier, but due to market shortages, the price is now £70,000.

Expectation interest: The manufacturer expected to receive a machine for £50,000. To put them in that position, they are entitled to the difference between the contract price and the cost of obtaining the equivalent. Damages would be £20,000.

Example 2: The Building Contract

A homeowner hires a builder to build an extension for £100,000. The builder does a shoddy job, using substandard materials, and the homeowner has to pay another builder £40,000 to rectify the defects and complete the work properly.

Expectation interest: The homeowner expected a properly built extension for £100,000. The cost of achieving that promised result is £40,000. This is the measure of their expectation loss.

The case of ***Ruxley Electronics and Construction Ltd v Forsyth*** [1996] AC 344 provides a nuanced application of this principle. A contractor built a swimming pool that was only 6 feet deep at the diving end instead of the specified 7 feet 6 inches. The trial judge found that the pool was perfectly safe for diving and the cost of rebuilding it (£21,560) was disproportionate to the loss in value (which was zero). The House of Lords held that in such circumstances, the claimant could not recover the cost of reinstatement if it was unreasonable to insist on it. Instead, a smaller award for "loss of amenity" was more appropriate, reflecting the true loss in the consumer's expectation.

11.1.2 Alternative Measures: Reliance and Restitution Interests

While the expectation interest is the default, there are circumstances where a claimant may choose to frame their claim differently.

The Reliance Interest

This aims to put the claimant back in the position they were in before the contract was made. It compensates for expenses wasted in reliance on the defendant’s promise. A claimant might elect this measure when it is difficult or impossible to prove their expected profit with sufficient certainty.

The leading case is ***Anglia Television Ltd v Reed*** [1972] 1 QB 60. Anglia Television hired the actor Robert Reed to star in a film. He later repudiated the contract. The claimants abandoned the film and sued for their wasted expenditure. They were unable to prove what profit, if any, the film would have made. The Court of Appeal held they could recover all their pre-contractual expenditure incurred in reliance on the contract, including money spent *before* the contract with Reed was signed, provided it was within the parties' contemplation. This allowed them to recover their reliance loss.

The Restitution Interest

This is fundamentally different. It is not concerned with compensating loss, but with preventing the unjust enrichment of the defendant. It allows the claimant to recover the value of a benefit they have conferred upon the defendant. The claim is for a reasonable sum for the work done or goods supplied, known as a *quantum meruit* (as much as he deserves).

The case of ***Planché v Colburn*** [1831] EWHC KB J56 is the classic illustration. The author agreed to write a book for a publisher. After he had done substantial work on it, the publishers abandoned the series. He successfully sued not for his lost profit on the book (expectation), but for a reasonable remuneration for the work he had done (restitution).

Example

A developer hires an architect to draw up plans for a new building. After the architect has completed 50% of the work, the developer wrongfully terminates the contract.

Restitution claim: The architect can sue for a reasonable fee for the 50% of the work completed and accepted by the developer, regardless of whether the developer's breach caused the architect to lose profit on the overall contract.

11.2 Causation and Remoteness of Damage

Not every loss that follows a breach of contract is recoverable. The law imposes two key control mechanisms: causation and remoteness.

11.2.1 Causation: The Breach must be the Cause of the Loss

The claimant must prove, on the balance of probabilities, that the loss was caused by the defendant's breach. This often involves applying the "but for" test: but for the defendant's breach, would the claimant have suffered this loss?

Sometimes, an intervening event (*novus actus interveniens*) may break the chain of causation. If the loss is primarily caused by an independent, supervening event or by the claimant's own unreasonable action, the defendant may not be liable for losses occurring after that point.

11.2.2 Remoteness: The Rule in *Hadley v Baxendale*

Even if a loss is caused by the breach, it may be too remote to be recoverable. The leading rule on remoteness was established in the seminal case of ***Hadley v Baxendale*** [1854] EWHC Exch J70 and remains the cornerstone of the law today.

The facts of the case are fundamental to understanding the rule. The claimants (millers in Gloucester) had a broken crankshaft. They engaged the defendants (carriers) to transport the shaft to Greenwich to serve as a pattern for a new one. The defendants delayed in delivering the shaft, causing the mill to be idle for longer than necessary. The claimants sued for the lost profits from the mill during the period of delay.

The Court of Exchequer laid down a two-limb test for recoverable losses. A loss is recoverable if it:

1. May fairly and reasonably be considered as arising naturally, i.e., according to the usual course of things, from the breach itself; or
2. May reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach.

The court held that the mill's loss of profit did not fall within the first limb because it was not "natural" for a mill to have only one shaft and to shut down completely while it was repaired. Furthermore, it did not fall within the second limb because the carriers had not been informed that the mill would be idle until the new shaft arrived. The claimants had not communicated these special circumstances. Therefore, the loss of profits was too remote.

First Limb: Losses Arising Naturally

This limb covers losses that any reasonable person, with only a general knowledge of the ordinary course of the world, would foresee as a likely consequence of the breach.

Example

A restaurant owner contracts to buy a new, large freezer from a supplier, with delivery on 1st June. The supplier delivers two weeks late. The restaurant owner has to throw away £1,000 worth of spoiled food that they had stocked in anticipation.

Application: It arises "naturally" from the late delivery of a freezer that perishable goods stored in the old freezer (which was presumably being replaced) might be lost. This loss is recoverable under the first limb of ***Hadley v Baxendale***.

Second Limb: Losses within the Contemplation of the Parties

This limb deals with losses that arise from special circumstances peculiar to the particular contract. For such losses to be recoverable, the special circumstances must have been communicated to the defendant at or before the time the contract was made. This puts the defendant on notice of the extraordinary risk they are undertaking.

The modern interpretation of this limb was clarified in ***Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*** [1949] 2 KB 528. The defendants sold a boiler to the claimants, a laundry business, knowing they were launderers and dyers and required it for immediate use in their business. The defendants delivered the boiler late. The claimants sued for two types of lost profit: (i) ordinary laundry profits and (ii) highly lucrative government dyeing contracts.

The Court of Appeal held:

- The loss of ordinary profits was recoverable under the first limb. It was a natural consequence of delaying the delivery of a boiler to a laundry business.
- The loss of the especially profitable dyeing contracts was only recoverable if the defendants had been made aware of them. As they had not been given this specific information, this latter loss was too remote.

The law was further refined in ***The Heron II*** [1969] 1 AC 350, a House of Lords decision, which emphasised that the test is one of *contemplation* as a "serious possibility" or "not unlikely" consequence, rather than a mere possibility.

11.3 The Duty to Mitigate Loss

The compensatory principle is tempered by a crucial common-sense rule: the innocent party cannot sit back and allow losses to accumulate when they could reasonably take steps to avoid them. This is the duty to mitigate.

11.3.1 The Principle and its Application

The innocent party is under a duty to take all reasonable steps to mitigate the loss consequent upon the breach. The burden of proof is on the defendant to show that the claimant has failed to mitigate.

It is vital to understand what "reasonable" means. The claimant is not required to take extraordinary steps, spend large sums of money, or take steps that would harm their commercial reputation.

Example 1: Sale of Goods

A buyer wrongfully rejects a consignment of perishable goods (e.g., fruit). The seller cannot let the fruit rot and then claim the full contract price. They must take reasonable steps to resell the goods in the market, even if this means selling at a lower price. The damages will be the difference between the contract price and the resale price.

Example 2: Employment Contract

An employee is wrongfully dismissed. They must take reasonable steps to seek alternative employment. They cannot simply remain idle and claim their full salary for the entire notice period. What is "reasonable" will depend on the seniority of the role, the state of the job market, and the need to accept a comparable position (they are not usually required to accept a demotion or a job in a different city).

The case of **Brace v Calder** [1895] 2 Q. B. 253 illustrates this. The claimant was employed by a partnership for a fixed term. The partnership was dissolved, which constituted a wrongful dismissal. The surviving partners offered to re-employ the claimant on the same terms, but he refused. It was held that his refusal was unreasonable, and his damages were limited to the short period between the dismissal and the offer of re-employment. His failure to mitigate meant he recovered only nominal damages.

11.3.2 Consequences of a Failure to Mitigate

If a claimant fails to take reasonable steps to mitigate their loss, they cannot claim for any part of the loss that is attributable to this failure. The damages awarded will be calculated as if they had taken those reasonable steps.

Example

A landlord's tenant wrongfully vacates the premises with 12 months of the lease remaining. The market rent is the same as the contract rent. The landlord, upset with the tenant, makes no effort to advertise the property or find a new tenant for 6 months.

Consequence: The landlord will only be able to recover 6 months' rent, not 12. The loss for the second 6-month period was caused by their own unreasonable inaction, not by the tenant's breach.

11.4 Liquidated Damages and Penalties

Parties often include a clause in their contract that seeks to pre-agree the damages payable in the event of a breach. This is known as a liquidated damages clause. Such clauses provide certainty and avoid the need for complex and costly litigation over quantum.

However, the law will not enforce a clause that is a penalty. The courts distinguish between a genuine pre-estimate of loss (enforceable) and a punitive clause designed to terrorise the other party into performance (unenforceable).

11.4.1 Distinguishing a Genuine Pre-Estimate of Loss from a Penalty

The traditional test, set out in ***Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*** [1915] AC 7 by *Lord Dunedin*, established a number of "presumptions":

- It will be a penalty if the sum stipulated is "extravagant and unconscionable" in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

- It will be a penalty if the breach consists only in not paying a sum of money, and the stipulated sum is greater than the sum which ought to have been paid.
- There is a presumption (but not a conclusive rule) that it is a penalty when "a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage."

11.4.2 The Modern Test for a Penalty Clause

The law in this area was significantly modernised by the Supreme Court in ***Cavendish Square Holding BV v Talal El Makdessi*** [2015] UKSC 67 and ***ParkingEye Ltd v Beavis*** [2015] UKSC 67, heard together.

The Supreme Court moved away from the strict "genuine pre-estimate of loss" test. The new, broader test is whether the clause imposes a detriment on the contract-breaker which is out of all proportion to any legitimate interest of the innocent party in enforcing the primary obligation.

A clause will be a penalty if it is not a genuine pre-estimate of loss *and* it is not protecting a legitimate business interest. The court must ask:

1. What legitimate business interest is the clause intended to protect?
2. Is the clause extravagant, exorbitant, or unconscionable in protecting that interest?

In ***Makdessi***, the clause stipulated that if the seller breached a non-compete obligation, he would lose the right to receive deferred payments for his shares (worth many millions). The Supreme Court held this was not a penalty because it was protecting the legitimate interest of the buyer in preserving the goodwill of the business it had purchased, and the clause was not disproportionate in that context.

In ***ParkingEye***, a £85 charge for overstaying in a car park was not a penalty. While it was not a pre-estimate of the landowner's loss, it was protecting a legitimate interest in managing parking space turnover. The sum was not extravagant or unconscionable in the context of regulating the use of the car park.

11.4.3 Consequences of a Clause being a Penalty

If a court determines that a clause is a penalty, the clause is unenforceable. It is void as a matter of public policy. However, this does not mean that the innocent party recovers nothing. The innocent party is still entitled to claim common law damages for the breach, following the normal rules of causation, remoteness, and mitigation discussed in this chapter. They simply cannot rely on the pre-agreed, penal amount.

Drafting Advice for Solicitors

When drafting a liquidated damages clause, a solicitor should:

1. Head the clause "Liquidated Damages".
2. State that the amount is a genuine pre-estimate of loss and not a penalty.
3. Where possible, provide a clear and logical rationale for how the figure was calculated.
4. Ensure the amount is proportionate to the likely loss from the breach and to any legitimate interest being protected.
5. Avoid having the same large sum payable for a multitude of breaches of varying seriousness.

11.5 Conclusion

The primary purpose of contract damages is compensation, not punishment. The goal is to protect the expectation interest and put the claimant in the position they would have been in had the contract been performed.

Alternative claims can protect the reliance interest (wasted expenditure) or the restitution interest (recovering the value of a benefit conferred). Recoverable losses are controlled by causation (the breach must cause the loss) and remoteness (the loss must not be too remote, as per the rule in ***Hadley v Baxendale***).

The innocent party has a duty to mitigate their loss and cannot recover for losses that could have been reasonably avoided. Liquidated damages clauses are enforceable if they are a genuine pre-estimate of loss or proportionate to a legitimate interest. Penalty clauses, which are extravagant and unconscionable, are unenforceable.

12

REMEDIES FOR BREACH OF CONTRACT II: SPECIFIC REMEDIES, INDEMNITIES AND GUARANTEES

In the previous chapter, we explored the primary remedy for a breach of contract: damages. While damages aim to compensate the innocent party financially, they are not always a sufficient or appropriate solution. What if the subject matter of the contract is unique, such as a piece of land or a rare painting? Money cannot truly compensate for its loss. What if one party has promised not to do something, but is threatening to do it? In these situations, the court may grant specific remedies that directly enforce the contractual obligations.

This chapter examines these powerful equitable remedies; specific performance and injunctions, as well as two crucial contractual devices: indemnities and guarantees. Understanding when these remedies are available is essential for any solicitor advising a client on how best to protect their interests when a contract has been breached.

12.1 Specific Performance

12.1.1 Nature as a Discretionary Equitable Remedy

Specific performance is a court order that compels the party in breach to perform their contractual obligations. It is not a claim for money, but an order to *do* what was promised. For example, it can order a seller to complete the sale of a property by transferring the legal title to the buyer.

It is vital to understand that specific performance is:

1. **An equitable remedy**: It originated from the Courts of Chancery, not the common law courts.

2. **Discretionary**: The court is not obliged to grant it, even if a breach of contract is proven. This contrasts with damages, which are available as of right once a breach is established. The court's discretion is exercised according to well-established principles and is not arbitrary.

3. **Subject to equitable maxims**: The claimant must come to court with "clean hands" and must not have unduly delayed in seeking the remedy ("delay defeats equities").

Because it is a discretionary order, backed by the threat of contempt of court (which can lead to fines or imprisonment), the courts will only grant it where it is just and equitable to do so.

12.1.2 When Granted: Inadequacy of Damages and other Guiding Principles

The most important principle for granting specific performance is the inadequacy of damages. The court will ask: would an award of damages be a sufficient remedy for the claimant? If the answer is yes, specific performance will be refused.

1. **Contracts for the Sale of Land**

   Land is considered unique. No two parcels of land are identical, and therefore damages are presumed to be an inadequate remedy. If a seller refuses to complete the sale of a house or a piece of land, the buyer will almost always be granted an order for specific performance. This is the most common application of the remedy.

2. **Contracts for Unique Goods**

Similarly, if a contract is for a unique item, such as a rare vintage car, a valuable painting, or a family heirloom, damages may be inadequate because the claimant cannot go into the market and find an identical replacement. The case of ***Falcke v Gray*** [1859] 4 Drew 651 involved a unique Chinese vase, and specific performance was ordered for its sale.

Conversely, for generic goods that are readily available on the market, such as a new model of a car or a ton of grain, damages will be adequate. The claimant can simply use the damages to buy an equivalent substitute.

3. **Where Damages are Difficult to Quantify**

Sometimes, even if the subject matter is not unique, the financial loss caused by the breach may be too speculative or difficult to calculate with any accuracy. In such cases, the court may find that damages are an inadequate remedy and grant specific performance.

The House of Lords in ***Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd*** [1998] AC 1 confirmed these principles but also highlighted a key limitation. They held that while the inadequacy of damages is a prerequisite, it does not automatically mean specific performance will be granted. The court must also consider whether the order would be impractical or require constant supervision.

12.1.3 Bars to the Remedy

Even if damages are inadequate, the court may refuse to grant specific performance for several reasons.

1. **Constant Supervision**

The court is reluctant to grant an order that would require the court to continuously monitor and supervise the defendant's performance. This was the decisive factor in ***Co-***

operative Insurance v Argyll. The landlord sought an order to compel Argyll to keep its supermarket open for the duration of the lease. The House of Lords refused, stating that such an order would require constant supervision by the court to ensure compliance, which would be unworkable. It is easier to grant a one-off order to convey land than a continuing order to operate a business.

2. Contracts for Personal Services

The court will never order specific performance of a contract for personal services. For example, it will not order an employee to work for an employer, or a singer to perform at a concert. This is partly because it would be tantamount to slavery (violating the *Thirteenth Amendment of the US Constitution* and similar principles in the UK) and partly because it is undesirable to force a relationship of trust and confidence where it has broken down. The case of ***Page One Records Ltd v Britton*** [1968] 1 WLR 157 is a classic example, where the court refused to order The Troggs pop group to continue employing their manager.

3. Lack of Mutuality

As a general rule, the remedy must be available to both parties. If the claimant could not themselves have been ordered to perform their obligations (e.g., because they are a minor), the court may refuse to grant specific performance against the defendant.

4. Hardship

If granting the order would cause severe and disproportionate hardship to the defendant, the court may refuse it. The hardship must be more than just the fact that the defendant has entered a bad bargain.

5. Claimant's Conduct

If the claimant has acted unfairly or has not complied with equitable maxims ("clean hands"), the court may deny the remedy.

12.2 Injunctions

An injunction is a court order that either prohibits a party from doing something (a prohibitory injunction) or requires them to do something to undo a wrongful act (a mandatory injunction). Like specific performance, it is a discretionary and equitable remedy.

12.2.1 Prohibitory Injunctions

This is the most common type of injunction. It orders a party not to do something, thereby restraining a breach of contract (or a tort). For example, it could prevent a former employee from using confidential trade secrets, or stop a neighbour from building a structure that breaches a restrictive covenant.

The principles for granting a prohibitory injunction are similar to those for specific performance. The court will consider the adequacy of damages. If the breach would cause irreparable harm that cannot be compensated by money, an injunction is likely to be granted.

12.2.2 Mandatory Injunctions

A mandatory injunction is more intrusive. It orders a party to take positive action to rectify a past breach. For example, it could order a landowner to demolish a wall built in breach of a covenant.

Courts are more cautious in granting mandatory injunctions because they compel action rather than inaction. The court will be particularly concerned with the cost to the defendant of complying with the order compared to the benefit to the claimant. In ***Wakeham v Wood*** [1982] 43 P & CR 40, the court ordered a defendant to rebuild a wall he had demolished, as the loss to the claimant's property value was significant and damages were inadequate.

12.2.3 Injunctions to Enforce Negative Covenants

A particularly important application of injunctions in contract law is to enforce negative covenants; promises not to do something. This is most frequently seen in employment contracts.

While a court will not order an employee to work (specific performance), it may be willing to issue an injunction to prevent them from working for a competitor if their contract contains a valid and reasonable restrictive covenant. This effectively forces the employee to either not work or to work for the original employer, but the technical order is only to refrain from the prohibited act.

The leading case is ***Warner Bros Pictures Inc v Nelson*** [1937] 1 KB 209. The actress Bette Davis had a contract with Warner Bros promising to act exclusively for them and not to work for any other film company. She breached this by attempting to work for another studio in the UK. The court granted an injunction to prevent her from working for anyone else. It did not order her to act for Warner Bros, but the practical effect was to leave her with little alternative if she wanted to work as an actress.

The enforceability of such covenants depends on them being reasonable in scope, duration, and geographical area to protect a legitimate business interest (such as trade secrets or customer connections).

12.3 Indemnities

12.3.1 Nature and Scope of an Indemnity

An indemnity is a promise by one party (the indemnifier) to protect another party (the beneficiary) from a specified loss or liability. It is, in essence, a contract to provide compensation. Indemnity clauses are common in commercial contracts, such as construction contracts, leases, and share purchase agreements.

For example, in a commercial lease, the tenant will often promise to "indemnify" the landlord against all costs, claims, and liabilities arising from the tenant's use of the property. If a visitor is injured on the premises and sues the landlord, the landlord can call on the tenant's indemnity to cover the legal costs and any damages payable.

The key feature of an indemnity is that it is a primary obligation. The indemnifier's liability is triggered by the occurrence of the event specified in the indemnity clause, not necessarily by a breach of contract.

12.3.2 Distinction between an Indemnity and a Claim for Damages

This is an important distinction for a solicitor to grasp, as it has significant practical consequences for the measure of recovery and, potentially, for the application of limitation periods.

Feature	Damages for Breach of Contract	Indemnity
Basis of Claim	Compensation for a breach of contract.	Fulfilment of a primary promise to cover a loss.
Measure of Recovery	Governed by remoteness rules (***Hadley v Baxendale***). Aims to put the claimant in the position they would have been in if the contract had been performed.	The amount actually incurred by the beneficiary to settle the liability or loss, as per the indemnity clause. It is not necessarily limited by remoteness.
Timing	Claimable once the breach occurs and loss is suffered.	Claimable when the liability is incurred, even if the money has not yet been paid out.
Duty to Mitigate	The innocent party has a duty to take reasonable steps to mitigate their loss.	No general duty to mitigate, unless the indemnity clause expressly imposes one.

The case of ***British Union for the Abolition of Vivisection (BUAV) v University of Oxford*** [2009] EWHC 3030 (Ch) illustrates this. The BUAV claimed against the University under an indemnity clause for costs it had incurred. The court analysed the clause to determine its scope, highlighting that the recoverable loss is defined by the wording of the indemnity itself, not by the common law rules on damages.

12.4 Guarantees

12.4.1 Nature of a Contract of Guarantee and the Requirement for Writing

A contract of guarantee (or suretyship) is a promise by one party (the guarantor) to answer for the debt, default, or miscarriage of another party (the principal debtor). It is a secondary obligation; the guarantor's liability is dependent on the principal debtor's liability.

Example: A small company wants to take out a loan from a bank. The bank, concerned about the company's creditworthiness, requires the company's director to provide a personal guarantee. If the company (the principal debtor) defaults on the loan, the director (the guarantor) becomes liable to pay the bank.

To prevent misunderstanding and fraud, *s.4* of the *Statute of Frauds 1677*, requires a contract of guarantee to be evidenced in writing to be enforceable. While the contract itself does not have to be in a formal written document, there must be some written note or memorandum signed by the guarantor (or their authorised agent) that sets out the essential terms of the guarantee.

12.4.2 Rights of the Guarantor (e.g., Subrogation)

If a guarantor is called upon to pay under the guarantee, they step into the shoes of the creditor and acquire certain rights against the principal debtor.

The most important right is the right of subrogation. Once the guarantor has paid the debt, they are entitled to be "subrogated" to all the rights and securities that the creditor held against the principal debtor. This means the guarantor can effectively sue the principal debtor for the amount they have paid and can also take the benefit of any security the creditor held (e.g., a mortgage or a charge over assets).

Other key rights include:

- **Right of indemnity**: An implied right to be reimbursed by the principal debtor for the amount paid. This exists independently of the right of subrogation.

- **Right to the benefit of any co-guarantors**: If there is more than one guarantor for the same debt, a guarantor who pays more than their share can claim a contribution from the other guarantors.

12.4.3 Discharge of the Guarantor

A guarantor can be discharged from their obligations if the underlying agreement between the creditor and the principal debtor is materially altered without the guarantor's consent. This is known as the rule in ***Holme v Brunskill*** [1878] 3 QBD 495.

The principle is that a guarantor has agreed to be liable for the risk associated with a specific contract. If that contract is varied in a way that could increase the guarantor's risk (even if it seems minor or is actually beneficial), the guarantor will be released from their obligations unless they consent to the variation.

Example: A landlord (creditor) and a tenant (principal debtor) agree to vary the lease by reducing the rent but extending the term. This is a material variation. If this is done without the consent of the tenant's guarantor, the guarantor will be discharged from their liability under the guarantee for all future rent. This is a harsh but important rule for solicitors acting for lenders or landlords to be aware of; any variation to the principal contract must be done with the guarantor's consent.

12.5 Conclusion

Specific Performance is a discretionary order to perform contractual obligations, granted where damages are inadequate (e.g., for land or unique goods) and subject to bars like constant supervision and personal service. Injunctions are discretionary orders to prohibit (prohibitory) or compel (mandatory) an action. They are crucial for enforcing negative covenants without falling foul of the rules against specific performance for personal services.

Indemnities are primary promises to compensate for a loss, with recovery defined by the contract wording, not the common law rules on damages. Guarantees are secondary promises to answer for another's debt, requiring written evidence. Guarantors have rights of subrogation and indemnity and can be discharged by material variations to the principal contract.

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