

Contract Law

Workbook



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Introduction to Contract Law

Contract law is the mechanism which allows parties to interact with each other on the basis of voluntarily assumed obligations – obligations which they have chosen for themselves and agreed to, rather than obligations imposed upon them. Contract law pervades a great range of transactions which individuals and commercial entities engage in. These transactions may be routine and commonplace, for example, agreement to the terms and conditions of a website or on making an everyday purchase. At the other extreme, they can be of significant value, such as the agreement for the sale and purchase of a company by private investors. As a result, contract law is fundamental to any complex society and is relevant to a range of legal practice areas including commercial law and litigation, employment law, property law and corporate transactions.



Agreement

1 Introduction to offer and acceptance



Figure 1.1: Requirements of a contract

In order for there to be a binding contract, the following must be present:

- Offer and acceptance;
- Intention to create legal relations; and
- Consideration.

You will first consider offer and acceptance.

For a contract to exist, one party (the offeror) needs to make a clear and certain offer displaying an intention to be bound and the other party (the offeree) needs to communicate an unequivocal acceptance.



Offeror: This is the person making the offer.

Offeree: This is the person to whom the offer is made.

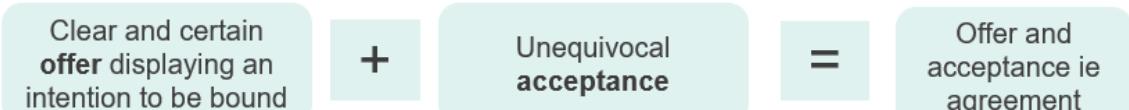


Figure 1.2: Offer and acceptance

1.1 The objective approach to agreement

When determining whether an agreement exists between the offeror and the offeree, the court is not concerned with the inward mental intent of the parties but rather with what a reasonable person would say was the intention of the parties, having regard to all the circumstances.

In *Storer v Manchester City Council* [1974] 1 WLR 1403 Lord Denning stated:

In contracts you do not look into the actual intent in a man's mind. You look at what he said and did. A contract is formed when there is, to all outward appearances a contract. A man cannot get out of a contract by saying: 'I did not intend to contract' if by his words he has done so.

The idea of offer and acceptance is that it shows a 'meeting of minds': but the law applies an **objective** test when it comes to identifying agreement.

2 Requirements of a valid offer

2.1 Offer and acceptance: Offers generally

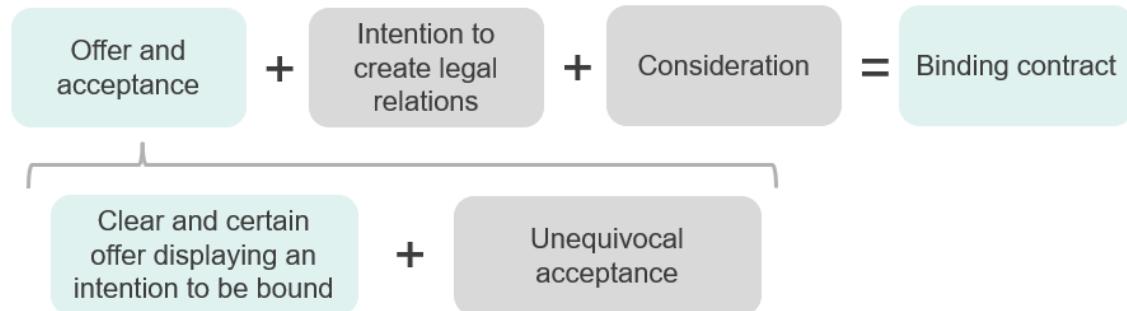


Figure 1.3: Requirements of a valid offer

We will now look at the concept of a **clear and certain offer displaying an intention to be bound** in more detail

2.2 Certainty of offer

An offer must be clear and certain. This issue is clearly illustrated in the following case



Key case: *Gibson v Manchester City Council [1979] 1 WLR 294*

Facts: The City Treasurer wrote to a tenant saying that the council 'may be prepared to sell the house to you at the purchase price of £2,725, less 20 per cent = £2,180 (freehold)'. The letter went on: 'If you would like to make a formal application to buy your council house please complete the form and return it to me as soon as possible'. The tenant completed and returned the form. Subsequently, the Council changed its policy on the sale of council houses, and, accordingly, the tenant was advised that the Council was unable to proceed with his application. The tenant brought his action claiming that the Council's letter was an offer which he had accepted by returning the application form.

Held: (By the House of Lords) There was no binding contract because there was never an offer made by the Council. The Council's letter stating that it 'may be prepared to sell' was not sufficiently clear and certain to be an offer. It was merely the first step in negotiations, lacking the requisite intention to be legally bound.

2.3 Intention to be bound

An offeror must also show an intention to be legally bound.

Look again at the summary in relation to *Gibson*. It also demonstrates the importance of an intention to be legally bound. The wording '**may** be prepared to sell' (emphasis added) used by the City Treasurer in *Gibson v Manchester City Council* was deemed to lack the requisite intention to be legally bound.

This can be contrasted with the similar case of *Storer v Manchester City Council [1974] 1 WLR 1403* in which the words 'If you will sign the agreement and return it to me I **will** send you the agreement signed on behalf of the corporation in exchange' (emphasis added) did demonstrate an intention to be bound.

Remember that the court takes an objective approach to ascertaining whether there was an intention to be bound. What matters is what a reasonable person would say the parties in *Gibson* and *Storer* intended, on the basis of their letters. What was actually in the minds of the people who wrote the letters is not relevant.

2.4 Unilateral and bilateral contracts

There are two kinds of contract: unilateral contracts and bilateral contracts. The distinction between them is important for reasons which will be addressed at different points in the module.



Bilateral contract: The most common type of contract. Each party assumes an obligation to the other party by making a promise to do something, such as to sell an item to the other party in exchange for a payment.

Unilateral contract: One party makes an offer or proposal in terms which call for an act to be performed by one or more other parties. For instance, the offer may call for specific lost property to be returned in exchange for a reward. A unilateral contract does not involve mutual promises – only the party making the offer assumes an obligation. Only actual performance of the required act will constitute acceptance.

Type of contract	Example	Features
Bilateral contract	In 10 days' time, you will deliver a watch to me, and I will pay you £100.	(a) Both parties make a promise. One party promises to pay £100. The other party promises to deliver a watch. (b) The offer can be accepted by an unequivocal communication of acceptance, at which point each party would be bound to do what it promised to do.
Unilateral contract	If you deliver a watch to me in the next 10 days, I will immediately pay you £100.	(a) Only one party makes a promise – the party promising to pay £100. The other party does not make any promise. (b) The offer is accepted by performance of the required act – by delivering a watch. At that point, the other party becomes bound to pay the £100.

2.5 Summary

- An offer must be clear and certain.
- An offeror must show an intention to be legally bound: words such as 'may be prepared to sell' do not show this.
- There are two kinds of contract: unilateral and bilateral contracts.
- Bilateral contracts are more common. Each party assumes an obligation to the other party by making a promise to do something, such as to sell an item to the other party in exchange for a payment.
- Unilateral contracts are less common. One party makes an offer or proposal in terms which call for an act to be performed by one or more other parties. Only actual performance of the required act will constitute acceptance.

3 Invitations to treat

An offer must be distinguished from a mere invitation to treat.

An invitation to treat is a first step in negotiations which may or may not lead to a firm offer by one of the parties. It usually takes the form of an invitation to make an offer.

An offer is an undertaking to be contractually bound by the terms of that offer in the event of an unconditional acceptance being made by the offeree.

In contrast, an invitation to treat cannot be accepted to form a binding contract.

This section will proceed to look at invitations to treat in the following contexts:

- (a) Advertisements
- (b) Display of goods for sale
- (c) Invitations to tender
- (d) Auction sales

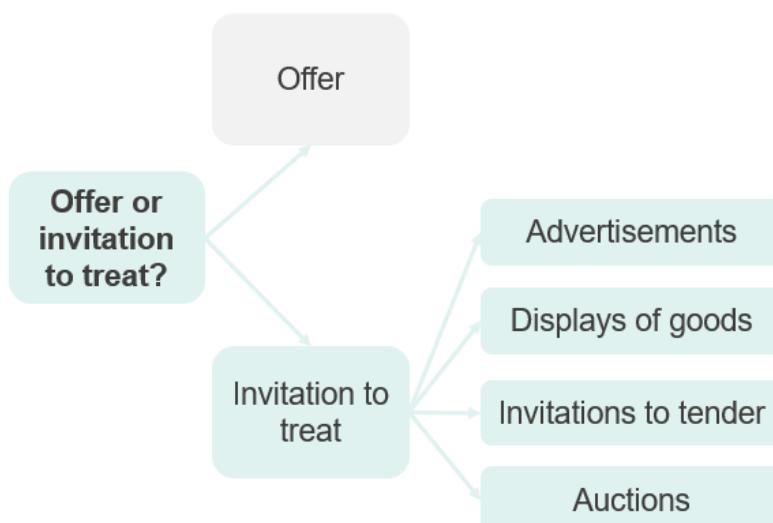


Figure 1.4: Invitations to treat

3.1 Advertisements

The general rule regarding advertisements is that they are regarded as statements inviting further negotiations or invitations to treat (*Partridge v Crittenden* [1968] 1 WLR 1204).

There are good reasons for this, including that the advertiser may have limited supplies of the goods in question. If the advert was an offer (rather than invitation to treat) it could be accepted by a larger number of people than the advertiser was able to supply, which would result in the advertiser breaching one or more contracts.

3.1.1 Advertisements – exception to the general rule

It should be noted that the general rule concerning advertisements does not apply where the advertisement amounts to a unilateral offer.



Key case: *Carlill v Carbolic Smoke Ball Co* (1893) 1 QB 256

Facts: The defendants, the proprietors of a medical preparation called 'The Carbolic Smoke Ball', issued an advertisement in which they offered to pay £100 to any person who used one of their smoke balls in a specified manner for a specified period but who nevertheless still contracted influenza. The defendants also proclaimed that they had deposited £1,000 in a named bank 'shewing our sincerity in the matter'. The plaintiff, on the faith of the advertisement, bought one of the balls and used it in the manner and for the period prescribed. Nevertheless, she contracted influenza.

Held: the facts established a contract under which the defendants were bound to pay the plaintiff £100 in relation to the event which had happened, and so the plaintiff was entitled to recover that sum.

The advertisement in this case was held to be a unilateral offer because there was a clear prescribed act (using the smoke balls in a specified manner for a specified period but nevertheless contracting influenza) performance of which constituted acceptance. Further, the defendant's intention to be bound was clearly demonstrated by their deposit of the £1,000 and the certainty of the language used in the advertisement. Similar reasoning would be applicable to an advertisement offering a reward for the return of lost property where there is clearly a conditional promise which will be turned into a binding contract when the property is returned to the rightful owner.

Note. *Carlill* makes clear that there are two requirements of a unilateral offer:

- (a) A prescribed act; and
- (b) A clear intention to be bound.

3.2 Display of goods for sale

The general rule is that price-marked goods displayed in a shop window are not an offer for sale but an invitation to treat (*Fisher v Bell* [1961] 1 QB 394). This is regardless of whether the shop actually expressly designates that the goods are an offer; a shop's 'special offer' usually amounts to no more than an invitation to treat.

Again, there are a number of good reasons for this, in particular that a trader would be obliged to sell the goods to anyone who accepted the offer (the act of acceptance might be taking items off the shelves or presenting them at the cash desk for payment) before any judgment could be made in relation to the particular customer concerned. This would be particularly problematic with certain goods – for example, those that can only be sold to customers of a certain age.

The same general principle applies equally to goods displayed on the shelves of a self-service store. In *Pharmaceutical Society of GB v Boots Cash Chemists* [1953] 1 QB 401 the display of goods on the shelves was held to be an invitation to treat.

Websites are regarded as equivalent to a display of goods, and so, an invitation to treat.

3.3 Invitations to tender

A request for tenders is used where a party (usually a company or public body) wishes to purchase a major item or service. The requestor invites tenders (ie offers) from those interested in supplying the goods or the services required. This action of inviting parties to tender is, as a general rule, deemed an invitation to treat (*Spencer v Harding* (1870) LR 5 CP 561) ie an invitation to interested parties to make offers to be considered. The requestor can accept or reject any tender, even if it is the most competitive.

A displacement of the general principle has been firmly recognised where the invitation to tender expressly contains an undertaking to accept the highest or the lowest bid (*Harvela Investments Ltd v Royal Trust Co. of Canada (Cl) Ltd* [1985] Ch 103). In such a case, the party requesting tenders has made an offer to enter into a contract with the party submitting the highest/lowest bid. This is a form of unilateral contract: the required act is making the highest/lowest bid, and when this is carried out, the other party is bound.

In *Blackpool & Fylde Aero Club Ltd v Blackpool Borough Council* [1990] 1 WLR 1195 it was held that an invitation to tender could give rise to a binding contractual obligation to consider tenders in circumstances where: (1) the tenders had been solicited from specified parties who were known to the requesting party; (2) there was an absolute deadline for submission; (3) the party requesting tenders had laid down absolute and non-negotiable conditions for submission. On this basis, Bingham LJ held that there was a contractual duty to consider those tenders which had complied with the conditions.

3.4 Auction sales

The general rule in relation to auction sales is that the auctioneer's request for bids is an invitation to treat (*Payne v Cave* (1789) 3 Durn & E 148). The bidder makes an offer which the auctioneer is then free to accept or reject. Acceptance of the bidder's offer will be indicated by the fall of the auctioneer's hammer. This is consistent with the rules of revocation of an offer ie the bidder may revoke their offer at any time before the hammer falls. It is also reflected in s 57 of the Sale of Goods Act 1979 which states:

a sale by auction is complete when the auctioneer announces its completion by the fall of the hammer, or in other customary manner; and until the announcement is made any bidder may retract his bid

Auctions 'without reserve' require special consideration and are considered below.

3.4.1 Auctions 'without reserve'

Many auction sales have a 'reserve' price: if no bid above this price is received, the seller keeps the goods. However, in an auction **without reserve** the seller promises to sell to the highest bidder whatever that bid turns out to be.

If the sale of the item in question is expressed to be 'without reserve' the auctioneer may be sued for breach of contract if they refuse to sell to the highest bona fide bidder. This view was expressed, obiter dicta, in *Warlow v Harrison* (1859) 1 E & E 309. The analysis of this case suggests that, where the sale is expressed to be without reserve, there are in fact two contracts. The first bilateral contract proceeds on the usual analysis of an auction sale whereby the bidder makes an offer which is capable of acceptance or rejection by the auctioneer. This contract determines who is entitled to the goods. The second contract is a unilateral contract based on the promise that the auction will be without reserve. If a reserve is not applied and the goods are withdrawn from sale there is a breach of this unilateral contract and the highest bona fide bidder is entitled to be compensated by the payment of damages. The highest bidder is not, however, entitled to the goods since this is dictated by the bilateral contract for sale. This approach has been approved by the Court of Appeal in *Barry v Davies* [2000] 1 WLR 1962.

3.5 Summary

- An invitation to treat is not an offer.
- An invitation to treat is a first step in negotiations.
- An offeror must show an intention to be legally bound: words such as 'may be prepared to sell' do not show this.
- An invitation to treat cannot be accepted to form a binding contract.
- Advertisements are generally invitations to treat, unless they relate to unilateral contracts. So are displays of goods for sale and websites.
- Invitations to tender are generally invitations to treat, unless they commit to accept the highest or lowest bid (in which case they are, in fact, unilateral offers).
- In most auctions, the bid is the offer, which is accepted by the fall of the auctioneer's hammer. In an auction sale without reserve, the auctioneer can be sued if they refuse to sell to the highest bidder.

4 Termination of an offer

An offer can come to an end by rejection, lapse or revocation. In each case, the offer loses its legal effect and becomes incapable of acceptance.

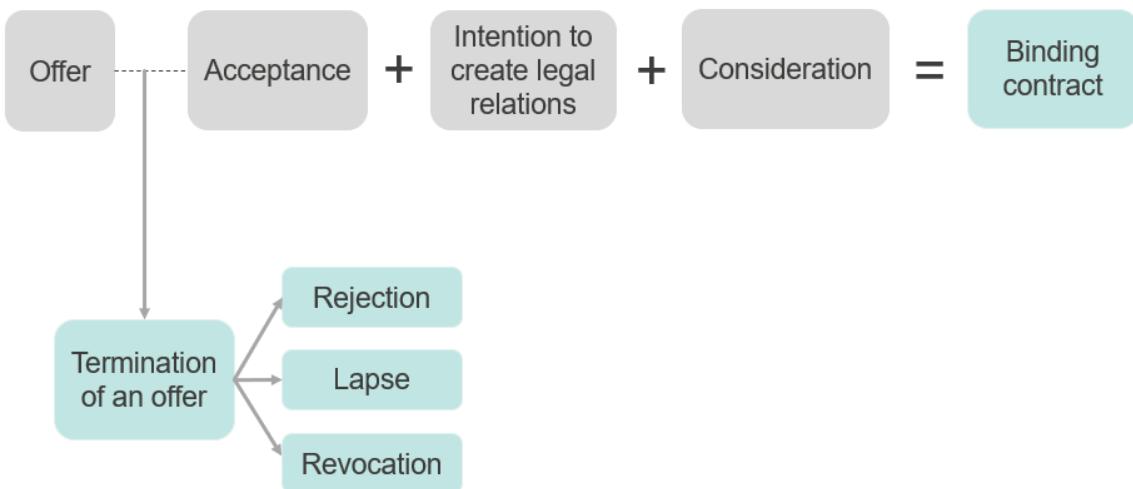


Figure 1.5: Termination of an offer

4.1 Rejection

An offer is terminated by rejection. Once an offer is rejected, it cannot then be accepted (unless the offeror makes the same offer again). A rejection does not take effect until it is actually communicated to the offeror as only then will the offeror know that they are free from the offer.

4.1.1 Rejection and counter-offers

An attempt to accept an offer on new terms may be a rejection of the offer accompanied by a counter-offer. Where an offeree makes a counter-offer, the original offer is deemed to have been rejected and cannot be subsequently accepted (*Hyde v Wrench* (1840) 3 Beav 334).

Where a counter-offer is accepted, its terms and not the terms of the original offer become the terms of the contract.

Difficulties can occur when an offer is made on the standard terms of the offeror and the purported acceptance is made on the standard terms of the offeree. If these terms are different in any way, the offeree has in fact made a counter-offer. It is sometimes said that the person who fires the last shot wins the battle, in the sense that the person who last asserts that their own terms and conditions should apply is likely to prevail (although if each side simply continues to assert that its own terms and conditions prevail, and the parties do not move past this, then no contract will be formed).

4.1.2 Rejection – distinguishing a counter-offer from a request for information

As set out above, if an offeree makes a counter-offer then this amounts to a rejection of the offer, after which the offer cannot be accepted. However, if an offeree responds seeking clarification of the extent and terms of the offer, or to ascertain if the offeror would consent to changing certain ancillary aspects of the offer, then the offeree's request may be construed as a request for further information. In this event, since there has been no counter-offer, the original offer remains open for acceptance.

For this reason, it is very important to distinguish between a counter-offer and a request for information, and the difference can be very slight. In *Stevenson, Jacques & Co. v McLean* (1880) 5 QBD 346 the defendant offered to sell to the claimant 3,800 tons of iron 'at 40s net cash per ton, open till Monday'. The claimant responded: 'Please wire whether you would accept 40 for delivery over two months, or, if not, the longest limit you would give'. Having received no reply, at 1:34pm, the claimant despatched a telegram accepting the original offer. The court held that the claimant's response was not a counter-offer but rather an enquiry which did not serve to reject the offer. Accordingly, a binding contract was made when the claimant sent the telegram accepting the offer.

4.2 Lapse of an offer

An offer may lapse and thus become incapable of acceptance:

- (a) By passage of time;
- (b) By the death of one of the parties.

4.2.1 Passage of time

An offer will lapse through passage of time in the following circumstances

- (a) Where acceptance is not made within the period prescribed by the offeror;
- (b) Where no period is prescribed and acceptance is not made within a reasonable time. What is reasonable will depend on the circumstances of the case.

4.2.2 Death of a party

In relation to the death of the **offeror** it appears that, if the offeree knows that the offeror has died, the offer will lapse; if the offeree is unaware of the offeror's death, it probably will not.

It seems that the death of the **offeree** will cause the offer to lapse and so that the offer cannot be accepted after the offeree's death by the offeree's representatives.

4.3 Revocation

The offeror may withdraw (ie revoke) their offer at any time before acceptance (*Payne v Cave* (1789) 3 Durn & E 148). However, once a valid acceptance has been made, the offeror is bound by the terms of their offer. An offer cannot be revoked after acceptance.

4.3.1 Communication essential

Revocation of an offer is effective only upon actual notice of it reaching the offeree. Where revocation is communicated by post it takes effect from the moment it is received by the offeree and not from the time of posting (*Byrne v Van Tienhoven* (1880) 5 CPD 344).

4.3.2 Indirect communication of revocation

Provided the offeror has shown, by words or conduct, a clear intention to revoke their offer and notice has reached the offeree, the revocation is effective. The means of communication do not matter, so the revocation will be effective even if communicated by a third party (*Dickinson v Dodds* (1876) 2 Ch D 463).

There is a danger arising from this rule: if the offeree receives notice of revocation from a third party, how do they know that the information from the third party is reliable?

4.3.3 Revocation of a unilateral offer

In relation to unilateral contracts, acceptance is perceived as the complete performance of the act(s) required by the terms of the unilateral offer. Consequently, it remains possible to revoke the offer at any time prior to the completion of the required act (*Great Northern Railway Company v Witham* (1873)).

However, an exception to this rule may apply where the offeree has partly performed the obligation and is willing and able to complete - it would undoubtedly cause hardship to the offeree to allow the offeror to withdraw the offer in this situation. In these circumstances the offeror may be under an implied obligation not to revoke the offer once performance has commenced. The offeree's acceptance and consideration for this implied promise is starting to perform the required act.

In *Errington v Errington & Woods* [1952] 1 KB 290 a father agreed to give his house to his son and daughter-in-law if they paid off the mortgage on the house. The act required of the couple was therefore paying off a building society mortgage loan. The couple had made several payments towards paying off the loan when the father sought to revoke the offer. The court held that the promise could not be revoked after the couple had started to pay the instalments and as long as they continued to be paid.

Communication of revocation in unilateral contracts made to the whole world

It has been stated that a unilateral offer can be made to the ‘whole world’ and that there is no requirement that those embarking on performance should communicate their intention to accept to the offeror: *Carlill v Carbolic Smoke Ball Co* (1893). Consequently, where such an offer has been made, the offeror may well have no knowledge of who or, indeed, how many, potential offerees may be responding to the offer. In such circumstances, communication of revocation is almost impossible, and it seems likely that revocation will be effective if the offeror takes reasonable steps to bring the revocation to the attention of all those who may have read the offer.

4.4 Summary

- An offer can come to an end, and cease to be available for acceptance, if rejected, if it lapses, or if it is revoked.
- Once an offer is rejected, it cannot then be accepted. Rejection takes effect when communicated to the offeror. A counter-offer has the effect of rejecting the original offer.
- In contrast, a request for further information about an offer is not a counter-offer and does not amount to a rejection of the original offer.
- An offer will lapse if the offeror indicates that it can only be accepted in a particular time period. Otherwise, it will lapse after ‘a reasonable time’. It will also lapse on the offeree’s death, and if the offeree knows of the offeror’s death.
- An offer can be revoked at any time prior to acceptance.
- In relation to a unilateral contract, there is an implied obligation on the part of the offeror not to prevent the offeree from competing the required act, once the offeree starts to perform that act.

5 Four rules in relation to acceptance

There are four aspects to identifying whether there has been the communication of an unequivocal acceptance needed to form a contract.

- (a) Acceptance must be in response to the offer.
- (b) Acceptance must be unqualified.
- (c) It may be necessary to follow a prescribed mode of acceptance.
- (d) Acceptance must be communicated.

5.1 Acceptance must be in response to the offer

Only the person/people to whom an offer is made (the offerees) can accept the offer. For example, it would not be possible to accept an offer you overheard that was not addressed to you.

Where an offer is made generally to the world at large then everyone with notice of the offer is an ‘offeree’, and a valid acceptance may be made by any person with notice of the offer: *Carlill v Carbolic Smoke Ball Co*. (1893).

5.2 Acceptance must be unqualified

Acceptance must be unqualified and must correspond exactly with the terms of the offer: *Hyde v Wrench* (1840) 3 Beav 334. This is sometimes called ‘the mirror image rule’. Not all transactions lend themselves to an easy analysis in terms of ‘offer’ and ‘acceptance’. Yet the court will always examine the communication between the parties to discover whether, at any one time, one party may be deemed to have assented to all the terms, express and implied, of a firm offer by the other party. An assent which is qualified in any way does not take effect as an acceptance.

Exercise: Engage

If the offeree’s response to the offer is qualified, it will be necessary to decide whether it constitutes a counter-offer or a request for information.



5.3 Prescribed mode of acceptance

Acceptance may be communicated in any manner whatsoever. Generally, the offeree may decide for themselves the manner of acceptance but if the offeror prescribes the mode of acceptance, the question arises as to whether communication of acceptance in any other manner will suffice.

In *Manchester Diocesan Council for Education v Commercial and General Investments* [1970] 1 WLR 241, Buckley J explained that it is open to the offeror to prescribe a mode of acceptance 'in terms insisting that only acceptance in that mode shall be binding'. Buckley J made it clear that particularly clear words would be required of the offeror to make their chosen mode mandatory:

If an offeror intends that he shall be bound only if his offer is accepted in some particular manner, it must be for him to make this clear.

If the offeror makes it clear that they will not be bound unless acceptance is communicated in that precise way and by no other then only acceptance by that mode will suffice. However, unless the prescribed mode of acceptance is made mandatory, another mode of acceptance which is no less advantageous to the offeror will bind them (*Tinn v Hoffman* (1873) 29 LT 271).

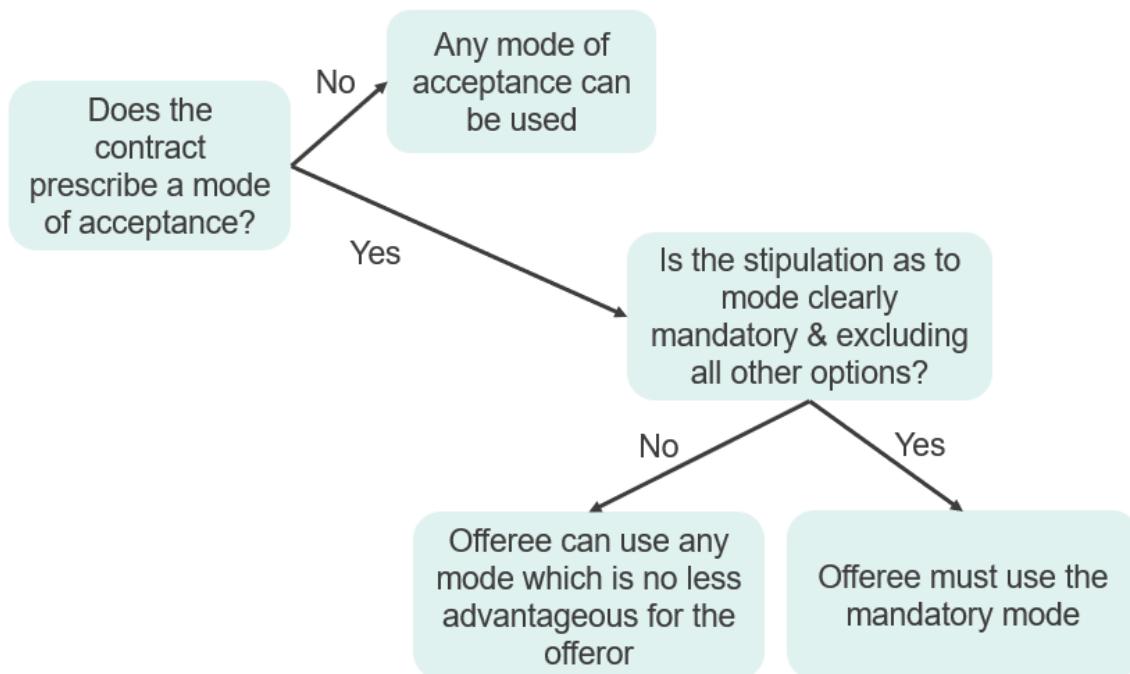


Figure 1.6: Prescribed mode of acceptance

5.4 Acceptance must be communicated

The general rule is that acceptance must be communicated to the offeror. Acceptance applies from the moment it is communicated. Where the offeree merely intended to accept, but did not communicate that intention to the offeror, there is no contract, ie mere mental assent is not sufficient. Moreover, the offeror may not stipulate that they will take silence to be acceptance and thus bind the offeree.

As a general proposition, the rule that silence cannot amount to acceptance seems a sensible one. Unless the offeror clearly waives the need for acceptance to be communicated, the offeror will want to know when they are bound. Furthermore, if silence in the face of an offer could amount to acceptance, this would place an unnecessary burden on the offeree to respond.

5.4.1 Third party communication of acceptance

It is possible for a contract to come into existence where a person other than the offeree informs the offeror of acceptance; in other words, where a third party has informed the offeror of the fact of acceptance. However, no contract will arise if the communication is made by a third party

without the authority of the offeree, in circumstances indicating that the offeree's decision to accept was not yet regarded by them as irrevocable.

5.4.2 The postal rule – *Adams v Lindsell*



Key case: *Adams v Lindsell* (1818) 1 B & Ald 681

This case laid down the postal rule and can be seen as a further exception to the rule that acceptance must be communicated to the offeror. It held that where post is deemed to be a proper means of communication, the acceptance takes effect from the moment the letter of acceptance is properly posted – not from the moment it is received by the offeror. A letter is properly posted when it is put into an official letter box or into the hands of a postal operative who is authorised to receive letters.

Rationale of the postal rule

The postal rule is at best an arbitrary one, based on an attempt to do justice as between the offeror and the offeree in circumstances where one party will inevitably be prejudiced in the event of a letter being delayed or lost. Clearly the rule places a greater burden on the offeror than the offeree – possibly justified by the fact that it is easier to prove posting than it is to prove receipt of a letter. In practice, the rule is just one of many factors which may be taken into account when looking at all the circumstances of the case. We now turn to consider the circumstances in which the rule will or will not apply. These are set out below, and then considered in further detail.

Applies even if the acceptance is delayed or lost in the post

The rule applies even where the acceptance is delayed or lost in the post: *Household Fire and Carriage Accident Insurance Co. v Grant* (1879) 4 Ex D 216.

Does not apply if it is not contemplated that post would be used

It must, however, have been contemplated that the post would be used. The case of *Henthorn v Fraser* [1892] 2 Ch 27 makes it clear that the postal rule is applicable only where it was reasonable in all the circumstances for the offeree to have used the post. It has been held to be unreasonable to use the post when there is an implied condition that prompt acceptance is required.

Does not apply to letters revoking offers

The rule applies only to letters of acceptance, not to letters revoking an offer. Revocation of an offer must be received in order to be effective (*Byrne v Van Tienhoven* (1880) 5 CPD 344).

A factual illustration of this is shown on the next section.



Example

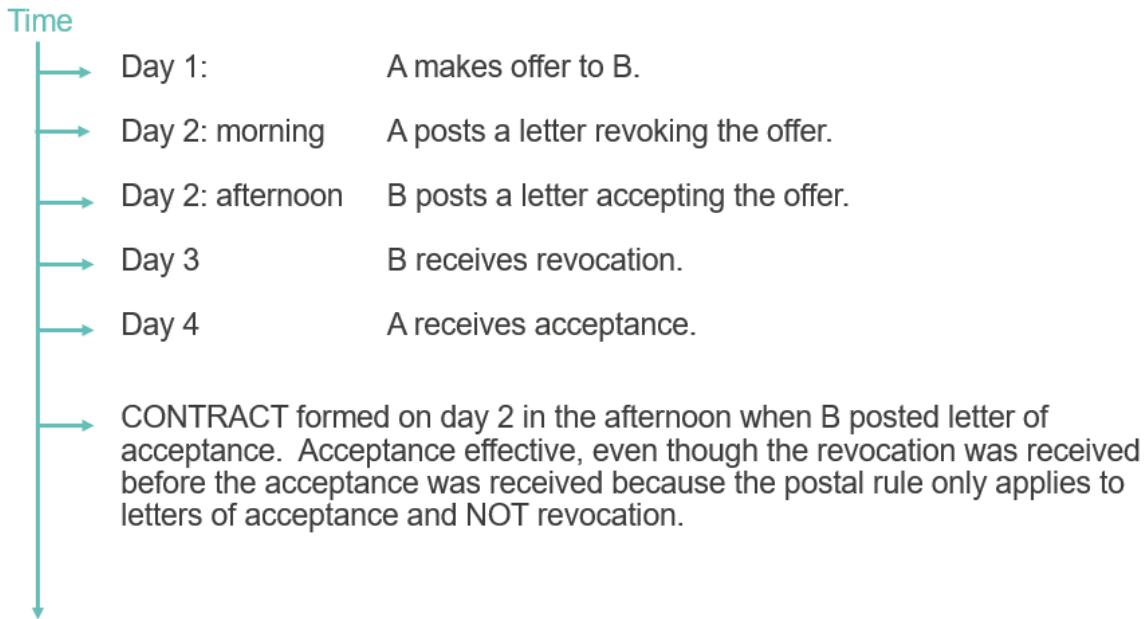


Figure 1.7: The postal rule does not apply to letters revoking offers

Does not apply if the acceptance is incorrectly addressed

It appears that the rule may be displaced if the acceptance is incorrectly addressed, the rationale being that the offeree, by their own carelessness, has lost the benefit of the postal rule.

Does not apply if disappled by offeror

It is always open to the offeror to redress the imbalance of the postal rule by requiring actual communication, for example, the offeror might state in their offer that they require receipt of acceptance. If the offeror sets aside ('ousts') the postal rule, a letter of acceptance would only be effective if and when it is received. The courts have interpreted this quite broadly, and so in *Holwell Securities v Hughes* [1974] 1 WLR 155 where the offer stipulated that 'notice in writing' was required the court held that this implied that the acceptance had to be received and the postal rule was set aside.

The postal rule

Applies even where...	Does not apply...
... the acceptance is delayed or lost in the post	... if not contemplated post would be used
	... to letters revoking offers
	... if incorrectly addressed
	... if disappled by offeror

5.4.3 Communication by instantaneous means



Exercise: Engage

Do you think the postal rule should apply equally to 'instantaneous communications', such as email or telephone?

Make a note of the advantages and disadvantages of the postal rule. Note to what extent these would apply if the postal rule applied to instantaneous communications.

Where an acceptance is made by an instantaneous mode of communication, the general rule is that the acceptance takes place at the moment the acceptance is received by the offeror (*Entores v Miles Far East Corporation* [1955]). As Denning LJ explained, in cases of instantaneous communication, the person sending the message of acceptance knows, or ought to know, whether their message has been received. Consequently, where the message of acceptance is not received, without any fault on the part of the offeror, no contract has been concluded.

On the other hand, if the acceptor reasonably believes that they have communicated their acceptance but this is not so because of the fault of the offeror (e.g. they do not hear the entirety of the acceptance due to their poor mobile reception but do not ask for it to be repeated) then the offeror may be prevented from saying that they did not receive the acceptance.

Exercise: Challenge yourself

Read the judgment of Denning LJ in *Entores Ltd v Miles Far East Corporation* (1955) 2 QB 327. Study how Denning LJ starts from an uncontroversial premise which does not involve communication over a distance (see eg paragraph beginning ‘the problem can only be solved by going in stages’), and reasons from that point to his conclusion.

For a time it was unclear whether an email was to be treated like other forms of instantaneous communication, following the usual rule that acceptance is binding on receipt, or whether the postal rule should apply. The position now seems more settled. In the High Court decision of *Thomas v BPE Solicitors* [2010] EWHC 306, Blair J expressed the view that the postal rule is inapplicable to email communications, therefore an acceptance by email is not effective when sent, but only when received (ie when the email arrives on the offeror’s email server).

The *Brimnes* [1975] QB 929 was a case concerning an instantaneous communication sent during ordinary office hours. The Court of Appeal concluded that a message that had been sent during ordinary office hours on Friday, but not been seen by office staff until the following Monday, was effective when received. The decision recognised the possible negligence of the office staff in failing to note the message in circumstances where the offeree could reasonably assume that there was an effective communication. Blair J in *Thomas v BPE Solicitors (a firm)* [2010] All ER (D) 306 makes clear that what is ‘office hours’ will depend on the particular context of the communications.

The question arises as to what the position will be if the instantaneous communication is sent outside ordinary office hours, a common problem in relation to international communications. The case of *Mondial Shipping and Chartering BV v Astarte Shipping Ltd* [1995] CLC 1011 deals specifically with this point. A message was sent on 23:41 on Friday, 2 December. It was held that the message was received at the start of business on Monday, 5 December.

5.4.4 Communication waived for unilateral contracts

The communication of acceptance is waived in a unilateral contract. *Carllill v Carbolic Smoke Ball Co.* (1893) is authority for this general principle. It was held in that case that the advert amounted to an offer, which was open to acceptance by performance of the acts required in the offer. Such performance was sufficient in itself to amount to acceptance and there was no need for separate notification of acceptance to be given to the offeror.

The same principle would apply in reward cases where a reward is offered for the return of lost property. All those who search for the item in question need not inform the offeror of their intention to do so; the acceptance is complete when the finder returns the object to the offeror.

5.5 Summary

- Only the person/people to whom an offer is made (the offerees) can accept an offer.
- Acceptance must be of precisely the same terms as offered.
- If a mode of acceptance is prescribed, then unless expressed to be mandatory, the offeree can use any alternative mode which is no less advantageous to the offeror.
- Acceptance is effective from when it is communicated to the offeror.
- Silence does not constitute acceptance, even if the offeror indicates it will.
- A third party with authority can effectively communicate acceptance on behalf of the offeree.

- The postal rule is an exception to the rule that acceptance must be communicated: acceptance takes effect from the moment the letter of acceptance is properly posted.
- There are exceptions to the postal rule if it is not contemplated that the post would be used, if the letter is incorrectly addressed or if the offeror disapplied the postal rule. The rule does not apply to letters revoking offers.
- Where acceptance is made by instantaneous communications (such as by telephone) it is effective when the communication is received by the offeror, but the offeror may be prevented from denying receipt of a communication if they are at fault for the non-receipt. Depending on the facts, such a communication might not be deemed received until the start of office hours after receipt.

6 Certainty

6.1 Introduction

A binding contract requires all material terms to be certain and complete. Only an agreement which is sufficiently certain can be enforced by a court.

To determine whether the parties have reached an agreement on all material terms the court applies an objective test, asking whether, in all the circumstances of the case, the parties have agreed all the terms they considered to be a precondition to creating legal relations (*RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Company KG* (UK Production [2010] UKSC 14)).

If an agreement is incomplete or uncertain, a court may not be able to enforce it.



Example

An agreement on ‘hire-purchase terms’ was too uncertain to be enforced. The court considered that as there are so many different kinds of hire-purchase agreements based on a variety of different terms this agreement was too vague to be an enforceable contract (*Scammell v Ouston* [1941] AC 25).

The previous example demonstrates that the courts will not enforce an agreement if it is too vague or ambiguous. However, this is seen as a last resort and the courts will look to enforce the agreement, reflecting the intentions of the parties, where this is possible.



Example

An agreement to buy ‘timber of fair specification’ was enforceable. The court considered that the words could be given a reasonable meaning (particularly in light of the parties previous dealings) and the agreement was binding (*Hillas v Arcos* (1932) 147 LT 503).

6.2 Summary

- If an agreement is incomplete or uncertain, a court may not be able to enforce it.
- To determine whether the parties have reached an agreement on all material terms the court applies an objective test, asking whether, in all the circumstances of the case, the parties have agreed all the terms they considered to be a precondition to creating legal relations.



Consideration

1 Introduction to consideration



Figure 2.1: Requirements of a contract

In order for there to be a binding contract, offer and acceptance, intention to create legal relations and consideration must be present.

This chapter focuses on consideration.

Consideration is an essential ingredient of an enforceable contract.



Consideration: Academic Frederick Pollock defines **consideration** as 'an act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable'.

This definition has been adopted by the House of Lords in *Dunlop v Selfridge* [1915] AC 847.

At the heart of Pollock's definition of consideration is the concept of exchange – in order to be able to enforce a promise made to you, you must be able to show that you agreed to provide something in return for that promise. The 'something in return' is known as consideration.

You will now look at the following sections which relate to consideration:

- (a) Consideration key principles
- (b) Existing obligations – when will an existing obligation amount to good consideration?
- (c) Promissory estoppel

2 Consideration - key principles

This section introduces the key principles of consideration.

2.1 Executory and executed consideration

Consideration can be executory consideration or executed consideration.



Executory consideration: Where contracting parties make promises to each other to perform something in the future after the contract has been formed.



Example

The classic example is a contract for the sale of goods where the seller promises to deliver the goods at some time in the future, and the buyer promises to pay for them either on delivery or by some other credit arrangement. At the time of the agreement, neither side has done anything towards the performance of the promises made but the agreement still has contractual force, and a party who fails to carry out their promise can be sued. A bilateral contract usually involves executory consideration.



Executed consideration: Where, at the time of the formation of the contract, the consideration has already been performed.



Example

The classic example is a unilateral contract where the promise of a reward is made and the ‘price paid’ in exchange for that promise is performance of the act stipulated in the offer: *Carlill v Carbolic Smoke Ball Co Ltd* (1893) 1 QB 256. The required act is both the acceptance of the offer (and thus the time when the contract is formed) and the executed consideration.

2.2 Rules governing consideration

We will now consider four important rules in relation to consideration, namely that:

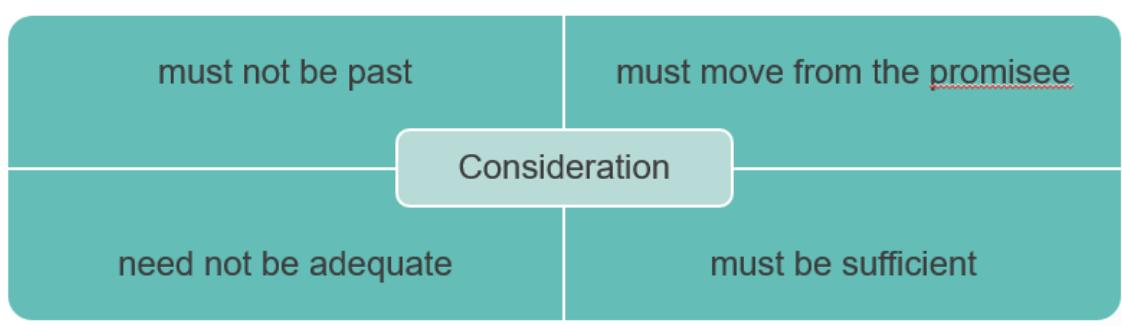


Figure 2.2: Rules governing consideration

2.2.1 Consideration must not be past

It is not generally possible to use as consideration some act or forbearance which has taken place prior to the promise to pay. Consideration must be given in exchange for the promise of the other party. If the act/forbearance has taken place prior to the promise, then it cannot be in exchange for that promise.

In *Eastwood v Kenyon* (1840) 11 A & E 438 a father died leaving his daughter, Sarah, in the care of a guardian, Eastwood. Eastwood borrowed £140 to help pay for Sarah's upbringing. When she came of age, Sarah married Kenyon, who then promised Eastwood that he would pay off the debt to repay Eastwood for having brought up Sarah. However, Kenyon failed to honour his promise. It was held that the consideration provided by Eastwood (by bringing up Sarah) was not good consideration to support Kenyon's subsequent promise to discharge the debt because it was in the past. It was held that the moral obligation to fulfil such a promise was insufficient to create a legally binding contract.

Exception to the past consideration rule

An exception to the past consideration rule exists where some prior act or service was provided by the promisee at the promisor's request and it was always understood that payment would be made for that act or service.

The leading case on the exception was heard by the Privy Council in *Pao On v Lau Yiu Long* [1980] AC 614. Lord Scarman outlined the necessary three conditions for the exception to apply:

- (a) The act must have been done at the promisor's request.
- (b) The parties must have understood that the act was to be rewarded either by a payment or the conferment of some other benefit. These could be because it was expressly agreed that there would be a reward/benefit, or because such an understanding can be implied. The latter is more likely in a commercial context.
- (c) The payment, or conferment of other benefits, must have been legally enforceable had it been promised in advance.

This case is conventionally cited as creating an exception to the rule of past consideration but the exception may be more apparent than real. The three conditions together indicate that, at some point in the request, an act was done at person A's request and with an understanding of reward/benefit for doing that. Perhaps at that stage (when the consideration is not yet 'past') a simple contract is formed, and all that happens later is that the precise value to be paid is fixed.

This analysis can be utilised in relation to many everyday transactions, eg taking a car to a garage for repairs and leaving the ultimate price to be decided after completion of the repairs or seeking advice from a professional person and being presented with a bill on completion of the service in question. Both these scenarios are consistent with accepted commercial practice and no reasonable person could realistically believe that payment could not be enforced because the service had been rendered prior to any explicit promise to pay for or to demand remuneration. To recognise such arrangements as contractually binding is simply to reflect the reasonable expectations of the parties.

2.2.2 Consideration must move from the promisee

The rule that consideration must move from the promisee effectively means that a party who has not provided consideration may not bring an action to enforce a contract. This rule is related to, but must be distinguished from, the doctrine of privity of contract which states that only a person who is party to a contract may sue or be sued on that contract (the rules on privity are not addressed in this chapter).

Tweddle v Atkinson (1861) 1 B & S 393 illustrates the rule that consideration must move from the promisee. The two fathers of a couple who were about to get married agreed that the father of the bride was to pay £200 and the father of the groom £100, to the bridegroom, William Tweddle, the claimant. The groom sought to enforce his father-in-law's promise, but it was held that he could not as he had provided no consideration for the promise – the consideration had been provided by the fathers.

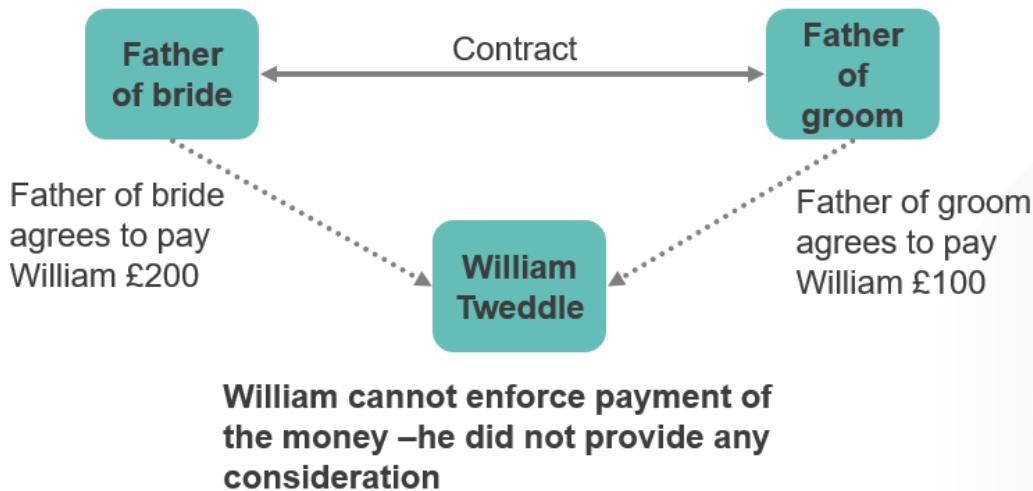


Figure 2.3: *Tweddle v Atkinson*

2.2.3 Consideration need not be adequate

According to the doctrine of freedom of contract, the courts will not interfere with a bargain freely reached by the parties. It is not the court's duty to assess the relative value of each party's contribution to the bargain. There is no reason, for example, why a party should not be bound by a promise to sell a new Rolls Royce car for one penny. If the agreement is freely reached, the inadequacy of the price is immaterial.

In *Chappell & Co v Nestle Co Ltd* [1960] AC 87. The Nestle company offered gramophone records of a particular tune to the public for 1s 6d, together with three chocolate bar wrappers. The wrappers were thrown away on receipt by the company. In relation to a claim for royalties, the question arose as to whether the wrappers were part of the consideration given for each record. The House of Lords held that the wrappers were part of the consideration even though they were of no further value once received by the company.

Lord Somervell stated:

They (the chocolate wrappers) are, in my view, in law part of the consideration. It is said that when received the wrappers are of no value to Nestle. This I would have thought irrelevant. A contracting party can stipulate for what consideration he chooses. A peppercorn does not cease to be good consideration if it is established that the promisee does not like pepper and will throw away the corn. As the whole object of selling the record was to increase the sales of chocolate it seems to me wrong not to treat the stipulated evidence of such sales as part of the consideration.

2.2.4 Consideration must be sufficient

Consideration must have some value 'in the eyes of the law'. It matters not how small that value is, so long as it is worth something. If a thing of value can be identified, then there will be sufficiency of consideration and, as seen above, the court will not enquire as to its adequacy.

In the case of *Thomas v Thomas* (1842) 2 QB 851 the executor of an estate agreed to transfer a house to the deceased's widow in return for a payment from the widow of £1 per annum towards the ground rent for the property and the widow's agreement to keep the house in repair. The court made clear that it did not matter whether the widow's obligations in any way matched the value of the property.

2.3 Summary

- Consideration can be 'executory' or 'executed'.
- Consideration must not be past – it cannot generally have taken place prior to the promise to pay.
- Consideration must move from the promisee – a party who has not provided consideration may not bring an action to enforce a contract.
- Consideration need not be adequate – the court will not assess the adequacy of the consideration.
- Consideration must be sufficient – it must have some value in the eyes of the law.

3 Existing obligations

3.1 Introduction

This section focuses on the question:

When will an existing obligation be good consideration?

Executory consideration amounts to a party taking on an obligation - promising to do (or not do) something. Before entering into a contract, a party might already be under an obligation to do the same thing, perhaps due to:

- (a) An existing contract between the same parties;
- (b) A public duty; or

- (c) An existing contract with a third party (ie not one of the parties entering into the contract – the existing obligation is owed to the third party).

If a party offers as consideration something they are already obliged to do (a pre-existing obligation), will this be deemed good consideration?

We will look at the three possibilities stated above in turn.

3.2 An obligation in an existing contract between the parties

If a party is already contractually bound to Party A to do something, then agreeing with Party A again to do that thing is not generally good consideration for a new contract.



Key case: *Stilk v Myrick (1809) 2 Camp 317*

The captain of a ship promised his crew that, if they shared between them the work of two seamen who had deserted, the wages of the deserters would be shared out between them. The court held that the promise was not binding because the seamen gave no consideration: they were already contractually bound to do any extra work to complete the voyage.

If the sailors had agreed to exceed their existing obligations, then there would have been consideration. In *Hartley v Ponsonby* (1857) 7 E & B 872 the sailors were contractually obliged to take 'all reasonable endeavours' to get a ship home, but they went beyond these existing obligations when they agreed to make the journey in dangerous conditions and when the ship was seriously undermanned – this amounted to good consideration.

If the sailors in *Hartley* were entitled to extra payment, why weren't those in *Stilk*? One explanation is that the proportion of sailors that deserted in *Hartley* was far greater, radically changing the nature of the voyage home. However, there also appears to have been a concern in *Stilk* about undue pressure being placed on the captain to pay more money. More recently, the court has developed the doctrine of economic duress which provides that a promise to pay in such circumstances might be unenforceable on the basis that the captain's consent to the contract was effectively obtained by (economic) force. Perhaps, if the same situation were to repeat itself today, the court would decide *Stilk* on the basis of economic duress rather than consideration. This chapter does not address economic duress.

The courts revisited the issue of promises to pay more in the next key case we will consider.



Key case: *Williams v Roffey Bros & Nichol (Contractors) Ltd [1991] 1 QB*

In *Williams v Roffey Bros & Nichol (Contractors) Ltd*, the defendants, Roffey Bros, had been contracted to build a block of flats and they sub-contracted the claimant, Lester Williams, to carry out the carpentry work in 27 of the flats for an agreed price of £20,000. Before the work was completed, Williams got into financial difficulty and it was clear that, without additional money, he would be unable to finish and would, therefore, be in breach of contract. Had the work not been finished on time, Roffey Bros would have been liable for substantial penalties to the main contractors under their contract to build the flats. Consequently, they promised Williams an additional £575 per completed flat. Roffey Bros did not stick to their promise and Williams sued for the additional sum.

In order to enforce the promise of extra payment, Williams needed to show that they had provided consideration in return. This was difficult for Williams as all they had done was complete the carpentry work they were obligated to under their original contract with Roffey to the same deadline. However, the court, did find consideration in the form of the 'practical benefit' that Roffey had received. The practical benefit Roffey obtained in was the avoidance of the late completion payment in the main contract, a more efficient working arrangement and avoiding the need to find an alternative contractor to do the work. Note that the court called the consideration in this case 'factual' consideration distinguishing it from legal consideration. The term 'factual' consideration acknowledges that nothing new is being promised but the party in receipt of the promise is still getting something out of the reshaped deal. The conditions necessary to establish factual consideration set out by Lord Justice Glidewell in *Williams v Roffey* are set out below.

(i) if A has entered into a contract with B to do work for, or to supply goods or services to, B in return for payment by B; and (ii) at some stage before A has completely performed his obligations under the contract B has reason to doubt whether A will, or will be able to, complete his side of the bargain; and (iii) B thereupon promises A an additional payment in return for A's promise to perform his contractual obligations on time; and (iv) as a result of giving his promise, B obtains in practice a benefit, or obviates a disbenefit; and (v) B's promise is not given as a result of economic duress or fraud on the part of A; then (vi) the benefit to B is capable of being consideration for B's promise, so that the promise will be legally binding.

3.3 Obligations under a public duty

We have just considered whether an existing contractual obligation owed to a party can amount to good consideration for a new contract with that party (or a variation of the contract). A similar question could be asked as to whether the party claiming to have given consideration has done any more than they were already obliged to do under public law (in contrast to being obliged under an existing contract). The principle in these circumstances is that merely carrying out a public duty imposed by the law will not amount to sufficient consideration.

The issue of sufficiency of consideration has also arisen in respect of rewards claimed by police officers for giving information. Could it not be said that police officers, in giving information, are doing no more than their public duty? This point arose for discussion in the case of *England v Davidson* (1840) 11 A & E 856, where the defendant offered a reward for information leading to the conviction of a particular criminal. The plaintiff, a police officer, gave the relevant information, but the defendant refused to pay, alleging that the police officer, by supplying the information, was doing no more than the public duty imposed on him by law. It was held that the duty of a police officer is the prevention of crime and they are not under a duty to provide information to a private individual. In doing so he went beyond his public duty and thus provided consideration for the offer of reward.

3.4 Existing obligations to a third party

What about the situation where Party A has an existing contractual obligation to Party B, and wishes to rely on a promise to do the same thing as consideration for a contract with Party C. The question to be considered here is whether it is possible to have given consideration by doing something one was already bound to do under a pre-existing contract with a third party. In contrast to the previous category, it is clear that the performance of the pre-existing duty owed to a third party will be regarded as sufficient consideration for a promise given by the promisor.

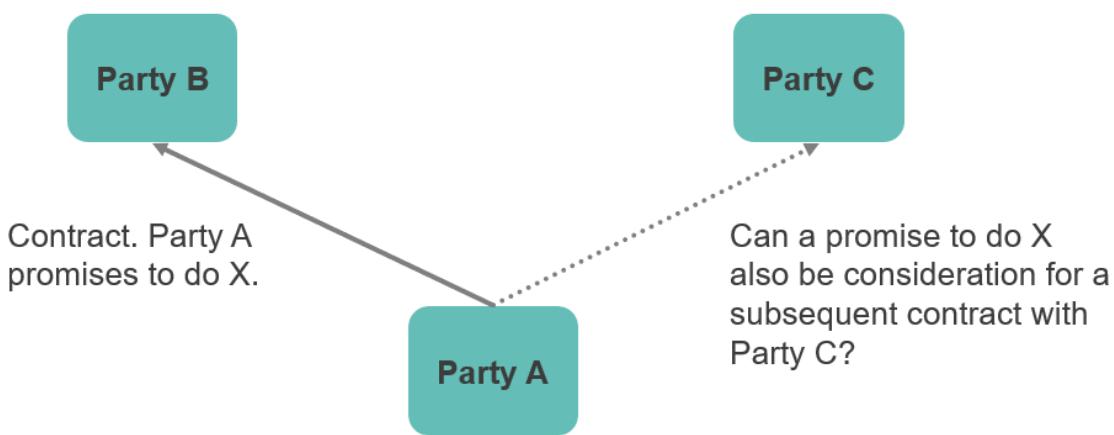


Figure 2.4: Existing obligations to a third party

In *New Zealand Shipping Co v AM Satterthwaite & Co (The Eurymedon)* [1975] AC 154 the claimant made an offer to the defendant that, if the defendant would unload the claimant's goods from a ship, then the claimant would treat the defendant as exempt from any liability for damage to the goods. In fact, the defendant was already bound to do this by a contract with a third party. Lord Wilberforce stated:

An agreement to do an act which the promisor is under an existing obligation to a third party to do, may quite well amount to valid consideration and does so in the present case: the promisee obtains the benefit of a direct obligation which he can enforce.

Lord Wilberforce makes the point that a party offering this sort of consideration is offering to put itself at risk of double liability – if it fails to meet its obligations, it will face action from two parties.

3.5 Part payment of a debt

We will now consider the case law on agreements to accept a lesser sum.

Where a debtor promises to pay part of their debt in return for a release from the remainder of their liability, they are simply offering to do something which they are already obliged to do: they are seeking to offer an existing obligation as consideration. This is not good consideration: the debtor remains liable even where the creditor has agreed to release them from further liability. Simply paying a smaller sum than that owed will not be sufficient consideration.

Key case: **Foakes v Beer (1884) 9 App Cas 605**

In *Foakes v Beer (1884) 9 App Cas 605*, Mrs Beer had obtained a judgment against Dr Foakes for £2,090. Dr Foakes requested time to pay and the parties agreed in writing that, if Dr Foakes paid £500 at once and the balance by instalments, Mrs Beer would not ‘take any proceedings whatever on the judgment’. The agreement made no reference to the question of interest although by virtue of the Judgments Act 1838, all judgment debts carry interest until paid. Dr Foakes ultimately paid the whole amount of the judgment debt itself and Mrs Beer then claimed the accrued interest. Dr Foakes refused to pay on the basis of the written agreement whilst Mrs Beer claimed that the agreement was unsupported by consideration. The House of Lords held that Mrs Beer’s claim should succeed – the agreement was unsupported by consideration.

3.5.1 Circumstances in which *Foakes v Beer* does not apply

Introducing a new element into the payment

The rule in *Foakes v Beer* is only applicable if the promise of the creditor to accept a lesser sum is unsupported by fresh consideration from the promisee. However, if, at the creditor’s request, some new element is introduced, then this will amount to good consideration, and the court will not enquire as to the value of the new element. Examples might be payment at a different place, or at a different time or by providing a different thing in place of money (*Pinnel’s case (1602) 5 Co Rep 117a*).

Payment of a lesser sum by a third party

Where a third party enters into an agreement with a creditor, by which the creditor accepts payment by the third party of a lesser sum than the debt in full satisfaction of the debtor’s obligation, the creditor cannot sue the debtor for the difference.

You might consider that the rule on *Foakes v Beer* decision does not sit well with *Williams v Roffey*. In *Williams v Roffey*, consideration for a promise to pay was found in the practical benefit obtained from the other contracting party completing its contracting obligations. Didn’t Mrs Beer obtain practical benefit from the instalment arrangement agreed with Dr Foakes, in the sense that if she had tried to force payment of the full sum, he might have been bankrupted, and she might have received nothing?

This point was considered in *Re Selectmove [1995] 1 WLR*. The Court of Appeal took a restrictive approach, concluding that *Williams v Roffey* and practical benefit had not application to cases where a creditor agrees to accept a lesser sum in settlement of a debt. This case created a clear dividing line between promises to pay more for an existing contractual obligation, where practical benefit can be applied, and promises to accept less than your legal rights, where it cannot. However, a different view was taken by the Court of Appeal in the next case we shall consider, *MWB Business Exchange Centres Ltd v Rock Advertising [2016] EWCA Civ 553*.

Key case: **MWB Business Exchange Centres Ltd v Rock Advertising Ltd [2016]**

EWCA Civ 553 - Court of Appeal

In *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* a landlord agreed orally to reschedule rental payments under a licence agreement to give a tenant longer to pay, thereby varying the licence. The Court of Appeal considered whether there had been valid consideration for the variation. The court acknowledged that part payment of a sum already due is not normally good consideration. However, the judges agreed that there was sufficient consideration. Their justification was that the landlord obtained a practical benefit by keeping the tenant in the property (compared to leaving the property vacant). This benefit went beyond the advantage of receiving prompt payment of a part of the arrears and a promise that it would be paid the balance over the coming months.

The court also considered the fact that the landlord was not under economic duress from the tenant. It can be seen that in reaching this decision, the court applied the terminology of 'practical benefit' and absence of duress from *Williams v Roffey*. This decision appeared to blur the dividing line between a promise to accept less and a promise to pay more.



Key case: *Rock v MWB [2018] UKSC 24 – Supreme Court*

On appeal, *Rock Advertising Ltd v MWB Business Exchange Centres Ltd*, the appeal was allowed on the basis that the oral variation was invalid for reasons unconnected to consideration. Disappointingly, therefore, that made it unnecessary for the court to deal with the issue of consideration. The question of whether providing a practical benefit in the absence of duress is sufficient to make a promise to accept less binding went unanswered. Whilst Lord Sumption considered that *Foakes v Beer* was 'ripe for re-examination', he stated that if were to be overruled:

It should be before an enlarged panel of the court and in a case where the decision would be more than obiter dictum.

It is important at this stage to mention the doctrine of promissory estoppel, an equitable doctrine that effectively allows a contract to be enforced despite not being supported by consideration. In essence, promissory estoppel is about protecting a party's reliance on a non-bargain promise. Many of the instances in which promissory estoppel is invoked involve part payment of a debt in response to a promise by the creditor that they will not require the debt to be paid in full, although promissory estoppel is not limited to such circumstances. Promissory estoppel is not addressed in this section, but you should note that this equitable doctrine is relevant when considering a scenario involving part payment of a debt.

3.6 Summary

- Something which a party is already obliged to do under an existing contract between two parties cannot generally be good consideration for a new contract between the parties.
- Where the new contract constitutes a practical benefit, and certain other criteria are satisfied (see *Williams v Roffey*), an existing obligation can be good consideration for a new contract.
- Carrying out a public duty imposed by the law will not generally amount to sufficient consideration.
- A promise to do something which a party is obliged to do pursuant to an obligation owed to a third party will be good consideration.
- Agreement to pay part of a debt is not generally good consideration. There are various exceptions to this rule.

4 Promissory estoppel

4.1 Introduction

In an earlier section we considered the rule in *Foakes v Beer*. This rule provides that part payment of a debt will not be good consideration to discharge the whole debt. This is because

consideration has not been exchanged between the parties. The creditor has received nothing in return for their promise to accept less than their full legal rights. The rule in *Foakes v Beer* has the potential to operate harshly against the debtor. The debtor may rely on the creditor's promise to accept less and face difficulty if the creditor reneges on their promise and demands repayment of the full amount. However, the potential harshness of this rule has been mitigated by the development of promissory estoppel.

Promissory estoppel is an equitable doctrine that effectively allows a promise to be enforced despite not being supported by consideration. In essence, promissory estoppel aims to protect a party who has relied on such a promise. Equity prevents, or 'estops', the promisor from going back on their promise in situations where the promisee has relied on it. Many of the instances in which promissory estoppel is invoked involve part payment of a debt. In such a case, a debtor may seek to defend a debt action against them by arguing that they have relied on a promise by the creditor that they will not require the debt to be paid in full. However, promissory estoppel is not limited to such circumstances.

The case from which the modern doctrine of promissory estoppel derives is *Hughes v Metropolitan Railway Co.* (1877) 2 App Cas 439. In this case, the tenant, by his lease, was under an obligation to keep the premises in good repair. In October, the landlord gave the tenant six months in order to undertake some repairs, with which the tenant agreed. In November, negotiations began between the landlord and tenant regarding the tenant's purchase of the lease. The tenant stated that, while negotiations were ongoing, he would not undertake the repairs. In December, the negotiations broke down. At the end of the six-month notice period the landlord, relying on the failure of the tenant to undertake the repairs, sought forfeiture of the lease. It was held, in a unanimous judgment of the House of Lords, that the landlord's conduct was an implied promise to the tenant that he would not enforce the forfeiture at the end of the notice period and, in not doing the repairs, the tenant had been relying on this promise.

Drawing on the developed principles of *Hughes v Metropolitan Railway Co.*, and extending them where it suited, Denning J (as he then was), in the case of *Central London Property Trust v High Trees House* [1947] KB 130, formulated the doctrine of promissory estoppel. Whilst the consensus of legal opinion is that Denning J developed the original doctrine beyond its established parameters, the doctrine is now very much part of the English law of contract. This central case will now be considered.

Key case: *CLP Trust v High Trees* [1947] KB 130

In 1937, the plaintiff landlord let a block of flats to the defendant tenant on a 99-year lease at a ground rent of £2,500 a year. When war commenced in 1939, only about one third of the flats had been let and the tenant was having difficulty paying the rent. Consequently, in 1940, the landlord agreed in writing to reduce the ground rent to £1,250, while the difficulties in letting the flats continued. The parties did not specify how long the reduced rent would operate for and there was no consideration for the reduction.

By 1945, the flats were fully let, and the tenant continued to pay the reduced rent. The landlord sought payment of the arrears for the last two quarters of 1945, from the time the flats were fully let, and for full rent for future years. Denning J held that the landlord should succeed in their claim. Although, the landlord was not seeking to obtain arrears for the war years, when the problems with letting the flats existed, Denning J considered, in obiter, whether such an action would succeed.

Denning J concluded that had the landlord sought the full rent from 1940 to 1945 this action would fail. In reaching this conclusion, Denning J relied on the doctrine of promissory estoppel. Denning J stated that where a promise was made which was intended to create legal relations and which, to the knowledge of the person making the promise, was going to be acted on by the person to whom it was made and which was in fact so acted on, then the promise would be binding. The tenant could rely on the defence of promissory estoppel to prevent the landlord from going back on their promise to accept reduced rent during the war years when the flats were not fully let.

This was a significant development in the doctrine of promissory estoppel. In his obiter comments Denning J would allow a promise to be enforced in the absence of consideration, provided that

the promisee had relied on the promise. This had the potential to impact heavily on the doctrine of consideration. However, as we will now go on to explore, there has been acute judicial keenness to constrain promissory estoppel within very strict parameters which has considerably limited its impact. The following parameters will now be considered.

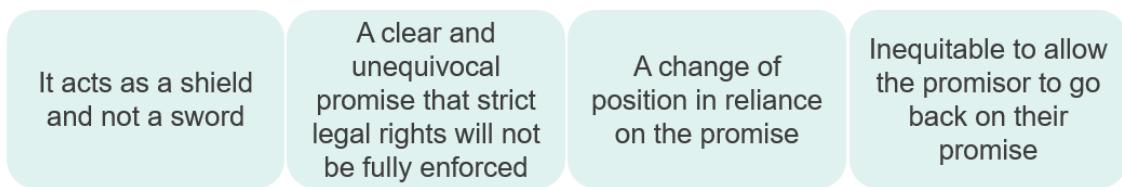


Figure 2.5: Parameters of promissory estoppel

4.2 It acts as a shield and not a sword

Promissory estoppel can only act as a defence (a ‘shield’) to an action; it cannot be used as a cause of action (a ‘sword’). In other words, promissory estoppel does not give a party the right to sue upon a promise. In order to sue upon a promise given to you, it must be shown that you have provided consideration in return for it. This was made clear by the judgments of the Court of Appeal in *Combe v Combe* [1951] 2 KB 215.

Following a divorce Mrs Combe’s husband indicated that he was prepared to make an allowance of £100 a year to Mrs Combe. However, he did not make any of the agreed payments. In 1950, the wife brought an action, claiming arrears of payment under the husband’s promise. The wife attempted to use promissory estoppel as a cause of action, based on the fact that the husband had made a promise which she had relied upon.

However, the Court of Appeal held that since the wife had given no consideration for the husband’s promise, the promise was not binding and she could not succeed in an action on it. She could not use promissory to enforce her husband’s promise to pay. It is only possible to use promissory estoppel to stop the promisor going back on their promise that they would not enforce their strict legal rights. In the language of counsel for the husband in *Combe v Combe*, the doctrine of promissory estoppel is ‘a shield and not a sword’.

4.3 A clear and unequivocal promise that strict legal rights will not be fully enforced

There must be a clear and unequivocal promise or representation that existing legal rights will not be fully enforced: *Woodhouse A.C. Israel Cocoa Ltd. S.A. and Another v Nigerian Produce Marketing Co. Ltd* [1972] AC 741. The promise must be intended to affect legal relations and not simply amount to a gratuitous privilege given to the promisee. A promise can be express or implied (for example by conduct).

4.4 A change of position in reliance on the promise

It is an essential element of the doctrine of promissory estoppel that the promisee (usually a debtor) should have relied upon the promise or representation, ie it must have influenced the conduct of the party to whom it was made (*High Trees*). It follows that, an act which takes place before the promise, cannot be in reliance on the promise.

Considering the common case of a part-payment of a debt, there is some debate about whether the part-payment itself can be the act of reliance, or whether there must be some other act of reliance. It may be that it can, provided that the promise influenced the part-payment.

Usually, to prove estoppel in equity, it must be shown that the promisee has relied to their detriment on the promise. In other words, the reliance on the promise is such that, if the promisor were to go back on their promise, the promisee would be in a worse position than if the promise had never been made. However, Denning made it plain in *High Trees* (and in a number of his judgements that followed) that detrimental reliance is **not** required for promissory estoppel. It is sufficient if the promisee has made a change of position in reliance on the promise so that it would be inequitable to allow the promisor to go back on their promise.

4.5 Inequitable to allow the promisor to go back on their promise

Promissory estoppel, as an equitable doctrine, is based on principles of fairness and is discretionary. The courts, in exercising their discretion, undertake a balancing exercise to determine whether it would be inequitable to allow the promisor to go back on their promise. If it would be inequitable, then the defence will apply, and the promisor will be estopped from going back on their promise. Although it is not necessary for the promisee to show that they relied on the promise to their detriment, if detrimental reliance is present, this would be a factor making it more likely to be inequitable for the promisor to go back on their promise (*The Post Chaser* [1981] 2 Lloyd's Rep 693).

In exercising their discretion, the courts will look to the conduct of both parties to determine whether or not to grant the defence. This point is well illustrated by *D & C Builders v Rees* [1966] 2 QB 617. The plaintiff builders had completed a project for defendants. The defendants, knowing that the builders were under considerable financial difficulties, offered a cheque for the sum of £300 in full and final settlement of a debt of £482. The builders reluctantly accepted but then later sued for the balance. In response to the builders claim for the balance, the defendants sought to rely on the defence of promissory estoppel. Lord Denning MR said that because this promise to accept less had been extracted from the plaintiffs by intimidation on the part of the defendants, they could not rely on the doctrine of promissory estoppel, since those who seek equity must do equity.

Does promissory estoppel suspend or extinguish legal rights?

It seems that the promisor's right to resume their strict legal rights may arise in one of two ways.

Firstly, the right to periodic payments may resume once the period over which the promissory estoppel operates ceases, as Denning envisaged in *High Trees*. Alternatively, the promisor may resume their full legal rights after giving reasonable notice of their intention to do so (*Tool Metal v Tungsten* [1955] 1 WLR 761).

This reflects that the effect of promissory estoppel is generally to suspend the rights concerned, but not to extinguish them. The key principle is that the court will order an outcome which is just and equitable, and in some cases, this might mean a past right is extinguished. For example, in *High Trees* itself, the landlord could recover the rent for the last two quarters of 1945 and going forward, but Denning J stated (obiter) that if the landlord had sought to recover the full rent from 1940 to 1945, he would have been estopped from doing so – the right to the rent for that period would have been extinguished. Exceptionally, rights might also be extinguished where it has become impossible for the other to party to meet the obligation concerned or it would be clearly inequitable to require them to do so.

4.6 Summary

- Most commonly, promissory estoppel is relied on to create an exception to the rule that part payment of a debt without fresh consideration does not discharge the debt obligation.
- Promissory estoppel can only act as a defence to an action: it cannot be used as a cause of action.
- In order for it to operate, there must be a clear and unequivocal promise or representation that existing legal rights will not be fully enforced.
- In addition, the promisee must have relied upon that promise/representation.
- The doctrine only applies when it would be inequitable for the promisor to go back on their promise.



Intention to create legal relations

1 Introduction to intention to create legal relations



Figure 3.1: Requirements of a contract

In order for there to be a binding contract, offer and acceptance, intention to create legal relations and consideration must be present.

This chapter focuses on intention to create legal relations.

The intention to create legal relations is an essential element in the formation of a contract. Where no intention to be bound can be attributed to the parties, there is no contract. By intention to create legal relations, we mean an intention to enter into an agreement with legal ramifications – a contract.



Intention to create legal relations: Is an intention to enter into an agreement that has legal ramifications. It is one of the necessary requirements of a binding contract.

The test of intention is objective, by which we mean that the intention of the parties is to be determined more by what the actions of the parties in the particular circumstances suggest, rather than by taking evidence from the parties of what was actually in their minds. As Lord Denning MR puts it in *Merritt v Merritt* [1970] 1 WLR 1211:

In all these cases the court does not try to discover the intention by looking into the minds of the parties. It looks at the situation in which they were placed and asks itself: would reasonable people regard the agreement as intended to be binding?

The courts seek to give effect to the intentions of the parties, whether expressed or presumed.

Although it can be difficult at times to make such distinctions it seems logical, for present purposes, to make a broad distinction between agreements of the commercial kind and agreements of the domestic kind.

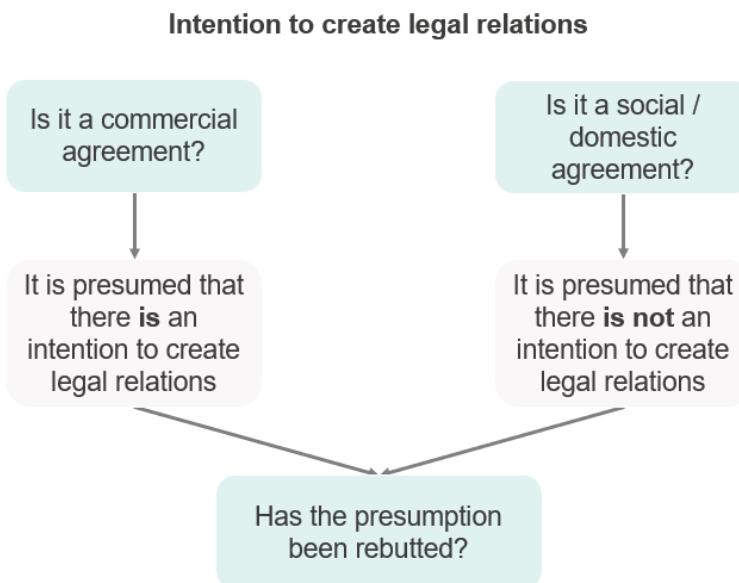


Figure 3.2: Intention to create legal relation

2 Commercial agreements

The ordinary presumption is that in a commercial agreement, the parties intend that it should be legally binding. The courts will readily imply this. Commercial agreements are not limited to agreements between two businesses. Commercial agreements would include agreements between individuals and businesses and agreements between individuals, eg if you bought a car through an online advert.

If a party to a commercial agreement wishes to assert that legal relations were not intended when the agreement was entered, the onus is on them to rebut the presumption and the burden of doing so is a heavy one.

It is open to the parties to include wording within the agreement that indicates that the parties do not intend to create legal relations. However, clear words will need to be used, as the language is likely to come under scrutiny, and ambiguous wording is unlikely to rebut the presumption that parties to commercial/business agreements intend those agreements to be binding.

In the case of advertisements, as you will be aware, alongside an intention to create legal relations, offer and acceptance and consideration are needed to form a binding contract. The first two of these requirements (an intention to create legal relations, and an offer and acceptance) can be very closely linked in the case of adverts.

In *Carlill v Carbolic Smoke Ball Co Ltd* (1893), the company argued that the advertisement was not binding because it was simply 'spin' or a 'mere puff'. The court, however, rejected this line of defence, holding that the assurance that the company had deposited £1,000 in a named bank was a demonstration of its intention to be bound and would be understood by a reasonable person to have that effect. The same reason justified holding that the advert was a unilateral offer to contract, not simply an invitation to treat.

In some circumstances, it is difficult to ascertain whether a particular promise is intended to have legal effect. In *Esso Petroleum Co. v Commissioners of Customs and Excise* [1976] 1 WLR 1, specially produced 'World Cup coins' were distributed by Esso to their dealers, who offered their customers a free coin with the purchase of four gallons of petrol. The House of Lords were divided in their opinion as to whether the offer of the free coin could amount to a 'sale' and, if so, whether there was any contract with regard to the coins. One argument put forward was that the coins could only be for sale if there was an intention to create legal relations in respect of the transfer of the coins between garage proprietors and motorists. The majority felt that there was such an intention, relying on the business context and the large commercial advantage Esso expected to derive from the promotion by attracting extra customers. This is not a completely satisfactory

analysis as, although it could justify attributing an intention to create legal relations to Esso, it could not be applied equally to the other contracting parties. Conversely, the minority found no intention to create legal relations relying on the language used in the offer, the trivial value of the coins and the unlikelihood that any motorist denied a coin would believe that a legal remedy was available to rectify the default.

2.1 Subject to contract

The expression 'subject to contract' creates a strong inference that the parties do not intend to be bound until the formal execution of a contract. An agreement 'subject to contract', *prima facie*, is not binding. In a sale of land, it is usual to express tentative preliminary agreement to be 'subject to contract', so as to give the parties an opportunity to reflect/seek legal or other advice before entering a binding contract. The expression 'subject to contract' has received judicial recognition for this purpose.

We have just considered commercial agreements. Now we will consider social/domestic agreements.

3 Social and domestic agreements

In cases of social, family or other domestic agreements, the usual presumption is that there is no intention to create legal relations. It is common sense that these types of agreements (eg in relation to family agreements as to the allocation of domestic chores or social arrangements to meet friends for a drink or a meal) do not amount to legally enforceable agreements. Such a conclusion is derived from the fact that none of the parties would reasonably envisage the right to sue the other for failure to honour the commitment. An example from the case law includes agreements made between spouses. If the parties reach the agreement before any breakdown in the relationship occurs, the courts have shown an unwillingness to find an intention to create legal relations (*Balfour v Balfour* [1919] 2 KB 571).

However, again the presumption can be rebutted and certain social and domestic agreements may be legally enforceable. The question of whether the presumption is rebutted will be resolved by examining the circumstances of each case and the language used by the parties. One situation where the courts have shown a willingness to rebut the usual presumption is in relation to agreements made between spouses who were in the process of separating or are separated when the agreement was reached (*Merritt v Merritt* [1970] 1 WLR 1211).

Similar problems of intention can arise between other family members. *Jones v Padavatton* [1969] 1 WLR 328 shows the difficulty of determining some such cases. The claimant and defendant were mother and daughter respectively. There was an agreement between the parties to the effect that if the daughter gave up her very satisfactory pensionable job in the USA and came to London to read for the Bar with the intention of practising law in Trinidad (where the mother lived), the mother would pay an allowance of 200 dollars a month to maintain the daughter and her small son while in England.

Exercise: Challenge yourself

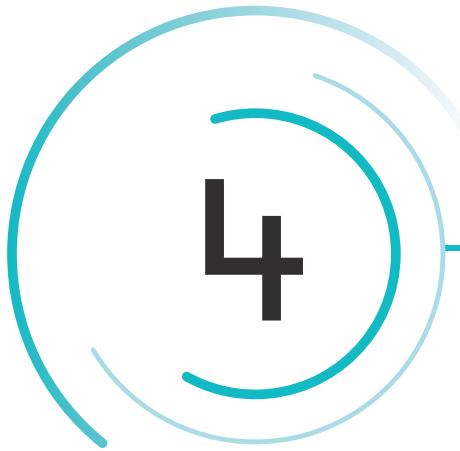
How would you decide the case? Perhaps you need more information?

If a client came to you with the facts set out above, what further information would you seek from the client to help you determine whether there was an intention to create legal relations?

4 Summary

- The intention to create legal relations is an essential element in the formation of a contract. Where no intention to be bound can be attributed to the parties, there is no contract.
- In the case of commercial agreements, it is presumed that there is an intention to create legal relations.
- In the case of social/domestic agreements, it is presumed that there is not an intention to create legal relations.

- Either presumption can be rebutted.
- The use of the expression ‘subject to contract’ when negotiating a contract creates a strong inference that the parties do not intend to be bound until the formal execution of a contract.



Capacity

1 Introduction

If a person (Person A) does not have capacity to enter into a contract, then a contract with Person A is unlikely to bind them.

There are rules on capacity to contract for those who are less capable of looking after themselves such as children, those who are mentally ill and others temporarily lacking mental capacity. The rules are there to protect the vulnerable and also to protect others who make contracts with those of limited capacity.

Persons over the age of 18 have full contractual capacity, if they are of sound mind and not suffering from a factor ruling out capacity such as drunkenness.

We will look at these categories of rules in turn:

- (a) Children (minors)
- (b) Those lacking mental capacity

2 Minors

Generally, a person is not bound by a contract entered into under the age of 18 even if the other party contracting does not know of this fact or the minor has lied about their age.

There are two main exceptions, relating to ‘necessaries’ and to contracts of employment, apprenticeship or education.

2.1 Necessaries

Firstly, a minor is bound by a contract to supply necessities to them if the contract is for their benefit. A minor must pay a ‘reasonable price’ for these rather than the actual cost of the ‘necessaries’ supplied.

Under the Sale of Goods Act 1979 s 3(3), ‘necessaries’ means goods suitable to the condition in life of the minor or other person concerned and to their actual requirements at the time of the sale and delivery. So, in *Nash v Inman* (1908) 2 KB 1, 11 waistcoats supplied to a minor who was an undergraduate at Cambridge University at the time were suitable according to the minor’s station in life (!) but not necessary as he already had sufficient clothing. Accordingly, the contract was not enforceable.

2.2 Contracts of employment, apprenticeship or education

Secondly, a minor is also bound by a contract of employment, apprenticeship or education (or analogous contract), but only if it is for their benefit. So, in *Aylesbury Football Club v Watford Association Football Club* (QB 12 June 2000) a young footballer’s contract with the club was not beneficial and could not be enforced because the player received no extra training or experience, the terms were onerous for him, they restricted his freedom to pursue a football career and the payment of wages depended on the will of his employer.

2.3 The effect of entering into a contract with a minor

Unless one of the exceptions applies, the contract cannot be enforced against the minor, although the minor can enforce it against the other party. By way of exception, there are a small number of contracts of exceptional types which are enforceable against the minor unless the minor specifically repudiates them.

If a minor ratifies a contract once they reach the age of 18, then the contract will be binding on them.

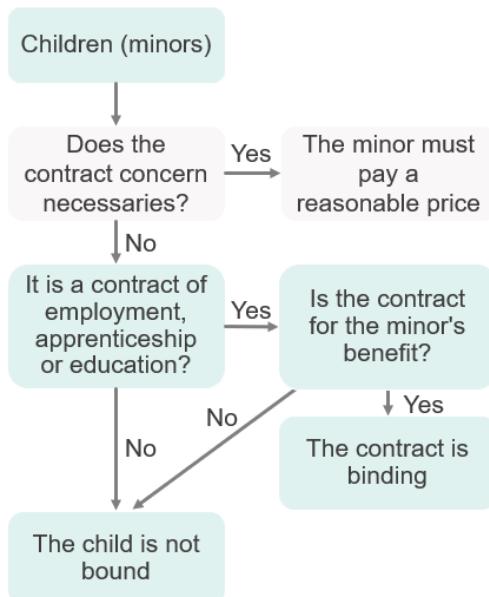


Figure 4.1: Entering a contract with a minor

3 Mental incapacity and intoxication

A person lacks capacity under s 2 of The Mental Capacity Act 2005 if ‘he is unable to make a decision for himself in relation to the matter’ at the time the contract is made, whether the impairment is permanent or temporary. It is important to understand that capacity is not something which a person has or has not for all purposes – whether or not someone has capacity is a question to be asked in relation to a particular decision. For example, someone with a brain injury might have the capacity to decide where they prefer to live, but not have the capacity to manage and invest a large sum of money to provide for future expenses.

Under s 3(1) the impairment is described in terms of being unable to:

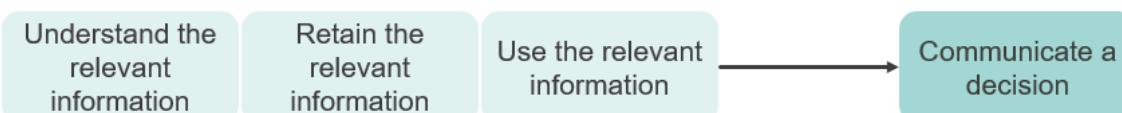


Figure 4.2: S 3(1) of the Mental Capacity Act 2005

According to s 3(4) the relevant information relates to the reasonably foreseeable consequences of:

- Deciding one way or another; or
- Failing to make a decision.

The Act also gives the Court of Protection the power to make declarations as to a person's capacity and ability to contract in specified situations (s 15).

The statutory definition of capacity set out above is expressed (in the Act) to be for the purposes of the Act only, but it is in practical terms very similar/the same as the approach to be taken when determining capacity for the purposes of contract law issues.

4 The effect of entering into a contract with a person lacking capacity

Under s 7, a person without capacity still remains liable to pay a reasonable price for 'necessaries'. These are defined as goods or services 'suitable to a person's condition of life and to his actual requirements at the time when the goods or services are supplied' (s 7(2)).

In any other case of incapacity, the position is that the contract is binding unless the person claiming incapacity can establish, first, that they did not understand what they were doing and, secondly, that the other party knew that to be the case: *Imperial Loan Co v Stone* [1892] 1 QB 599. If this can be established, the contract will be voidable.

Similar rules apply to contracts entered into by drunken persons. The individual who becomes so intoxicated that they do not understand what they are doing will have to pay a reasonable price for necessities but will not be bound by any other contract they make: *Matthews v Baxter* (1873) LR 8 Ex 132. This position should logically extend to those incapacitated by other intoxicating substances.

5 Summary

- There are rules on capacity to contract for those who are less capable of looking after themselves such as children, those who are mentally ill and others temporarily lacking mental capacity.
- Persons over the age of 18 have full contractual capacity, if they are of sound mind and not suffering from a factor ruling out capacity such as drunkenness.
- A person under the age of 18 is not generally bound by a contract unless it relates to 'necessaries' or to a contract of employment, apprenticeship or education.
- A person also lacks capacity under s 2 of The Mental Capacity Act 2005 if they are 'unable to make a decision for [themselves] in relation to the matter' at the time the contract is made.
- A person without capacity still remains liable to pay a reasonable price for 'necessaries'. In any other cases, the contract is binding unless the person claiming incapacity can establish that they did not understand what they were doing and that the other party knew that to be the case.
- Similar rules apply to contracts entered into by drunken persons.



Duress

1 Introduction

Contracts are about two or more parties assuming obligations to each other, by consent. Duress, however, involves one party coercing another party into a contract: consent is not present or not given freely in the same way. A contract or variation of a contract which has been entered into under duress is voidable, which means that the wronged party may be able to take action to have it set aside and to have the parties returned to the position they were in before the contract was entered into.

Historically, the doctrine of duress was confined to the threat of or the act of violence (duress to the person). Solicitors rarely encounter cases of this duress. However, the doctrine of duress has been extended to duress to goods and economic duress - threats to economic or business interests. This latter category is a developing and increasingly important area of commercial law.

3 types of duress

Duress to
the
person

Duress to
property

Economic
duress

Figure 5.1: Types of duress

1.1 Duress to the person

Duress can vitiate a contract when it amounts to actual or threatened violence. Duress to the person is the least controversial and most long established category of duress.

The leading case on duress to the person is *Barton v Armstrong* [1976] AC 104. The Privy Council concluded in this case that once it is established that the physical threats contributed to the decision to enter into the contract, duress will be found, so long as the threats were one of the reasons for contracting. They further stated that the burden of proof was on the party who exerted the pressure to show the threats and unlawful pressure contributed nothing to the victim's decision to contract. Consequently, it can be seen that the causation test for duress to the person is not a difficult one to overcome – the duress need be only one factor influencing the wronged party's behaviour.

1.2 Duress to goods

A contract can also be avoided where there is a threat to seize the owner's property or to damage it (*Occidental Worldwide Investment v Skibs A/S Avanti (The Sibeon & The Sibotre)*) [1976] 1 Lloyds Rep 293.

To succeed in establishing duress to goods it seems likely that it must be shown that the agreement would not have been entered into if there had not been the duress. Unlike duress to the person, it is unlikely to be sufficient to show that duress will be one factor (but not a decisive factor) influencing the wronged party's behaviour.

1.3 Economic duress

Economic duress is a doctrine which has developed more recently than duress to the person or duress to property. It poses particular difficulties, and it appears to be less well settled than the other two doctrines. A definition of duress which perhaps best reflects the current position was set out by Dyson J in *DSND Subsea Ltd v Petroleum Geo Services ASA* [2000] 7 WLUK 875.



Key case: *DSND Subsea v Petroleum Geo Services* [2000] 7 WLUK 875

'The ingredients of actionable duress are that there must be **pressure**, (a) whose practical effect is that there is compulsion on, or a **lack of practical choice**, for the victim, (b) which is **illegitimate**, and (c) which is a **significant cause** inducing the claimant to enter into the contract' [emphasis added].

The courts have subsequently clarified that 'significant cause' means it must be shown that the agreement would not have been entered into if there had not been the duress.

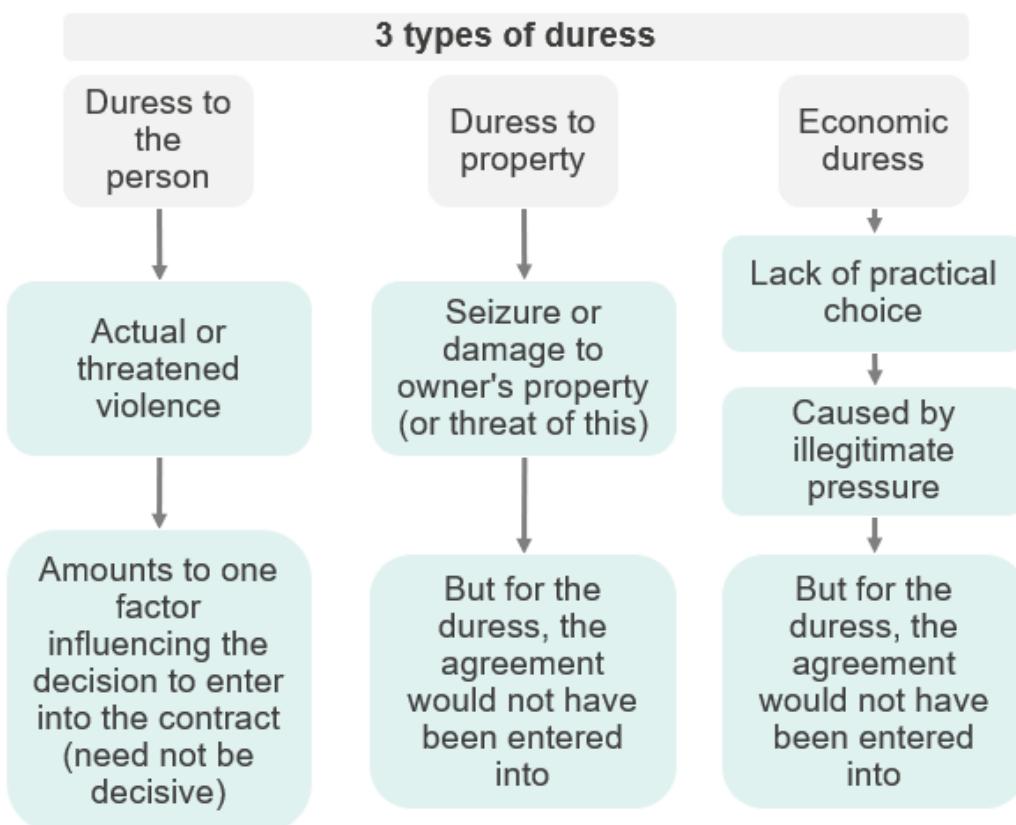


Figure 5.2: Summary of the 3 types of duress

1.4 Legal effect of duress

A person who enters a contract under duress has not done so under their own free will. This results in the contract being 'voidable', which means whilst it remains in force unless some action is taken, the party subject to duress may choose to avoid the contract after the duress has ceased. The remedy is rescission. Rescission is not detailed in this chapter, but broadly involves attempting to return the parties to the situation each was in prior to the contract being entered into.



Voidable: A contract which is capable of being voided (annulled) but which remains in force unless some action is taken to void it.

Rescission: A remedy which involves returning the parties to their pre-contractual position.

The remedy of rescission may be lost where the contract is affirmed, as affirmation operates as a bar to rescission. The court might conclude that a contract is affirmed if, after the duress has ceased, the innocent party fails to challenge the contract in a timely way and/or acts in compliance with its terms.

1.5 Summary

- When a contract has been entered into or varied under duress, it is voidable.
- There are three types of duress: duress to the person, duress to property, and economic duress.
- Actual or threatened violence would be duress to the person.
- A threat to seize or damage property would be duress to property.
- Economic duress results when one party has a lack of practical choice as to whether to enter/vary the contract, and this has been caused by illegitimate pressure.
- The proper remedy for duress is for the contract to be voided and for rescission to be awarded – returning the parties to the situation each was in prior to the contract being entered into.

2 Economic duress

Economic duress is a doctrine which has developed more recently than duress to the person or duress to property. It poses particular difficulties, and it appears to be less well settled than the doctrines of duress to the person or duress to property. This section covers economic duress in more detail.



Key case: **DSND Subsea v Petroleum Geo Services [2000] 7 WLUK 875**

'The ingredients of actionable duress are that there must be **pressure**, (a) whose practical effect is that there is compulsion on, or a **lack of practical choice**, for the victim, (b) which is **illegitimate**, and (c) which is a **significant cause** inducing the claimant to enter into the contract' [emphasis added].

We will explore these considerations in turn. Many of the cases that follow predate DSND. They remain relevant because there is considerable overlap between earlier formulations of the test for economic duress and the test as it now stands. Secondly, the same cases may be used as authority for different elements of the test.

2.1 Lack of practical choice

The pressure must result in a lack of practical choice for the victim. They have no practical alternative but to acquiesce to the demand.

In *Carillion Construction Ltd v Felix (UK) [2001] BLR 1*, Carillion was the main contractor employed to carry out the construction of an office building. Carillion subcontracted the supply of the cladding to Felix. Felix's work was delayed, and there was no certainty as to when it would be completed. Although Felix's liability to Carillion for this delay was potentially substantial, Felix was in a strong position to renegotiate with Carillion. Felix knew that a number of trades were dependent upon it completing the work in order to ensure the building was watertight. Moreover, Felix knew that it would be impossible for Carillion to find an alternative supplier in time to meet the main contract completion date. Felix got Carillion to agree to pay substantially more money to Felix in return for Felix delivering the cladding by the original deadline in the contract. Before paying the money, Carillion wrote a letter protesting against Felix's demand.

The court accepted that Carillion had paid this sum under duress. If Carillion were to complete the main project on time, and so avoid the heavy fees for late completion, they had no viable

alternative but to agree to Felix's demands. It was held that it would be unrealistic to expect the other party to seek a mandatory injunction because of the delay of six weeks caused if Carillion had sought such an injunction. Following the test set out in *DSND Subsea Ltd v Petroleum Geo Services*, Mr Justice Dyson held that there was illegitimate pressure or a threat, the practical effect of which was that Carillion had no practical choice but to enter into the agreement.

In *Atlas Express v Kafco Ltd* [1989] 1 All ER 641, the claimant, a firm of road hauliers, contracted with the defendants to deliver cartons of basket ware to various branches of a particular store throughout the UK. A manager of the claimant's firm fixed the contract price at a rate of £1.10 per carton, based on an estimate that each load would consist of between 400 and 600 cartons. The first load fell significantly below his estimates, comprising only 200 cartons. The manager then refused to take any further loads unless the defendant agreed to renegotiate the contract price to a minimum of £440 per load. The defendant, a small organisation, was heavily reliant on the contract with the store and unable to find another carrier, so reluctantly agreed to pay the imposed minimum charge. At a later stage, the defendant refused to pay the minimum charge and, when sued for the transport charges, lodged a claim of economic duress as a defence. It was held that, where a party has no alternative but to accept revised terms that were detrimental to its interest, this amounted to economic duress.

In *B & S Contracts and Design Ltd v Victor Green Publications Ltd* [1984] ICR 419, the plaintiff contracted to erect stands at Olympia for the defendant. A week before the exhibition, the plaintiff's workmen went on strike, refusing to work until a pay demand was met. The plaintiff demanded an additional £4,500 to continue with the contract. The defendant paid the extra £4,500 to get the contract performed: the cancellation of the contract would have caused serious damage to the defendant's economic interests. However, the defendant then deducted this figure from the contract price paid to the plaintiff. The plaintiff then claimed the balance. It was held by the Court of Appeal that, since the cancellation of the contract would have caused serious damage to the defendant's economic interests, they had no practical choice but to pay the sum demanded by the plaintiff. The plaintiff was therefore not entitled to the extra £4,500 which the defendant had paid under economic duress.

In *Kolmar Group AG v Traxpo Enterprises PVT Ltd* [2010] EWHC 113 (Comm) the defendants had an agreement to sell methanol to the claimants at a fixed price within a set timeframe. Knowing that the claimants needed the methanol to satisfy an order for an important client who had an urgent requirement for it, the defendants gave the claimants a 'take it or leave it' proposal for delivery of less methanol at an increased price. The Court held that the claimants had no alternative but to accept the revised proposal. The defendants had made demands that they knew would cause the claimants loss that were backed by coercive and unlawful threats that they would not perform their obligations, and the claimants had complied with those demands as a result of those threats.

2.2 Illegitimate pressure

In *DSND*, Dyson J stated that the following created a subset of factors to consider when assessing the legitimacy of the pressure:

In determining whether there has been illegitimate pressure, the court takes into account a range of factors. These include **whether there has been an actual or threatened breach of contract; whether the person allegedly exerting the pressure has acted in good or bad faith; whether the victim protested at the time; and whether he affirmed and sought to rely on the contract.** These are all relevant factors.

We will now consider these factors in turn.

2.2.1 Illegitimate pressure – threatened breach of contract?

A threat to breach a contract is an unlawful threat. This section does not cover what amounts to a breach but, for our purposes at this stage, a breach of contract is a failure to comply with the terms of the contract, and it will normally give rise to a right of the innocent party to claim damages.

A threat to breach a contract will therefore usually amount to illegitimate pressure. The cases of *Carillion* and *Atlas* mentioned above are examples of this. In *Carillion*, Felix's late completion of works was a breach of contract, as was *Atlas'* refusal to carry further loads of goods in *Atlas*.

2.2.2 Illegitimate pressure – was pressure applied in good or bad faith?

A threat to breach a contract is an unlawful threat. If this unlawful threat is made for illegitimate ends, then this threat is made in bad faith and will almost inevitably lead to a finding of duress. In both *Carillion* and *Atlas*, the party exerting the pressure was threatening to breach its contract. This threat was made to extort money from the other contracting party that they were not entitled to. There was no legitimate basis for the demand; it was a claim in bad faith amounting to duress.

Contrast this with *DSND* where the pressure was found to be exerted in good faith. In this case, *DSND* threatened to suspend its work under the contract until Petroleum Geo's (PGS) provision of insurance and indemnities covering the safety of the deep-sea divers under the contract was clarified. In the face of that threat, PGS entered into an agreement to make further payments and provide further reassurances to *DSND*. PGS later argued that this was entered into under duress. The court held that this was not illegitimate pressure, Mr Justice Dyson concluding that the pressure exerted by *DSND* was: 'reasonable behaviour by a contractor acting bona fide in a very difficult situation'. In practice, the dividing line between legitimate commercial pressure exerted in good faith and unconscionable illegitimate pressure amounting to duress may be quite a fine one.



Example

Consider a contract by which Party A agrees to transport goods for Party B at an agreed price. If the cost of petrol rises, it may become difficult for Party A to continue to transport the goods at that price. But on the analysis set out above, if Party A seeks to renegotiate the contract under threat of breaching it, it risks the contract being unenforceable due to duress.

You might consider that this is harsh, and that Party A's conduct should not amount to illegitimate pressure. However, the commercial reality is that contracting parties are expected to consider risks (such as changes in the cost of material/labour) when entering into a contract. Part of the bargain is that Party A accepts this risk (note that if the cost of petrol falls rather than rises, Party A effectively gets a boost in the profit earned under the contract).

What if Party A does not want to take this risk? It can enter into a shorter contract (which reduces the risk), or none at all. Or alternatively, it can include a 'price escalation' clause in the contract, which would provide for the price payable by B to rise in stated circumstances – such as if the cost of petrol rises.

2.2.3 Illegitimate pressure – did the victim protest?

The victim should demonstrate evidence of protest at the time the alleged duress was exerted.

In *Carillion*, before paying the money *Carillion* wrote a letter protesting against Felix's demand. *Carillion's* registering of their dissatisfaction was material in their claim succeeding. This can be contrasted with *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd and Another (The Atlantic Baron)* [1979] QB 705. *Hyundai* (shipbuilders) agreed to build a tanker for *North Ocean* (a shipping company), but refused to deliver the ship unless *North Ocean* agreed to pay 10% more than the contract price. The court readily concluded that this threat to breach a contract was illegitimate but ultimately *North Ocean Shipping's* claim failed because they failed to protest at the threatened breach (in addition, as explained further below, it was not until some eight months later that they claimed the return of the extra 10%).

The cases highlight the difficulty of the party in the position of the victim of economic duress. Very often they are caught between a rock and a hard place. If they protest too loudly during the performance of the contract, the threatened breach may materialise. If, however, they fail to protest, that failure may be taken as acquiescence in the changed circumstance.

2.2.4 Illegitimate pressure – did the victim affirm?

One of the principal reasons the claimants in *North Ocean Shipping Co* were unable to get relief for the alleged duress was that they delayed in taking action to set aside the contract. It was not until some eight months later that the owners claimed the return of the extra 10 per cent. It was

suggested that they did not seek the return of the money sooner because they were concerned about the delivery of a sister ship also being built for them. However, the arbitrators found that this fear was groundless. It was held that, although the agreement to pay the extra money might initially have been voidable for economic duress, the fact that the shipping company waited eight months before taking steps to avoid the contract meant they lost their right to have the new contract for the increased payments set aside. They had, in effect, affirmed a variation to the contract.

Unless the victim of duress takes immediate action once the pressure has ceased to operate, they may be taken to have affirmed the contract. *The Atlantic Baron* may be contrasted with *B & S Contracts and Design Ltd v Victor Green Publications Ltd*. Victor Green, acted sufficiently promptly by deducting the extra £4,500 paid under duress from B & S Contracts' invoice, thereby avoiding the new agreement and satisfying the criterion that the victim takes steps to avoid the contract as soon as possible.

2.2.5 Significant cause

To succeed in establishing economic duress it must be shown that the agreement would not have been entered into if there had not been the duress. After reviewing the authorities, Mance J (as he then was) stated in the case of *Huyton SA v Peter Cremer GmbH & Co* [1999] 1 Lloyd's Rep 620:

The minimum basic test of subjective causation in economic duress ought, it appears to me, to be a 'but for' test. The illegitimate pressure must have been such as actually caused the making of the agreement, in the sense that it would not otherwise have been made either at all or, at least, in the terms in which it was made. In that sense, the pressure must have been decisive or clinching.

This 'causation' aspect can be contrasted with the situation in relation to duress to the person, where duress will be established if the duress is one factor influencing the wronged party's behaviour (it need not be a decisive factor).

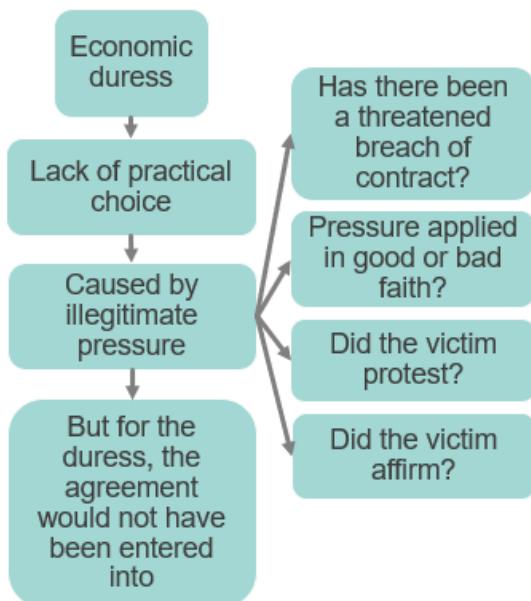


Figure 5.3: Economic duress

2.3 Example

We will now revisit the case of *Carillion Construction Ltd v Felix (UK)* [2001] BLR 1 and apply the detailed framework in relation to economic duress set out in this chapter to its facts.



Key case: Carillion Construction Ltd v Felix (UK) [2001] BLR 1

Carillion was the main contractor employed to carry out the construction of an office building. Carillion subcontracted the supply of the cladding to Felix. Felix indicated that it might not be able to complete its work on time unless the contract was varied to provide for increased payments to Felix. Carillion agreed to these new terms, but later argued successfully that the revised contract was voidable on the basis of duress.

The application of the test in DSND to Carillion is set out on the next section.

Consideration	Application								
Lack of practical choice	Carillion needed this work to be completed on time to allow other work in the property to proceed. If all the work was not completed on time, Carillion would incur heavy fees for late completion in relation to its contractor with the building owner. It would be impossible for Carillion to find an alternative supplier or pursue legal action against Felix in time.								
Caused by pressure	Felix refused to complete the work on time unless Carillion agreed to the new terms.								
Pressure illegitimate?	<table border="1"><tr><td>Has there been a threatened breach of contract?</td><td>The refusal to complete on time amounted to a threatened breach of contract (ie was unlawful).</td></tr><tr><td>Was the pressure applied in good or bad faith?</td><td>The threat was made in bad faith to extort money from Carillion.</td></tr><tr><td>Did the victim protest?</td><td>Before paying the money Carillion wrote a letter protesting against Felix's demand.</td></tr><tr><td>Did the victim affirm?</td><td>Carillion did nothing that would amount to affirming the contract.</td></tr></table>	Has there been a threatened breach of contract?	The refusal to complete on time amounted to a threatened breach of contract (ie was unlawful).	Was the pressure applied in good or bad faith?	The threat was made in bad faith to extort money from Carillion.	Did the victim protest?	Before paying the money Carillion wrote a letter protesting against Felix's demand.	Did the victim affirm?	Carillion did nothing that would amount to affirming the contract.
Has there been a threatened breach of contract?	The refusal to complete on time amounted to a threatened breach of contract (ie was unlawful).								
Was the pressure applied in good or bad faith?	The threat was made in bad faith to extort money from Carillion.								
Did the victim protest?	Before paying the money Carillion wrote a letter protesting against Felix's demand.								
Did the victim affirm?	Carillion did nothing that would amount to affirming the contract.								
But for the duress, the agreement would not have been entered into.	The new terms were much worse for Carillion, and Carillion would not have entered into them had there been no duress.								

2.4 Summary

- Economic duress results when one party has a lack of practical choice as to whether to enter / vary the contract, and this has been caused by illegitimate pressure.
- When considering whether there has been illegitimate pressure, the court will consider:
 - Whether there has been an actual or threatened breach of contract.
 - Whether the party exerting pressure has done so in good or bad faith.
 - Whether the victim protested at the time of the duress.
 - Whether the victim affirmed the contract after the duress ceased.
- To succeed in establishing economic duress it must be shown that the agreement would not have been entered into but for the duress.

3 Economic duress and consideration

It may help you to understand economic duress when you consider it alongside the rules in relation to consideration.

The relationship between economic duress and consideration is most clearly illustrated in cases where an attempt has been made to vary a contract.

For example, X agrees to supply a computer package to Y. The original price for the package is agreed at £1,000. X then tries to reshape the deal: after further negotiations, X persuades Y to pay more, say £1,250.

In order to establish whether the variation (ie the promise to pay more) is binding, we need to return to first principles and answer this question: what makes a promise binding? If the variation is to be binding it must demonstrate all the characteristics of a valid contract – consideration, intention to create legal relations and agreement.

Of particular interest for present purposes is consideration. If a party does no more than it was already bound to do, there is no consideration to make the variation binding (*Stilk v Myrick* (1809) 2 Camp 317). So, if X does no more than supply the computer package to the original specification, then it has offered no consideration to make Y's promise to pay more binding. The variation lacks consideration so it is not enforceable.

However, if X does something above and beyond its original contractual obligations, it may amount to good consideration, eg it adds to the computer package an anti-virus program which Y needs (*Hartley v Ponsonby* (1857) 7 E & B 872). In other words, the variation is supported by consideration and, provided there is also the necessary intention to create legal relations and agreement, the variation will be enforceable.

Taking it a step further, in *Williams v Roffey Bros & Nicholls (Contractors) Ltd* [1991] 1 QB 1, the Court of Appeal demonstrated a clear willingness to look imaginatively at the doctrine of consideration, identifying practical benefit as good consideration to make Roffey's promise to pay more binding. However, even where such practical benefit exists, the promise will not be enforceable where duress has been exercised to extract the promise to pay more.

3.1 Summary

- The court is increasingly likely to find 'consideration' by way of practical benefit to support a variation. This means that more variations would appear (from the perspective of consideration) to be binding, and the doctrine of economic duress is therefore increasingly important in ensuring that a party can seek relief from such variations where the circumstances justify this.



Undue influence

1 Introduction

Contractual obligations should be both freely and independently assumed. If the consent to a transaction was produced in a way such that the consent ought not fairly to be treated as the expression of a person's free will, then the transaction will not be allowed to stand. The objective is to ensure that the influence of one person over another is not abused,

This concept overlaps with that of duress. Ideally, the doctrines of duress and undue influence would have clear and distinct targets. However, the doctrine of duress is a common law doctrine, whereas undue influence was developed by the courts of equity. The two have not always developed with a clear view as to the role of the other. Where a contract appears to be the result of pressure/coercion, you should consider each doctrine in turn.

On a practical note, where there is doubt as to whether any particular act of coercion is duress or undue influence, the claimant should bring their action on both grounds.



Key case: *RBS v Etridge (No 2) [2002] 2 AC 773*

The leading case on undue influence is *RBS v Etridge (No 2) [2002] 2 AC 773*. In this case the court stated that undue influence exists where 'a person's consent to a transaction was produced in a way such that the consent ought not fairly to be treated as the expression of their free will'. The court stated that it was 'impossible to be more precise or definitive'.

The definition of undue influence provided in *Etridge* suggests the court wants to keep its options open to find undue influence in any situation which falls within this test. Notwithstanding this, the court detailed the circumstances in which undue influence has already been established. *Etridge* clarified much of the case law in this area.

In *Etridge* the court set out two types of undue influence.

First, there are instances of overt acts of improper pressure or coercion such as unlawful threats. This type has much overlap with the idea of duress.

Second, there are situations where one party has influence or ascendancy over the other, and the first party takes advantage of that influence/ascendancy. In these cases there may be no specific or overt act of pressure or coercion, but the underlying relationship is sufficient for the undue influence to be exercised. The lack of an act of pressure or coercion makes this quite distinct from duress.

We will look at each type of undue influence in turn.

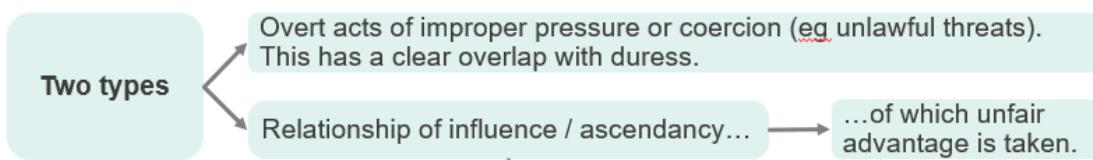


Figure 6.1: Two types of undue influence

1.1 Overt acts of improper pressure or coercion

Insofar as the first type is concerned, these cases are necessarily rare. Many cases which fall into this category would today probably be decided on the basis of duress.

In so far as the behaviour constituting undue influence is of a deceitful/fraudulent nature, the causation test is the same as for duress to the person. It is necessary only for the innocent party to establish that the undue influence is a factor in inducing the claimant to enter into the contract. The innocent party does not need to establish that the undue influence was a decisive factor. If the behaviour is not deceitful/fraudulent, then the situation is less clear, and it may be that the 'but for' test applies: but for the behaviour constituting undue influence, would the innocent party have entered into the contract?

1.2 Taking advantage of influence or ascendancy in a relationship

This type is more common and the majority of recent authorities are concerned with this type.

A common situation is where a husband or wife (the 'business owner') wants their spouse to enter into an agreement with the effect that the spouse's share in the matrimonial home is used as security for a loan to the business owner's business. The effect is that the spouse might lose their interest in the home. If the spouse has placed trust and confidence in the business owner and the business owner abuses this trust in seeking the spouse's consent to the transaction (for example, by misrepresenting the nature of the transaction), then this can amount to undue influence. Note the absence of a specific act of coercion or pressure.

There is no definitive list of relationships of influence or ascendancy. Commonly, the influence will come from the trust and confidence which one party has in the other. However, a relationship where one party is very vulnerable or dependent might also allow the other party to have significant influence, even if the innocent party has not positively placed trust or confidence in the other party.

There are a number of relationships in which there is an irrebuttable presumption that one party has influence over the other. In these cases, the court will not allow any argument that, in fact, there was no influence in that relationship. Such relationships include those between parent and child, guardian and ward, trustee and beneficiary, solicitor and client and doctor and patient. However, parent and adult child, or (crucially) spouses do **not** give rise to this presumption. The influence will therefore need to be positively shown.

Note that it is not every transaction between parties to such a relationship that gives rise to undue influence. It is only where the relationship is taken advantage of that there will be undue influence, for example because the party with influence has deceived the innocent party, or simply taken a decision entirely in their own interests.

1.2.1 Proof of taking advantage of influence or ascendancy in a relationship

If a party wishes to allege it has been the victim of undue influence, it must prove this.

The court has established some basic principles as to how this might be proved.

If a party can show that there is a **relationship of trust and confidence** (or presumably one of the categories of irrebuttable presumption) and also a '**transaction which requires explanation**', then this will be enough for the court to determine that the transaction is the product of undue influence, unless the alleged wrongdoer can produce evidence to convince the court that there was no such undue influence.

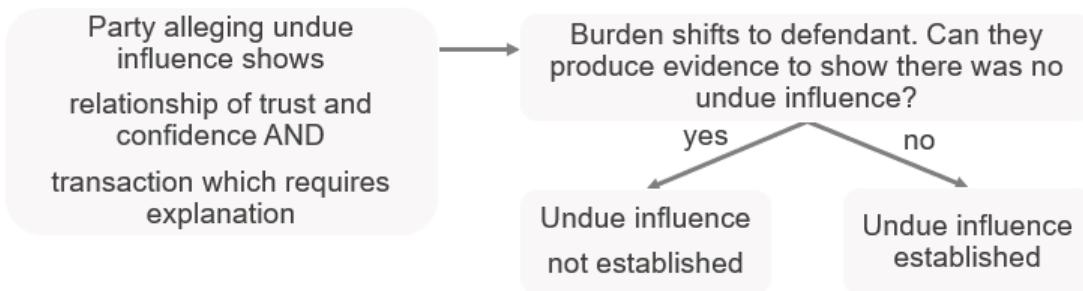


Figure 6.2: Proof of taking advantage of influence or ascendancy in a relationship

A transaction will require explanation if it does not fit with what would usually be expected in the relationship concerned. It might be a suspicious type of transaction, or be for a suspiciously high value.

Note that the court has indicated that, in the majority of cases, a husband/wife offering their interest in the matrimonial home as security for a loan to their spouse's business is not a transaction which requires explanation, so the party alleging undue influence would need to prove that unfair advantage had been taken of the relationship.

Etridge approved Lindley LJ in *Allcard v Skinner* 1887 LR 36 ChD 145:

Lindley LJ pointed out that where a gift of a small amount is made to a person standing in a confidential relationship to the donor, some proof of the exercise of the influence of the donee must be given. The mere existence of the influence is not enough. He continued, at p 185: 'But if the gift is so large as not to be reasonably accounted for on the ground of friendship, relationship, charity, or other ordinary motives on which ordinary men act, the burden is upon the donee to support the gift'.

Where a party has shown a relationship of trust and confidence and a transaction which requires explanation, then the wrongdoer might argue (for example) that the innocent party received comprehensive independent advice about the transaction, and therefore that they could not have been subjected to undue influence. Whether such an argument would succeed will depend on all the facts. The court has made clear that even when someone fully understands a transaction having received independent legal advice, it is possible that their consent to it is still being given only as a result of undue influence.

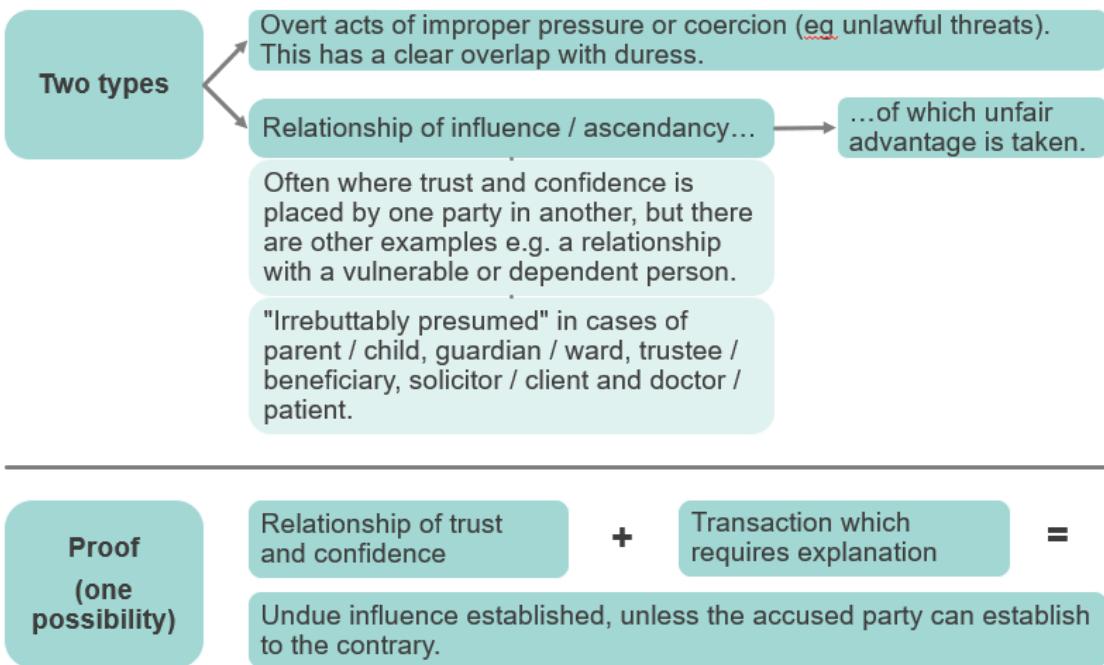


Figure 6.3: Summary of undue influence

1.3 Limits on equitable relief

Where undue influence is proven, a contract (or gift by deed) may be set aside. However, this relief is equitable and, therefore, discretionary. The court may not allow this relief where the innocent party has delayed making its claim because 'delay defeats equity'. Also, it may be disallowed where the claimant's conduct has been underhand because those who come to equity must come with clean hands.

1.4 Summary

- Undue influence will be established where the contract results from overt acts of improper pressure or coercion – this is similar to duress.
- More common is undue influence arising from a relationship where one party has influence or ascendancy over the other, and abuses this position, for example by misrepresenting the situation to the other party or simply favouring its own position.
- There is no limit to the possible relationships of influence or ascendancy, but they will commonly be relationships where one party has placed trust and confidence in other. Some relationships, such as parent/child or solicitor/client are irrebuttably presumed to be such relationships – they will always amount to a relationship of influence or ascendancy by their very nature.
- If a party can show a relationship of trust and confidence and a transaction which calls for an explanation, then undue influence is inferred, unless the other party can establish to the contrary.
- Relief for undue influence is discretionary and delay or a failure to come to court with 'clean hands' may lead to a remedy being refused.

2 Undue Influence and third parties

2.1 Introduction

Undue influence has, in the past, been largely confined to where a victim is attempting to avoid a transaction because the other party has exerted an unfair advantage over them by virtue of their relationship to one another. However, it sometimes arises, particularly in the context of a marital

relationship, that the victim is persuaded to enter into a guarantee or surety contract with a bank or some other creditor on the basis of some undue influence, misrepresentation or other legal wrong, not by the bank or creditor (ie not by the other party to the transaction), but by some third party, for instance, their spouse.

If the contracting party (eg the bank) has actual notice (ie is aware) of the undue influence, the contract will be affected. However, it is highly unlikely that the bank will have actual notice of undue influence. Much more likely is that there are circumstances which might lead a bank to realise that a transaction carries a risk of undue influence. Does this have any implications for the transaction? In this area of law, this problem translates to the question of when will the bank be fixed with constructive notice of the undue influence – ie when will it be treated as having notice of something that it is not actually aware of.

It should be noted that the first question to consider is whether there was undue influence.

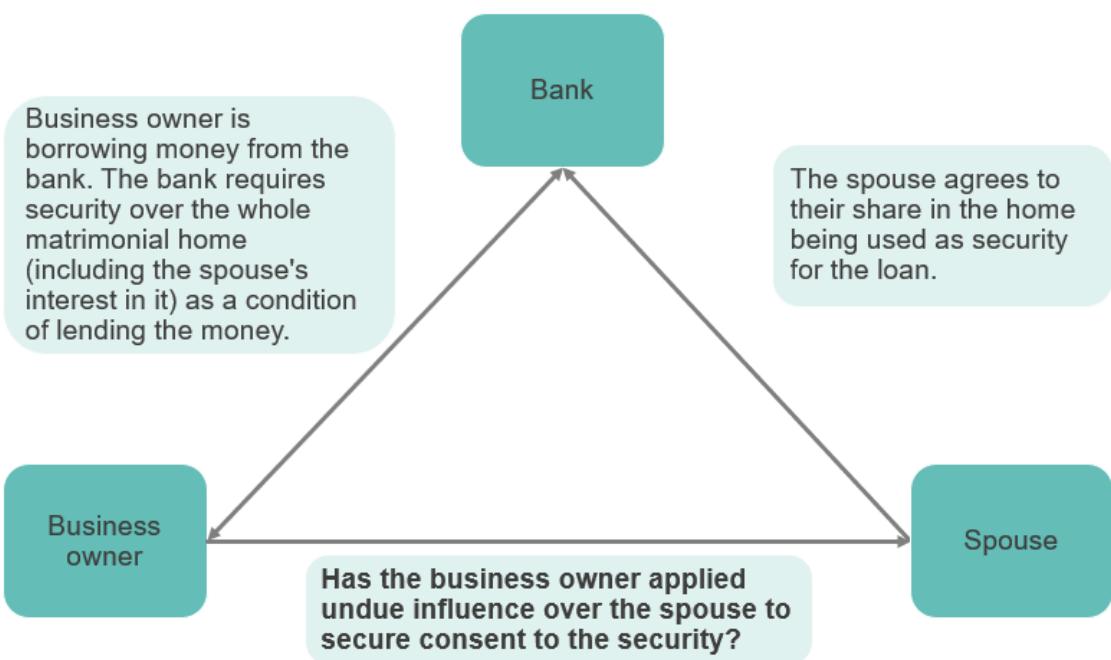


Figure 6.4: Undue influence and third parties

Exercise: Engage

Before reading on, remind yourself of the approach to take when seeking to establish if there is undue influence. Try to follow that approach to ascertain the circumstances in which a party might have exercised undue influence over their spouse and how the spouse might go about establishing this.

When considering whether a spouse has exercised undue influence over the other spouse in these circumstances, there are two specific points worth noting/remembering.

Firstly, a relationship between spouses is not one where there is an irrebuttable presumption of a relationship of influence/ascendancy. The spouse will therefore need to prove such a relationship, most likely by establishing that they placed trust and confidence in their spouse. In most cases, it will be relatively easy to establish this.

Secondly, the court has indicated that, in the majority of cases, a spouse offering their interest in the matrimonial home as security for a loan to their spouse's business is not a transaction which requires explanation – so it will be for the party offering security to show more explicitly how their spouse's influence has been used unduly.

It is only if undue influence is established, that the issue of the notice of the bank will be relevant.

2.2 Barclays Bank plc v O'Brien

The frequent tripartite problem involving spouses and a bank was considered in *Barclays Bank plc v O'Brien* [1994] 1 AC 180 and a number of subsequent similar cases which have refined (and challenged) the principles.



Key case: *Barclays Bank plc v O'Brien* [1994] 1 AC 180

Mr O'Brien was a shareholder in a company and wanted to increase the overdraft facility of the company in question. The company's bank agreed a loan of £12,000 that was to be guaranteed by Mr O'Brien, his liability in turn being secured by a second charge over the matrimonial home, which was jointly owned by Mr O'Brien and his wife. The bank manager gave instructions for a legal charge to be signed by both Mr O'Brien and his wife, together with a guarantee to be signed by Mr O'Brien. He also instructed that both Mr O'Brien and his wife should be made aware of the nature of the transactions and that, if they had any doubts, to obtain independent advice.

However, the bank staff had not followed these instructions and subsequently both husband and wife signed the documents without reading them. When the company's indebtedness increased beyond the agreed limit, the bank took proceedings to enforce its security against the husband and wife. In her defence, Mrs O'Brien contended that, firstly, her husband had put undue pressure on her to sign the agreements and, secondly, that her husband misrepresented the effect of the legal charge in that she believed it was limited to a sum of £60,000 over three weeks when in fact the charge covered £135,000.

It was held by the House of Lords that the bank was aware that the parties were husband and wife and as such were put on notice that influence may be exercised. The bank had failed in its duty to take reasonable steps to warn the wife of the risks she ran in entering into the surety contract nor had it properly advised her to seek independent legal advice. On this basis, the bank was fixed with constructive notice of the misrepresentation made by the husband to induce his wife into the surety contract and therefore the wife was entitled to have the legal charge set aside.

It was held that a creditor would be put on notice when:

[...] a wife offers to stand surety for her husband's debts by the combination of two factors: (a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction.

It follows that unless the creditor who is put on inquiry takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained, the creditor will have constructive notice of the wife's rights.

The steps that the creditor needs to take to so satisfy itself are addressed later in this section.

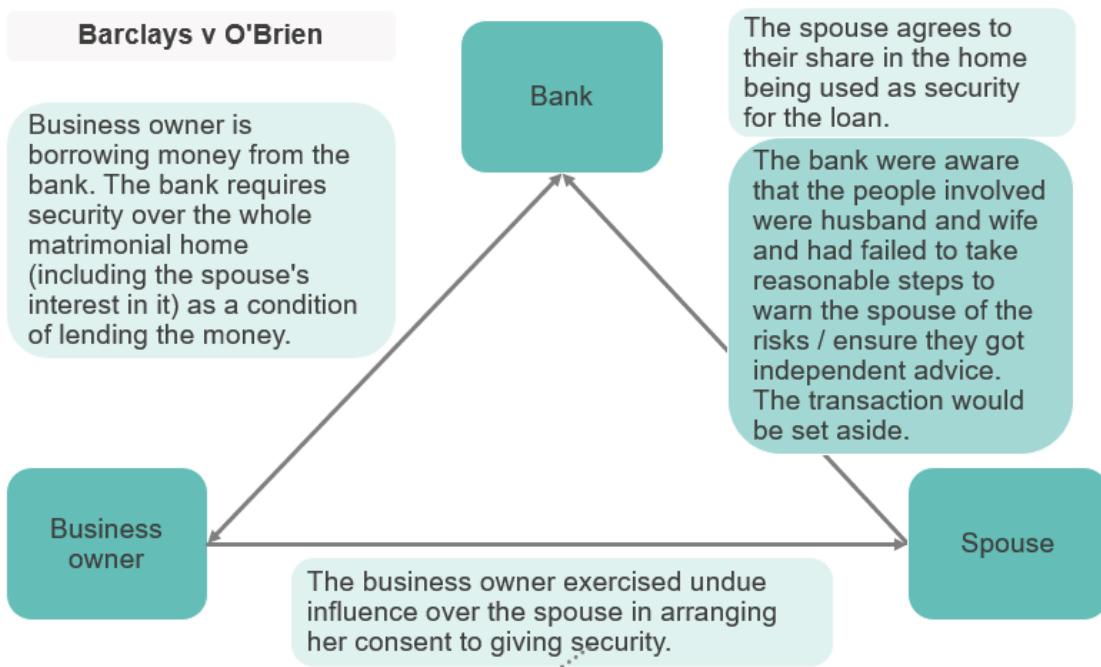


Figure 6.5: Barclays v O'Brien

2.2.1 Post O'Brien developments in surety transactions

The House of Lords was once more asked to consider this area of law in the consolidated appeal of *RBS v Etridge (No 2)* [2002] 2 AC 773. As well as clarifying and/or approving many of the authorities in this area, Lord Nicholls extended the principles of constructive notice beyond cases of spouses when he stated that ‘the only practical way forward is to regard banks as put on inquiry in every case where the relationship between surety and debtor is non-commercial’. He clarified that a bank is put on inquiry whenever one party in a non-commercial setting is standing as surety for the other party.

This confirmed the approach taken in *CIBC Mortgages plc v Pitt* [1994] 1 AC 200, where the husband used the borrowed money to speculate on the stock market, losing everything in the 1987 stock market crash. The wife sought to have the mortgage on the matrimonial home set aside on the grounds of undue influence, having signed the mortgage without reading it under pressure from her husband.

The House of Lords rejected the wife’s claim. The husband had not been acting as the lender’s agent and the lender had no actual or constructive notice of the husband’s undue influence. As the mortgage application said that the loan was for a holiday cottage, there was nothing to put the lender on notice that the transaction was anything other than a normal advance for the couple’s joint benefit.

2.2.2 What are reasonable steps?

The purpose here is to ensure that the innocent party is fully aware of the risks being taken and advise them to take independent advice.

Lord Nicholls, in *Etridge* said:

- There is no obligation on the creditor to have seen the wife itself as it is ordinarily reasonable to rely on a confirmation from a solicitor that they have advised the wife in an appropriate manner, unless the creditor is aware that this has not been done. It is for the solicitor to determine whether there is a conflict of interest if the wife’s solicitor also advises the husband.
- The creditor must provide the solicitor with sufficient information about the transaction for the solicitor to be able to explain it fully to the wife.
- If the creditor is aware, either actually or constructively, that the wife may have been misled, then the creditor must tell the solicitor of this.

2.2.3 The solicitor's position

According to Lord Scott in *Etridge*, the solicitor should start by warning the wife that their involvement may be relied upon by the bank to counter allegations that she could not properly understand the transaction or had given her consent to it. If the wife then consents to advice being given, the core minimum the advice should contain is:

- (a) An explanation of the documents and their practical consequences, including the risk that the wife may lose her home.
- (b) The seriousness of the risk, including the duration and terms of the security and the wife's assets and means.
- (c) The fact that the wife has a choice.

The solicitor should then obtain any necessary information from the lender/creditor.

If the solicitor fails in his duty to the wife, then she will have an action in negligence against the solicitor, but she will have no recourse to the lender/creditor which is entitled to assume that the solicitor has properly advised the wife.

2.3 Summary

- A common problem is when a 'victim' is persuaded to enter into a contract such as a contract giving security to a bank on the basis of undue influence not by the bank but by some third party.
- This gives rise to whether the contract with the bank can be set aside, despite the fact that the bank exerted no undue influence. This depends on whether the bank had notice of the undue influence by the third party. Unless the bank had actual notice of the undue influence, the 'victim' will need to show that the bank had constructive notice of the undue influence.
- A bank will be held to have constructive notice in every case where the relationship between party giving the guarantee and the borrower is non-commercial, unless the bank takes reasonable steps to warn the weaker party of the risks of the transaction or to ensure that it gets independent advice.
- If the weaker party gets independent legal advice, the courts have given guidance as to what is expected from the solicitor giving such advice.



Terms

1 Introduction to terms

The terms of a contract are its contents. They define the rights and obligations arising from the contract.

Contractual terms may be express or implied.

Express terms are statements made by the parties, by which they intend to be bound. A contract can have terms agreed in writing, or agreed orally, or a mixture of the two.

Implied terms are not formed by statements made by the parties – they have not been agreed upon, orally or in writing. Nonetheless, the law deems that they exist.

For reasons to be explored in this chapter, it can be hard to identify the express and implied terms of a contract, but it is clearly a crucial task.

In the course of this topic, you will look at the following sections in relation to terms:

Section	What it covers
Express terms contrasted with representations.	The distinctions between statements that become terms and those that are representations.
Express terms generally	How terms are incorporated into a contract, and the significance of a written contract.
Implied terms generally	The basis on which the court will imply terms into a contract.
Implied terms under the Sale of Goods Act 1979	Terms implied on the basis of the provisions of the Sale of Goods Act 1979
Implied terms under the Supply of Goods and Services Act 1982	Terms implied on the basis of the provisions of the Supply of Goods and Services Act 1982.
Implied terms under the Consumer Rights Act 2015	Terms implied on the basis of the provisions of the Consumer Rights Act 2015.
Conditions and warranties	How to distinguish conditions, warranties and innominate terms, and the significance of this distinction.

2 Express terms contrasted with representations

2.1 Introduction

One challenge in relation to express terms is to pick out from the many statements which might have been made orally or in writing those which have become terms of the contract.

Statements made by the parties during negotiations leading up to a contract can be divided into three groups: mere puffs; representations and terms.



Mere puff: Statements of no legal significance.

Representations: Statements of fact or law which induce the making of the contract which the parties do not intend to be binding.

Terms: Statements of fact which the parties intend to be binding.

2.2 Why does the distinction between representations and terms matter?

The distinction between representations and terms becomes important when the statement turns out to be untrue, or the promise is not fulfilled. The court then has to decide which statements are contractual terms and which are non-contractual representations, inducing the contract but forming no part of it. If a statement is a term of the contract and this term is not fulfilled, this will amount to a breach of contract, for which the innocent party may claim, amongst other remedies, damages.

If the untrue statement is not a term of the contract but a representation, this may amount to a misrepresentation. This is not the same as a breach of contract, but the innocent party may still be able to obtain a remedy in the law of misrepresentation.

Also note that a statement can be both a term and a representation, giving rise to an action for both breach of contract and misrepresentation.

This chapter does not address the law in relation to misrepresentation.

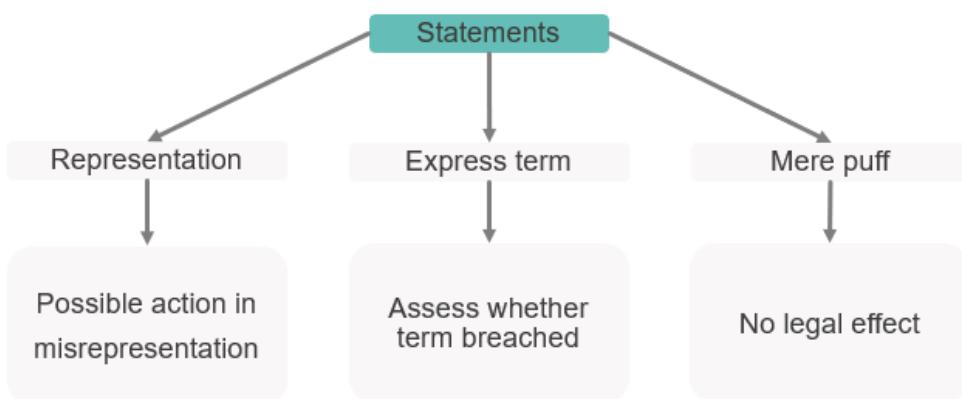


Figure 7.1: Pre-contractual statements

2.3 How do I know if a statement was a representation or a term (or both)?

The difference between a representation and a term is that only the latter is intended to be binding. In seeking to discover whether the parties intended to be bound by a statement made by one of them, the court will apply an objective test based on the question: 'what would a reasonable person understand to be the intention of the parties, having regard to all the circumstances?'

Where a statement is made during negotiations for the purpose of inducing the other party to enter into the contract, there is, *prima facie*, ground for inferring that the statement was intended to be a binding term of the contract. However, the inference can be rebutted if the party making the statement can show that it would not be reasonable to hold them bound by it.

The court will take into account any factors which appear to be relevant. There are no hard and fast rules to be applied but some useful guidelines may be discerned from the case law set out in the following pages.

2.4 The importance of the statement

One factor which the courts take into account is the importance attached to the statement by one of the parties. A statement may be regarded as a term of the contract if it can be shown that the injured party considered it so important that it would not have entered into the contract but for that statement. An example of the application of this guideline can be seen in the case of *Bannerman v White* (1861) 10 CB NS 844. In this case, in respect of negotiations to purchase hops, the defendant said: 'if they have been treated with sulphur, I am not interested in even knowing the price of them'. When the plaintiff produced samples, the defendant again enquired whether sulphur had been used and was assured that it had not. In fact, a small amount of the crop, some five acres out of a total of 300 acres, had been treated with sulphur. The defendant treated the contract as repudiated, and the question as to whether they were entitled to do so hinged upon whether it could be regarded as a condition of the agreement that the hops may be rejected if sulphur had been used. It was argued by the plaintiff that the conversation relating to the sulphur was preliminary to entering the contract and, as such, was not part of the contract. The court held that the statement was understood and intended by the parties to be a term of the contract of sale.

2.5 Timing

The time of the making of the statement appears to be an important factor. If the statement was made at the time of contracting, it is more likely to be a term of the contract than if it was made at an early stage of the negotiations. If, on the other hand, there is a delay between the making of the statement and the parties entering into the contract, then it is less likely to be treated as a term.

In *Routledge v McKay* [1954] 1 WLR 615 the private seller of a motorcycle told the buyer, in good faith, that it was a 1941 or 1942 model. One week later, the buyer and seller entered into a contract of sale. The written memorandum of the sale did not mention the year of the model. The motorcycle was a 1930 model and the buyer sued for breach of contract. The Court of Appeal held that the lapse of time between the making of the statement and entering into the contract meant the statement as to the year of the model was a representation and not a term of the contract.

2.6 Reduction of the contract into writing

It is also apparent from the decision in *Routledge v McKay* that the court was influenced by the fact that the contract had been reduced into writing and the written contract made no mention of the previous oral statement about the motorcycle being a 1941 or 1942 model. The inference drawn by the court was that the statement could not have been regarded as significant by the parties. If it had been, they would have ensured its inclusion in the written agreement. Consequently, the court concluded that the statement regarding the year of the model was never intended to be a term of the contract but a representation.

Note. This is not necessarily decisive in classifying the statement as a mere representation.

2.7 Special knowledge or skill

Where the party who made the statement had exclusive access to information or special knowledge as compared with the other party, this is likely to be taken into account in the latter's favour.

Perhaps the best indication of the effect of the concept of skill and knowledge can be seen in the contrasting cases of *Oscar Chess Ltd v Williams* [1957] 1 WLR 370 and *Dick Bentley v Harold Smith* [1965] 1 WLR 623.

Oscar Chess Ltd v Williams	Dick Bentley Productions v Harold Smith (Motors)
The claimant car dealers, Oscar, agreed on a trade-in of Williams' old car as part of a new purchase. Williams had no knowledge of the	Mr Smith, of the defendant company, told Mr Bentley that a car had done 20 thousand miles only since the fitting of a new engine

Oscar Chess Ltd v Williams	Dick Bentley Productions v Harold Smith (Motors)
<p>motor trade. The registration book of the car traded in gave its date as 1948 and Williams confirmed this date in good faith. It was later discovered that the date should have been 1939 and the car was worth much less than thought. The Court of Appeal held that the age of the car was not a term of the contract and therefore there was no breach of contract by Williams. It was clear that the skill and expertise lay in the hands of Oscar, the car dealers, and not in the hands of Williams, who was making the statement. Consequently, the statement remained as a representation without contractual force.</p>	<p>and gearbox. The milometer also showed 20 thousand miles. Later that day, Mr Bentley took his wife to see the car and Mr Smith repeated his statement. Mr Bentley bought the car but it soon became clear that it had done more than 20 thousand miles since the change of engine and gearbox. The Court of Appeal held that the statement as to the mileage was a term of the contract. The defendant was a car dealer who should be taken to have better knowledge of such matters than Mr Bentley, who was not involved in the motor trade.</p>

2.8 Assumption of responsibility/further checks

A statement may become a term of the contract where the vendor expressly accepts the responsibility for the soundness of the sale item in question. This factor was taken into account in *Schawel v Reade* [1913] 2 IR 81 (HL). Here, the claimant required a horse for stud purposes. He attempted to examine the defendant's horse but was told that he need not look for anything and that the horse was sound in every way. The price was agreed and delivery of the horse took place three weeks later. The horse was not in fact fit for stud purposes and the judge directed the jury to consider two points: did the defendant, at the time of the sale, represent that the horse was fit for stud purposes? Did the purchaser act on that in purchasing the horse? Both questions were answered in the affirmative and consequently, the statement was deemed to be a term of the contract.

Another factor which may have been at work was that the defendant, by the strength of his statement, actually dissuaded the plaintiff from making further checks himself with regard to the fitness of the horse for stud purposes. This can be contrasted with *Ecay v Godfrey* (1947) 80 Lloyd's Rep 286, where the seller of a boat stated that it was sound but advised the buyer to have it surveyed. This advice showed that the seller did not intend that his statement should be taken as a term of the contract and that the onus of verification of the soundness of the boat lay with the purchaser.

A representation or a term of the contract?

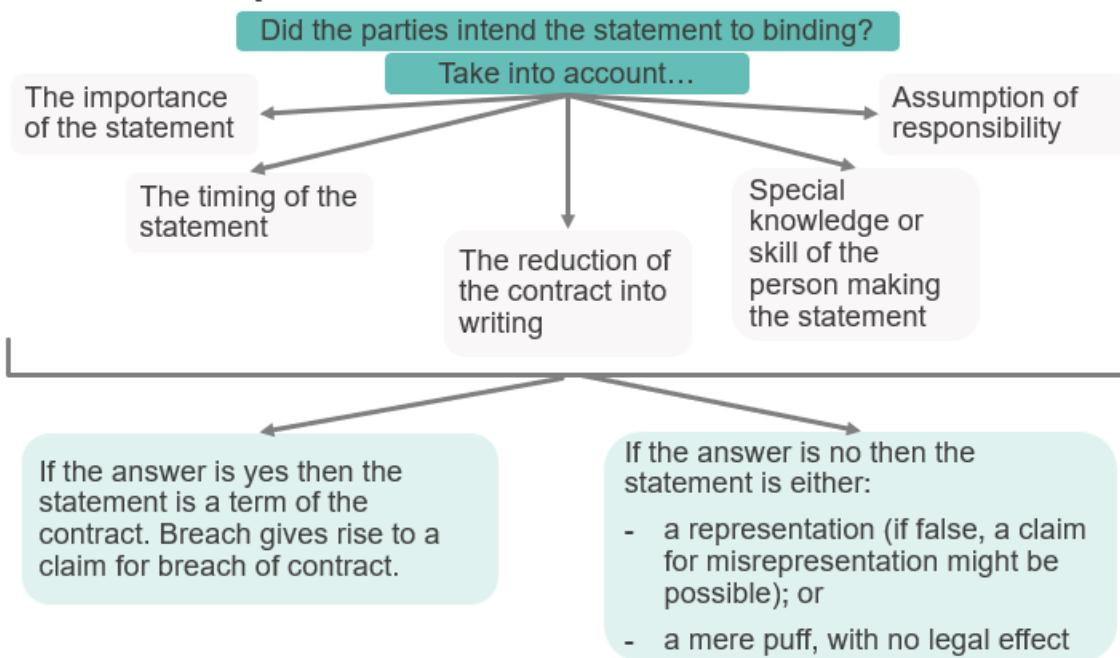


Figure 7.2: Analysing pre-contractual statements

2.9 Summary

- Statements made by the parties during negotiations can be divided into 'mere puffs', representations or terms of the contract.
- If an untrue statement is a term of the contract then this may give rise to a claim for breach of contract.
- A representation is likely to be a term if the parties intended the statement to be binding. To ascertain if this is the case, the court will consider:
 - The importance of the statement.
 - The timing of the statement.
 - The reduction of the contract into writing.
 - Special knowledge or skill of the person making the statement.
 - Assumption of responsibility by the person making the statement.

3 Express terms

The process of ascertaining the express terms of a contract is, at heart, a search to ascertain what an objective observer would think that the parties intended to be bound by. The terms that the parties intend to be bound by (as it would appear to an objective observer) will be terms of the contract. This is the essence of a contract: agreement between the parties. However, how this 'intention to be bound' is demonstrated varies in different circumstances. We will now look at some of the possibilities.

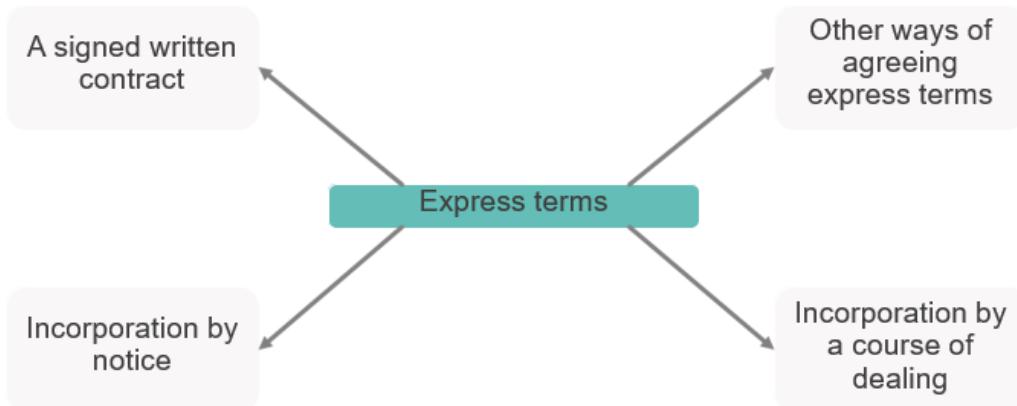


Figure 7.3: The incorporation of express terms

3.1 A signed written contract

Firstly, written terms might be set out in a signed written contract. In almost all such cases the signing of a contract shows that the parties intended to be bound by it. This is true even if a party signing has not read the terms or has not understood what they mean. A party can express an intention to be bound by something they have not read or understood (although it is not wise to do so!) (see *L'Estrange v Graucob Ltd* [1934] 2 KB 394). Accordingly, all the terms of the signed contract will be binding.

By way of exception, if the document signed was not one which was intended to have any contractual effect (eg it was a document simply acknowledging receipt of goods) then the terms within it will not form part of the contract (see *Grogan v Robin Meredith Plant Hire* [1996] CLC 1127). This is because signing such a document does not indicate an intention to be bound by its terms, precisely because it was not intended that the document would have any contractual effect. In this regard, timing is also important: the document in *Grogan* was described by Auld LJ as a ‘post contractual document’ making it much less likely it would have contractual effect.

In addition, a party may be prevented from relying on incorporation of a clause through signature of a document if it has orally misrepresented the meaning of the clause to the other party (*Curtis v Chemical Cleaning and Dyeing Co* [1951] 1 KB 805).

3.2 Incorporation by notice

Terms can also be incorporated by notice ie by one party notifying the other party of them. In *Parker v South Eastern Railway Co* (1876-77) 2 CPD 416 it was established that terms will form part of the contract if reasonable steps have been taken to bring them to the claimant’s attention. This is logical, where reasonable steps have been taken to draw terms to a party’s attention, that party’s persistence with the transaction suggests an intention to be bound by the terms.

What will amount to reasonable notice will be dictated by the facts of the case. *Thompson v London, Midland & Scottish Railway* [1930] 1 KB 41 established that terms may be incorporated by reference to a different document (in this case the contractual document, a ticket, referred to terms contained within a railway timetable). Examples where insufficient notice was given include *Henderson v Stevenson* (1875) LR S SC & Div 470 where the clause was not referred to on the front of the ticket and *Sugar v London, Midland & Scottish Railway* [1941] 1 All ER 241 where the clause was illegible.

Where a party wants to incorporate terms which are particularly adverse to the other party, it must clearly bring these to the other party’s attention. In *Thornton v Shoe Lane Parking* [1971] 2 QB 163, Lord Denning MR, stated that where a clause was particularly onerous it would need to be ‘printed in red ink, with a red hand pointing to it, or something equally startling’ to give sufficient notice. This principle was confirmed in the case of *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433.

The above discussion relates to the incorporation of onerous terms through reasonable notice. Note that when a document containing contractual terms is signed the signing party is bound by those terms, even if the offending clause is onerous (*L'Estrange v Graucob Ltd*).

3.2.1 Timing

For a clause to be incorporated into the contract, reasonable notice of it must be given before or at the time of contracting. It follows that any clause will not amount to a binding term if it is communicated only after the contract is made. In *Thornton v Shoe Lane Parking* [1971] 2 QB 163 the events were as follows:

- The claimant drove his car to a multi storey automatic car park that he had never used before. At the entrance was a sign giving the charges for the car park.
- The claimant drove up to the entrance. The movement of the car turned a light at the entrance from red to green, and a ticket machine produced a ticket that stated that the ticket was issued 'subject to the conditions of issue as displayed on the premises'.
- The claimant drove into the car park without reading the words on the ticket or those displayed on a pillar opposite the ticket machine.
- The claimant parked his car and went about his business.
- When the claimant returned to the car park, he attended the office in the car park, and paid the necessary charges.
- The claimant then returned to his car and was severely injured whilst attempting to put his belongings into his car.

The defendant company claimed that the ticket was a contractual document and that it incorporated a condition exempting them, *inter alia*, from liability for injury to the customer occurring when the customer's motor vehicle was in the car park.

Exercise: Engage

Before reading on, try to answer the following questions in relation to Thornton:

When do you think the contract was formed?

Do you think the condition exempting the defendant from liability was incorporated into the contract?

Lord Denning's judgment includes the following:

We have been referred to the ticket cases [...] These cases were based on the theory that the customer, on being handed the ticket, could refuse it and decline to enter into a contract on those terms. He could ask for his money back. That theory was, of course, a fiction. No customer in a thousand ever read the conditions. If he had stopped to do so, he would have missed the train or the boat. None of those cases has any application to a ticket which is issued by an automatic machine. The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. He may protest to the machine, even swear at it. But it will remain unmoved. He is committed beyond recall. He was committed at the very moment when he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive the money. The acceptance takes place when the customer puts his money into the slot. The terms of the offer are contained in the notice placed on or near the machine stating what is offered for the money. The customer is bound by those terms as long as they are sufficiently brought to his notice before-hand, but not otherwise. He is not bound by the terms printed on the ticket if they differ from the notice, because the ticket comes too late. The contract has already been made.

Accordingly, the contract had been formed before the machine produced the ticket, and the conditions referred to on the ticket (or later) were not incorporated into the contract.

3.2.2 Contractual effect

Finally, terms will only be incorporated by notice if the document giving notice was intended to have ‘contractual effect’ (there is an analogy here with the law in relation to signed documents outlined above).

In *Chapleton v Barry UDC* [1940] 1 KB 532, the claimant hired a deck chair. Having paid for the hire, he was given a ‘ticket’. On the back of the ticket there were additional terms and conditions. These were held not to be binding, because the ticket was not intended to have contractual effect –an observer would have understood it to be only a receipt.

3.3 Incorporation by a course of dealing

It is often the case that the contract in question is one of a number of contracts entered into by the parties. They may have dealt with each other on many occasions over a period of years. Where a clause has been brought to the notice of the other party during previous dealings, it may be implied into the current transaction to give effect to the presumed intentions of the parties, even though it has on this particular occasion been omitted. In order for this rule to operate, it must be shown that the course of dealing has been consistent over a period of time. In *McCutcheon v David MacBrayne* [1964] 1 WLR 125 an attempt to incorporate by a course of dealing was unsuccessful because the written terms relied upon had not been consistently incorporated in the past – sometimes a signature in relation to those terms had been required, sometimes it had not.

As well as being consistent, a course of dealing must also have been regular. Incorporation by a course of dealing will not be established if the parties have contracted with each other on only a few occasions over a number of years. In *Hollier v Rambler Motors (AMC) Ltd* [1972] 2 QB 71 three or four transactions over a period of five years was held to be insufficiently regular to establish a course of dealing. Contrast this with *Henry Kendall & Sons v William Lillico & Sons Ltd* [1969] 2 AC 31 and *Petrotrade Inc v Texaco Ltd* [1999] 12 WLUK 745 where three or four times per month and five instances over 13 months respectively appeared sufficiently regular.

3.4 Other ways of agreeing express terms

We have set out above how terms can be incorporated by notice or by a course of dealing, or how they might be contained in a written contract. We have addressed these possibilities because they give rise to interesting legal issues. However, the terms of a contract can be arrived in many other ways, provided that the parties adequately express an intention to be bound by those terms. Obvious and common examples include the agreement of terms in a conversation or verbal exchange (such terms often being quite simple), or terms being set out in writing (for an example in an email) and the other party agreeing to those (for example, by expressing agreement in reply by email).

3.5 Incorporation and exemption clauses

It is frequently the case that a party seeks to limit or exclude liability for its own breach by terms incorporated by reference or by a course of dealing. Such ‘exemption clauses’ are often ‘onerous’ in the sense that they can leave one party with a dramatically reduced remedy than would otherwise be the case, in the event of breach. Much of the case law about incorporation and about giving ‘reasonable notice’ of clauses was created in the context of exemption clauses. If you are studying, or interested in, exemption clauses specifically, you should study the case law relating to exemption clauses carefully.

3.6 Entire agreement clauses

We have already explored the challenges of:

- Distinguishing representations from terms of the contract.
- Identifying whether there are binding oral terms alongside the written terms.

These challenges can cause uncertainty and confusion for the parties to the contract. The parties might seek to reduce this uncertainty and confusion by including in a written contract an ‘entire agreement’ clause. In its simplest form, such a clause provides that a particular document or set of documents constitutes the entire agreement between the parties. This is an example:

Possible boilerplate clause – ‘entire agreement’ clause

The parties agree that this agreement constitutes the entire agreement between them and supersedes any previous understandings and/or arrangements between them, whether oral or written.

The courts will uphold such clauses where they are indeed an attempt to avoid any misunderstanding about the scope of the parties’ agreement. Such a clause might therefore be effective in avoiding confusion about whether any oral terms or preceding written statements form part of the contract.

Note. It is unlikely that such a clause would be effective to exclude liability for misrepresentation. Misrepresentation, and clauses excluding liability for it, are not explored in this chapter.

3.7 Summary

- The terms that a party intends to be bound by will be the terms of the contract. How the ‘intention to be bound’ is demonstrated varies in different circumstances.
- Signing a written contract almost always shows an intention to be bound.
- Terms can be incorporated by notice, but ‘reasonable steps’ need to be taken to bring those terms to a party’s attention, and notice of the terms must be given before or at the time of contracting.
- Terms can be incorporated by a regular and consistent course of dealing.
- Terms can be agreed in many other ways, such as by a conversation or an exchange of emails.
- An ‘entire agreement’ clause in a written agreement helps rule out the possibility of there being representations or terms agreed orally which form part of a contract.

4 Implied terms

4.1 Introduction

There is a general presumption that the parties have expressed, orally or in writing, every material term which they intend should govern their contract. But there are circumstances where terms which have not been expressed by the parties are inferred by the courts. An implied term is binding to the same extent as an express term.

A term may be implied in a contract on the basis of fact or law. A term is implied in fact to give effect to the presumed but unexpressed intentions of the parties. A term is implied in law because the courts or statute require this, regardless of the intention of the parties.

4.2 Terms implied in fact

In order to discover the unexpressed intention of the parties, the courts may take notice of trade customs and the need to give ‘business efficacy’ to a contract.

It must be emphasised that, where the parties have made an unambiguous express provision in their contract, the court will not imply a term to the contrary.

4.2.1 Trade or professional customs

Where a term is implied on the grounds of a custom, the implication is based on the assumption that it was the intention of the parties to be bound by well-known customs of a particular trade (*British Crane Hire v Ipswich Plant* [1975] QB 303).

4.2.2 A course of dealing between the parties

A term may be implied into an agreement on the basis that the parties have dealt with each other on many occasions over a long period of time. A term will only be implied in these circumstances where the dealings of the parties have followed a consistent and regular pattern (see *McCutcheon v MacBrayne* [1964] 1 WLR 125 and *Hollier v Rambler Motors* [1972] 2 QB 71).

4.2.3 Business efficacy

A term may be implied to give ‘business efficacy’ to a contract – ie to make the contract produce its intended objective (*The Moorcock* (1889) 14 PD 64). A term will not be implied merely on the grounds that such an implication will transform the agreement into a business-like arrangement. A term will only be implied on this ground if, without the implied term, the arrangement would be so unworkable that sensible people could not be supposed to have entered into it. Something so obvious that if suggested to the parties, they would respond. ‘Oh, of course’ (*Shirlaw v Southern Foundries* [1939] 2 KB 206 CA).

When implying terms in fact, one must ask what the reasonable person would understand the contract to mean rather than enquiring as to the subjective intentions of the parties.

4.3 Terms implied as a matter of law

Terms implied at common law

Terms can also be implied by the courts at common law in order to give effect to legal duties which arise, as a matter of policy, out of certain common types of contractual relationships, for example in the context of a landlord and tenant relationship (see *Liverpool City Council v Irwin* [1976] 2 WLR 562). These are often referred to as terms implied in law.

4.4 Terms implied by statute

Certain statutes indicate that stipulated terms will be implied into contracts. Statutory implied terms will also operate irrespective of the intention of the parties, unless there is a valid exemption clause. Examples of statutory implied terms are to be found, most notably, in the Sale of Goods Act 1979, the Consumer Rights Act 2015 and the Supply of Goods and Services Act 1982 (as amended).

These acts provide for the implication of certain very important obligations on the seller in contracts for the sale of goods and the supplier in contracts for the supply of goods and services. The detail of these acts is not considered in this section.

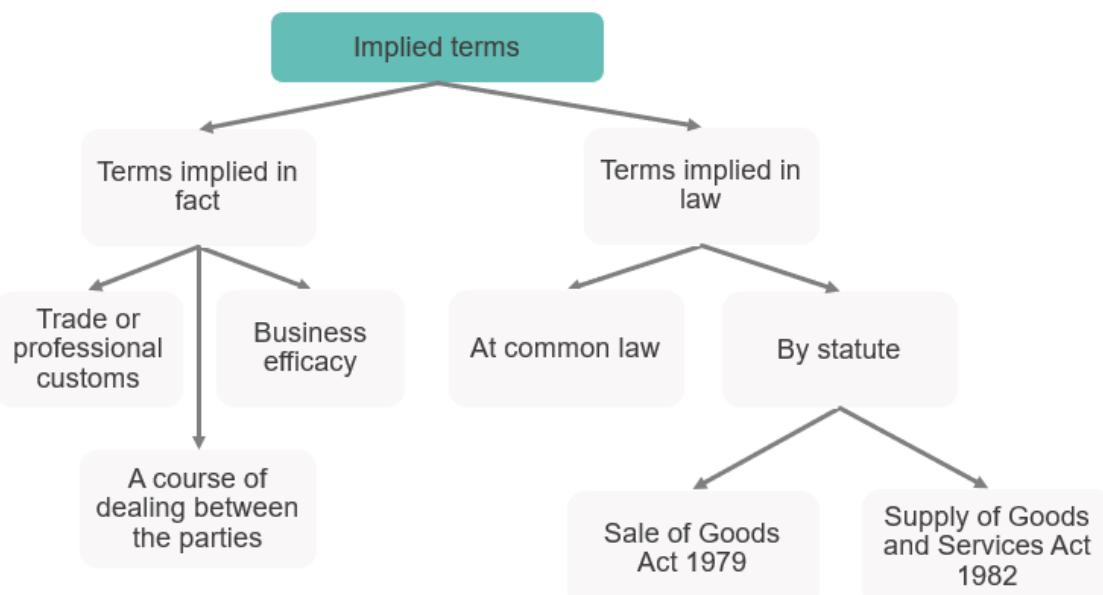


Figure 7.4: Implied terms

4.5 Summary

- Terms can be implied on the basis of fact or law.
- Terms can be implied in fact on the basis of a custom or on the basis of a course of dealing between the parties.

- Terms can also be implied in fact to give ‘business efficacy’ to a contract.
- Terms can be implied at common law, as a matter of policy, in certain types of relationships.
- Terms can be implied at law as a result of statutes which indicate that they will be implied, such as the Sale of Goods Act 1979, the Supply of Goods and Services Act 1982 and the Consumer Rights Act 2015.

5 The Sale of Goods Act 1979

The Sale of Goods Act 1979 (as amended by the Sale and Supply of Goods Act 1994) (SGA) is probably the most important piece of legislation in relation to the sale of goods generally. This section addresses the most important implied terms originating from that legislation, but its scope is considerably broader than the matters addressed in this section.

Important

Implied terms set out in this section do not apply to consumer contracts as defined in the Consumer Rights Act 2015. That Act implies many similar terms into consumer contracts, but the provisions are not precisely the same, and accordingly the two situations must not be confused.

5.1 Implied terms as to title – s 12

Section 12 provides for the implication that the seller has the right to sell the goods.

The term implied by ss 12(1) is categorised as a condition of the contract. The distinction between conditions and warranties and the relevance of that distinction are not detailed in this section.

5.2 Correspondence with description – s 13

Section 13(1) provides:

Where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description

Where goods are described as having certain characteristics and specifications then they must correspond with that description.

The term implied by ss 13(1) is categorised as a condition under s 13(1A).

5.3 Satisfactory quality – s 14(2)

Section 14(2) of the Sale of Goods Act 1979 (as amended) provides:

Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality

According to s 14(2A), the goods are of satisfactory quality if:

they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances

Section 14(2B) provides a checklist of what may be taken into account in assessing whether the goods are of satisfactory quality. These are:

- (a) Fitness for all the purposes for which goods of the kind in question are commonly supplied;
- (b) Appearance and finish;
- (c) Freedom from minor defects;
- (d) Safety; and
- (e) Durability.

If goods have a self-evident purpose, eg a hot-water bottle, this self-evident purpose will clearly be covered by s 14(2B)(a) as a purpose for which the ‘goods of the kind in question are commonly supplied’.

The exceptions to the implied term as to satisfactory quality are to be found in s 14(2C)(a) and (b). Thus, there is no condition as regards defects specifically drawn to the buyer’s attention before

the contract was made, or, if the buyer examines the goods before the contract is made, as regards defects which that examination ought to have revealed.

Breach of s 14(2) is classified as breach of a condition by s 14(6).

5.4 Fitness for a particular purpose – s 14(3)

In addition to satisfactory quality, the goods should also be fit for purpose.

Section 14(3) states where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known to the seller:

any particular purpose for which the goods are being bought, there is an implied term that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller or credit-broker.

The section above makes clear that no implied condition as to fitness for a particular purpose arises where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the seller's skill or judgment.

Breach of s 14(3) is classified as breach of a condition by s 14(6).

5.5 Sale by sample – s 15

Where a sale is by sample, two conditions are implied into the contract by the Sale of Goods Act 1979 by virtue of s 15(2):

- (a) 'that the bulk will correspond with the sample in quality;
- (b) [...]
- (c) that the goods will be free from any defect, making their quality unsatisfactory, which would not be apparent on reasonable examination of the sample.'

Breach of s 15(2) is classified as breach of a condition by s 15(3).

5.6 Modification of remedies for breach of condition - s 15A

Although a breach of ss 13, 14(2), 14(3) and 15 is breach of a condition, this is subject to s 15A.

Section 15A provides that if the breach is so slight that it would be unreasonable for the buyer to reject the goods and repudiate the contract, the breach should be treated as a breach of warranty, which will only entitle the buyer to claim damages.

The burden of proving that the breach is so slight and therefore unreasonable for the buyer to reject the goods falls on the seller.

5.7 Contracting out of the implied terms under the Sale of Goods Act 1979 (as amended)

Section 55 indicates that a seller's liability under ss 12, 13, 14 and 15 of the SGA 1979 can be excluded and/or restricted by agreement of the parties, subject to the Unfair Contract Terms Act 1977 (UCTA).

UCTA does in fact significantly limit the ability to exclude/restrict these terms.

Under s 6(1)(a) of UCTA, the implied undertaking as to title contained in s 12 SGA 1979 cannot be excluded or restricted.

Under s 6(1A) of UCTA, the implied undertakings as to description, quality, fitness for purpose or sample contained in ss 13-15 of the SGA can be excluded/restricted subject to the requirement of reasonableness. The detail of this is not addressed in this chapter.

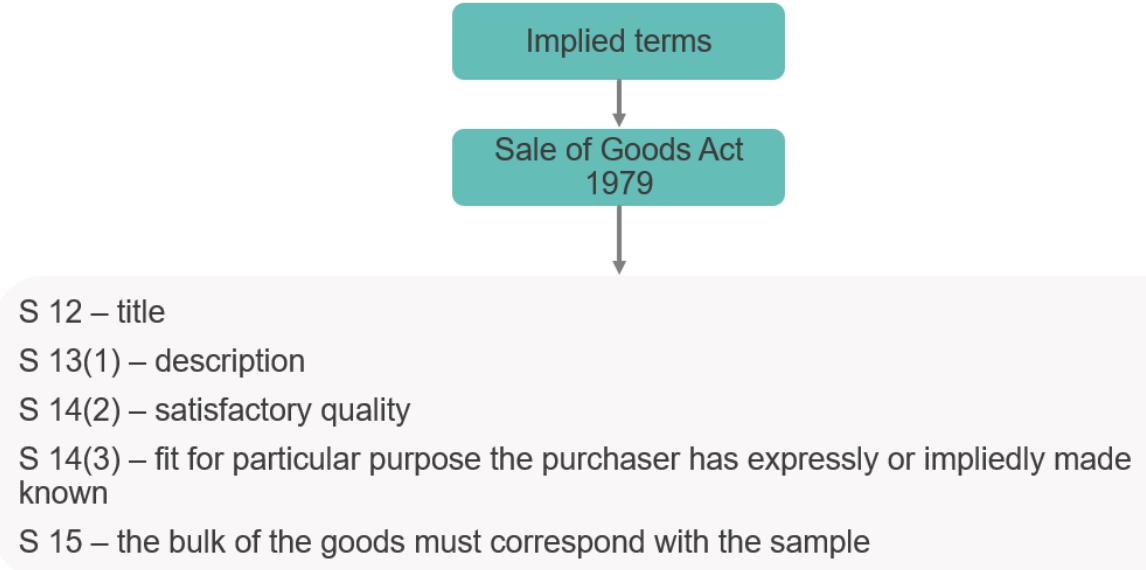


Figure 7.5: Implied terms under the Sale of Goods Act 1979

5.8 Summary

The Sale of Goods Act 1979 implies the following terms into contracts for the sale of goods:

- Broadly, the seller has the right to sell the goods (s 12);
- The goods will comply with their description (s 13);
- The goods will be of satisfactory quality (s 14(2));
- The goods will be suitable for any purpose made known to the seller (s 14(3)); and
- The goods will comply with any sample (s 15).

6 Supply of Goods and Services Act 1982

The Supply of Goods and Services Act 1982 (SGSA) provides for the implication of terms in:

- (a) Certain contracts for the transfer of property in goods;
- (b) Contracts for the hire of goods; and
- (c) Contracts for the supply of services.

The SGSA 1982 also governs the exclusion of such implied terms.

Important

It is important to note that the implied terms set out in this section do not apply to consumer contracts as defined in the Consumer Rights Act 2015.

6.1 Contracts for the transfer of property in goods

For the purposes of the SGSA, pursuant to s 1 a ‘contract for the transfer of goods’ means a contract under which one person transfers or agrees to transfer to another the property in goods (broadly, these are contracts where ownership of the goods changes hands) other than any of the following:

- (a) A contract of sale of goods;
- (b) A hire purchase agreement;
- (c) A contract under which the property in goods is or is to be transferred in exchange for trading stamps;
- (d) A transfer made by deed for which there is no consideration other than presumed consideration; and
- (e) A contract intended to operate by way of security.

In any contract for the transfer of goods, terms will be implied corresponding to those which are implied in the case of contracts for the sale of goods. They are implied terms regarding title (s 2), implied terms where transfer is by description (s 3), implied terms about quality or fitness (s 4) and implied terms where transfer is by sample (s 5). Those terms are not addressed in detail in this here.

6.2 Contracts for the hire of goods

For the purposes of the SGSA, pursuant to s 6 a ‘contract for the hire of goods’ means a contract under which one person bails or agrees to bail goods to another by way of hire (broadly, this means contracts where party A owns the goods but party B voluntarily has possession of the goods – this is what happens in a common hire arrangement) other than any of the following:

- (a) A hire purchase agreement; and
- (b) A contract under which goods are bailed in exchange for trading stamps.

In any contract for the hire of goods, terms will be implied corresponding to those which are implied in the case of contracts for the sale of goods (as amended). They are: implied terms about the right to transfer possession (s 7 – this is equivalent to the implied term concerning title in a sale of goods contract), implied terms where hire is by description (s 8), implied terms about quality or fitness (s 9) and implied terms where hire is by sample (s 10).

6.3 Contracts for the supply of services

The SGSA 1982 provides for the following implied terms in any contract for the supply of a service:

- (a) Care and skill: where the supplier is acting in the course of a business there is an implied term that the supplier will carry out the service with a reasonable care and skill: s 13.
- (b) Time of performance: where the supplier is acting in the course of a business and the time for the service to be carried out is not fixed by the contract, left to be fixed in a manner agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the supplier will carry out the service within a reasonable time: s 14.
- (c) Consideration: where the consideration for the service is not determined by the contract, left to be determined in a manner to be agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the party contracting with the supplier will pay a reasonable charge: s 15.

What is a reasonable charge and a reasonable time is a question of fact and will depend on the particular circumstances.

6.4 Contracting out of terms implied under the SGSA

In the case of contracts for transfer of goods or the hire of goods, under s 11 a supplier may negative or vary the terms set out in this section, subject to the provisions of the Unfair Contract Terms Act 1977 (UCTA).

Similarly, in the case of contracts for the supply of services, under s 16 a party may contract out of the implied terms set out in this section, subject to the provisions of UCTA.

UCTA does in fact significantly limit the ability to negative/vary these terms. The detail of this is not addressed in this here.

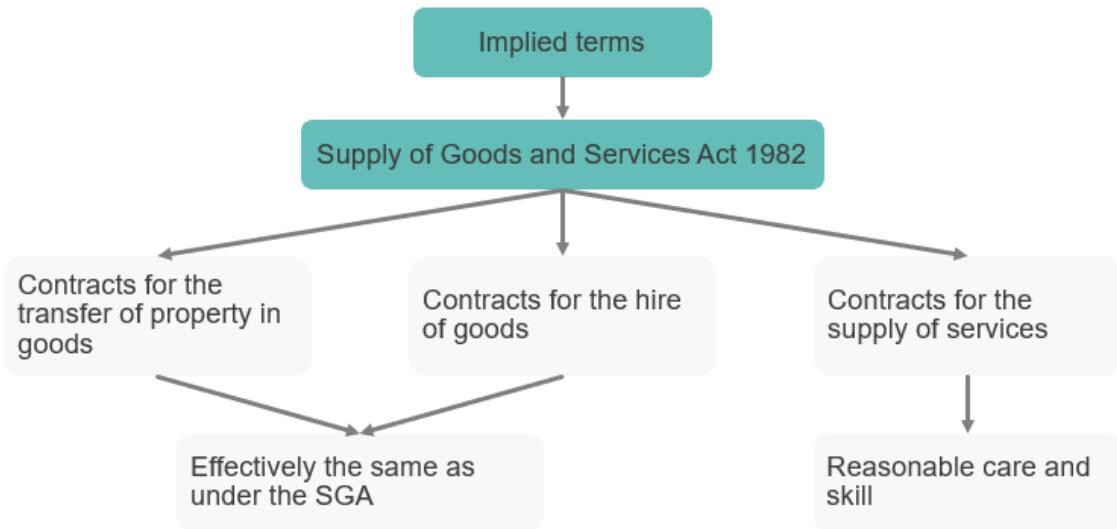


Figure 7.6: Implied terms under the Supply of Goods and Services Act 1982

6.5 Summary

- The Supply of Goods and Services Act 1982 implies the following term into contracts for the supply of services:
 - Services will be carried out with reasonable care and skill (s 13).

7 The Consumer Rights Act 2015

The Consumer Rights Act 2015 comprises three Parts.

Part I deals with consumer contracts for goods, digital content, and services.

Part II regulates unfair terms (in consumer contracts).

Part III is of a miscellaneous and general nature.

We will analyse sections of Part I, which is of particular significance to contract law. Part I provides a bespoke scheme of regulation for each of three classes of consumer contracts that are covered – contracts for goods, contracts for digital content, and contracts for services.



Figure 7.7: The Consumer Rights Act 2015

Exercise: Read alongside

Access the Consumer Rights Act 2015. Read the relevant sections in the Act as they are referred to below.

Part I of the Act applies to contracts to supply goods, digital content or services between a **trader** and a **consumer**.

A ‘consumer’ is defined as ‘an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession’.

A ‘trader’ is defined as ‘a person acting for purposes relating to that person’s trade, business, craft or profession, whether acting personally or through another person acting in the trader’s name or on the trader’s behalf’. Section 2(4) provides that, where a trader claims that an individual was

not acting for purposes wholly or mainly outside the individual's trade, business, craft or profession, then it is for the trader to prove it.

Note. Contracts between a consumer and a business entered into prior to 1 October 2015 are governed by the Sale of Goods Act 1979 or the Supply of Goods and Services Act 1982 and the Unfair Contract Terms Act 1977.

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.8: Contracts for goods

The cornerstone rights implied in a consumer sale of goods are that:

- (a) Goods should be of a satisfactory quality (s 9);
- (b) Goods should be reasonably fit for any purpose which the consumer makes known to the trader that the consumer intends to use the goods for (s 10); and
- (c) Where goods are sold by description the goods should match that description (s 11).

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.9: Contracts for digital content

Where a consumer contracts for digital content—for example, for an e-book, a game or a music download—which rights does the Act specify to be included? In line with the provisions for consumer goods, the implied terms are that the digital content:

- (a) Should be of satisfactory quality (s 34);
- (b) Should be reasonably fit for purpose (s 35); and
- (c) Should match any description of it given by the trader to the consumer (s 36).

According to s 34(2), the 'quality of digital content is satisfactory if it meets the standard that a reasonable person would consider satisfactory'. Such a reasonable person would take account of matters of description and price together with 'all other relevant circumstances' (s 34(2)(c)), such circumstances including 'any public statement about the specific characteristics of the digital content made by the trader, the producer or any representative of the trader or producer' (s 34(5)).

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.10: Contracts for services

What are the statutory rights of a consumer under a services contract? Most importantly, the consumer has a right:

- (a) That the service is performed with reasonable care and skill (s 49);
- (b) That (where a price has not been agreed) a reasonable price is to be paid (s 51); and
- (c) That (where a time has not been fixed) the service is provided in a reasonable time (s 52).

In addition, s 50(1) also provides that anything that is said or written to the consumer, by or on behalf of the trader, about the trader or the service is to be included as a term where it is taken into account by the consumer:

- (a) When deciding to enter into the contract; or
- (b) When making any decision about the service after entering into the contract.

7.1 Additional remedies under the Consumer Rights Act 2015

Not only does the Consumer Rights Act 2015 imply terms as set out earlier in this section, it also specifies remedies for consumers when those terms are breached. Unless otherwise stated, these remedies sit alongside the remedies which would be available to the consumer under the general law. Remedies under contract law generally are not considered in this chapter, but it makes sense to consider the remedies under the Consumer Rights Act 2015 at this stage.

Again, we will consider the 3 types of contact in turn.

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.11: Contracts for goods

The Consumer Rights Act 2015 provides that where goods sold to a consumer fail to meet any of the requirements in s 9 (satisfactory quality), s 10 (reasonably fit for their particular purpose) or s 11 (correspondence with description) then the goods are regarded as non-conforming. Where the goods are non-conforming, there are three remedial options available to the consumer, namely:

- (a) The short term right to reject;
- (b) The right to repair or replacement;
- (c) The right to a price reduction or the final right to reject.

Broadly speaking, the short term right to reject is available to the consumer for 30 days running from the time (i) that ownership has passed (or, in the case of contracts for hire or the like, possession has been transferred) and (ii) the goods have been delivered and (iii) in cases where the trader is required to install the goods or to take other action to enable the consumer to use the goods, the trader has notified the consumer that the required steps have been taken (s 22).

The right to repair or replacement is available unless repair or replacement is either impossible or disproportionate (in the sense that it imposes an unreasonable cost on the trader relative to the other remedies and the interests of the consumer) (s 23).

The consumer is not entitled to both a price reduction and final rejection; and, in either case, the remedy may only be exercised where: (a) after one repair or one replacement, the goods do not conform to the contract; or (b) the consumer can require neither repair nor replacement of the goods (because it is impossible or disproportionate); or (c) the consumer has required the trader to repair or replace the goods, but the trader is in breach of the requirement to do so within a reasonable time and without significant inconvenience to the consumer (s 24).

It should also be noted that s 24(10) provides that the general rule is that, where the final right to reject is exercised within 6 months (the clock running—as with the short term right to reject—from the time that ownership has passed, and so on), there should be a full refund with no deduction for use—but this does not apply to motor vehicles or any other goods that may be specified by statutory order.

Finally in relation to contracts for goods, it is worth noting that consumers cannot treat the contract as at an end as a result of a breach of a term implied by ss 9, 10 or 11, save to the extent set out in the Act (summarised above). So in one sense, the implied terms are neither conditions or warranties – the extent to which breach gives rise to a right to treat the contract as at an end is set out in the Act.

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.12: Contracts for digital content

Section 42 provides that, where the digital content is non-conforming in breach of the terms implied by ss 34 (satisfactory quality), 35 (fitness for purpose) and/or 36 (matching description), there are two remedial options available to the consumer, namely:

- The right to repair or replacement; and
- The right to price reduction.

In relation to these remedies, s 42(9) provides that ‘digital content which does not conform to the contract at any time within the period of six months beginning with the day on which it was supplied must be taken not to have conformed to the contract when it was supplied.’

Section 43 elaborates and qualifies the right to repair or replacement in the way that we have seen already in relation to contracts for goods. In particular, s 43(2)(a) requires the trader to repair or replace the digital content ‘within a reasonable time and without significant inconvenience to the consumer’; s 43(3) precludes the consumer from requiring repair or replacement where this would be impossible or disproportionate; and s 43(5) identifies the nature of the digital content together with the purpose for which the digital content was obtained or accessed as material to judging ‘what is a reasonable time or significant inconvenience’.

Similarly, s 44 qualifies the right to price reduction, this right being exercisable only where the consumer either cannot require repair or replacement (because this is impossible or it would be disproportionate) or where the trader has failed to repair or replace the digital content within a reasonable time and without significant inconvenience to the consumer.

Section 45 gives the consumer the right to receive a refund of all money paid for the digital content. A refund must be given within 14 days. The trader must give a refund using the same payment method that the consumer used to pay for the digital content, without imposing any fee in respect of the refund.

Like the provisions in relation to goods, it is not open to a consumer to treat a contract as at an end as a result of a breach of these implied terms.

What is the legal position if non-compliant digital content causes damage to a device or to other content? According to section 46, where (a) a trader supplies digital content to a consumer under a contract, (b) the digital content causes damage to a device or to other digital content, (c) the device or digital content that is damaged belongs to the consumer, and (d) the damage is of a kind that would not have occurred if the trader had exercised reasonable care and skill, then the consumer is entitled to repair or to a compensatory payment.

Contracts for goods

Contracts for digital content

Contracts for services

Figure 7.13: Contracts for services

Section 54 provides that, where the services are non-conforming in breach of the term implied by ss 49 (reasonable care and skill), there are two remedial options available to the consumer, namely:

- (a) The right to require repeat performance; and
- (b) The right to a price reduction.

The right to require repeat performance is elaborated and qualified in ways that are analogous to the parallel provisions in relation to goods and digital content. In particular, s 55(2)(a) requires the supplier to provide the repeat performance within a reasonable time and without significant inconvenience to the consumer (s 55(4) offering the usual guidance on what, for this purpose, is reasonable and significant), and s 55(3) states that the consumer cannot require repeat performance if completion in conformity with the contract is impossible.

According to s 56(3), a price reduction becomes available only where repeat performance is impossible or where the trader has failed to provide repeat performance within a reasonable time and without significant inconvenience to the consumer.

Where the services are non-conforming in breach of the term implied by ss 52 (performance within a reasonable time) the remedial option is the right to a price reduction.



Example

A consumer buys a kettle from a trader. On day two the kettle will not switch on. What is the consumer's legal position under the Act? Clearly, the kettle is non-compliant relative to the requirements in s 9 (satisfactory quality) or s 10 (fitness for particular purpose) or both. In principle, the consumer may (within 30 days) reject the kettle and get a full refund, or accept a replacement or insist on repair. The consumer is likely to be happy with either an exchange or a refund.

Suppose, however, that the consumer does not use the kettle at once (it has been bought as a spare) and the problem only comes to light when the consumer first uses the kettle, this being at a time when the short-term right to reject is no longer available. In this scenario, the consumer's rights are more constrained. The consumer must first give the trader the opportunity to repair or replace the kettle. Provided that the consumer is happy with this, there is no problem. However, if what the consumer wants is a price reduction or rejection, this will not be available until the trader has had an opportunity to repair or replace the kettle.

What if the goods are more complex than a kettle? What would the consumer's remedies look like if the goods were a laptop? Suppose, for example, that a consumer is convinced that a laptop is faulty but the particular problem is intermittent. Each time that the laptop goes back for repair, the supplier reports either that no fault has been detected or that the fault has been fixed—but, then, the consumer soon finds that the problem recurs. Or, again, suppose that the supplier/repairer reports that the problem has been fixed but will not tell the consumer what the fault actually was. Does such a consumer, who no longer has any confidence in the reliability or durability of the laptop, have the right to reject the goods?

These more complex cases are resolved by reference to standards of reasonableness, proportionality and other equally imprecise concepts. For example, s 23(2)(a) requires the trader to repair or replace the goods 'within a reasonable time and without significant inconvenience to the consumer'. If the goods under repair are the consumer's only laptop, what would be a reasonable time for undertaking the repairs and at what point would the inconvenience to the consumer be significant? According to s 23(5) these questions of reasonableness and significance are to be determined by taking into account '(a) the nature of the goods; and (b) the purpose for which the goods were acquired'. In the laptop case, before we can determine what is reasonable or significant, we need to know more about the particular context.

7.2 Summary

- The CRA 2015 implies the following terms into contracts between traders and consumers:
 - Contracts for goods: goods will be of satisfactory quality, fit for any particular purpose made known to the trader, and will comply with their description.
 - Contracts for digital content: the content will be of satisfactory quality, fit for any particular purpose made known to the trader, and will comply with its description.
 - Contracts for services: the services will be performed with reasonable care and skill, provided in a reasonable time, and (where price has not been agreed) a reasonable price will be paid.
- The CRA 2015 sets out various remedies which are available when these terms are breached. These remedies sit alongside normal contractual remedies, but a consumer cannot treat a contract as at an end as a result of a breach of these terms other than in the manner specifically provided for in the Act.

8 Conditions and warranties

8.1 Introduction

The terms of a contract (whether express or implied) can be classified as conditions, warranties or innominate terms. We will begin by considering the distinction between conditions and warranties before considering the law in relation to innominate terms.

8.2 The significance of the distinction between conditions and warranties

The question of whether a term is a condition or a warranty becomes significant in the event of breach of contract. As a general principle, if a party breaches a condition, the innocent party has a right to treat the contract as repudiated ie they can terminate the contract, put an end to it with the effect that both parties are released from all future obligations under the contract. The innocent party may also sue for damages immediately. If it does not exercise the right to elect to treat the contract as at an end, and instead chooses to affirm the contract, the contract remains in full force and effect, meaning that all parties will remain bound to perform their obligations under the contract, but the innocent party can still sue for damages with respect to the other party's breach. In such instance, the innocent party waives the right to repudiate.

In contrast, if a party is in breach of a warranty, the only remedy available to the innocent party is to sue for damages ie there is no right to treat the contract as repudiated.

8.3 How to distinguish conditions and warranties

According to the traditional approach, the distinction between a condition and a warranty is that a condition is an important term 'going to the root of the contract' (*Poussard v Spiers* (1876) 1 QBD 410). A warranty is a less important term not going to the root of the contract.

The crucial question is, whether the parties intended, at the time of contracting, that any breach of the relevant term could result in the innocent party terminating (see *Poussard v Spiers* again). Only if the answer to this question is clearly 'yes' should the term be categorized as a condition from the outset.

8.4 Innominiate terms

The traditional distinction between conditions and warranties is no longer regarded as exhaustive. In *Hong Kong Fir Shipping Co v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, the Court of Appeal held that there are many terms which, at the outset, are neither conditions nor warranties but are of an 'innominate' or intermediate nature. The term in question in *Hong Kong Fir* was that the ship being hired was, 'in every way fitted for ordinary cargo service'. This is a clause that could be breached in a variety of ways, ranging from the minor to significant. Rather than classify such terms at the outset the court advocated looking at the consequences of breach and asking:

Does the breach deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract?

If the answer to this question is 'yes' then the term will be treated as a condition and the innocent party is entitled to treat the contract as repudiated and claim damages. If the answer is 'no' the innocent party is entitled to claim damages only.

This is quite different from the traditional approach based on the intention of the parties at the time they made their contract which distinguishes between minor terms (warranties) and important terms (conditions). Admittedly, this analysis may promote justice as between the parties, but such justice is achieved at the cost of certainty, in particular certainty as to whether the innocent party has the right to terminate the contract as a result of the breach.

Taking all this into account, when considering the classification of terms, the starting position should be to consider whether the term in question has been classified as a condition or a warranty by: i) statute; ii) the parties or iii) previous judicial decision(s). If that does not provide an answer, then the court will need to look at the contract, the subject matter and the surrounding facts to determine whether the parties intended for any breach of the term to entitle the innocent party to terminate the contract (this is where the 'root of the contract' test may be relevant). If the court cannot determine the parties' intention, or determines that their intention was that not every breach would lead to the right to terminate, then the court is likely to decide that the term is innominate, and apply the test from *Hong Kong Fir*.

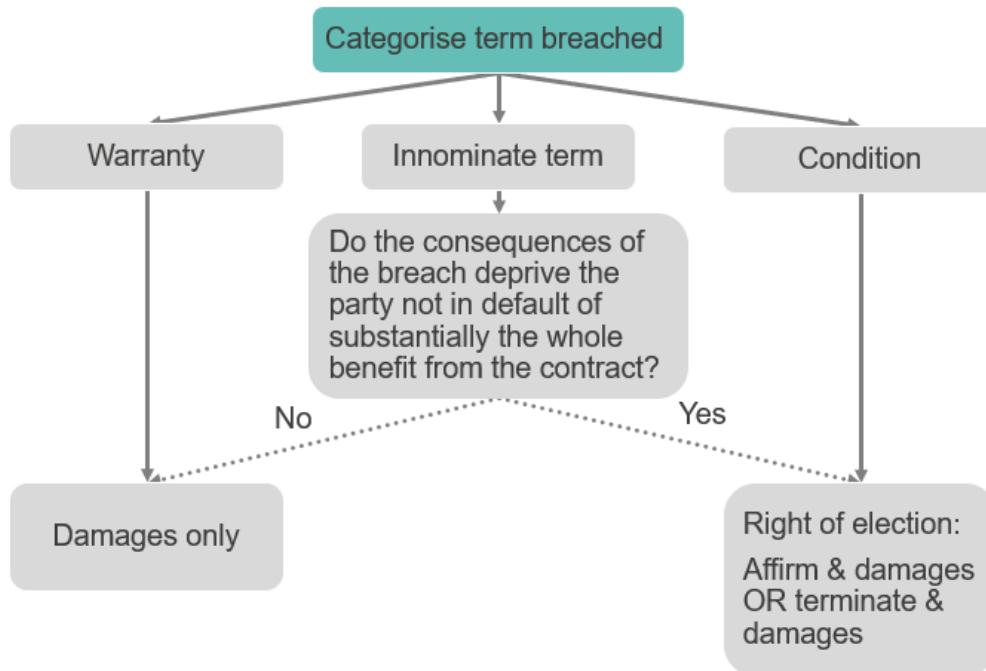


Figure 7.14: Categories of term



Condition: An important term going to the root of the contract.

Warranty: A less important term not going to the root of the contract.

Innominate term: A term which at the outset is neither a condition or warranty but is of an intermediate nature.

Turning to the issue of classification of statutory implied terms, key terms implied by statute are classified as follows:

Statute	Conditions (breach gives rise to right to reject and claim refund)	Innominate Terms
Sale of Goods Act 1979	ss 12-15	
Supply of Goods and Services Act 1982		s 13

Importantly, however, the remedy for breach of the terms implied by ss 13-15 SGA has been altered as a result of s 15A. Section 15A does not apply to s 12(1) SGA, the implied condition as to title. Section 15A provides that if the breach is so slight that it is unreasonable for the buyer to repudiate the contract and reject the goods, the breach should only be treated as a breach of warranty. In such instance, the buyer will only be entitled to claim damages. The effect is that breach of these implied terms is not to be treated automatically as a breach of condition but may, at the court's discretion, be treated as a breach of warranty and accordingly the only remedy available will be to claim damages.

In relation to the Consumer Rights Act 2015, a different approach is taken. When it comes to the terms implied in contracts for the supply of goods by s 9 (satisfactory quality) s 10 (reasonably fit for their particular purpose) or s 11 (correspondence with description) the Consumer Rights Act 2015 specifically provides rights to reject goods, but only in certain circumstances: in this way, the classification of these terms is not really of central importance. The detail of this is not addressed in this section.



A note on terminology

A party that has committed a breach of a **condition** is said to have committed a **repudiatory breach**. The innocent party can then elect to ‘**treat the contract as repudiated**’. Another way of phrasing this is that the innocent party can elect to ‘**accept the repudiatory breach**’ (which has been committed by the defaulting party) and to treat the contract as at an end. Alternatively, one can simply say that the innocent party can terminate the contract (because the defaulting party has committed a repudiatory breach).

Repudiatory breach: A party that has committed a breach of condition is said to have committed a **repudiatory breach**. Generally, the innocent party has a right to treat the contract as repudiated ie they can terminate the contract.

8.5 Time for performance or completion

One area where the law on conditions and warranties has developed in a particular way is in relation to contractual terms setting out the time performance or completion of the contract.

Time is of greater or lesser importance to the parties in most kinds of contract. It is quite usual for the contracting parties to stipulate for a date for delivery for the sale of goods. Failure to comply with such a stipulation is, obviously, a breach of contract, but whether it is a breach of a condition or a warranty will depend on the intention of the parties. This intention will be assessed by reference to the express terms of the contract and, where appropriate, by implication, depending on the nature and circumstances of the contract.

Where a requirement as to timing is essential to the contract, for instance in mercantile contracts, the expression used is that ‘time is of the essence’. If time is of the essence, lateness will amount to a repudiatory breach entitling the other party to terminate the contract.

Where time is not of the essence, it can usually become so, by the innocent party serving a notice on the defaulting party which states time is of the essence. Such a notice must state completion date, which must be reasonable.

8.6 Summary

- The terms of a contract (whether express or implied) can be classified as conditions, warranties or innominate terms.
- If a party breaches a condition, the innocent party has a right to treat the contract as repudiated ie they can terminate the contract
- If a party is in breach of a warranty, the only remedy available to the innocent party is to sue for damages
- The distinction between a condition and a warranty is that a condition is an important term ‘going to the root of the contract’.
- Some terms, at the outset, are neither conditions nor warranties but are of an ‘innominate’ nature. A breach of such a term, if it has a minor effect, will allow the innocent party to claim damages only. A breach with more serious consequences will allow the innocent party to treat the contract as repudiated and claim damages.
- Where terms are implied by statute, the statute will normally specify whether they are conditions or warranties (in some cases the statute will also state or modify the remedy available upon breach of such a term).



8

Exemption clauses

1 Introduction

An exemption clause is a contractual term that purports to limit or exclude a liability that would otherwise attach to one of the contracting parties. The obligations affected by an exemption clause may be contractual, tortious, or both.



Exemption clause: A contractual term that purports to limit or exclude a liability that would otherwise attach to one of the contracting parties.

Where commercial parties are negotiating a contract it is more common for a party to limit its liability, rather than exclude it. A limitation of liability clause will typically cap liability in relation to particular events at a particular sum. For example, in a contract for the installation of a computer system, the supplier might want to limit its liability for any damage caused to the purchaser's property as a result of its negligence during the installation process to the sum of £300,000 (meaning the purchaser cannot claim any losses beyond £300,000 in relation to such damage from such negligence). Nevertheless, there might be certain kinds of loss or damage (such as loss of profits or damage caused by a computer virus) for which the supplier might seek to exclude its liability altogether. The extent of these limitations and/or exclusions will often form an important part of the negotiations in a commercial transaction.

You will sometimes encounter the expression 'exclusion clause'. This suggests the type of exemption clause which excludes (rather than only limits) liability, although sometimes the expression is used in the same way as we will use the expression 'exemption clause' – to refer to clauses which limit or exclude liability.

When you are considering whether a party can rely on an exemption clause, you need to consider the following three points:

Incorporation

Is the exemption clause part of the contract? This depends on the ordinary principles governing the incorporation of terms, and these are not considered in this topic. However, it is worth noting that much of the case law about incorporation and about giving 'reasonable notice' of clauses was created in the context of exemption clauses.

Construction

Does the clause, as drafted, cover the alleged breach(es) and resulting loss?

Statutory controls

What is the effect on the clause of the Unfair Contract Terms Act 1977 and the Consumer Rights Act 2015?

Figure 8.1: Controls on exemption clauses

2 Construction of exemption clauses

2.1 Introduction

When you are considering whether a party can rely on an exemption clause, you need to consider the three points set out in the ‘controls on exemption clauses’ diagram above:

- (a) Incorporation;
- (b) Construction; and
- (c) Statutory controls.

So, if the clause has been incorporated into the contract, then the second part of the analysis comes into play: the construction of the clause. That is the focus of this section.

Exemption clauses can be drafted in a variety of ways. They will generally have two or more of the following elements:

- (a) **A statement of whether liability is entirely excluded or only limited to a stated amount.**
- (b) A statement of which types of claim/duties the exemption relates to.
- (c) A statement of which types of loss the exemption relates to.

The formatting (ie **bold**, *italics* or underlined) in the following examples indicates the elements listed above (not all of which are present in all the examples). You might disagree with the way we have analysed these clauses – there are other ways it could be done. The important thing is to consider all three aspects when looking at the overall effect of a clause.

- (a) Any express or implied condition, statement, or warranty, statutory or otherwise not stated herein is hereby **excluded**.
- (b) We will **not be liable** for any personal injuries to the riders of the machines hired.
- (c) The relevant clauses stated that the defendant's liability for pollution and contamination would be **limited to £5 million in the aggregate**. The exclusion stated that:
- (d) Liability for any claim in relation to asbestos is **excluded**.
- (e) **All liability** for loss or damage arising to property or goods directly or indirectly resulting from negligence or malfunction of the systems or components is **excluded**.

2.2 Contra proferentem

The general rule is that exemption clauses will be construed contra proferentem. This means that if there is any doubt as to the meaning and scope of the exemption clause, the ambiguity will be resolved against the party (the ‘proferens’) seeking to rely upon it. Clear words must be used if they are to excuse one party from its liability. It should be noted that the courts apply the contra proferentem rule with less rigour where the clause in question merely limits (rather than excludes) liability: *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co* [1983] 1 WLR 964.

Exercise: Engage

A driver has taken out a car insurance policy. The insurer has drafted the wording of the policy, including a clause which excludes liability ‘for damage caused or arising whilst the car is conveying any load in excess of that for which it was made’.

Make a note of the possible meanings of this clause. Consider and make a note of which meaning(s) would be preferred when the clause is construed contra proferentem. Then continue reading to consider the case of *Houghton v Trafalgar Insurance* [1954] 1 QB 247 in which a clause such as this was considered.

In *Houghton v Trafalgar Insurance* [1954] 1 QB 247 a car carrying six passengers was involved in an accident. The car was designed to hold a maximum of five passengers. The defendant insurance company sought to rely on the clause within the insurance contract which excluded liability, ‘for damage caused or arising whilst the car is conveying any load in excess of that for which it was constructed’. The question for the court was whether ‘load’ could refer to passengers. Lord Somervell concluded that it did not:

I think that it would need the plainest possible words if it were desired to exclude the insurance cover by reason of the fact that there was at the back one passenger more than the seating accommodation.

The ambiguous clause was construed against the proferens. The claimant in this case was a consumer. The court is less likely to read a clause *contra-proferentum* in a contract between commercial parties of equal bargaining power. In *Victoria Street v House of Fraser [2011] EWCA Civ 904* the court stated:

The words used, commercial sense, and the documentary and factual context are, and should be, normally enough to determine the meaning of a contractual provision.

The *contra-proferentum* rule should therefore be applied with sensitivity to the particular circumstances of the case.

2.2.1 Exemption clauses and negligence

Clear words must be used if a party is seeking to exclude liability resulting from its own negligence. The requirement is most obviously met where the word ‘negligence’ itself is used and, in practice, most drafters will avoid ambiguity by using the word negligence.

The requirement may be satisfied if the words do not expressly refer to negligence but are nevertheless wide enough to extend to negligence (eg ‘all liability howsoever caused’). However, if general words are used their effectiveness may depend on the following distinction:

- (a) Cases where the only basis for liability is negligence
- (b) Cases where the party will be liable irrespective of negligence

Traditionally, a clause falling in the first category would be effective to cover negligence and the second would not. The requirements referred to above are sometimes called the ‘Canada Steamship rules’ after the case *Canada Steamship Lines v R [1952] AC 192*. The decision in *Persimmon Homes Ltd v Ove Arup & Partners Ltd [2017] EWCA Civ 373* has cast doubt on the extent to which the Canada Steamship rules apply to commercial contracts. In recent years, the courts have favoured a more commercial, and less mechanistic, approach to interpreting exemption clauses and to the application of the Canada Steamship rules. Lord Justice Jackson commented in *Persimmon Homes* that the *contra-proferentum* rule now has a very limited role in relation to commercial contracts negotiated between parties of equal bargaining power.

2.3 Third parties and exemption clauses

Even if the excluding or limiting term is incorporated into the contract and sufficiently clear and unambiguous, the question may still arise as to whether the clause can operate to protect a person who is not party to the contract.

The doctrine of privity of contract establishes that, at common law, a party outside the contract **cannot** benefit from its terms. Nor can that party have an obligation imposed upon it by the contract. The doctrine applies to an exemption clause in just the same way it would to any other kind of clause.

The effect of this common law rule has been reduced, in certain circumstances, by the Contracts (Rights of Third Parties) Act 1999.

The doctrine of privity and the Contracts (Rights of Third Parties) Act 1999 are not covered in this chapter.

2.4 Summary

- Generally, if there is any doubt as to the meaning and scope of an exemption clause, the ambiguity will be resolved against the party (known as the ‘proferens’) seeking to rely upon it.
- The court is less likely to read a clause *contra-proferentum* in a contract between commercial parties of equal bargaining power.
- Clear words must be used if a party is seeking to exclude liability resulting from its own negligence. The requirement is most obviously met where the word ‘negligence’ itself is used.

3 Unfair Contract Terms Act 1977

3.1 Introduction

If the clause has been incorporated into the contract and, properly construed, excludes/limits the liability being considered, then you must move on to consider:

- (a) In the case of contracts between businesses, the Unfair Contract Terms Act 1977 (UCTA); and
- (b) In the case of contracts between a business and a consumer, the Consumer Rights Act 2015 (CRA).

This section considers UCTA. The CRA is not considered in this section.

When you are considering whether a party can rely on an exemption clause, you need to consider the following three points:

- (a) incorporation
- (b) construction and
- (c) statutory controls (see ‘controls on exemption clauses’ diagram above)

3.2 Purpose of UCTA

The preamble to UCTA clearly sets out its purpose:

An Act to impose further limits on the extent to which [...] liability for breach of contract, of for negligence or other breach of duty, can be avoided by means of contract terms and otherwise

This purpose is achieved by provisions that ensure:

- (a) Certain types of exemption clause have no effect; and
- (b) Other types of exemption clause are effective only so far as they satisfy the requirements of reasonableness.

Exercise: Read alongside

Access the Unfair Contract Terms Act 1977 and read alongside the sections of the Act referred to below.

3.3 Scope of UCTA

There are three matters fundamental to the scope of UCTA.

First, the provisions we are exploring in this section do not apply to ‘consumer contracts’, which, as stated above, are governed by the different statutory regime in the Consumer Rights Act 2015. A consumer contract is one where one party is acting in the course of his trade, business, craft or profession, and the other party is not.

Secondly, s 1(3) of UCTA states that the operative provisions of UCTA (sections 2 to 7) apply only to ‘business liability’. Accordingly, unless you are dealing with this type of liability, UCTA will generally not apply.

Section 1(3) sets out a definition of ‘business liability’ as follows:

[...] liability for breach of obligations or duties arising:

- (a) from things done or to be done by a person in the course of a business (whether his own business or another’s); or
- (b) from the occupation of premises used for business purposes of the occupier; and references to liability are to be read accordingly [...]

The combined effect of these two considerations is (broadly) that:

- (a) Where both parties are acting in the course of a business, UCTA applies;
- (b) Where one party is acting in the course of a business and the other party is not, the CRA 2015 applies;

(c) Where neither party is acting in the course of a business, neither statutory regime applies. Thirdly, given its name, it might be assumed that UCTA applies to all ‘unfair’ terms. In fact, that is not the case. Instead, UCTA only regulates exemption clauses, ie those clauses which limit or exclude liability (whether directly or indirectly).

As previously mentioned, UCTA provides that certain types of exemption clause have no effect, but that other types of exemption clause are effective only so far as they satisfy the requirements of reasonableness.

3.4 Negligence liability

Negligence for the purposes of UCTA is defined in s 1(1), and includes breach of:

(a) Any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;

(b) Any common law duty to take reasonable care or exercise reasonable skill

The tort of negligence is covered by UCTA’s definition of negligence (s 1(1)(b)). Duties of care imposed by contract are also caught (s 1(1)(a)), for example a breach of s 13 of the Supply of Goods and Services Act 1982 (SGSA) to carry out a service in the course of a business with reasonable care and skill, constitutes negligence (s 1(1)(a)).

3.4.1 Exempting liability for death or personal injury resulting from negligence

Section 2(1) of UCTA provides that:

A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence

Accordingly, any attempt to exclude or restrict liability for death or personal injury resulting from negligence will be void.

3.4.2 Exempting liability for other loss resulting from negligence

In relation to other loss or damage (for example, damage to personal property) resulting from negligence, s 2(2) of UCTA provides:

a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness

Type of liability	The term limiting liability is in a business-to-business agreement
Death or personal injury resulting from negligence (eg through breach of a term implied by s 13 SGSA)	Void (s 2(1))
Loss (other than death or personal injury) resulting from negligence (eg through breach of a term implied by s13 SGSA)	Valid if reasonable (s 2(2))

3.4.3 Exempting liability for breach of statutory implied terms about quality of goods

Section 6(1A) of UCTA provides that liability for breach of s 13-15 of the Sale of Goods Act 1979 (seller’s implied undertakings as to conformity of goods with description or sample, quality or fitness for a particular purpose):

[...] cannot be excluded or restricted by reference to a contract term except in so far as the term satisfies the requirement of reasonableness.

Type of liability	The term limiting liability is in a business-to-business agreement
Breach of statutory implied terms under s 13-15 SGA	Valid if reasonable (s 6(1A))

3.5 Exempting liability arising in contract

Pursuant to s 3, where any party deals on its own written standard terms of business (s 3(1)), that party cannot rely on a contract term to exclude or limit its liability in the event it commits any breach of contract, except so far as the term passes the reasonableness test (s 3(2)(a)).

Similarly, under 3(2)(b)(i & ii) a party cannot by reference any contract term claim to be entitled to:

- Render a contractual performance substantially different from that which was reasonably expected (s 3(2)(b)(i)); or
- Claim to be entitled in respect of the whole or any part of the contractual obligation, to render no performance at all (s 3(2)(b)(ii)).

Except in so far as the contract term satisfies the requirement of reasonableness.

Type of liability	The term limiting liability is in a negotiated agreement	The term limited liability is in a party's 'standard terms'
Breach of contract (eg breach of an express term of the contract)	UCTA does not apply	Valid if reasonable (s 3)

Although UCTA does not define 'deals on written standard terms of business', the courts appear to take a relatively common sense approach. In *St Albans City Council v. International Computers Ltd* [1995] FSR 686 the court considered that even where a party's general terms had been the subject of negotiation, they were still dealing on 'standard terms' for the purposes of UCTA as the terms remained effectively untouched. More recently, there has been support for the proposition that, if the exemption clauses are from one party's standard terms, then even if other clauses are negotiated or come from the other party, UCTA will apply: *Commercial Management (Investments) Ltd v Mitchell Design and Construct Ltd* [2016] EWHC 76 (TCC).

Due to the requirement in s 3(1) for dealing on 'written standard terms', any business-to-business contract which is concluded other than on 'written standard terms' is outside the ambit of s 3. Accordingly, exclusions/limitations of liability for breach of contract in individually negotiated business to business contracts are not regulated by UCTA unless they relate to areas which are regulated by other areas of UCTA, such as attempts to limit liability for death or personal injury caused by negligence.

3.6 Reasonableness test (s 11 & schedule 2)

The UCTA reasonableness test is set out in s 11(1). In order to pass the UCTA reasonableness test, the term:

[...] shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

Note. The requirement of reasonableness is judged at the time the contract was made.

In the abstract, 'fair and reasonable' is clearly a difficult test to apply. Fortunately, UCTA gives some guidance as to the factors to be taken into account when applying the test. Section 11(2) provides that, when considering the reasonableness test, 'regard shall be had in particular to the matters specified in Schedule 2 to this Act'.

Although s 11(2) explicitly states that the Schedule 2 guidelines should be taken into account for the purposes of s 6 and s 7 of UCTA, the Courts have clarified that the Schedule 2 guidelines may be used more widely (ie at any time the UCTA reasonableness test is being applied): *Stewart Gill Ltd v Horatio Myer & Co. Ltd* [1992] 1 QB 600.

The guideline factors in Schedule 2 which, where appropriate, should be taken into account when applying the reasonableness test are as follows:

- (a) The strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;
- (b) Whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having a similar term;
- (c) Whether the customer knew or ought reasonably to have known of the existence and the extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
- (d) Where the term excludes or restricts any relevant liability if some condition was not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
- (e) Whether the goods were manufactured, processed or adapted to the special order of the customer.

Some indication of the judicial approach to 'reasonableness' is found in the case of *George Mitchell (Chester Hall) Ltd v Finney Lock Seeds Ltd* (1983) 2 AC 803. In the House of Lords, Lord Bridge (with whom the majority of their Lordships agreed) emphasised that the question whether an exemption clause is reasonable can largely, though not entirely, be equated with the concept of judicial discretion. In other words, it involves a large element of judgment of the facts governed by a few legal rules. As such there is scope for legitimate differences of judicial opinion as to the reasonableness or otherwise of an exemption clause. Lord Bridge warned that:

the appellate court should treat the original decision [of the trial judge] with the utmost respect and refrain from interference with it unless satisfied that it proceeded on some erroneous principle or was plainly and obviously wrong.

This approach suggests that, as the deliberations regarding reasonableness are significantly dependent upon the facts of the case, there will be little precedent value in the decisions themselves.

3.7 Summary

Type of liability	The term limiting liability is in a business-to-business agreement
Death or personal injury resulting from negligence	Void (s 2(1))
Loss (other than death or personal injury) resulting from negligence	Valid if reasonable (s 2(2))
Breach of statutory implied terms under ss 13 - 15 SGA	Valid if reasonable (s 6(1A))

Type of liability	The term limiting liability is in a negotiated agreement	The term limited liability is in a party's 'standard terms'
Breach of contract	UCTA does not apply	Valid if reasonable (s 3)

4 Consumer Rights Act 2015 (exemption clauses)

The CRA comprises three Parts.

Part I deals with consumer contracts for goods, digital content, and services.

Part II regulates unfair terms (in consumer contracts).

Part III is of a miscellaneous and general nature.

This section will analyse sections of Part II – the regulation of unfair terms.

The CRA regulates unfair terms in two areas:

- (a) It regulates attempts to exclude or limit liability for breach of contract (or occasionally other duties): this is similar terrain to that regulated by the Unfair Contract Terms Act 1977 in relation to business contracts.
- (b) It regulates unfair terms more generally – the regulation of a large class of terms in consumer contracts is quite different to the situation in relation to business-to-business contracts, where the majority of terms cannot be considered for fairness.

We will consider each of these in turn.

It is worth noting at the outset that (unlike the UCTA provisions relating to business-to-business contracts), the CRA makes no distinction between contracts on standard terms, and contracts which have been individually negotiated. In practice, it is rare for consumer contracts to be individually negotiated in any event.

Exercise: Read alongside

Access the Consumer Rights Act 2015 and read the below alongside the sections referred to.

4.1 Introduction

If the clause has been incorporated into the contract and (properly construed) excludes/limits the liability being considered, then you must move on to consider:

- (a) In the case of contracts between businesses, the Unfair Contract Terms Act 1977 (UCTA); and
- (b) In the case of contracts between a business and a consumer, the Consumer Rights Act 2015 (CRA).

This section considers the CRA. UCTA is not considered in this section.

4.2 Attempts to exclude or limit liability for breach of contract (or occasionally other duties)

We will look first at clauses which attempt to exclude liability. In relation to exemption clauses, it is worth considering the following structure: i) incorporation, ii) construction and iii) statutory controls (see ‘controls on exemption clauses’ diagram above).

4.2.1 Exempting liability for death or personal injury resulting from negligence

Section 65(1) of CRA provides that:

A trader cannot by a term of a consumer contract or by a consumer notice exclude or restrict liability for death or personal injury resulting from negligence

Accordingly, any attempt to exclude or restrict liability for death or personal injury resulting from negligence will not be binding on the consumer.

Negligence for the purposes of this section is defined in s 65(4), and includes breach of:

- (a) Any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;
- (b) Any common law duty to take reasonable care or exercise reasonable skill; and
- (c) The common duty of care imposed by the Occupiers' Liability Act 1957.

The tort of negligence is unsurprisingly covered by CRA's definition of negligence (by s 65(4)(b)). Duties of care imposed by contract are also caught (by s 65(4)(a)). In this regard, remember that s 49 CRA itself implies a term into a contract for the supply of a service that the supplier will carry out the service with reasonable care and skill. Breach of such term (ie carrying out the service without taking reasonable skill and care) would constitute negligence for the purposes of the CRA.

Type of liability	The term limiting liability is in a consumer contract
Death or personal injury resulting from negligence	Not binding on consumer (s 65)

4.2.2 Exempting liability for breach of statutory implied terms about goods

Section 31 of CRA provides that any attempt to exclude or restrict liability for the following terms implied by the CRA will not be binding on the consumer:

- (a) Section 9 – goods to be of satisfactory quality
- (b) Section 10 – goods to be fit for particular purpose
- (c) Section 11 – goods to be as described.

Type of liability	The term limiting liability is in a consumer contract
Breach of CRA implied terms under ss 9, 10 & 11 about goods	Not binding (s 31)

4.2.3 Exempting liability for breach of statutory implied terms about digital content

Section 47 of CRA provides that any attempt to exclude or restrict liability for the following terms implied by the CRA will not be binding on the consumer:

- (a) Section 34 – digital content to be of satisfactory quality
- (b) Section 35 – digital content to be fit for particular purpose
- (c) Section 36 – digital content to be as described.

Type of liability	The term limiting liability is in a consumer contract
Breach of CRA implied terms under ss 34, 35 & 36 about digital content	Not binding (s 47)

4.2.4 Exempting liability for breach of statutory implied terms about services

Section 57 of CRA provides that any attempt to entirely exclude the following term implied by the CRA will not be binding on the consumer:

- (a) Section 49 – service to be performed with reasonable care and skill.

Any attempt to restrict/limit liability under s 49 will not be binding to the extent that it would prevent the consumer from recovering the price paid – so effectively, liability cannot be limited to less than the price paid.

Type of liability	The term limiting liability is in a consumer contract
Breach of CRA implied term under s 49 about services	Exclusions - not binding (s 57) Restrictions/limitations – not binding if preventing recovery of price paid.

4.3 Regulation of terms other than exemption clauses

As well as the specific regulation of exemption clauses as set out above, the CRA provides that **any** term in a consumer contract is not binding on the consumer if it is unfair (s 62). However, terms specifying the main subject matter of the contract cannot be assessed for fairness, nor can the court assess the fairness of the price for the goods, digital content or services concerned provided that the terms are **transparent** and **prominent** (s 64).

A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer (s 62(4)).

This is judged at the time the contract is entered into.

In addition, the CRA in Part 1 of Schedule 2 contains a list of terms which 'may be regarded as unfair'. It is not intended to be a complete list of all such terms. You should consider the list, but an interesting inclusion is any term inappropriately excluding or limiting the legal rights of the consumer in relation to inadequate performance by the trader of any of the contractual obligations (ie the vast majority of exemption clauses which are not already rendered non-binding by specific provisions of the CRA).

4.4 Anti-avoidance provisions

As you can see, CRA makes certain provisions exempting/limiting liability not binding on the consumer. In this sense, it restricts parties' contractual freedom. Parties might try to get around these limitations in a number of ways, but CRA has most such avenues covered. For example:

- A party might decide that rather than trying to limit or exclude certain claims in Contract A (which CRA might prevent) it will enter into a separate contract (Contract B) by which the other party will agree not to pursue any such claims in relation to Contract A. Such use of parallel or secondary contracts to attempt to avoid the mechanisms in CRA are generally prohibited (eg see s 72).
- A party might decide that rather than trying to limit or exclude liability in a way that CRA would interfere with, it will make the liability or its enforcement subject to certain onerous conditions, or limit the rights/remedies/evidence/court procedures available in relation to such a liability. Such mechanisms are also generally prohibited (eg see s 31(2)).

4.5 Summary

Type of term	Impact of the CRA
Limitation of liability in relation to: <ul style="list-style-type: none">• Death or personal injury resulting from negligence• Breach of statutory implied terms under ss 9, 10 and 11 about goods, under ss 34, 35 and 36 about digital content or under s 49 about services	Not binding on the consumer (save for limitations in relation to s 49, which are not binding if preventing recovery of price paid).
Transparent and prominent terms specifying the main subject matter of the contract/price.	Cannot be assessed for fairness.
Any other term (including, but not limited to, exemption clauses not specifically addressed above).	Not binding if contrary to the requirement of good faith it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.



9

Misrepresentation

1 Elements of an actionable misrepresentation

1.1 Introduction

Pre-contractual statements made during negotiations leading to a contract may qualify as 'representations'. A representation is a statement asserting the truth of a given state of facts. In some circumstances, false representations can give rise to an action for misrepresentation. The law relating to misrepresentation has developed alongside contract law, and encompasses elements of tort and statute.

In this chapter, we will look at the necessary aspects of a successful claim for misrepresentation.



Representation: A statement asserting the truth of a given state of facts.

Representor: The party who allegedly made the representation.

Representee: The party who allegedly received the representation.

1.2 Definition of an actionable misrepresentation

An actionable misrepresentation is:

An unambiguous false statement of fact made to the claimant and which induces the claimant to enter into the contract with the statement maker.

Merkin, R & Saintier, S. Poole's Textbook on Contract Law (16th ed, Oxford University Press, 2023).

All elements of this definition must be present for an action in misrepresentation to succeed.

The effect of a misrepresentation is, subject to limitations, to make the contract **voidable** but **not void**. In order to avoid the contract, the wronged party must take action to rescind the contract. The remedies for misrepresentation are not considered in this section.



Misrepresentation: An unambiguous false statement of fact made to the claimant and which induces the claimant to enter into the contract with the statement maker.

1.3 Actionable misrepresentation

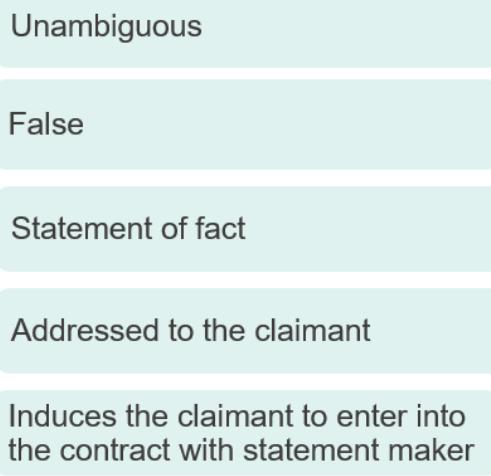


Figure 9.1: Elements of an actionable misrepresentation

We will now look at each element in turn.

1.3.1 Unambiguous

The representation must be clear and will only form the basis of a claim in misrepresentation if it unambiguously has the meaning put forward by the representee.

The representor will not be liable if the representee has placed its own unreasonable construction on the representation: *McInerny v Lloyd's Bank Ltd* [1974] 1 Lloyd's Rep 246.

1.3.2 False

The statement must be false. It will not be false if it is substantially correct.

[A] representation may be true without being entirely correct, provided it is substantially correct and the difference between what is represented and what is actually correct would not have been likely to induce a reasonable person in the position of the claimants to enter into the contracts

per Rix J, *Avon Insurance Plc v Swire Fraser Ltd* [2000] 1 All ER (Comm) 573.

1.3.3 Statement of fact

To be actionable, a representation must be a statement of fact ie 'a representation is not an undertaking to do, or not to do something. It is a statement asserting a given state of affairs' *Kleinwort Benson Ltd v Malaysia Mining Corp* [1989] 1 WLR 379

Representations distinguished from mere 'puff'

Mere advertising 'puff' will not qualify as a representation. The law allows a salesperson a good deal of latitude in their choice of language eg the 'desirable residence' advertised by the estate agent may leave much to be desired, but there is no misrepresentation, because this is just 'advertising puff'. So in *Dimmock v Hallett* (1866) LR 2 Ch App 21, a description of land as 'fertile and improvable' did not amount to a representation but was viewed as mere puff.

Conduct

Statements are usually made by words, but statements of fact can also be made by conduct. In *Gordon v Selico* (1986) 278 EG 53, the intentional concealment of dry rot was deemed to be a misrepresentation.

Statement of law

The traditional rule was that a statement of law could not give rise to an actionable misrepresentation. However, the distinction has now been abolished and it is clear that a statement of law can give rise to an actionable misrepresentation.

Statements that do not amount to statements of fact

With some important exceptions, statements of opinion, statements of future intention and instances of silence, are not, on the face of it, actionable. The exceptions to these general rules are discussed in detail in a later section of this chapter, ‘Statement of fact’. In that section you will learn that the concept of statement of fact is at the heart of the law of misrepresentation.

1.3.4 Addressed to the claimant

The misrepresentation must be addressed by the representor to the claimant.

1.3.5 Induces the claimant to enter into the contract with statement maker

The representation must have caused the representee to enter into the contract in order to be an actionable misrepresentation. This requirement was not satisfied in the case of *JEB Fasteners v Mark Bloom* [1983] 1 All ER 583, where the Court of Appeal held that the defendants’ representation did not play a ‘real and substantial’ part in inducing the claimants to act.

When considering the issue of inducement, the first question for the court is whether the representation was material.

The test for materiality is an objective one: did the statement relate to an issue that would have influenced a reasonable person (per Lord Mustill in *Pan Atlantic Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501)? There are two possible outcomes to this inquiry.

- (a) If the statement is found to be material, then inducement will generally be inferred as a matter of fact: *Smith v Chadwick* (1884) 9 App Cas 187. The ‘burden’ then shifts to the defendant to rebut the inference that the claimant was induced. The defendant does this by proving that the claimant was not subjectively induced.
- (b) Alternatively, if the statement is not found to be material, then inducement of the claimant cannot be inferred as a matter of fact. In these circumstances, the claimant must prove that they were subjectively induced. If the claimant can prove this, then they will be held to have been induced by the misrepresentation: *Museprime Properties Ltd v Adhill Properties Ltd* (1990) 61 P. & C.R. 111.

Inducement

Inducement is established if:

Either

Representee shows that the statement would have influenced a reasonable person



Representor cannot show that the statement did not influence this particular representee

Or

Representee shows that it personally was induced by the statement (subjective test)

Figure 9.2: Inducement

As the representation must have induced the representee to enter the contract, there is no actionable misrepresentation where:

- (a) The statement was not actually communicated to the representee; or
- (b) The statement did not affect the representee's decision to enter the contract; or
- (c) The statement was known to be untrue by the representee.

The misrepresentation need not be the only reason the claimant entered the contract. In *Edgington v Fitzmaurice* (1885) 29 Ch D 459 the plaintiff was induced to lend money to the company by a misrepresentation contained in the company prospectus. However, he was also induced by his own mistaken belief that he would have a charge on the assets of the company in relation to the loan. Nevertheless, he was able successfully to claim for fraudulent misrepresentation even though he admitted that he would not have lent the money had he not held this mistaken belief.

A representor may seek to argue that the representee was not induced where the representee chooses to test the validity of the representor's statement by making its own investigations (*Attwood v Small* (1838) 6 CL & F 232).

In *Attwood v Small* (1838) 6 CL & F 232, the vendor of a mine made wildly exaggerated statements about its earning capacity. The purchaser did not believe the glowing reports made by the vendor and, therefore, sent his own agent to make an independent report. The agent produced a similarly positive report to that of the vendor. The mine then turned out to be virtually worthless and the purchaser brought a claim maintaining that the prospects of the mine had been misrepresented to him. The claim was dismissed. The purchaser had not relied on the statement of the vendor but had been induced to purchase the mine on the strength of his own agent's report: a party cannot bring a claim in misrepresentation when it has relied not on the misrepresentation, but on its own investigations.

Redgrave v Hurd (1881) 20 Ch D 1 clarified that the key point in *Attwood* is not that separate enquiries were made or could have been made – the crucial point is that the separate enquiries showed that the vendor's statements were not relied upon. In other cases, separate enquiries might not be such as to show that the purchaser did not also rely on the vendor's statements – the separate enquiries do not automatically prevent a claim for misrepresentation. *Redgrave* also established that there is no general duty to check the misrepresentor's statement.

However, still on the topic of checking representations, if a representee does not check, where the court considers it reasonable for them to have done so, or carries out a negligent investigation, this would open up the possibility of a defence of contributory negligence being mounted against the representee for failing to investigate or for investigating negligently. Note that contributory negligence cannot be pleaded where the misrepresentation is fraudulent. It may well be that the more commercial the representee is (and therefore the more resources they have at their disposal to carry out an investigation), the more likely it is that the court will consider it reasonable for the representee to have investigated (by analogy to *Smith v Eric Bush* [1990] 1 AC 831).

1.3.6 Summary

- An actionable misrepresentation is an unambiguous, false, statement of fact, addressed to the claimant which induces the claimant to enter into the contract with the statement maker.
- 'Unambiguous' means clear.
- 'Statement of fact' means an assertion of a state of affairs. There are special rules for statements of law, opinion, future intention or silence.
- 'Induced' means formed one of the reasons for entering into the contract. If the statement is material, inducement will be inferred. If not material, then inducement must be proved.

2 Statements of fact

At the heart of the law of misrepresentation is the concept of a false statement of fact.

As a general rule, statements of opinion, statements of future intention and silence will not normally amount to statements of fact on which a claim for misrepresentation can be based. In this section, we will consider some of the exceptions to these general rules.

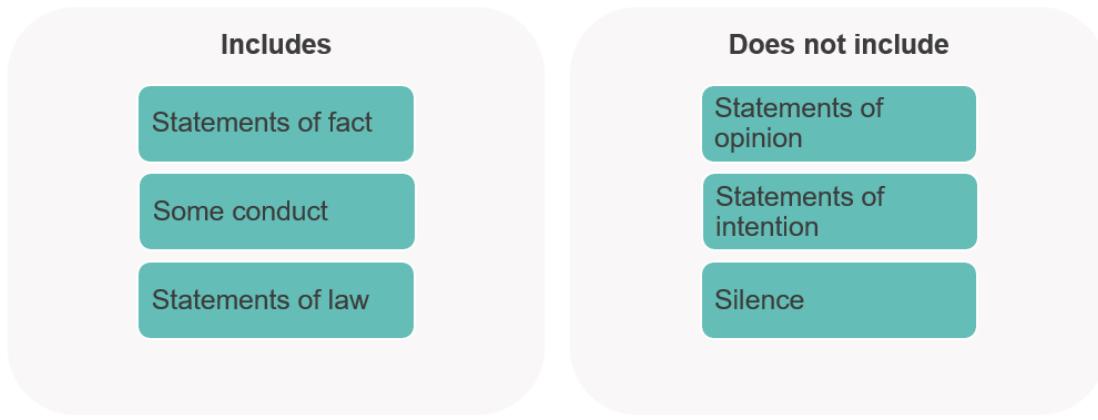


Figure 9.3: Statements of fact

We will now consider some of the subtleties of these distinctions

2.1 Statement of opinion

A statement of opinion is not a statement of fact. Usually, it cannot form the basis of a claim in misrepresentation. For example, in *Bisset v Wilkinson* [1927] AC 1977 the claimant agreed to purchase land from the defendant for the purpose of sheep farming. The defendant made a statement that his ‘idea was that [the land] would carry two thousand sheep’. The claimant was aware that neither the defendant nor anybody who had owned the land previously had used it for sheep farming. The court held that the statement was merely an opinion that the defendant honestly held and the claim for misrepresentation failed.

However, when someone expresses an opinion, they impliedly state that they know facts which justify their opinion. Where the same facts are known to each party, this implicit statement is unlikely to have much impact on the representee, as the representee can determine whether the facts justify the opinion themselves. However, if the representor is considered to have greater knowledge than the representee, then the implied statement that there are facts which justify the opinion can significantly mislead the representee. For example in *Smith v Land and House Property Corporation* (1885) LR 28 Ch D 7 (CA) a seller stated that the property they were selling was let to a ‘most desirable tenant’. The seller was aware of information that directly contradicted his statement. The implied statement made by the seller was that he had facts to back up his opinion. As the seller did not have such facts this amounted to a false statement of fact for the purposes of misrepresentation.

If a representor is in a position of superior knowledge or experience, a statement of opinion by them may be held to involve a statement of fact that there are reasonable grounds for their opinion. If there are no reasonable grounds for that opinion (or, to put it another way, the opinion is one which someone with the knowledge of the representor, could not have reasonably held), then a false statement has been made.

In *Esso v Mardon* [1976] QB 801 Mardon took a lease of a petrol station after being assured by an Esso representative that the annual throughput would be 200,000 gallons of petrol per year. This estimate was not accurate. The estimated gallonage was never reached and, as a result, the petrol station was uneconomic. Mardon alleged misrepresentation. Esso argued that, as there had not previously been a petrol station on that site, the estimated throughput was merely a statement of opinion.

The Court of Appeal held that the statement as to the maximum sales contained within it a statement that Esso had carefully estimated, based on their substantial skill and expertise in estimating potential sales, the throughput at 200,000 gallons per year. In fact, the assessment had not been carried out carefully.

Esso could be distinguished from that of *Bisset v Wilkinson* where the land had never been used as a sheep farm, and both parties were equally able to form an opinion as to its carrying capacity.

An expression of opinion is a representation that the statement maker believes the opinion that they express. Such a representation will be a misrepresentation if in fact the opinion expressed is not one which the representor held.

2.2 Statement of future intention

A representation is an assertion of the truth that a fact exists or did exist. It is a statement of fact. It can, therefore, have no reference to future events or promises.

There is a clear difference between a representation of fact and a representation that something will be done in the future. A representation that something will be done in the future cannot be true or false at the moment it is made; and although you may call it a representation, if anything it is a contract or promise.

Beattie v Ebury (1872) LR 7 Ch App 777, per Mellish LJ

Consequently, it is not a misrepresentation if the representor makes a promise regarding a future intention but is prevented from following that course of conduct or if circumstances alter so that they change their mind about that intention.

In *Wales v Wadham* [1977] 1 WLR 199, a husband left his wife to live with another woman. Prior to and during divorce proceedings, the wife asserted that she would not remarry after divorce as she had a conscientious objection to remarriage. The divorce settlement was negotiated on the more generous basis that she would remain single. Prior to the conclusion of the settlement, the wife agreed to marry another and did not communicate this change of intention to the husband. The husband sought to rescind the agreement on the ground of his wife's non-disclosure of her intention to remarry. The court upheld the settlement and dismissed the husband's claim. The wife had not misrepresented her then current intention when she told her husband that she would not remarry, and she was under no duty to disclose her change of intention.

However, if the representor states that they intend to do something, then they are making a limited statement of fact: they are stating that they do have that intention. So if, at that point in time, they know that they cannot do what they state, or they do not intend to do it, they misrepresent their existing intention (*Edgington v Fitzmaurice* (1885) 29 Ch D 459). They are stating that they have an intention to do something (which is a statement of fact) and this is untrue. They have not only made a promise which is ultimately broken but one which they never intended to keep. Bowen LJ put it this way: 'The state of a man's mind is as much a fact as the state of his digestion [...]'

Exercise: Challenge yourself

 In *Edgington v Fitzmaurice* (1885) 29 Ch D 459, a company issued a prospectus inviting the public to purchase debentures in the company. The prospectus said that the money would be used to improve the company's premises and expand its business. This was a statement of intention. The money was not used in this way. The investors alleged that the directors of the company knew that the money would not be used in this way and therefore the directors had misrepresented their intention.

Speculate as to evidence that might exist to show that the directors did not have the intention they said they had. For example, you might hope to find emails between the directors setting out what they intend to do with the money. Try to imagine five other examples. When you have prepared your list, review it again, and ask yourself how likely it is that such evidence would exist in a case like this. Then stand in the directors' shoes, and try to think up ways of explaining away the evidence. How hard do you think it is in practice to succeed on a misrepresentation claim in relation to a statement of intention?

2.3 Silence

It is hard to conceive of silence as a statement of fact (or of anything else). In most cases, mere silence will not give rise to an action for misrepresentation. It is not a statement, whether of fact or otherwise. Accordingly, the general rule is that there is no duty to disclose facts which, if known, might affect the other party's decision to enter the contract.

So, for example, in *Keates v The Earl of Cadogan* (1851) 10 CB 591 the defendant let a house to the plaintiff knowing that the plaintiff wanted it for immediate occupation but did not tell the plaintiff that the house was in fact uninhabitable. It was held that in the absence of fraud, the defendant was under no implied duty to disclose the state of the house.

This rule may be justified by saying that a general duty of disclosure would be too vague since it would be impossible to specify precisely what should be disclosed. However, there are a number of recognised exceptions to the general rule in *Keates*. These are:

- (a) Half-truths;
- (b) Continuing representations; and
- (c) Contracts *uberrimae fidei*.

2.3.1 Half-truths: exception to silence

An exception to the rule that silence does not amount to a misrepresentation occurs where there is a half-truth (*Nottingham Patent Brick & Tile Co v Butler* (1866)). Consequently, it is a misrepresentation (ie a false statement of fact) to make statements which are technically true but misleading. Thus, to describe property which is the subject of negotiations for sale as ‘fully let’ without disclosing that, although the property is indeed fully let at that time, the tenants have given notice to quit, is a misrepresentation: *Dimmock v Hallett* (1866) LR 2 Ch App 21.

2.3.2 Continuing representations: exception to silence

If, at the beginning of negotiations, a statement is made which is true but which prior to entering into the contract becomes false, the representor is under an obligation to correct the representation. If they fail to do so and allow the other party to enter into the contract still believing that the representation is true, then they will be liable for misrepresentation. This is the principle of ‘continuing representations’.

With v O'Flanagan [1936] Ch 575: a professional man was selling his medical practice. At the beginning of negotiations, he stated that the income of the practice was at a certain level but during the course of negotiations he became ill and the income had fallen to virtually nothing by the time of the sale. He did not reveal this fact. HELD: By remaining silent, he had made a continuing representation, holding out his original statement as still being true. There was a duty to disclose the change in circumstances and the consequent change in income.

Contrast *With v O'Flanagan* and *Wales v Wadham* (explained earlier in this section). *With v O'Flanagan* is concerned with a representation relating to existing fact, whereas *Wales v Wadham* related to a statement of future intention. In other words, the statement in *With v O'Flanagan* was actionable because it related to an existing fact which was true at the time it was made but later became false. Consequently, the statement maker was required to disclose the change of circumstances. This can be contrasted with *Wales v Wadham*, which concerned a statement of future intention. The wife was not obliged to disclose her change of intention. Her statement was not actionable.

2.3.3 Contracts *uberrimae fidei* (utmost good faith): exception to silence

There is a duty to disclose material facts in some types of contracts in which one party is in a particularly strong position to know the material facts which form the basis of the contract. Such contracts are known as contracts *uberrimae fidei* (utmost good faith). The most common example of this type of contract is a contract of insurance where (at common law) disclosure of all material facts must be made to the insurer.

There can similarly be an obligation to disclose information between parties who are in a fiduciary relationship – a particularly close relationship characterised by trust and obligations of good faith. Examples of such a relationship are that between a company and its directors, or between a trustee and beneficiaries of a trust.

2.4 Summary

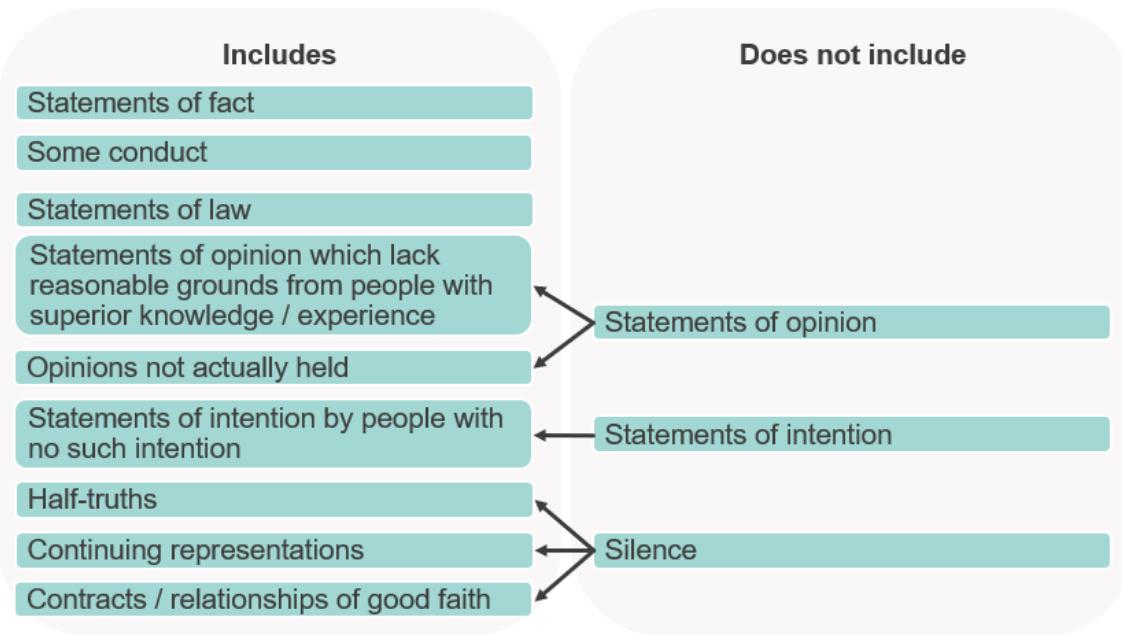


Figure 9.4: Statements of fact - summary

3 Categories of misrepresentation

Once the essential elements of an actionable misrepresentation have been established, the remedies available depend upon the category of the misrepresentation in question.

Due to important changes brought about by the Misrepresentation Act 1967 (MA 1967) the categories of misrepresentation that are available today are:

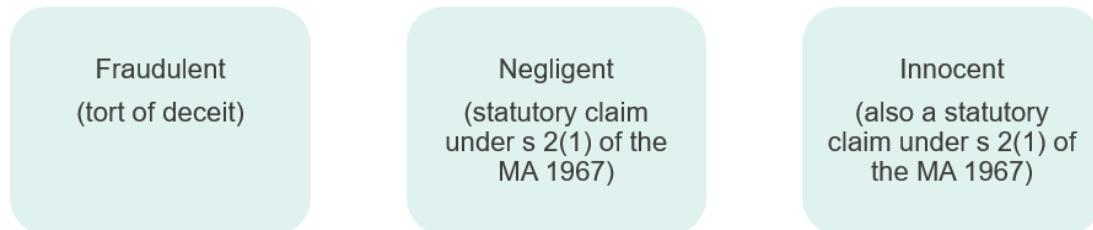


Figure 9.5: Categories of misrepresentation

The definitions of each of the above categories are discussed below.

3.1 Fraudulent misrepresentation

The classic definition of fraudulent misrepresentation was given in *Derry v Peek (1889) 14 App Cas 337* in the House of Lords.



Key case: *Derry v Peek (1889) 14 App Cas 337*

A tramway company was empowered by a special Act of Parliament to operate certain tramways by using animal power. The Act further provided that, with the consent of the Board of Trade, mechanical power might be used. The directors of the company, wishing to raise more capital, included the following statement in a prospectus:

the company has the right to use steam or mechanical motive power instead of horses, and it is fully expected that by means of this a considerable saving will result [...]

P, relying on this representation, bought shares. The company was later wound up because the Board of Trade refused to allow the use of mechanical power over the whole of the company's tramway. P contended that there was fraud.

After a review of the authorities, Lord Herschell said:

First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (a) knowingly, or (b) without belief in its truth, or (c) recklessly, careless whether it be true or false. Although I treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states [...]. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

The claimant had failed to show knowledge that the statement was false or an absence of belief in its truth, and therefore the false statement in the prospectus was not fraudulent.

Recklessness was defined in *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573, where it was held that to find fraud it had to be shown that the level of recklessness required was a 'flagrant disregard for the truth'.

Difficulties can arise in trying to categorise a misrepresentation based on change of circumstances. It might be thought that failure to disclose a change in circumstances will be easy to argue as being fraudulent, simply on the basis that the representor has the new information and does not disclose it. However, in *With v O'Flanagan*, Lord Wright MR noted that:

[...] the Court is more reluctant to use the word 'fraud' and would not generally use the word 'fraud' in that connection because the failure to disclose, though wrong and a breach of duty, may be due to inadvertence or a failure to realise that the duty rests upon the party who has made the representation not to leave the other party under an error when the representation has become falsified by a change of circumstances.

Accordingly, the Court would need to be satisfied that the failure to disclose was, in fact, deliberate or dishonest, and not just due to inadvertence or a failure to realise the requirement of disclosure.

Note that where a misrepresentation is not fraudulent, it may still be negligent, as considered later in this section under the requirements of s 2(1) of the Misrepresentation Act 1967 (see below).

In terms of proving fraudulent misrepresentation, the burden of proof on the claimant is a difficult burden to discharge. An allegation of fraud is treated with extreme seriousness by the court and it is therefore more difficult to persuade a court that a defendant has done something fraudulent than (for example) negligent.

3.2 Negligent misrepresentation (Misrepresentation Act 1967)

Section 2(1) of the MA 1967 provides:

Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true.

In summary, the defendant will be liable for negligent misrepresentation under s 2(1) unless they can prove that they had reasonable grounds to believe, and did believe up to the time the contract was made, that the statement was true.

Moreover, following the (sometimes criticised) decision in *Royscot Trust Ltd v Rogerson* [1991] 2 QB 297, s 2(1) also has the effect that, where a representor is found liable for a negligent misrepresentation, they will be treated to all intents and purposes as if they had made a fraudulent misrepresentation. This has important ramifications as regards damages.

In *Howard Marine and Dredging Co. Ltd. v A. Ogden & Sons (Excavations) Ltd.* [1978] 2 WLR 515 Ogden hired two barges from Howards. Howards told Ogden that the barges' capacity was 1600 tonnes when in fact it was 1055 tonnes. The figure had been derived from Lloyd's Register which was wrong. The Court of Appeal held that it was a negligent misrepresentation under MA 67 s 2(1). The true figures were in the ships' documents and Howards had failed to show any 'objectively reasonable ground' for disregarding the figure in the documents and relying instead on the Register.

Exercise: Engage

Do you think the decision in *Howard Marine v Ogden* is a fair one?

It is important to note that the statutory right to damages for negligent misrepresentation reverses the normal burden of proof by requiring the representor to prove that they had reasonable grounds to believe their statement and did believe their statement. Clearly, this makes negligent misrepresentation under s 2(1) MA 1967 an easier claim for the representee to establish than that of fraudulent misrepresentation.

3.3 Innocent misrepresentation (Misrepresentation Act 1967)

An innocent misrepresentation is one which is not made fraudulently or negligently. The definition of innocent misrepresentation also derives from s 2(1) of the MA 1967. Logically therefore, the definition of an innocent misrepresentation is a statement made where the representor:

- Proves that they had reasonable grounds for belief in the truth of their statement; and
- Proves that they believed up to the time of the contract that what they were saying was true.

Category	Fraudulent	Negligent	Innocent
Legal basis	Tort of deceit	s 2(1) MA 1967	s 2(1) MA 1967
Test in terms of knowledge of representor	Representee to prove that representor made statement knowing untrue/without belief in truth/reckless as to truth	Representor fails to show reasonable grounds to believe true and/or not believing true up until the contract was made	Representor has shown reasonable grounds to believe and actual belief up until the contract was made

3.4 Summary

- The categories of misrepresentation are fraudulent, negligent and innocent.
- A fraudulent misrepresentation is one that has been made (a) knowingly, or (b) without belief in its truth, or (c) recklessly, careless whether it be true or false.
- The burden of proving that a misrepresentation was fraudulently made is on the claimant, and it is a heavy burden to discharge.
- Where a representation is not fraudulent, it will be deemed negligent unless the defendant can prove that they had reasonable grounds to believe and did believe up to the time the contract was made, that the statement was true.
- An innocent misrepresentation is one that was made neither fraudulently nor negligently.

4 Remedies

The remedies potentially available in relation to misrepresentation are those of rescission, damages and indemnity. The exact combination of remedies available depends upon the nature of the misrepresentation. It should be noted that, in addition, the representee may refuse further performance of the contract, pleading the representor's misrepresentation as a defence in the event of his being sued for breach of contract by the representor.

4.1 Rescission

The effect of misrepresentation is to render the contract voidable but not void. Accordingly, the contract is still valid and subsisting until the representee decides to set it aside (rescind the contract). The remedy of rescission is available in principle for any type of misrepresentation.

The general rule is that, in order to rescind, the representee must communicate the intention to do so to the representor. Alternatively, the representee may initiate proceedings for rescission of the contract, the object being to obtain from the court an order that the contract is rescinded.

Rescission is an equitable remedy and is given (or withheld) entirely at the discretion of the court – so a party can establish misrepresentation but the court still has the discretion not to award rescission. Generally, rescission will be awarded only where the parties can be restored to their original position by returning all the property transferred between the parties under the contract.

There are several reasons why rescission will not be awarded ('bars to rescission') as follows:

- (a) Affirmation: a contract is affirmed if the representee declares their intention to proceed with the contract or does some act from which such an intention may reasonably be inferred.
- (b) Lapse of time: an action for rescission must be brought promptly, for delay defeats the equities. Lapse of time without any attempt to effect rescission does not in itself constitute affirmation but it may be treated as evidence of such an intention.
- (c) Restitution is impossible: The right to rescind is lost if it is no longer possible to restore the parties to their previous position before the contract was made. This will be the case where the nature of the subject matter has been changed or it has declined in value.
- (d) Third party rights accrue: the effect of a misrepresentation is to make the contract voidable, not immediately void, and so the contract remains valid up until the time notice is given of the intention to rescind. Consequently, at any time prior to rescission, a person acquiring goods under such a contract is able to pass good title to those goods to an innocent third party who purchases the goods without notice of the misrepresentation. This would prevent restitution.

4.2 Indemnity

It is possible that, as part of the equitable process of rescission, an indemnity may be awarded to cover expenses for obligations assumed as a direct result of the contract.

For example, if a representee is induced into buying a leasehold property by a misrepresentation, obligations arising from the purchase such as council tax, service charge and so forth would be covered by an indemnity. The obligations must have been created by the contract. Generally, where an action for misrepresentation will give a right to damages (ie an action for fraudulent or negligent misrepresentation), an indemnity will not be awarded. However, no damages as of right are available for an innocent misrepresentation and in this type of action an indemnity is more likely to be awarded. It is important to appreciate the distinction between an indemnity and the common law right to damages (*Whittington v Seale Hayne* (1900) 82 LT 49).

4.3 Damages

Damages for misrepresentation are potentially the greatest where the misrepresentation is a fraudulent one. However, it must be borne in mind that damages for an action for negligent misrepresentation, under s 2(1) MA 1967, will often match those that would be available for fraudulent misrepresentation. In addition, damages in lieu of rescission may be available under s 2(2) for an action brought under s 2(1). Finally, innocent misrepresentation does not afford any damages per se, although damages in lieu of rescission may be available under s 2(2) (see below for further discussion on this issue).

4.3.1 Damages for fraudulent misrepresentation

A party who has been deceived by a fraudulent misrepresentation may sue for damages. Fraudulent misrepresentation is part of the tort of deceit, and this is reflected in the way damages are calculated on the ‘tortious’ basis. The measure of damages is that which is necessary to place the innocent injured party in the position they would have been in had the misrepresentation not been made. It was held by the Court of Appeal in *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158 that the claimant can recover:

[...] all the damage directly flowing from the tortious act of fraudulent inducement which was not rendered too remote by the plaintiff’s own conduct, whether or not the defendant could have foreseen the loss.

To this have been added requirements that the claimant must mitigate as soon as the fraud is discovered and, second, that any damages awarded to the claimant will be reduced by the value of any benefit the claimant has acquired as a result of the contract.

Contributory negligence is not available as a defence to a claim for fraudulent misrepresentation (*Standard Chartered Bank v Pakistan National Shipping Corporation (No.2)* [2003] 1 AC 959).

4.3.2 Damages for negligent misrepresentation under s 2(1) MA 1967

Section 2(1) of the MA 1967 provides:

Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true.

The court has confirmed that the effect of s 2(1) of the MA 1967 is that the correct measure of damages for negligent misrepresentation must be based on the tort of deceit (*Royal Trust v Rogerson* (1991)).

For example, the claimant is entitled to recover all losses even if those losses are unforeseeable. Concern has been expressed that to place such an interpretation on s 2(1) draws no distinction between the honest but careless representor and the fraudulent representor, but that is the current state of the law. Note however that in relation to negligent misrepresentation, damages may be reduced for contributory negligence where the loss was in part the fault of the representee.

Section 2(2) provides:

Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of the opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.

The remedy of damages in lieu of rescission is available only at the discretion of the court and is only available for negligent and innocent misrepresentation (ie not fraudulent misrepresentation). In exercising its discretion, the court must have regard to the nature and seriousness of the misrepresentation, the loss that would be caused if the contract were upheld, and the loss that rescission would cause to the other party: *UCB Corporate Services v Thomason* [2005] 1 All ER (Comm) 601.

Section 2(2) MA 1967 damages are a separate award of damages to those awarded under s 2(1) (discussed above). Section 2(1) damages are intended to compensate the claimant for the loss directly flowing from the negligent misrepresentation. Section 2(2) damages are intended to compensate the representee where the court has decided, at its discretion, not to award

rescission. Where damages in lieu of rescission are awarded, the damages awarded under s 2(1) will be reduced to reflect those awarded under s 2(2). This is made clear by s 2(3) which states:

Damages may be awarded against a person under subsection (2) of this section whether or not he is liable to damages under subsection (1) therefore, but where he is so liable any award under the said subsection (2) shall be taken into account in assessing his liability under the said subsection (1).

4.3.3 Damages for innocent misrepresentation

Where an innocent misrepresentation has been made, the representee is only entitled to the remedy of rescission and, if applicable, an indemnity to cover the cost of the legal obligations arising from the contract entered into. There is no automatic right to damages for an innocent misrepresentation but, as with negligent misrepresentation (above), the court has the discretion under s 2(2) to award damages in lieu of rescission – see above for a full discussion of this issue.

4.4 Misrepresentation and exemption clauses

If a contract contains an exemption clause purporting to protect a party from liability for misrepresentation or purporting to exclude or restrict any remedy available to the other party, the clause will be of no effect except in so far as it satisfies the requirement of reasonableness: s 3 Misrepresentation Act 1967 (MA 1967) as substituted by s 8 of the Unfair Contract Terms Act 1977.

Section 3 provides:

If a contract contains a term which would exclude or restrict:

(a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or

(b) any remedy available to another party to the contract by reason of such a misrepresentation

that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in s 11(1) of the Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does.

4.5 Non-reliance clauses

A party may wish to exclude liability for misrepresentations. It is doubtful whether an ‘entire agreement’ clause, which states that the agreement constitutes the entire agreement between the parties, would be sufficient to exclude liability for any misrepresentations. If a party wants to exclude liability for misrepresentations, a clause such as the following might be desirable.



Example

Example ‘non-reliance’ clause: The parties agree and confirm that neither party has made any representations to the other in relation to this contract or its subject matter, and neither has any party relied on any representation from the other in entering into this contract.

Note that the example above might well be construed as a clause which attempts to exclude/limit liability for misrepresentation. Any such clause is subject to the reasonableness test in the Unfair Contract Terms Act 1977 (see s 3 Misrepresentation Act 1967 – explained above). In addition, the court will not allow liability for fraudulent misrepresentation to be avoided in this way.

4.6 Summary

Category	Fraudulent	Negligent	Innocent
Legal basis	Tort of deceit	s 2(1) MA 1967	s 2(1) MA 1967

Category	Fraudulent	Negligent	Innocent
Test in terms of knowledge of representor	Representee to prove that representor made statement knowing untrue/without belief in truth/reckless as to truth	Representor fails to show reasonable grounds to believe true and/or not believing true up until the contract was made	Representor has shown reasonable grounds to believe and actual belief up until the contract was made
Rescission?*	Yes	Yes	Yes
Indemnity?	Unlikely to be needed	Unlikely to be needed	Yes, as part of rescission
Damages	Yes, generous remoteness rules, no reduction for contributory negligence.	As for fraud, but potential reduction for contributory negligence. Can also be given in lieu of rescission.	Can be given in lieu of rescission.

*Rescission is an equitable remedy and will not be awarded in cases where the contract has been affirmed, excessive time has elapsed, restitution is impossible or third-party rights accrue which make restitution impossible.

5 Alternative claims to misrepresentation

5.1 Representations distinguished from terms of a contract

A representation may become a term of the contract if the court decides it is incorporated into the contract. The way in which terms are incorporated into a contract is not addressed in this chapter. If the court decides that a representation is a term, and it is false, this will give rise to an action for both breach of contract and potentially for misrepresentation (if the misrepresentation is actionable).

If, on the other hand, a representation is not deemed to be incorporated into the contract then it will remain a representation. In this case, the only option is to pursue an action for misrepresentation.



Example

Consider the statement: 'This car has been serviced in accordance with the recommended schedule', and assume the statement is false.

5.2 Negligent misstatement at common law (tort of negligence)

The law of misrepresentation intervenes in relation to false statements which induce the representee to enter into a contract.

There is another area of law which could intervene in relation to false statements. That is the law of negligent misstatement, which is part of the law of negligence. Very broadly, where there is a relationship of sufficient proximity between two parties, the court might find that one party owes a duty of care to the other to take reasonable care that statements made are accurate. This duty would extend to statements made during contractual negotiations, but it would not be limited to such statements – it could relate to any statements that caused the recipient of the statement loss.

This area of law is not set out in this chapter – if you study a tort module, you may study this area of law as part of that module. Where a claim in misrepresentation is available, it is rare that a

party would need/want to pursue a claim in negligent misstatement instead. The latter type of claim is generally harder to establish and likely to lead to a less favourable calculation of damages.

5.3 Summary

- If this statement is important, is made close in time to the conclusion of a contract, and is made by a car dealer, it may become a term of the contract for the sale of the car (which has been breached) as well as amounting to a misrepresentation.
- If it is not a term, then the only option is a claim for misrepresentation.
- A representation which is incorporated into a contract as a term gives rise to a potential claim in breach of contract.
- Where there is a relationship of sufficient proximity between two parties, the court might find that one party owes a duty of care to the other to take reasonable care that statements made are accurate. A breach of this duty of care may give rise to a claim in negligent misstatement. If you study a tort module, you may study this area of law as part of that module.

10

Mistake

1 Introduction

'Mistake' has a narrower meaning in contract law than it does in its ordinary English meaning. If a contract is affected by mistake in the way the word is used in contract law (called an 'operative' mistake), then there are serious consequences: the contract is void meaning the contract will be declared a nullity from its beginning, or to use the legal Latin term, the contract is void *ab initio*. 'Void' is different to 'voidable' – the latter means that the contract can be brought to an end/avoided, but until that happens, it remains in force – it is not declared a nullity from the beginning.



Operative mistake: A mistake which is recognised in the law of contract as preventing a contract from taking legal effect – the contract will be void from the outset.

Void: A contract which is **void** has no legal effect from the outset.

The law of mistake is therefore an exception to the general rule of contract that parties are bound by the terms of their agreement and must rely on the contract for protection from the effect of facts unknown to them.

Given these serious consequences, it is no surprise that only quite specific types of mistake amount to operative mistakes in contract law.

At the heart of the concept of mistake is the idea that the parties have not truly reached an agreement: either the parties cannot be said to have reached agreement because of the mistake, or the mistake renders the agreed contract something other than that which was intended.

2 Categories of mistake

There are three categories of mistake.

1

Common Mistake...

...occurs where both parties to an agreement are suffering from the same misapprehension.

2

Mutual mistake...

...occurs where both parties are mistaken but they are mistaken about different things. In other words, they have negotiated at cross-purposes.

3

Unilateral mistake...

...occurs where only one party is mistaken and the other party knows, or is deemed to know, of the mistake.

Figure 10.1: Categories of mistake

2.1 Common mistake

Common mistake occurs where both parties to an agreement are suffering from the same misapprehension.

It is necessary to consider whether the underlying common mistake is sufficiently fundamental to affect the validity of the contract.



Example: Common mistake

What if, at the time of the contract and unbeknown to both parties, the subject-matter of the contract is not in existence – for example because it has been destroyed? This is a common mistake – both parties are making the same mistake.

Example: A seller agrees to sell to the buyer some corn which is being transported on a particular ship. Without either party knowing, that corn has in fact been destroyed prior to the contract.

Unless the contract is interpreted as providing for this possibility, then the contract is void.

2.1.1 Common mistake as to a fact or quality fundamental to the agreement

In the absence of contractual misdescription, the general proposition is that mistake about the quality of goods does not void the contract. This is the case even if the mistake as to quality affects the utility of the goods to the buyer, or, alternatively, affects the value of the goods in question.

It has been suggested that there is a limited category of cases where the mistake is so severe that the contract will be void for mistake as to quality. The test to be applied to engage this exception is unclear. It could be a question of whether the mistake is such that the subject matter is 'essentially different' from that intended (*Bell v Lever Brothers* [1932] AC 161), or alternatively whether the mistake renders the assumed performance 'impossible', or alternatively whether the subject matter is rendered 'radically different'.

The restrictive approach to common mistake in *Bell v Lever Brothers* was endorsed in *Leaf v International Galleries* [1950] 2 KB 86. Although Leaf's action was in misrepresentation, the court stated, obiter, that a claim in mistake in relation to a painting both the buyer and seller mistakenly believed to be a Constable would fail. The parties had contracted for the sale of a painting, and this is what the buyer received under the contract. It is worth noting, however, that a remedy in misrepresentation may be available in such circumstances.

Circumstances where common mistake will not operate

- (a) The mistake is not sufficiently fundamental.
- (b) One party is at fault.
- (c) The contract makes provision for the issue.

2.2 Mutual mistake

Mutual mistake occurs where both parties are mistaken but they are mistaken about different things. In other words, they have negotiated at cross purposes.



Example: Mutual mistake

Where A and B have negotiated completely at cross purposes, whereby A is offering one thing whilst B is accepting another, it cannot be said that they were ever in agreement. Genuine mutual consent is obviously lacking. Such a contract will be void.

For example, A agrees to sell a horse to B. A intended to sell his chestnut horse, but B thought he was agreeing to buy A's grey horse. Needless to say, the colour of the horse was not mentioned during the formation of the contract.



Exercise: Challenge yourself

It is sometimes said that the court will employ an objective test in determining whether there has been a mutual mistake. Can you explain what this means? Try to do so, before reading on.

What this means is that in these circumstances the court will employ an objective test and decide what a reasonable third party would believe the agreement to be, based on the words and conduct of the parties themselves. Using this test, it may be decided that the agreement was that which A understood it to be or that which B understood it to be, or it may be decided that no meaning can be attributed to the agreement at all. The result is that if, from the available evidence, a reasonable person would infer the existence of a contract in a given sense, the court will hold that a contract in that sense is binding upon both parties, notwithstanding a material mistake.

2.3 Unilateral mistake

Unilateral mistake occurs where only one party is mistaken and the other party knows, or is deemed to know, of the mistake.

Where unilateral mistake has occurred, the acceptance does not correspond with the offer, and there is consequently no real agreement reached.



Example 1: Unilateral mistake as to the expression of intention

Where the offeror makes a material mistake in expressing their intention, and the other party knows, or is deemed to know, of the error, the mistake is likely to lead to the contract being void.

Example: in *Hartog v Colin & Shields* [1939] 3 All ER 566 the defendants entered into a contract to sell 3,000 Argentinian hare skins to the claimants. By mistake, they offered them for sale at 10d per pound, instead of the 10d per piece they intended. The negotiations had proceeded on the basis of a price per piece (there being three pieces per pound). As a result, the court found that the defendants' offer was not an accurate reflection of their true intention and that there was no binding contract. The claimants could not 'snap up' an offer when that party was aware that the other had made a mistake relating to the offer terms.



Example 2: Unilateral mistake as to the nature of the document signed

The general rule is that a person is bound by the terms of any instrument which they sign or seal even though they did not read it or did not understand its contents: *L'Estrange v Graucob* [1934] 2 KB 394. An exception to this general rule arises, under certain circumstances, where a person signs or seals a document under a mistaken belief as to the nature of the document. Where a person signs a document or executes a deed in such instances, they may raise the defence of *non est factum* ('it is not my deed').

In light of the case law it seems that a plea of *non est factum* may be available where the mistake was due to either:

- The blindness, illiteracy, or senility of the person signing; or
- A trick or fraudulent misrepresentation as to the nature of the document, provided that person took all reasonable precautions before signing.

Example: In *Thoroughgood's Case* (1584) 2 Co Rep 9a an illiterate woman was induced to execute a deed in the belief that it was concerned with arrears of rent. In fact, the document was a deed releasing another from claims which the woman had against him. It was held that the deed was a nullity.



Example 3: Unilateral mistake as to the identity of the person contracted with

In this type of mistake, one party mistakenly believes they are contracting with a person that the other party is pretending to be. Whether or not such a contract is void depends on the precise circumstances. Unilateral mistake as to identity is considered in a separate section.

2.4 Summary

- If a contract is affected by a mistake recognised in contract law as an 'operative mistake', it will mean the contract is void – it has no legal effect from its outset.
- There are three categories of mistake that can amount to operative mistakes: common mistake, mutual mistake and unilateral mistake.

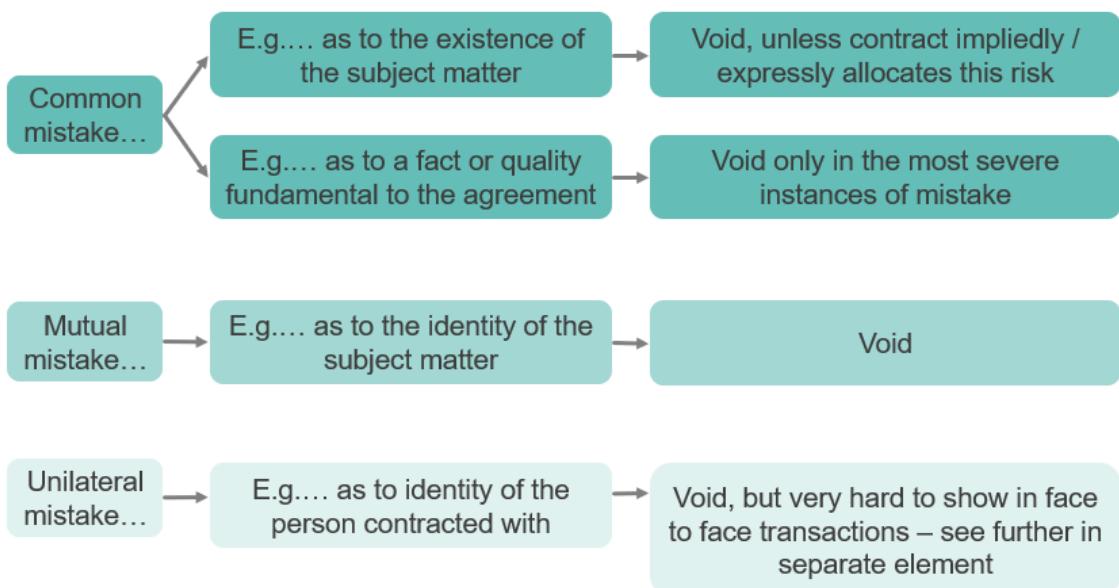


Figure 10.2: Categories of mistake and their consequences

3 Unilateral mistake of identity

3.1 Unilateral mistake

Unilateral mistake occurs where only one party is mistaken and the other party knows, or is deemed to know, of the mistake. It is often relied upon where there has been a mistake as to the identity of the other contracting party. However, the circumstances where such a claim will succeed are very tightly constrained.

3.2 Unilateral mistake as to the identity of the person contracted with

In this type of mistake, one party mistakenly believes they are contracting with a person that the other party is pretending to be. Whether or not such a contract is void depends on the precise circumstances.



Key case: Lewis v Avery [1972] 1 QB 198

Facts: the claimant put an advertisement in a newspaper, offering to sell his car for £450. In response to the advertisement, a man (who turned out to be a fraudster) telephoned and asked if he could see the car. That evening, when he came to see the car, he told the claimant that he was Richard Greene, making the claimant believe that he was the well-known film actor of that name. The fraudster wrote a cheque for the agreed sum of £450. At first, the claimant was not prepared

to let him take the car until the cheque had cleared. When the fraudster pressed to be allowed to take the car with him, the claimant asked: 'Have you anything to prove that you are Mr Richard A. Greene?'. The fraudster produced a special pass of admission to Pinewood Studios, bearing his own photograph and the name of Richard A. Greene. The claimant was satisfied that the man really was Mr Richard Greene, the film actor. He let the fraudster take the car in return for the cheque.

A few days later, the claimant discovered that the cheque was worthless. In the meantime, the fraudster sold the car to the defendant, who paid £200 for it entirely in good faith. The fraudster then disappeared. The claimant brought an action against the defendant, claiming damages for conversion.

Held: The Court of Appeal held that it is presumed that the seller intended to deal with the person in front of them identified by sight and hearing and that is what had happened. So the contract was not void for mistake, although it would be voidable for misrepresentation (the fraudster had misrepresented who he was).

This presumption will only be rebutted, and the contract held void for mistake, if the seller is able to establish that identity, rather than attributes, was of 'vital importance'. Applying that test to the facts, the Court of Appeal held that what the seller really cared about in this case was Mr Green's creditworthiness – an attribute, rather than a matter of identity. Therefore, the contract was voidable for misrepresentation (the buyer had misrepresented his attributes) but not void for mistake.

Viewed in this way, it seems a very heavy burden to show an operative mistake in the case of a face-to-face contract.

Before proceeding further, it is worth pausing to consider why it matters whether the contract is void for mistake or voidable for misrepresentation.

Consider the claimant in *Lewis v Averay*. The cheque bounces. The claimant has neither the £450 nor the car. Ideally, he probably wants to recover £450 from the fraudster, because that is what was agreed. But the chances of him finding the fraudster are small, and the chances of the fraudster having £450 are also small. What is much more likely is that the fraudster has sold the car to a third party (and disappeared), and that at some point, the car will surface in the hands of that third party. Can the claimant take the car back?

The answer will often depend on whether the contract is void for mistake (because the mistake is about identity) or voidable for misrepresentation (because the mistake is about attributes). You might recall that 'void' means the contract will be declared a nullity from its beginning, whereas 'voidable' means that the contract can be brought to an end/avoided, but until that happens, it remains in force.

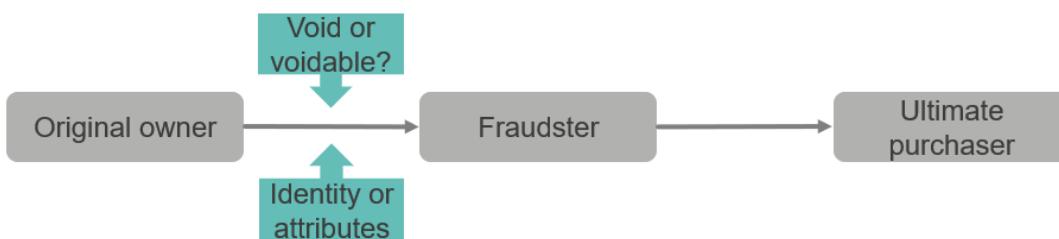


Figure 10.3: Transactions where a fraudster has assumed the identity of another

Where a contract for the sale of goods is voidable then until it is avoided title (ownership) still passes from the seller to the buyer, albeit the buyer's title is a 'voidable title' – one that could later be avoided. If the buyer seeks to sell the goods on to a third party, s 23 of the Sale of Goods Act 1979 is relevant because it provides that:

When the seller of goods [in the scenario above, this means the fraudster] has a voidable title thereto, but his title has not been avoided at the time of the sale, the buyer [in the scenario above, this means the third party] acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect in title.

Provided the third party does not know about or have reason to suspect the deception, the third party has acquired good title, and the claimant cannot take the car back. In practical terms, the seller is likely to be left without a remedy.

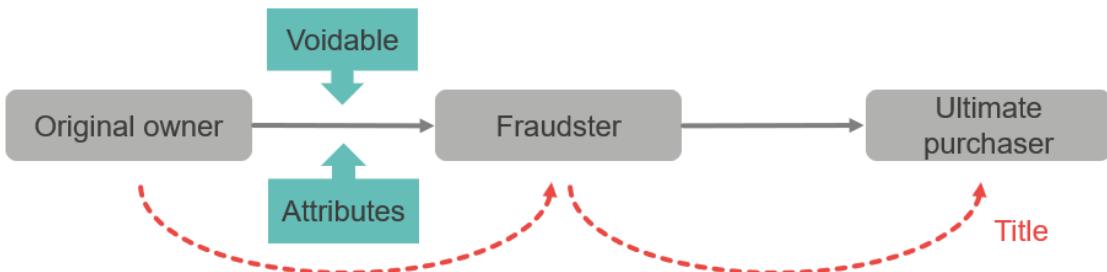


Figure 10.4: Transactions where a fraudster has assumed the identity of another - voidable title

On the other hand, where the identity of the buyer is fundamental and the contract is void for mistake, then it is void and ineffective from the outset. The buyer (the fraudster) has no title (voidable or otherwise) and cannot give any sort of title to the third party by selling the goods on. This is an example of the principle of *nemo dat quod non habet* ('no one gives who possesses not' – you cannot give what you do not have). As the third party has no title, the third party must return the goods to the duped seller, even if the third party paid good money for the goods and knew nothing about the deception.



Figure 10.5: Transactions where a fraudster has assumed the identity of another - void for mistake

3.2.1 What if the parties do not contract face-to-face?

Lewis v Avery considered a situation in which the parties were contracting face to face. Is the situation different where the parties do not contract face to face, ie they contract in a distance-selling situation? The case law seems to suggest that this may be so. After all, it is more difficult to allege that you are mistaken as to the identity of the other contracting party when they are standing in front of you.

In *Cundy v Lindsay* (1878) 3 App Cas 459 a man called Blenkarn placed an order with Lindsay on credit (ie payment would be after delivery) for goods to be delivered to 'Blenkarn, 37 Wood Street'. There was a reputable firm of Blenkiron & Co. at 123 Wood Street. Blenkarn signed his signature in such a way as to make it appear that he was in fact ordering for Blenkiron, and Lindsay (who knew of Blenkiron but not their precise address) believed they were dealing with Blenkiron. Blenkarn took delivery of the goods and sold them on to Cundy. Blenkarn never paid Lindsay. Lindsay brought a claim against Cundy on the basis they never got good title to the goods.

It was held that the respondents at all times believed that they were dealing with Blenkiron & Co. of Wood Street and not the fraudster, Blenkarn. The contract was void for mistake as to identity.

The leading case on unilateral mistake of identity is now *Shogun Finance Ltd v Hudson* [2004] 1 AC 919.



Key case: *Shogun Finance Ltd v Hudson* [2004] 1 AC 919

Facts: In this case a fraudster visited the showrooms of a car dealer and agreed to buy a car on hire-purchase terms. The fraudster signed a draft finance agreement in the name of Mr Patel. As proof of identity the fraudster produced a genuine but unlawfully obtained driving licence in the name of a Mr Patel. The car dealer sent the signed document and a copy of the licence to the finance company, Shogun Finance Ltd. The finance company checked the credit rating of Mr Patel and approved the sale. The fraudster paid a minimal deposit and drove the car away with its accompanying paperwork. The fraudster immediately sold the car on to an innocent third party, Mr Hudson. The finance company traced the car to Mr Hudson and sued him for the return of the car, or its value.

Held: Shogun Finance Ltd was entitled to the return of the car as the contract was void for mistake.

In *Shogun v Hudson* the House of Lords considered both face-to-face situations as in *Lewis v Averay*, and distance-selling situations as in *Cundy v Lindsay*. The majority ultimately decided that Shogun was a distance-selling situation between the finance company and the fraudster, and decided to keep the distinction, reaffirming the principles to be considered in each situation as set out in this chapter.

Not every distance selling transaction will result in the court finding the contract void by mistake. In *King's Norton Metal Co Ltd v Edridge Merrett & Co Ltd* (1897) 14 TLR 98 (CA) the claimant sent goods on credit to Hallam and Co., a fictitious entity, created by the fraudster. The letterhead used by the fraudster gave the impression of a large and successful company. The court held that the mistake made by the original seller in this case was one as to attributes (ie the creditworthiness of the fraudster), not identity. Unlike *Cundy v Lindsay* where the claimants intended to deal with an identifiable third party (Blenkiron & Co. who were known to them) in King's Norton, the claimants intended to deal with the writer of the letters.

3.3 Summary

- In a face-to-face transaction the court will presume that the seller intended to deal with the person in front of them. This is a difficult presumption to rebut and requires the seller to show that identity, not attributes (ie creditworthiness) was of 'vital importance'. Although there is a misrepresentation of attributes, this is rarely a useful remedy for the innocent party. The innocent party is usually the seller and will generally want to argue that the property purportedly sold has not in fact been sold, and therefore still belongs to the seller – this requires the contract to be void for mistake, not merely voidable for misrepresentation.
- In a distance selling transaction it is easier for the seller to show that they intended only to deal with the person named in the correspondence and if proved a finding of mistake will follow. Mistake renders a contract void and title will remain with the original seller.



11

Illegality

1 Introduction

Prior to the decision of the Supreme Court in *Patel v Mirza* [2016] UKSC 42 the general rule in English law was that a contract to perform an illegal act, or a contract contrary to public policy, would be declared void and unenforceable. Following *Patel*, this general principle no longer exists. Instead, a court will adopt a discretionary approach, applying principles of public policy and proportionality. The key case of *Patel v Mirza* will now be considered.

2 A discretionary approach to illegality



Key case: *Patel v Mirza* [2016] UKSC 42

Mr Patel and Mr Mirza entered into a contract where Mr Patel paid a large sum of money for Mr Mirza to bet on the changes in share prices. Mr Mirza expected to receive ‘inside information’ about the shares concerned. The parties were therefore pursuing ‘insider dealing’ and this made the agreement between them illegal. The bet did not actually go ahead because the inside information was not received, and Mr Patel sought the return of the money. Mr Mirza defended this claim on the basis of illegality – that Mr Patel was involved in an illegal transaction and the court should not, therefore, allow Mr Patel’s claim.

All nine supreme court judges agreed the defence of Illegality should not apply to defeat the Mr Patel’s claim for the return of his money. The Supreme Court held that the underlying policy question which needed to be answered when determining whether illegality applied is, ‘whether allowing recovery for something which was illegal would produce inconsistency and disharmony in the law, and so cause damage to the integrity of the legal system’.

In order to determine this question, the Supreme Court identified the following ‘trio of necessary conditions’:

- (a) ‘to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim,
- (b) to consider any other relevant public policy on which the denial of the claim may have an impact and
- (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts’.

3 Summary

- When determining the remedial consequences of entering an illegal contract the underlying policy question to be considered is ‘whether allowing recovery for something which was illegal would produce inconsistency and disharmony in the law, and so cause damage to the integrity of the legal system’.
- In order to determine this question, the Supreme Court in *Patel v Mirza* identified the following ‘trio of necessary conditions’:

- (a) ‘to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim,
- (b) to consider any other relevant public policy on which the denial of the claim may have an impact, and
- (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts.’

12

Privity of contract and rights of third parties

1 Introduction

At common law, a contract creates rights and obligations only between the parties to it. A contract does not confer enforceable rights on a third party to the contract, nor does it impose obligations on a third party. It is a fundamental principle of the common law that no person can sue or be sued on a contract unless they are a party to it (*Dunlop Pneumatic Tyre Co. v Selfridge & Co.* [1915] AC 847). This is known as privity of contract.

When considering how a contract is formed, there is a rule that there must be consideration, and that consideration must move from the promisee. This is closely related to the doctrine of privity of contract, but the rules on consideration and privity are distinct legal principles. Their combined effect is that no person can sue on a contract unless:

- (a) They are a party to the contract; and
- (b) They have provided consideration.

The case of *Tweddle v Atkinson* (1861) 1 B&S 393 concerned an agreement reached between two fathers of a couple who were about to get married. The father of the bride agreed to pay £200 to the groom, the claimant. The groom sought to enforce his father-in-law's promise. It was held that he could not. The judgments concentrated on the fact that the consideration for the promise was not provided by the claimant groom but by his father. However, the claim could also have failed on the ground that the groom was not a party to the contract; the contract was between the fathers of the couple.

Considering the merits of the doctrine of privity, it has always been uncontroversial that a third party should not be subjected to a burden by a contract to which they are not party. What is more controversial is the rule that a third party should not be able to obtain a benefit from a contract to which they are not a party.

Various common law and statutory devices were used to circumvent the rules on privity.

Parliament entered the fray relatively late, with the Contract (Rights of Third Parties) Act 1999. This allows a third party, who is neither a party to the contract, nor has provided consideration, to enforce a term of the contract in certain circumstances (see s 1). Given that the Act only applies in certain circumstances, the old common law and statutory devices for circumventing privity may still be utilised and may well give superior rights to the third party concerned, as they will not be subject to the limitations in the Act.

In this chapter, you will consider the common law and statutory devices used to circumvent the rules on privity, as well as the Contract (Rights of Third Parties) Act 1999.

2 Common law methods of circumventing the doctrine of privity

It is a fundamental principle of the common law that no person can sue or be sued on a contract unless they are a party to it. However, the rule that a third party should not be able to obtain a benefit from a contract to which they are not a party seems unfair at times. The judicial creativity

in circumventing the doctrine which is clear in some of the following cases is evidence of the courts' uneasiness with the doctrine.

We will consider the following common law exceptions:

- Agency
- Assignment
- Collateral contract
- Actions in tort
- Other judicial attempts to avoid the doctrine

2.1 Agency

An agency relationship occurs where one party, the agent, is authorised either expressly or by implication, by the principal, to contract on behalf of the principal. In practice, businesses selling goods sometimes appoint agents to find customers, negotiate sales and/or enter into contracts with customers on their behalf. If an agent enters into a contract with Party A on their principal's behalf, it is as if the contract were made between the principal and Party A. The basic requirements necessary to establish an agency relationship are as follows:

- (a) The principal should be named (usually by the agent) and it should be clear that the agent is contracting on the principal's behalf;
- (b) The agent should be authorised to act as agent. In the vast majority of cases, the agent's authority will be limited by the principal – eg the agent may be authorised to sell certain of the principal's goods within a certain range of prices. The agent does not have freedom to enter into any contract it wishes to on behalf of the principal. The principal is only bound by acts of the agent which are within the agent's authority (or, in certain circumstances, by acts which appear to be in the agent's authority); and
- (c) Consideration has moved from the principal.

It could be argued that this is an exception to the doctrine of privity since the principal and Party A do not deal directly with each other. However, it can be cogently argued that this is not a true exception to the doctrine of privity since it is the principal rather than the agent who is a party to the contract with Party A. It is the principal who can sue and be sued on the contract. The agent is not a party to the contract and, once the contract has been concluded, the agent's existence is no longer relevant. The principle of agency in this sense is simply a method of getting around the doctrine of privity, otherwise it would lead to difficulties in a business context.

2.2 Assignment

Where A is under a contractual obligation to B and B assigns their contractual rights to C, it may be possible for C to sue A on their promise to B. Crucially, because B is simply passing their rights to C, the extent of C's rights can never exceed the rights of B.

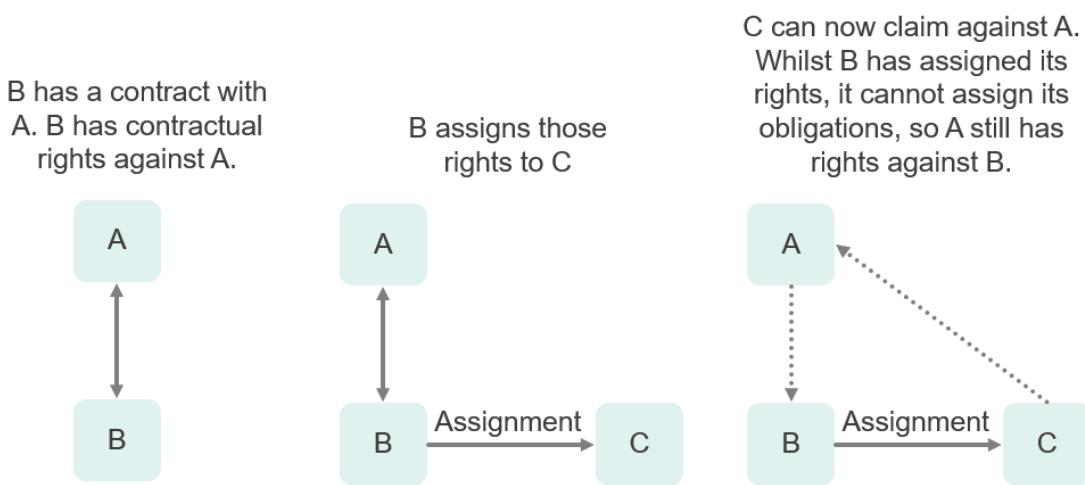


Figure 12.1: Assignment

If there is a prohibition against the assignment in the main contract, then any attempted assignment is likely to be unsuccessful.

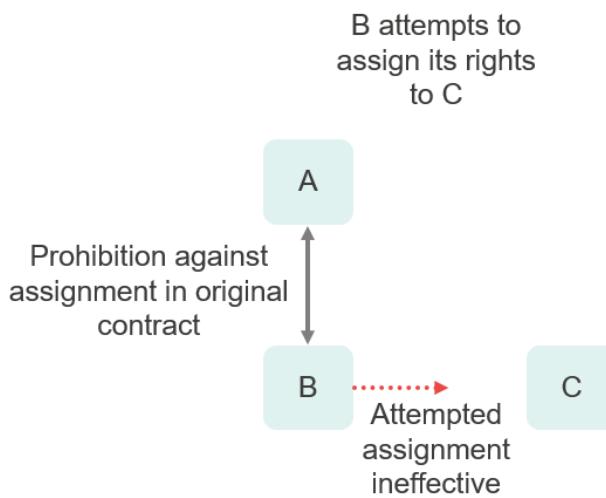


Figure 12.2: Prohibition on assignment

When the parties agree that assignment of rights is prohibited this is called a 'non-assignment' clause, and is quite common.



Example: 'Non-assignment' clause

Neither party shall be entitled to assign this Agreement or sub-contract any part of this Agreement to any person, persons or company without the prior written consent of the other party.

As an alternative to a total prohibition on assignment or sub-contracting (as set out above), the parties may agree to allow limited assignment of the benefit of the contract or sub-contracting of the work, for example, within a group of companies or to a named person or persons.

2.3 Collateral contract

The court may find a collateral contract between the promisor and the third party to provide an exception to the doctrine of privity. The case of *Shanklin Pier v Detel Products Ltd* [1951] 2 KB 854 is a good factual illustration of this device.

Shanklin Pier employed contractors to paint the pier. It was a term of the contract that Shanklin Pier was to specify the paint to be used. Detel informed Shanklin Pier that their paint would last for at least seven years. Shanklin Pier instructed the contractors to buy and use Detel's paint. The paint lasted three months. Shanklin Pier sued for breach of contract. However, the contract was between Shanklin Pier and the contractors. Mr Justice McNair held that there was a collateral contract between Shanklin Pier and Detel, the consideration for which was, on the one hand, the warranty by Detel that the paint would last for seven years and on the other, the instruction by Shanklin Pier to the contractors to buy the paint.

This shows that if the court can establish the existence of a separate collateral contract between the promisor and the third party, it can avoid the difficulties of privity. It should be noted that the promisor and the third party had communicated with each other, and also that the court found consideration for the bargain between them.

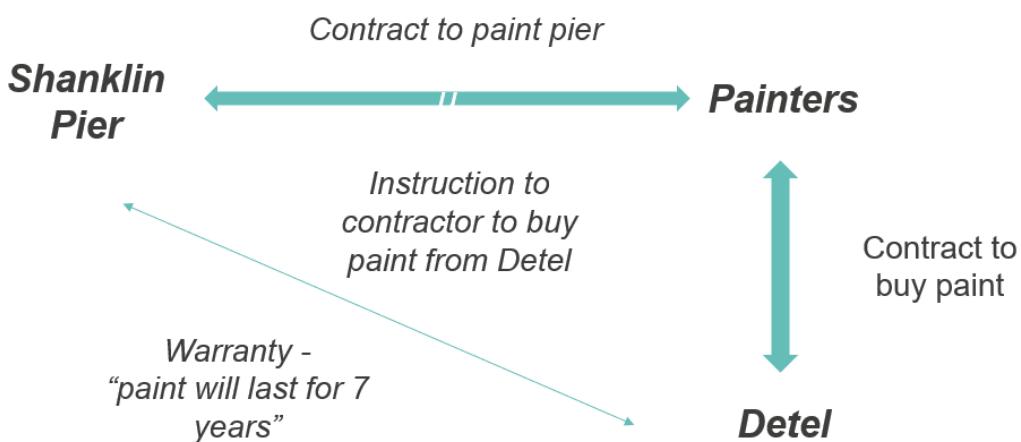


Figure 12.3: *Shanklin Pier v Detel Products Ltd* [1951] 2 KB 854

2.4 Actions in tort

During the development of the (tort) law of negligence, a critical question arose as to whether a person, C, who is not a party to the contract between A and B, may be owed a duty of care, so that conduct amounting to a breach of contract on the part of one of the contracting parties will constitute a breach of the duty of care owed to C, giving a third party (C) the right to sue that contracting party for damages in tort.

In the landmark case of *Donoghue v Stevenson* [1932] AC 562, the majority of the House of Lords (led by Lord Atkin) held that, in principle, a claim of this kind was available. In fact, in *Donoghue*, the plaintiff (C) was not only a third party in relation to the contract of sale between the manufacturer of the bottle of ginger beer and the retailer (the contract between A and B) but was also a third party in relation to the contract of sale between the retailer and the purchaser of the bottle of ginger beer (the contract between B and Y). Nevertheless, it was held that the plaintiff, as the ultimate consumer of the goods, could bring a claim in the tort of negligence directly against the manufacturer (A). In effect, this seminal decision held that the privity principle that restricted the range of claims for breach of contract did not also restrict the range of claims in tort. In so doing, it opened up the possibility of a far more extensive liability regime for negligence.

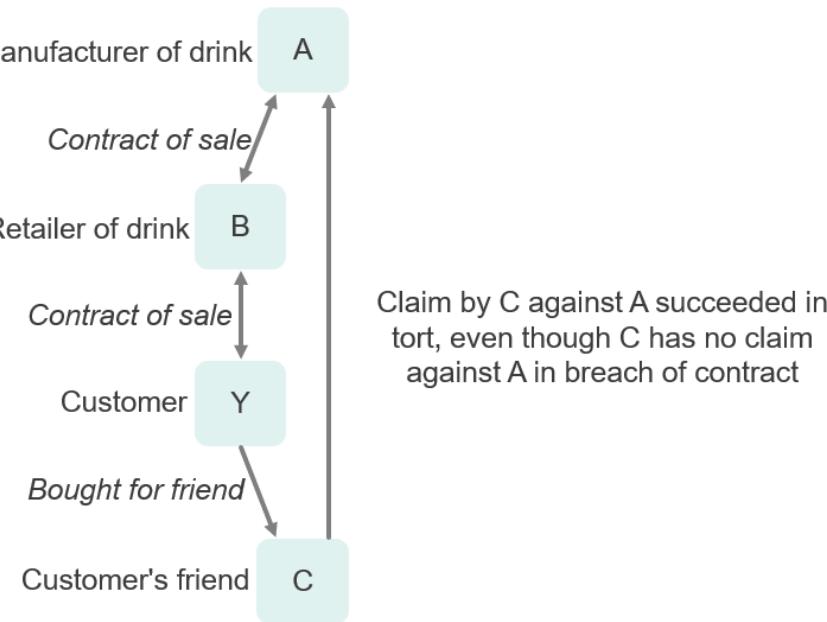


Figure 12.4: *Donoghue v Stevenson* [1932] AC 562

2.5 Judicial attempts to avoid the doctrine

The doctrine of privity came under direct criticism from the House of Lords in the case of *Woodar v Wimpey* [1980] 1 WLR 277.

The problem is that in some cases, A contracts with B to provide something of benefit to C. If B fails to do so, C has suffered a loss, but cannot bring a claim because it is not party to the contract. A is a party to the contract, but has suffered no loss.

Lord Scarman stated:

I regret that this House has not yet found the opportunity to reconsider the two rules which effectually prevent A or C recovering that which B, for value, had agreed to provide

These rules have the potential to operate harshly and in some cases the courts have taken a rather flexible approach to the doctrine of privity. A notable example can be seen in the case of *Jackson v Horizon Holidays* [1975] 1 WLR 1468. The claimant booked a holiday for himself, his wife and his two children at a total cost of £1,200. The defendant's brochure described the holiday hotel as having excellent facilities. This proved not to be the case and the claimant brought an action for breach of contract. At first instance, the judge made an award of £1,100 damages, which was just less than the full cost of the family holiday, despite his assertion that he would only consider the mental distress of the claimant and not that of his wife and children. The defendant appealed against the amount of damages. The Court of Appeal upheld the award. As clarified by subsequent authorities (in particular *Woodar v Wimpey*) the proper interpretation of the decision is probably that either:

- Mr Jackson's own losses were £1,100. The basis for reaching that conclusion is not really explained clearly in any of the judgments that suggest it; or
- The case is an exceptional type of contract 'calling for special treatment' and an example of one of the many situations 'which require some flexibility in the law of contract' (as per Lord Wilberforce in *Woodar v Wimpey*).

2.6 Summary

- Using a relationship of agency, Party A can enter into a contract on behalf of Party B, and Party B (but not Party A) becomes a party to the contract (unless Party A is also contracting on its own behalf).
- The court has used the device of the collateral contract as an exception to the doctrine of privity of contract.

- As a general rule a party can assign its rights under a contract (but not its obligations) to another party, but the contract concerned might prohibit this.
- Where a ‘third party’ is prevented by the privity rule from bringing a claim under the contract, you should consider whether a claim can be brought in tort instead.
- In certain circumstances, the courts have taken a flexible approach to the doctrine of privity, allowing a contracting party to recover in relation to losses suffered by a third party.

3 Contracts (Rights of Third Parties) Act 1999

At common law, a contract creates rights and obligations only between the parties to it. A contract does not confer enforceable rights on a third party to the contract, nor does it impose obligations on a third party. It is a fundamental principle of the common law that no person can sue or be sued on a contract unless they are a party to it. This is known as privity of contract.

The courts have sought to evade the unfairness that this rule can cause in various ways. There have also been various statutory interventions aimed at particular contracts/relationships.

However, the Contracts (Rights of Third Parties) Act 1999 introduced the most fundamental exception to the doctrine of privity. The Act allows a third party, in limited circumstances, to enforce a term of a contract to which they are not a party. This is the case even if the third party has not provided any consideration. The Act does not, however, allow a contract to be enforced against a third party.

The doctrine of privity remains intact and the Act simply creates a further (but substantial) exception to the doctrine which sits alongside the previous exceptions. The Act states, in s 7(1), that the existing common law and statutory exceptions are preserved.

In addition, the Act leaves the common law unchanged for those contracts excluded from the operation of the Act by virtue of s 6. Contracts listed under s 6 include employment contracts and contracts between a company and its members.

Exercise: Read alongside

Access the Contracts (Rights of Third Parties) Act 1999 and read the below alongside the Act, reading within the Act the sections referred to.

3.1 The circumstances in which a third party may enforce a term of a contract to which they are not a party

As stated above, the circumstances in which a third party may enforce a term of a contract to which the third party is not a party are limited. The circumstances are set out in s 1.

Exercise: Engage

In what circumstances may a third party enforce a term of a contract to which they are not a party? See s 1(1).

Note that ss 1(1)(a) and s 1(1)(b) create alternative circumstances in which a third party can enforce a term.

Under s 1(1)(a), the contract must specifically provide that the third party can enforce a term of the contract. For example, s 1(1)(a) would apply if the contract specifically stated: ‘X has the right to enforce this contract’ or ‘X has a right to sue on this contract’.

Under s 1(1)(b) in conjunction with s 1(2), it need not be stated specifically that the third party has the right to enforce a term. However, it must be established that:

- The agreement purported to confer a benefit on the third party; and
- It was not the case that the contracting parties ‘did not intend the term to be enforceable by the third party’.

3.1.1 Identification of the third party



Exercise: Engage

In order for the third party to be entitled to enforce a term under s 1(1)(a) or s 1(1)(b), how must the third party be identified? See s 1(3).

The fact that there is no requirement that the third party be in existence at the date of the contract means that a right can be conferred on, for example, an unborn child, being expressly identified as a member of an identified class or answering a particular description.

3.1.2 In what circumstances does s 1(1)(b) not apply?



Exercise: Engage

According to s 1(2), in what circumstances will s 1(1)(b) not apply?

In essence, where a term ‘purports to confer a benefit’ on a third party, s 1(1)(b) creates a rebuttable presumption that the third party will be able to enforce the term. Section 1(2) provides that this presumption will be rebutted 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’. The indications are that the courts will be slow to hold that, where the contract does purport to confer a benefit on a third party, there is no intention that the third party should have a right to enforce the term. In other words, once it is held that the contract purports to confer a benefit on a third party, there will be a rebuttable presumption in favour of the third party having a right to enforce the term and it will be difficult to rebut that presumption.

It is of course possible that the parties do not want any third parties to have any rights under the contract. To avoid any possibility that an agreement has ‘purported to confer a benefit on the third party’, the parties can explicitly exclude this. A possible boiler plate ‘**exclusion of third-party rights**’ clause is provided below.



Example: A clause excluding third party rights

For the purpose of the Contracts (Rights of Third Parties) Act 1999, this Agreement does not and is not intended to give any rights, or any right to enforce any of its provisions, to any person who is not a party to it.

Importantly, it should be noted that the Act also allows third parties to rely on exemption or limitation clauses in contracts to which they are not a party in the same way in which it allows third parties to enforce contractual terms (s 1(6)).

3.2 What are the remedies available to the third party?



Exercise: Engage

When a third party enforces a right under s 1, how do the remedies available to the third party compare to the remedies the third party would have obtained had they been a party to the contract? See s 1(5).

The rights conferred by s 1 would be of less use if the contracting parties were able, without the consent of the third party, to vary or rescind the contract so as to extinguish or alter the third party’s rights. Consequently, s 2(1) states:

Subject to the provisions of this section, where a third party has a right under section 1 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter his entitlement under that right, without his consent if:

- (a) the third party has communicated his assent to the term to the promisor,
- (b) the promisor is aware that the third party has relied on the term, or
- (c) the promisor can 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.

For the purposes of s 2(1)(a) the third party may communicate assent by ‘words or conduct’ (s 2(2)(a)) but, if the assent is sent by post, s 2(2)(b) stipulates that such communication will not be effective until received by the promisor.

If the contracting parties wish to allow variation or rescission without the consent of the third party or in circumstances not provided for in s 2(1), they can do so by including an express term in the contract (s 2(3)).

Section 2 also provides that the court can dispense with the third party’s consent where their whereabouts cannot reasonably be ascertained (s 2(4)(a)), where they are mentally incapable of giving their consent (s 2(4)(b)) or where their reliance on the term cannot be reasonably ascertained (s 2(5)). In such circumstances, where the court or arbitral tribunal sees fit to dispense with such consent, it may impose such conditions, for example a requirement to pay compensation, as may be thought fit (s 2(6)).

By virtue of s 3, the promisor’s defences against the third party are both the same as they would be against the promisee and anything specific that they may be able to claim against the third party.

Section 3(6) provides that a third party is not, by virtue of s 1, to be placed in a better position than if the third party had been a party to the contract itself. If, as such a party, they would not for whatever reason have been able to enforce the term (including, in particular, a term to exclude or limit liability) then they may not enforce it under s 1. Obvious examples would include where the benefit to be given would have been illegal under the contract or where the third party lacks contractual capacity.

3.3 How does s 1 affect the right of the promisee to enforce the contract?

Exercise: Engage

How does section 1 affect the right of the promisee to enforce the contract? See s 4.

As a breach of a relevant term could expose the promisor to actions by both the promisee and the third party, s 5 sets out to protect the promisor from double liability. It provides that any award to a third party may be reduced by the court or arbitral tribunal to such extent as is thought appropriate if the promisee has already recovered a sum in respect of the third party’s loss or the expense incurred by the promisee in making good to the third party the default of the promisor.

(a) Identify relevant contracts.

(b) Identify potentially relevant third parties:

on whom do you want to confer rights and whose rights do you want to preserve? An example might include the original supplier in respect of a supply contract between a retailer and a customer or the head franchisor in a franchise agreement between franchisee and sub franchisee.

(c) Consider whether third parties should be given enforceable rights:

it might be a question either of preserving an existing mechanism which circumvents the privity doctrine and confers a right on a third party; making the third party a contracting party in the first place; or, making use of the Act.

(d) Consider whether, if enforceable rights are given to third parties, there should be any restrictions on their ability to enforce such rights

Fundamentally, consideration will be given as to whether the Act should be excluded. As discussed above, there is a rebuttable presumption under the Act that, if a term purports to confer a benefit on a third party, this will be enforceable unless it is clear from the construction of the contract that the parties did not intend to confer such a benefit on the third party. In practice, you will find that there will often be express exclusion of the Act.

Figure 12.5: Application of the Contracts (Rights of Third Parties) Act 1999

3.4 Summary

- The Contracts (Rights of Third Parties) Act 1999 introduced a fundamental exception to the doctrine of privity. The Act allows a third party, in limited circumstances, to enforce a term of a contract to which it is not a party.
- Broadly, a third party will have such a right:
 - Where the contract states it should; or
 - Where the contract purports to confer a benefit on it, unless it appears the parties did not intend the term to be enforceable by the third party.
- The third party must be expressly identified in the contract, but this can be by describing a class of people, and the third party does not need to exist at the time of the contract.
- Once a third party has a right under the Act, that right sometimes cannot be reduced/extinguished by the parties without the third party's consent.
- The third party's rights will never be greater than they would have been had the third party been a party to the contract.

13

Discharge

1 Introduction

Every contractual obligation gives rise to a corresponding contractual right. Where the obligation of one party is discharged, the corresponding right of the other party is extinguished. Where all obligations arising under a contract are discharged and all rights thus extinguished, the contract is discharged.

A contract might be discharged in one of the following ways:

- (a) Performance;
- (b) Expiry;
- (c) Agreement;
- (d) Breach; or
- (e) Frustration.

You will consider each of these in turn.

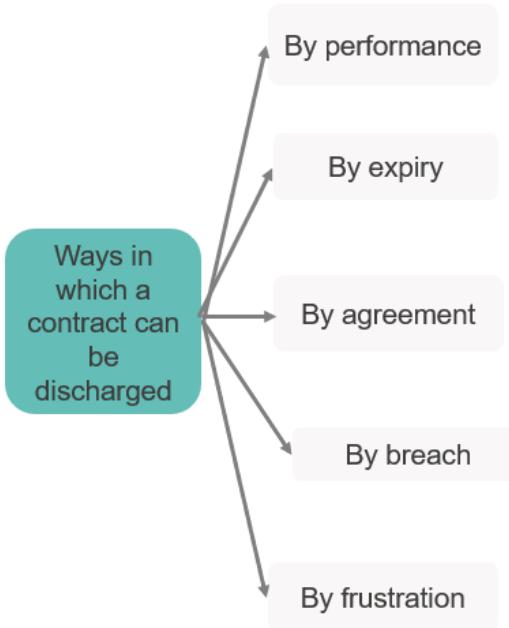


Figure 13.1: Ways in which a contract can be discharged

2 Discharge by expiry and by performance

There are a number of ways in which a contract can be discharged. This section focuses on discharge by expiry and by performance.

A contract may be terminated in accordance with the agreement on the occurrence of a stipulated event such as the expiry of a fixed term or through performance. This section will cover both methods of discharge but will focus on the more contentious, performance, and what constitutes performance.

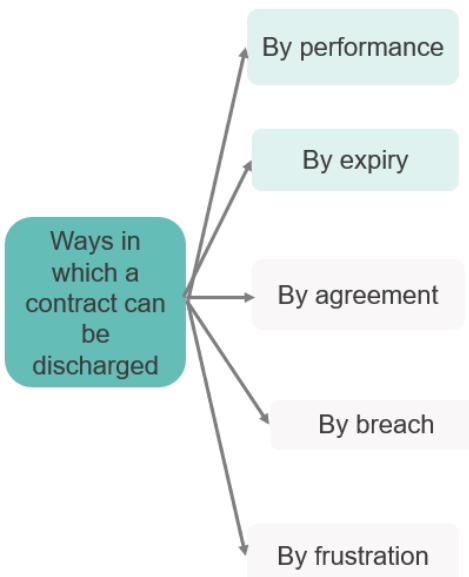


Figure 13.2: Discharge by performance and expiry

2.1 Discharge by expiry

A contract will expire when it is completed according to its own terms. Contract expiration is often by date ie the parties incorporate a term in the contract which stipulates when the contract comes to an end. For example, the contract provides that the contract will expire 12 months after the commencement date. A contract can also expire based on the occurrence of an event. For example, a contract may include a term that the supplier is to deliver goods to the buyer within a given time frame and upon delivery the contract comes to an end.

2.2 Discharge by performance

2.2.1 The entire obligations rule

A contractual obligation is discharged by a complete performance of the obligation. The promisee is entitled to the benefit of complete performance exactly according to the promisor's 'undertaking'. A promisor who only performs part of their obligation is not discharged from that obligation.

Imagine that a contract provides that A will pay B after B has performed its obligations (such as providing a service). B cannot bring a claim for the payment until performance is entirely complete. Nor, as a general rule, can B bring a claim for half of the payment when it has provided half the service, even if half the service is of value to the other party. B has to entirely complete performance, and then it is entitled to the entire payment.



Key case: *Cutter v Powell (1796) 6 Term Rep 320*

Facts: Cutter agreed to serve on a ship from Jamaica to Liverpool. The defendant, Powell, agreed in return to pay Cutter 30 guineas (which was four times the going rate) 'provided he proceeds, continues and does his duty [...] from hence to the port of Liverpool'. Cutter died at sea some seven weeks into the voyage and nineteen days short of Liverpool. Cutter's widow brought an action to recover a proportion of the agreed contract price.

Held: the action failed. The contract was said to be entire. Cutter was obliged to perform the given duty fully before he could demand payment. As the contract had not been completely performed the widow was entitled to nothing.

2.2.2 Exceptions to the entire obligations rule

The entire obligations rule can sometimes have a harsh effect.



Exercise: Engage

Why do you think exceptions to the entire obligations rule exist? It might assist you in answering this question if you think back to the decision in *Cutter v Powell*.

There are several exceptions to the rule which mitigate this harsh effect. The following exceptions will be considered in turn.

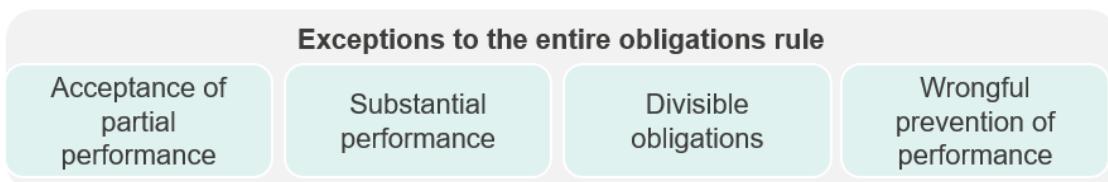


Figure 13.3: Exceptions to the entire obligations rule

Acceptance of partial performance

Where one party has given only partial performance of the contractual obligations, it is possible that the innocent party, rather than reject the work done, might accept that part of the performance. However, it should be noted that such an acceptance of partial performance is at the discretion of the innocent party. If the innocent party voluntarily accepts partial performance, then the party in default will be entitled to payment on a quantum meruit basis. Quantum meruit (meaning as much as is deserved) is a remedy whereby the claimant may be able to claim a reasonable sum so that the defendant is not unjustly enriched. The court will assess the value of a quantum meruit award on an objective basis using the information available to it, for example the usual market price for goods or services.

In *Sumpter v Hedges* (1898) 1 QB 673 Sumpter had agreed to build two houses with stables on Hedges' land, in return for a fixed price. After completing work worth around half of the contract price, Sumpter told Hedges that he did not have enough money to finish the job, so Hedges did it for himself.



Exercise: Engage

Before reading on, consider for yourself whether Hedges accepted partial performance in the case of *Sumpter v Hedges*.

In *Sumpter v Hedges*, because the work had been done on the innocent party's land, the court felt that the innocent party had no choice but to complete the work. He was in possession of what he could not fail to keep. This was not voluntary acceptance of partial performance as the innocent party did not have the option to take or not to take the benefit of the work done. If the court had found otherwise, however, the builder would have been entitled to a quantum meruit to compensate him for the value of the work done. In the event, he was entitled to compensation for the value of the materials which he had left on site which had not been incorporated into the building which the innocent party used to complete the work. This was because the innocent party had the choice as to whether or not to use these, as they could have been returned.

Substantial performance

Where a contract has been substantially performed, it may be possible for the party who rendered such substantial performance to obtain the contract price subject to a deduction to reflect the cost of remedying the 'defect' (ie the aspect which has not been performed). When considering such a plea, the court considers the nature and extent of the defect, which is done by measuring the cost of remedying the defect against the contract price. If the defect is too serious, the party who rendered the defective performance will not be entitled to recover any money.

However, if substantial performance is found to have been rendered, then the party will be entitled to the contract price subject to a deduction.

In defining what is ‘substantial performance’, the court takes a similar approach to when deciding whether has been a repudiatory breach of contract: the question is whether the defect goes ‘to the root of the contract’.

The two cases to be considered next illustrate the distinction.

In *Hoenig v Isaacs* [1952] 2 ALL ER 176 Hoenig agreed to redecorate completely and refurnish Isaacs’ one bedroom flat. Hoenig finished the work, but the job had some defects which would require further attention eg the wardrobe he fitted needed a new door, and the built in bookcase was slightly too short for the space. The total value of the work was around £750, and the repairs would cost around £55. Hoenig sued for payment but admitted that Isaacs was entitled to reduce the payment to reflect the cost of repairs. Isaacs said that entire performance was a condition precedent to any payment, and therefore, following Sumpter, he only had to pay a quantum meruit (in return for taking the benefit of the work).

The court held in this case, the contract had been substantially performed, and all that was left were ‘defects and omissions’. These did not go to the root of the contract. Hoenig was therefore entitled to the contract price, less a deduction for the defects (probably calculated as the cost of remedying the defects).

The case of *Hoenig v Isaacs* might be compared with the decision in *Bolton v Mahadeva* [1972] 1 WLR 1009. The claimant undertook to install a central heating system in the defendant’s house at a cost of £560. The system did not work, and the defendant refused to pay any money. The cost of remedying the defects would have been £174. The court had to determine whether the claimant was entitled to recover any payment under the contract.

It was held that whether or not the contract had been substantially performed should be viewed with regard to the purpose of the contract and the circumstances as a whole. The purpose of the contract in this case was to install a central heating system to heat a house. If that system did not function adequately and moreover produced harmful fumes, then it was not possible to say that the contract had been substantially performed. Accordingly, the claimant was not entitled to recover any of the contract price but, had he offered to remedy the defects, and had then done so, he would be justified in claiming the contract price.

Divisible obligations

Some contracts are clearly intended to be divided into parts, eg the payment of a salary under a fixed contract of employment. If this is the case, then the performing party is entitled to payment for each part which is performed. However, the question as to whether a contract is divisible or entire depends upon the intention of the parties.

Wrongful prevention of performance

Where one party performs part of the agreed obligation, and is then prevented from completing the rest by some fault of the other party, they will be entitled to payment despite not having completed the rest of the obligation (*Planche v Colborn* (1831) 131 ER 305). The innocent party has two options:

- (a) To sue for damages for breach of contract; or
- (b) To claim a quantum meruit.

2.2.3 Defences to allegations of failure to perform

It is important to note that a party being accused of failing to perform their obligations can potentially draw on a defence.

Tender of performance

In an action for breach of contract for failing to perform an obligation, it is a good defence for the defendant to show that they ‘tendered performance’. In order for a plea of tender to be successful, the promisor must show that they unconditionally offered to perform their obligations in accordance with the terms of the contract, but that the promisee refused to accept such performance. For instance, if the seller delivered goods but the purchaser refused to accept delivery, the seller would be relieved of liability for failing to deliver. In relation to payment of a

debt, a plea of tender does not discharge the debt. However, it would prevent the creditor from claiming interest or damages on that debt subsequent to the tender of performance.

2.3 Summary

- A contract will expire when it is completed according to its own terms. Contract expiration is often by date but a contract can also expire based on the occurrence of an event.
- Generally, an obligation is discharged by complete performance of the obligation. Until the obligation is completely performed, the performing party is not entitled to payment. There are four key exceptions:
 - If one party accepts partial performance, the other party is entitled to payment for the partial performance on a ‘quantum meruit’ (as much as is deserved) basis;
 - If one party has substantially performed the contract, they may be entitled to the contract price subject to a deduction for the cost of remedying the defect;
 - Some contracts are divisible, and a party is entitled to payment for each part. This turns on the intention of the parties;
 - Where a party is prevented from completing performance by the other party’s default, they can sue for damages for breach of contract or claim a quantum meruit.

3 Discharge by agreement

There are a number of ways in which a contract can be discharged. This section focuses on discharge by agreement.

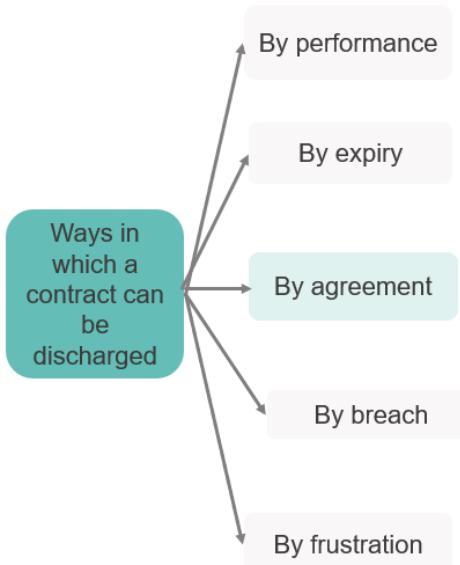


Figure 13.4: Discharge by agreement

3.1 Introduction

On the basis that something may be destroyed in the same manner by which it was created, a contractual obligation may be discharged by agreement. This may occur in one of two ways:

- (a) By a subsequent binding contract between the parties; or
- (b) Alternatively, by operation of a term of the original contract.

3.2 Discharge by subsequent binding contract

The essence of this concept is the formation of a new contract, and this may occur in several ways.

For instance, where both parties have obligations which remain unperformed, the contract may be discharged by mutual waiver. This is a new contract by which each party agrees to waive their rights under the old contract in consideration for being released from their obligations under the old contract.

This type of arrangement is very common in commercial situations where parties wish to end an existing contract and achieve commercial certainty. They will often agree the terms of a termination agreement to release and settle any liabilities under the original contract so that they can be sure that they will have no further liabilities or obligations arising from it in the future.

For this discharge to be effective, two elements must be present, sometimes called ‘accord and satisfaction’: there must be agreement that the obligation will be released (‘accord’), and there must be consideration for the promise to release a party from the obligation (‘satisfaction’).

Accord (agreement to release obligation)	Satisfaction (consideration for the promise)
A agrees to release B from its obligations under the old contract.	B agrees to release A from its obligations under the old contract.

However, this can give rise to difficulties in relation to the necessity for consideration where one party has performed its obligations in their entirety but something remains to be done by the other party. This problem is illustrated in the table below.

Accord (agreement to release obligation)	Satisfaction (consideration for the promise)
A agrees to release B from its obligations under the old contract.	Arguably there is no satisfaction. B cannot meaningfully agree to release A from its obligations under the old contract, because A has already performed those obligations.

One way of resolving this issue is that the party to whom the obligation is owed may release the other party by a subsequent agreement under deed. This avoids the need for consideration altogether, because a gratuitous promise (one without any consideration) is enforceable if made in a contract in the form of a deed.

Accord (agreement to release obligation)	Satisfaction (consideration for the promise)
There is no need for accord and satisfaction when a party is released from an obligation by deed.	

Alternatively, the party to whom the obligation is owed may provide consideration by agreeing with the other party to accept something different in place of the former obligation, for example the accelerated payment of a sum payable in instalments:

Accord (agreement to release obligation)	Satisfaction (consideration for the promise)
A agrees to release B from its obligations under the old contract.	B agrees to accept a new and different obligation to the existing obligation – such as paying instalments earlier.

Where there has been accord and satisfaction, the former obligation is discharged. The essential point is that, unless there is a new consideration, there can be no satisfaction, ie there can be no discharge of the previous agreement and no formation of an agreement on new terms.

3.3 Discharge by the operation of a term in the contract

There is no reason why a contract should not contain a term providing for the discharge of obligations arising from the contract. Such a term may be either a condition precedent or a condition subsequent.

3.3.1 Condition precedent

A condition precedent is a condition which must be satisfied before any rights come into existence. Where the coming into existence of a contract is subject to the occurrence of a specific event, the contract is said to be subject to a condition precedent. The contract is suspended until the condition is satisfied. Where a condition precedent is not fulfilled, there is no true discharge because the rights and obligations under the contract were contingent upon an event which did not occur, ie the rights and obligations never came into existence in the first place.



Condition precedent: A condition which must be satisfied before any rights come into existence.



Figure 13.5: Condition precedent



Example

Certain companies are required by law to obtain approval from shareholders before carrying out high value contracts. When agreeing the high value contract, the company could include a clause stipulating that it is a 'condition precedent' of the contract that approval is provided by the shareholders. Until that approval is provided, the remaining rights and obligations in the contract are not binding. If the shareholders refuse to provide the approval, then the contract never becomes binding, and the company does not infringe the law which prevents the high value contract.

3.3.2 Condition subsequent

A condition subsequent is a term providing for the termination of the contract and the discharge of obligations outstanding under the contract, in the event of a specified occurrence.



Condition subsequent: A condition which, if satisfied, releases a party from binding obligations.



Figure 13.6: Condition subsequent



Example

A common example is a term which provides the right for one or both parties to end the agreement by giving notice to the other party. If the condition transpires (the giving of notice), then the contract comes to an end. A more sophisticated version of the same idea would be a clause which entitles a party to give notice to terminate the contract if the other party commits a breach of contract of a specified seriousness.

Another common example is the inclusion of a termination clause specifying that the contract will come to an end upon the occurrence of specified events, such as when a particular date occurs.

In appropriate cases the court will even imply a term to empower a party to determine the contract on giving reasonable notice to the other party.

3.4 Summary

- The parties can discharge a contract by agreeing to do so in a subsequent binding contract.
 - For this to happen, the new contract needs to be supported by consideration (unless it is effected by deed). Particular care needs to be taken where one party has performed the old contract in full, in which case being released from it will not be good consideration.
- A contract can include terms providing its own discharge:
 - A 'condition precedent' is a condition that must be satisfied before any rights come into existence. This is not discharging a contract in the strict sense, it is preventing it from becoming binding in the first place.
 - A 'condition subsequent' is a term providing for the termination of the contract and the discharge of obligations outstanding under the contract upon the happening of a specific event.

4 Discharge by breach

There are a number of ways in which a contract can be discharged. This section focuses on discharge by breach.

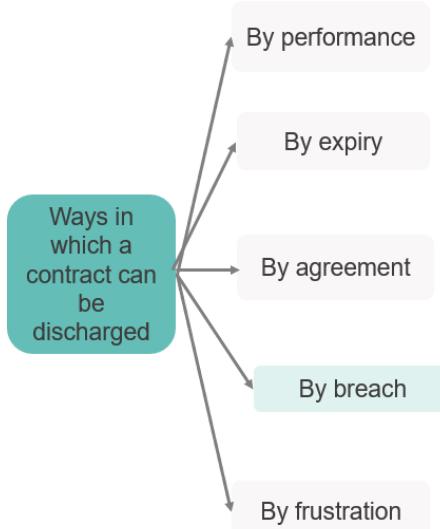


Figure 13.7: Discharge by breach

4.1 Repudiatory breach of contract at common law

The usual remedy for breach of contract is an award of compensatory damages, ie monetary compensation. Such a remedy is in principle available for any breach of contract, but a party does not always acquire a right to terminate the contract as a result of a breach of contract.

However, in certain circumstances, the innocent party may, in addition, treat the contract as having been terminated for repudiatory breach. This is where one party has breached a term of the contract which is either a condition or an innominate term which is to be treated as a condition. The distinction between conditions and innominate terms is not addressed in this section.

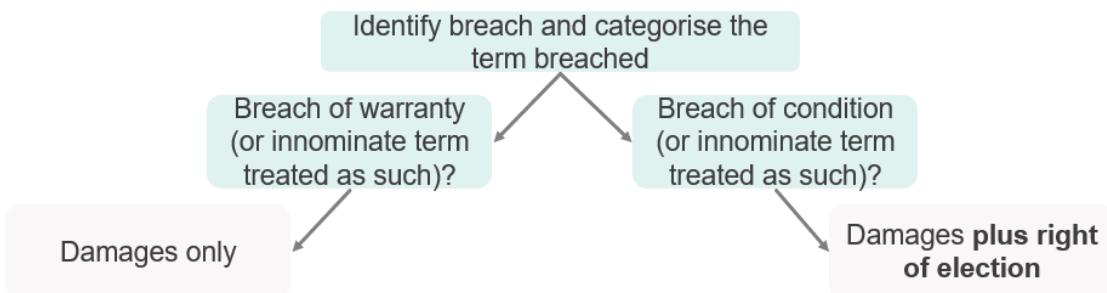


Figure 13.8: The consequences of a breach of contract

Termination for repudiatory breach is therefore one way in which a contract may come to an end. Generally, where there has been a repudiatory breach, a party has a choice as to whether to terminate the contract or to affirm it (keep it in place). The choice is not entirely unrestricted. We will consider the effect of termination before considering this choice. However, before considering either of these, we will consider the concept of 'anticipatory breach'.

4.2 Anticipatory breach

It is important to note at this stage a particular type of breach of contract known as 'anticipatory breach'. This is where a party indicates they will not perform their contractual obligations in advance of the date for performance. A party who, by words or conduct, leads a reasonable person to conclude that they do not intend to perform their part of the contract, is said to have 'renounced' the contract. The innocent party has an immediate right to 'accept' the renunciation and to treat the contract as terminated (*Hochster v De la Tour* (1853) 2 E&B 678).

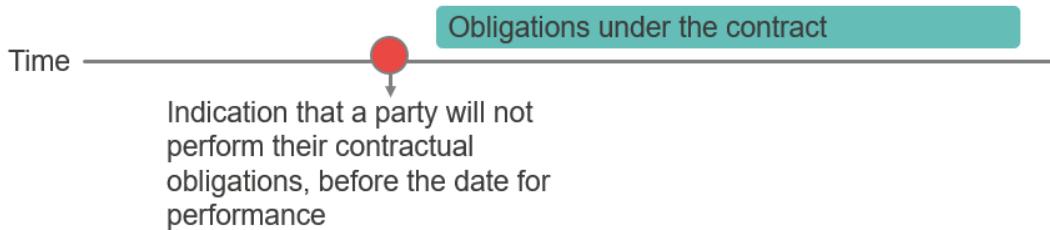


Figure 13.9: Anticipatory breach

An indication by a party that he will not perform their contractual obligations in only a minor regard will not give rise to the right to terminate. If a party wants to rely on an anticipatory repudiatory breach to terminate the contract then it will need to demonstrate that if the breach occurred at the time performance was due it would have been repudiatory.



Repudiatory breach: Where one party has breached a term of the contract which is either a condition, or an innominate term which is treated as a condition, entitling the other party (in principle) to treat the contract as terminated.

Anticipatory breach: Where a party indicates they will not perform their contractual obligations in advance of the date for performance.

4.3 What is the effect of terminating a contract for repudiatory breach?

Where the contract is terminated following a repudiatory breach this puts an end to all primary obligations of both parties remaining unperformed. Furthermore, the innocent party can claim damages not only arising from the specific breach but also the loss of the contract caused by the termination of the contract as a whole.

The discharge from remaining rights and obligations is ‘prospective’ only – any rights and obligations which have accrued before termination remain enforceable. For example, if a customer owes fees for services provided prior to termination then it would still be obliged to pay them. However, it would no longer be obliged to accept and pay for services going forward.

4.3.1 The risks of wrongful termination

An important point is that terminating a commercial contract for repudiatory breach often involves a high degree of risk for the client, in particular with regard to the risks of wrongful termination.

For example, imagine that a party (A) gives notice to terminate its contract with another party (B) on the grounds of a breach by B which it believes to be a breach of a condition and therefore repudiatory.

If a court later finds that the breach was of a warranty, then A had no right to terminate and its notice to do so was wrongful. In this context A's wrongful notice will be regarded as a ‘renunciation’ of future performance of the contract and/or a serious breach of contract and may be accepted by the other party, B (the original contract breaker), as repudiating the contract.

By serving a notice without justification for doing so, A has turned what it thought was a termination on the grounds of breach by B into a damages claim against it on the basis that A is the party actually in repudiatory breach.

This can be disastrous commercially and the risks for the terminating party are exacerbated by the fact that unless the term which has been breached has been defined as a condition then the categorisation of the term will depend on the application of the *Hong Kong Fir* test. This is a high bar and can be a difficult point to establish. It is generally no excuse for the aggrieved party, A, to plead that they acted in good faith, believing that B's breach justified the remedial action that was taken.

This uncertainty of the *Hong Kong Fir* test combined with the risks described above often leads commercial parties to inject certainty into their contracts by explicitly agreeing a list of breaches which will give rise to a right to terminate.



Example

- (a) A hires a robot from B for its factory to replace human labour for 10 months. A agrees to make monthly payments for the robot. B agrees to provide telephone support on how to use it.
- (b) A expects to make £10,000 additional profit per month from using the robot.
- (c) After 2 months the robot breaks down and develops a serious fault.
- (d) A identifies that the failure of the robot amounts to a breach of an innominate term of the contract, and that it deprives A of substantially the whole benefit of the contract. A therefore concludes that it is a repudiatory breach (let us assume that A is correct in this analysis).
- (e) A accepts the repudiatory breach as bringing the contract to an end, and communicates this acceptance to B.
- (f) A and B are discharged from future performance – A no longer has to make monthly payments. B no longer has to provide telephone support.
- (g) A cannot find a replacement robot and has to resort to human labour at the previous cost.
- (h) A will have a damages claim for its loss of bargain being the £80,000 profit it would have expected to have made had it had the robot available for the full eight months. A can claim these damages, which relate to the loss of the contract as a whole, despite the fact that it was A's choice to terminate the contract upon B's breach.
- (i) A will still have to pay charges which accrued in the two months of valid hire, if these have not been paid already.

4.4 The right of election

Where there has been a repudiatory breach of contract, the contract is terminated only if the aggrieved party makes the election (meaning choice) to treat the breach as repudiating the contract, ie putting an end to all unperformed primary obligations. The innocent party must make their decision to terminate the contract known to the party in default (*Vitol SA v Norelf Ltd, The Santa Clara* [1996] 3 All ER 193).

The innocent party is allowed a period of time in order to decide between these two alternatives.

4.4.1 The benefits of affirmation

If the innocent party elects to affirm the contract, the contract survives and the rights of the innocent party are preserved. There may be many commercial reasons why this might be a better option for the innocent party than termination. The precise rationale will depend on the circumstances. For example, the contract may relate to a major project whereby affirming and continuing with the project and giving the contractor an opportunity to finish is a better option than abandoning it altogether and having to sue for damages and find another contractor.

In the alternative, the innocent party may calculate that if the contract can be performed such that a right to charge the contractual charges as a debt will arise, then it will put itself in a better and more certain financial position than if it terminates the contract and brings a claim for unliquidated damages. This is because the value of a damages claim is uncertain (you will study damages claims in a later chapter). However, if the contract is affirmed and can be performed, the right to the contractual charges is relatively clear and certain.

Where a party has indicated an intention not to perform its obligations (ie has renounced the contract – see earlier in this section), the innocent party can still affirm the contract, perform its own obligations and claim the sum due under the contract in a debt action *White and Carter (Councils) Ltd v McGregor* [1962] AC 413.

If a party does affirm a contract, it is important to note that the innocent party will retain a claim for damages arising from the breach but cannot terminate as a result of it (so the damages would not include compensation for loss of performance of the contract as a whole). The election is between accepting the contract as discharged or continuing. The election is not a waiver of damages from the relevant breach.

4.4.2 How a contract is affirmed

There must be evidence of a very clear and unequivocal commitment to continuing with the contract.

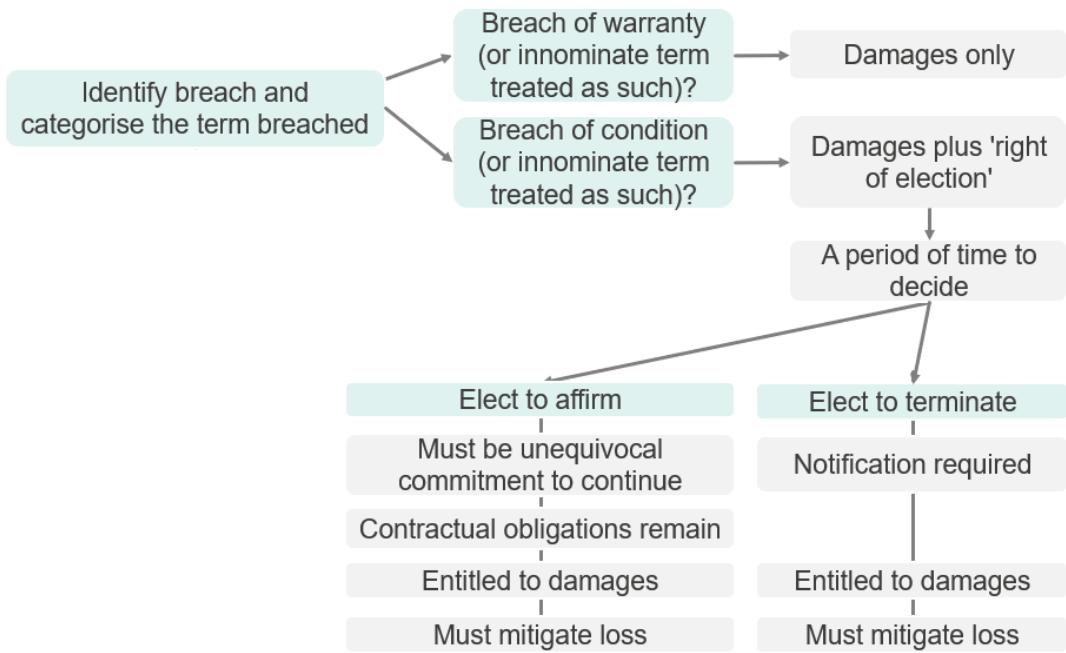


Figure 13.10: The right of election

4.4.3 Limits on affirmation of a contract

There are two important limitations on the innocent party's right to affirm the contract in response to a repudiatory breach. These are:

- The co-operation of the breaching party is required for continued performance of the contract (*Hounslow London Borough Council v Twickenham Garden Developments Ltd* [1970] 3 WLR 538); or
- The innocent party has no 'legitimate interest, financial or otherwise' in affirming the contract and continuing with performance (*Ocean Marine Navigation Ltd v Koch Carbon Inc (The Dynamic)* [2003] EWHC 1936 (Comm)).

In relation to (a), this qualification should be uncontroversial - if the innocent party requires the co-operation of the other contracting party in order to fulfil their obligations under the contract, this will prevent the innocent party claiming the contract price.

In relation to (b) it is only in extreme cases that the innocent party will not have a legitimate interest in affirmation and will only operate if the defendant can show that i) damages would be an adequate remedy for the claimant and ii) an election to keep the contract alive would be unreasonable.

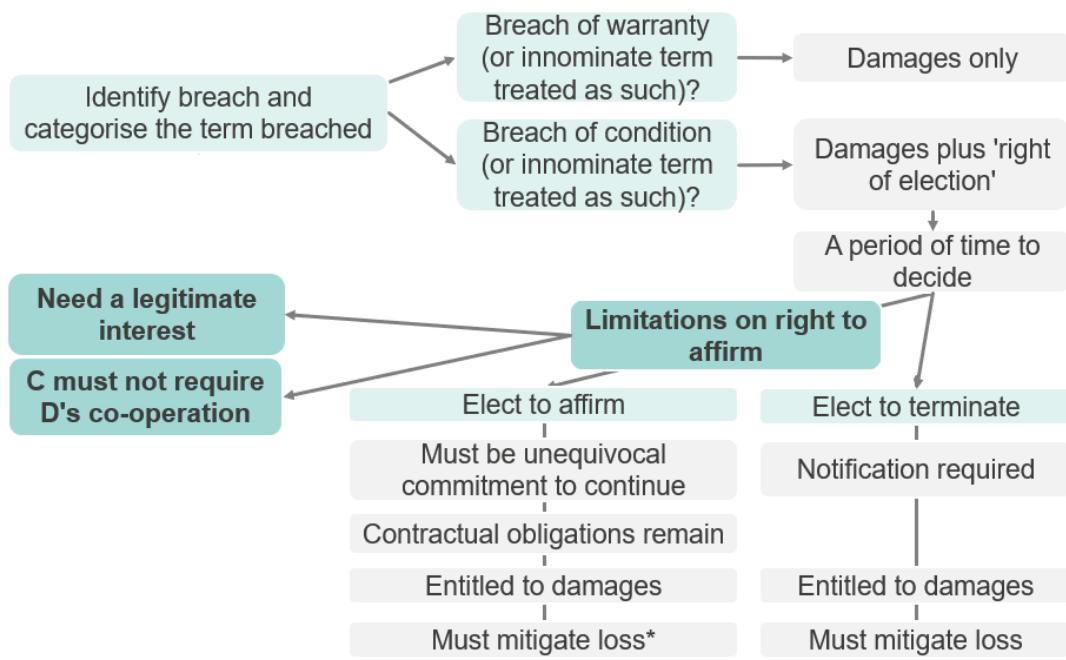


Figure 13.11: Limitations on the right to affirm

4.5 Summary

- Any breach entitles a party to damages in principle, but a breach of a condition (or an innominate term treated as a condition) – a repudiatory breach – also entitles a party to terminate the contract.
- A party is not obliged to terminate upon a repudiatory breach – it has a choice to affirm or to terminate.
- The innocent party has a period of time to make this choice. A decision to terminate must be communicated. Affirmation requires a clear and unequivocal commitment to continue with the contract.
- If a party terminates, it can seek damages not only arising from the specific breach but also the loss of the contract caused by the termination of the contract as a whole.
- If a party affirms, the parties' obligations under the contract remain in place. For example, if the party in breach is obliged to make further payments under the contract in the future, this obligation will remain in force.

5 Discharge by frustration

There are a number of ways in which a contract can be discharged. This section focuses on discharge by frustration.

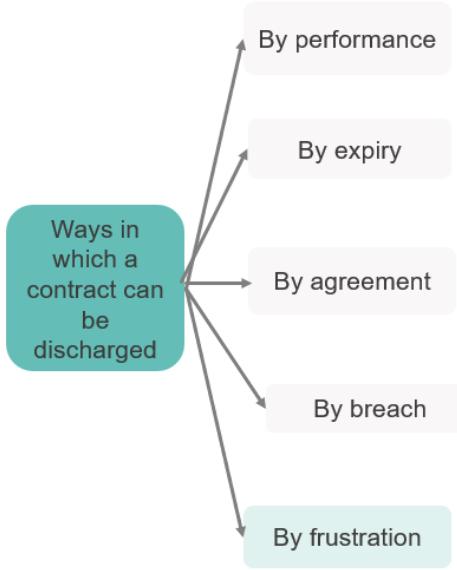


Figure 13.12: Discharge by frustration



Key case: *Davis Contractors v Fareham Urban District Council [1956] AC 696*

The modern definition of frustration is provided by Lord Radcliffe:

[F]rustration occurs whenever the law recognises 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. [...] It was not this that I promised to do.

From this we can understand that frustration is about events that are **beyond the control of either party**, occur **after** the formation of the contract and which render performance **radically different** from that which was agreed to at the time the contract was formed.

The effect of frustration is broadly to relieve a party from further obligations under the contract, so they do not have to meet these radically different obligations. If a contract is frustrated, it is brought to an end automatically: the parties have no choice in the matter. Frustration may be raised as a defence to an action for breach of contract.

In this section, you will explore:

- What might render performance radically different; and
- The limitations on the doctrine of frustration.

This is illustrated in the diagram on the following page.

The effect of frustration is also important, but it is not addressed in this particular section.

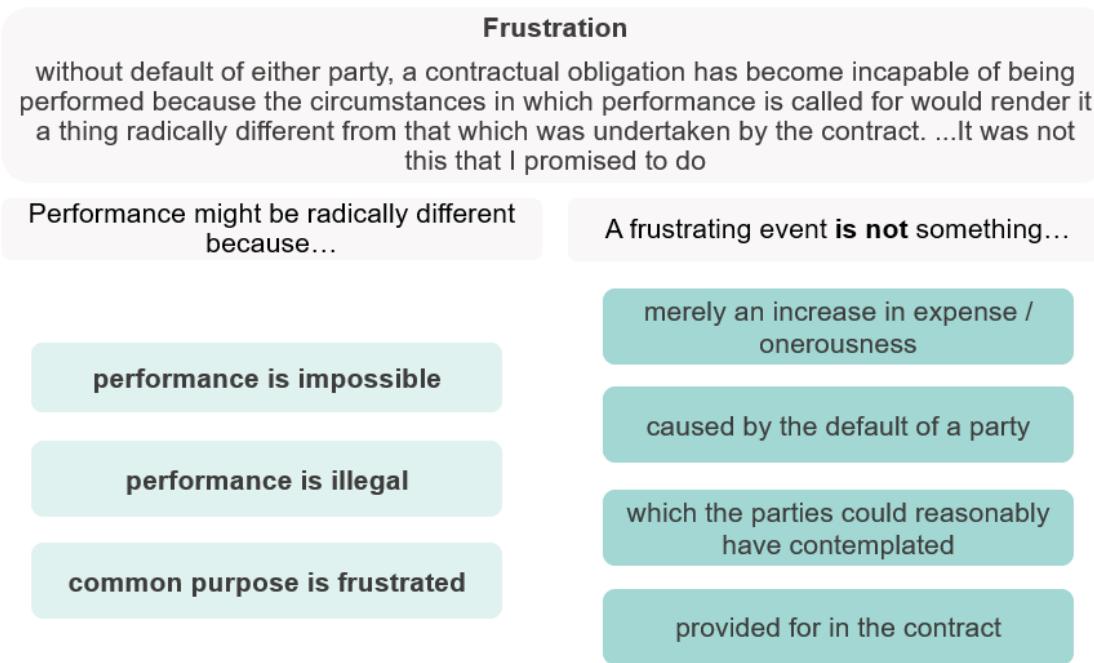


Figure 13.13: The doctrine of frustration

5.1 What might render performance radically different?

Performance may be radically different for a number of reasons, three of which will be considered in this section:

- Performance is impossible;
- Performance is illegal; or
- The common purpose of the contract is frustrated.

It is important to note that this list of categories is not exhaustive, nor will all frustrating events fit neatly into one category or another. Indeed, a frustrating event may fit into more than one category. The whole factual matrix of the situation needs to be considered. These categories do, however, provide helpful guidance as to when performance will be considered by the court to be radically different. When considering whether a contract might be frustrated, you should use the categories as broad guidance to assist in applying the overarching principle.

5.1.1 Impossibility and unavailability

Case law shows that the doctrine of frustration may be invoked in circumstances where the contract becomes impossible to perform due to the total or partial destruction of some object necessary to the performance of the contract.



Key case: *Taylor v Caldwell (1863) 3 B & S 826*

In *Taylor v Caldwell* (1863) 3 B & S 826 the defendants granted the claimants a licence to use its music hall at a cost of £100 per concert. After the contract had been entered into but before the first performance, the music hall was destroyed. No provision had been made for this risk in the contract. The court held that the contract was frustrated due to the destruction of the music hall rendering it impossible to continue with the contract.

In *Taylor v Caldwell* the subject matter of the contract, ie the music hall, was destroyed. Frustration may also operate where the event destroys an asset that does not form the subject matter of the contract in question, but rather is essential for the performance of the contract. For example, in *Appleby v Myers (1867) LR 2 CP 651* a contract to install and maintain machinery in a factory was frustrated when the factory was destroyed by fire. The factory was not the subject matter of the contract, but was nevertheless essential to its performance.

Impossibility might be extended to situations of death or illness of one of the parties in a personal contract, especially where a specified individual is engaged to render a particular service.

In *Condor v The Barron Knights Ltd* [1966] 1 WLR 87, the drummer in a music group was taken ill and only capable of working three or four nights a week, whereas the group had engagements for seven nights a week, such that the contract was frustrated because the drummer was not capable of performing the contract in the way intended.

The concept of unavailability is common in shipping contracts. Even temporary unavailability may discharge a contract if the interruption is such as to make performance substantially different from what was originally undertaken. Thus, where a ship was requisitioned for a period of five months out of a year's charterparty, the contract was frustrated: *Bank Line v Arthur Capel & Co* [1919] AC 435.

In *Tamplin SS Co Ltd v Anglo-Mexican Petroleum Co* [1916] 2 AC 397, the court had to decide whether the requisitioning of a ship (for the purposes of war) in February 1915 frustrated a five-year charterparty which was to last until December 1917. The court held that it did not, on the basis that the war would soon be over and thus a considerable proportion of the charterparty would remain. In the circumstances, this was overly optimistic, but it nevertheless demonstrates the problems facing a court in reaching satisfactory conclusions.

In *Edwinton Commercial Corporation v Tsaviris Russ (Worldwide Salvage & Towage) Ltd, The Sea Angel* [2007] EWCA Civ 547 the court made clear that the amount of time left to run in the contract is the starting point only in establishing frustration. A multifactorial approach should be adopted when assessing whether unavailability was sufficient to amount to frustration. The factors to be considered included:

the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances.

5.1.2 Supervening illegality

Frustration may also occur where a change in the law or state intervention renders performance illegal.

Key case: *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32

Facts: a contract for the sale of machinery provided for it to be shipped to a port in Poland. That port was then occupied by the enemy during the Second World War.

Held: the contract was frustrated – the parties could not be obliged to perform a contract when to do so would be illegal.

5.1.3 Frustration of purpose

Where the common purpose for which the contract was entered into can no longer be carried out because of some supervening event, the contract may be frustrated despite the fact that it is still physically possible to carry out the contract. It is important to remember that it must be the joint purpose of the parties. It is not enough that it is the purpose of just one party.

In the case of *Krell v Henry* [1903] 2 KB 740 the defendant agreed, by a written contract, to hire a room in a flat on Pall Mall from the plaintiff for two days. The purpose in hiring the room was to view the coronation procession that was to pass along the street below on those days. However, no express mention was made of this in the contract. King Edward VII fell ill and the processions did not go ahead as planned. The Court of Appeal held that the common foundation of the contract was that the room was hired to view the king's procession and this purpose had been frustrated. This is a highly unusual case. The rooms were hired out for the day only and both parties understood that the only purpose in hiring the rooms was to have a view of the procession.



Exercise: Engage

Consider if a common foundation would exist in *Krell v Henry* if the room hired was part of a hotel, hired on a typical nightly basis.

In *Herne Bay Steamboat Co Ltd v Hutton* [1903] 2 KB 683, the plaintiff hired their steamboat to the defendant ‘for the purpose of viewing the Naval Review and for a day’s cruise round the fleet’. The naval review was cancelled but the cruise could still go ahead. The contract was not frustrated. Viewing the naval fleet might have been the principal motivation for the defendant but it was not the common foundation of the contract.

In *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch) the European Medicines Agency (EMA) argued that its lease of its headquarters premises in Canary Wharf was frustrated when it was forced to move its headquarters to Amsterdam following Brexit. Mr Justice Smith found that there was no common purpose which had been frustrated and that the parties had divergent purposes when they entered into the bargain set out in the lease. The EMA wanted premises which suited its purposes but with flexibility as to exit and a low rent. The landlord in contrast wanted a secure long term cash flow opportunity and a balance on its obligations as to the condition of the premises. They had bargained for the possibility that the EMA might not fulfil the full term for some reason (albeit not due to Brexit) when they entered into the contract. Putting it another way, had Brexit been a possibility then the parties could have taken it into account and still agreed an adjusted commercial arrangement. The nature of the bargain had therefore not fundamentally changed for both parties.

From the above, *Krell v Henry* can be seen as a very narrow decision which has been distinguished rather than followed.

5.2 Limitations on the doctrine of frustration

The doctrine of frustration, as Viscount Simonds stated in *Tsakiroglou Co Ltd v Noblee Thorl GmbH* [1962] AC 93, ‘must be applied within very narrow limits’. While in *Pioneer Shipping Ltd and others v BTP Tioxide Ltd, The Nema* [1981] 2 All ER 1030, Lord Roskill remarked that ‘the doctrine is not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains’. It is unsurprising, therefore, that the law has developed a number of limitations on the doctrine.

5.2.1 Contracts which become more difficult or expensive to perform



Key case: *Davis Contractors v Fareham Urban District Council* [1956] AC 696

Facts: Davis Contractors agreed to build 78 houses within eight months for Fareham Council. The work took three times as long as it was supposed to, due to a lack of skilled labour, occasional stoppages due to a shortage of materials including bricks, timber and plumbers’ goods, and an exceptionally long frost followed by excessively muddy conditions. Davis Contractors incurred an additional cost of £17,600 in this time, on top of the £92,400 contract price, and they sought to claim this additional cost from Fareham. As the law stood at that time, if the contract had been frustrated, they would have been entitled to do so.

Held: ‘[W]here, without the default of either party, there has been an unexpected turn of events, which renders the contract more onerous than the parties had contemplated, that is [not] by itself a ground for relieving a party of the obligation he has undertaken.’

Applying that to the facts of the case, the court held that the contract was not frustrated.



Exercise: Engage

Before reading on, do you think the contract was frustrated in this case?

It is very rare for a contract to be held to have been frustrated by an event which leaves it possible to perform but which simply makes it much more onerous to one party. Consequently, it is accepted that it is unlikely that a contract will be frustrated merely because an event has

occurred which renders that contracted for by one party worth less than he anticipated, or where an unexpected event merely makes the contract more expensive to perform.

5.2.2 Self-induced frustration

Frustration will not apply where the event was induced by one of the parties, ie because the event was their fault or choice. It is for the party alleging self-induced frustration to prove that it is. If they succeed in showing the frustrating event is self-induced then the defence of frustration fails and the defendant will be in breach of contract.

This is illustrated by *J Lauritzen AS v Wijsmuller BV ('Super Servant Two')* [1990] 1 Lloyd's Rep 1. The defendants agreed to transport the claimant's oil rig using one of their barges, either Super Servant One or Super Servant Two. The defendants elected to use Super Servant Two for this contract and before the date of performance entered into other contracts to use Super Servant One. Super Servant Two sank. The defendants could not use Super Servant One as this was needed to perform the other contracts. The court held that it was the defendants choice to allocate Super Servant One to other contracts making it impossible to perform their contract with the claimants. This choice meant the defence of frustration failed – it was self induced.

5.2.3 Foreseeable events

The doctrine of frustration is a means of allocating unforeseen risks. In *Edwinton Commercial Corporation v Tsaviris Russ (Worldwide Salvage & Towage) Ltd, The Sea Angel* [2007] EWCA Civ 547, [2007] 2 All ER (Comm) 634, Rix LJ summarised the relationship of foreseeability to the doctrine of frustration:

In a sense, most events are to a greater or lesser degree foreseeable. That does not mean that they cannot lead to frustration. Even events which are not merely foreseen but made the subject of express contractual provision may lead to frustration: as occurs when an event such as a strike, or a restraint of princes, lasts for so long as to go beyond the risk assumed under the contract and to render performance radically different from that contracted for. However, [...] the less that an event, in its type and its impact, is foreseeable, the more likely it is to be a factor which, depending on other factors in the case, may lead on to frustration.

If you could have foreseen an event, but failed to make provision for it in your contract, the doctrine of frustration will be less likely to apply.

In *Flying Music Company Limited v Theater Entertainment SA* [2017] EWHC 3192 (QB), the negative effect on a contract in Greece of civil unrest and the economic crisis could not amount to frustration because at the time the contract concluded there were already signs of unrest. Although Theater Entertainment had hoped matters would improve there was a risk that they might not and the parties were deemed to have had the opportunity to deal with this risk and allocate responsibility for it in the terms of the contract that was eventually concluded. The Court refused to re-allocate the risks by intervening in the contract and deeming it frustrated.

However, in *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* Mr Justice Smith found that the key test is whether the event would have informed the manner in which the parties assessed the risk of entering into the contract. Highly theoretical risks which the parties would not have taken into account would not be relevant:

There will, no doubt, be many cases where something can be foreseen as a theoretical possibility, but where neither party can be criticised for failing to take it into account.

5.2.4 Express contractual provision

The doctrine of frustration cannot override express and unambiguous contractual provision for the frustrating event. Commercial contracts often contain what is known as a force majeure clause, a clause that states what will happen to the contractual relationship between the parties should a particular set of circumstances (which could otherwise amount to frustrating events) materialise. Force majeure clauses often refer to acts of terrorism, war and 'Acts of God'. The inclusion of a force majeure clause enables the parties to allocate risks in relation to these events at the outset and may allow for the continuance of the contractual relationship in circumstances that would otherwise amount to frustration of the contract. It is very unlikely that a party would be allowed to

rely on the doctrine of frustration in relation to a particular event when the risk has already been provided for by the parties through a force majeure clause.

5.3 Summary

- Frustration occurs when the law recognises, 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 radically different.
- Examples include performance becoming radically different because:
 - Performance is impossible;
 - Performance is illegal;
 - The parties' common purpose is frustrated.
- A frustrating event is not something:
 - Caused by the default of a party;
 - Provided for in the contract;
 - Which is merely an increase in expense/onerousness; nor
 - Which the parties could reasonably have contemplated.

6 The consequences of frustration

This section sets out the legal consequences of frustration.

If a frustrating event occurs all future obligations are automatically discharged by the common law. The Law Reform (Frustrated Contracts) Act 1943 deals with obligations arising prior to the frustrating event.

6.1 Law Reform (Frustrated Contracts) Act 1943



Exercise: Read alongside

Access the Law Reform (Frustrated Contracts) Act 1943. Read the sections referred to below.

The Act does not apply to future obligations. If a frustrating event occurs future obligations are automatically discharged by the common law. The Act deals with obligations arising prior to the frustrating event.

Section 1(2) of the Act makes the following provision:

- Money paid before the frustrating event can be recovered.
- Money that should have been paid before the frustrating event no longer needs to be paid.
- Expenses incurred by the payee (usually the supplier) can be recovered out of the total sum paid/payable before the event. The recovery of expenses is at the discretion of the court and is discussed further on the next page.

S1(2) gives the court a discretionary power to order such retention or recovery of money as it thinks just in all the circumstances to account for expenses incurred by the payee. The expenses incurred by the payee must be directly related to an attempt to perform the contract.

The amount retained or recovered is capped and cannot exceed (i) the actual expenses incurred and (ii) the amount paid or payable prior to the frustrating event. It is for the payee to establish that the expenses were incurred and that it is just for the court to deduct them from the sums paid or payable to them before the frustrating event.

If the supplier has expenses exceeding the amount of advanced payments actually paid or invoiced then it cannot claim them back. If nothing was paid or payable before the frustrating event, the party will not be able to get any expenses at all.

It is also important to note the requirement that it be just for the supplier to retain the expenses. The sum retained or recovered to account for the expenses may not be the actual expenses incurred but only what the court considers to be a just sum having regard to all the circumstances of the case.

So how does a judge decide (within the parameters set out above) what it would be just to allow the supplier to retain?



Key case: Gamerco SA v ICM/Fair Warning (Agency) Ltd [1995] 1 WLR 1226

Mr Justice Garland's held that burden or proof is on the payee (the party seeking to retain or recover their expenses from the sum of money paid or payable in advance) to show that it is 'just' for him so to do. As to how much, he held that the court has a 'broad discretion' and:

It is self-evident that any rigid rule is liable to produce injustice. The words, 'if it considers it just to do so having regard to all the circumstances of the case' clearly confer a very broad discretion [...]. I see no indication that the court is obliged to incline towards either total retention or equal division. Its task is to do justice in a situation which the parties had neither contemplated nor provided for, and to mitigate the possible harshness of allowing all loss to lie where it has fallen.

The court therefore has a 'broad discretion' when considering whether and how much to allow the payee to retain or recover to account for his expenses under s 1(2) (provided it does not exceed the actual expenses incurred or the sums paid or payable in advance of the frustrating event).

Where the benefit conferred before the frustrating event occurs is a non-monetary benefit, s 1(3) of the Act may be of some assistance. It provides that a party who has gained a valuable benefit under the contract before the frustrating event may be required to pay a just sum for it. The task for the court when applying this subsection is, firstly, to identify and value the benefit conferred, and then, secondly, to make an assessment of the just sum that should be awarded. The amount awarded cannot exceed the value of the benefit obtained. Provided the court does not award more than this amount, the court may award whatever sum is just, having regard to all the circumstances of the case and, in particular, s 1(3)(a) and (b).

The leading case on the interpretation of s 1(3) is *BP Exploration Co (Libya) Ltd v Hunt (No.2)* [1982] 1 All ER 925.



Key case: BP Exploration Co (Libya) Ltd v Hunt (No.2) [1982] 1 All ER 925

Facts: Hunt owned the right to oil from a Libyan oil field. He could not afford to develop the oil field on his own, so he entered an agreement with BP whereby they would pay the development costs in return for (i) a half stake in the oil field, and (ii) reimbursement of some of the costs out of Hunt's half, once the oil started pumping. In other words, Hunt would not have to contribute to the high costs of finding and extracting the oil in the field.

Large sums were spent by BP and they found and extracted some oil. Libya expropriated BP's half of the concession after Gaddafi's 1969 revolution. The Libyan government allowed Hunt to take oil for about two more years before his half was also expropriated.

BP brought a claim against Hunt on the basis that their agreement had been frustrated, and therefore they were entitled to a just sum to reflect the non-money benefits accrued to Hunt, for example the oil he received, but also the benefit of BP's expertise in finding and extracting the oil for him.

A key question was whether the valuable benefit gained by Hunt was the value of the work carried out by BP (ie the value of finding and developing the oilfield) or the value of the end benefit received by Hunt (significantly less, because the oil field was significantly devalued by having been expropriated by the Libyan Government).

Held: on the wording of the legislation it was clear that 'benefit' meant the end product of the claimant's services, not the services themselves. So in this case, the lesser of the two options.

The practical impact of this is that where the value of the benefit has been reduced to nil by the frustrating event, the provider of the 'benefit' has no claim. The defendant's benefit under s 1(3) is clearly not necessarily the value of the claimant's performance.

6.2 Summary

- Frustration discharges all future obligations. This happens automatically, irrespective of the parties' wishes.
- Under the Law Reform (Frustrated Contracts) Act 1943:
 - Section 1(2) provides that money paid before the frustrating event can be recovered even if failure of consideration is only partial. Money payable but not yet paid ceases to be payable. But the court has a discretionary power within specified limits to allow the party returning the money (normally the seller/supplier) to retain a sum for expenses incurred in attempting to perform the contract.
 - Section 1(3) provides that where a party receives a non-monetary benefit prior to the frustrating event, the court must (a) identify and value the benefit conferred; and (b) make an assessment of a just sum to be paid by that party for the benefit.



14

Remedies

1 Introduction

A right would be of little value if it did not lead to a remedy. Therefore, the law has developed a range of remedial responses available where a breach of contract occurs.

One remedy is an order for ‘specific performance’, requiring the defendant to carry out their undertaking exactly according to the terms of the contract.

Another remedy is an injunction, preventing the defendant from doing something which the contract says he may not do.

However, the principal remedy for breach of contract is damages – payment of money. This is by far the most common remedy and is available in the vast majority of instances of breach. The aim of an award of damages for breach of contract is to compensate the claimant for the damage, loss or injury they have suffered as a result of the defendant’s breach.

In this chapter you will study sections relating to:

- (a) The ‘assessment’ of damages – how the court decides what amount of damages should be payable;
- (b) What position the law of contract takes in relation to damages for certain types of loss, such as loss of reputation or loss of a chance to achieve something;
- (c) Factors limiting the damages that can be recovered namely:
 - (i) The requirements in contract law that recoverable damages must be those caused by the breach (‘causation’) and be not too remote from the breach (‘remoteness’); and
 - (ii) Losses that could have been avoided by mitigation.
- (d) Some advanced points in relation to remedies – in particular looking at alternative ways of measuring damages;
- (e) Remedies under the Consumer Rights Act 2015;
- (f) Liquidated damages and penalties; and
- (g) Specific performance and prohibitory injunctions

2 The assessment of damages

2.1 The purpose of damages in the law of contract

The aim of an award of damages for breach of contract is to compensate the claimant for the damage, loss or injury they have suffered as a result of the defendant’s breach.

Punishing the defendant is not the aim.

A claimant who has not suffered any loss by reason of the breach is nevertheless entitled to a judgment; but the damages recoverable will be purely nominal. Nominal damages are a token amount (a very small amount eg £1) which are awarded to acknowledge that there has been a breach of contract in a case where no other remedy is available.

2.2 What does compensating the innocent party mean?

The default approach to compensating the innocent party means putting the innocent party in the same position post-breach that they should have been in had the contract been performed.

This is sometimes called protecting the innocent party's 'expectation' interest – putting them in the position they 'expected' to be in.

In the leading authority, *Robinson v Harman* (1848) 1 Ex 850, Parke B stated:

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

This is normally what the innocent party will want – if they did not want to be in a position as if the contract had been performed, they would not have entered into the contract in the first place. As we will see, the apparently simple principle that, so far as money can do this, damages should be designed to put the innocent party in the same position as if the contract had been performed, is sometimes difficult to apply.



Example

On 1 February you agree to sell me a car. We agree you will deliver it to me on 1 May. On 1 April, in breach of contract, you indicate that you will not be delivering the car to me

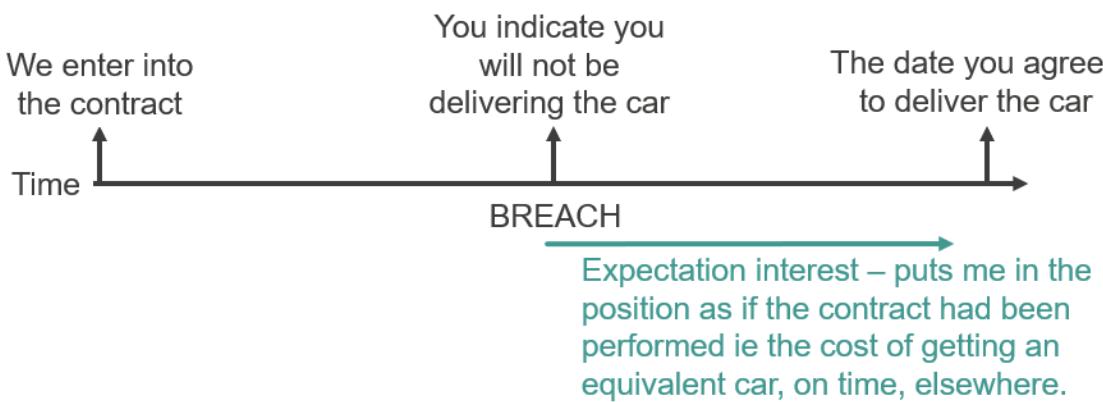


Figure 14.1: An example of the expectation interest

We will look first at the 'expectation' interest and various mechanisms for calculating it, before looking at the alternative of the 'reliance' interest.

2.3 Three mechanisms for calculating the expectation interest

The courts have developed three alternative mechanisms for calculating the expectation interest: cost of cure, diminution in value and loss of amenity. We will look at these in turn.

Three mechanisms for calculating the expectation interest

Cost of cure

Diminution in value

Loss of amenity

Figure 14.2: Mechanisms for calculating the expectation interest

Before we look at these mechanisms, and to understand why they are needed, consider first the facts of *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344 set out below.



Exercise: Engage

In *Ruxley v Forsyth*, Mr Forsyth employs Ruxley Electronics to build a swimming pool in his garden at a cost of £17,797.40. The contract provides that the pool should be 7 feet 6 inches deep. Ruxley Electronics builds it only to a depth of 6 feet. The pool is still perfectly safe for swimming and diving.

What sum of money is needed to put Mr Forsyth in the position as if the contract had been performed?

To the public at large, the pool is worth the same whether 6 or 7½ feet deep. So perhaps Mr Forsyth has suffered no loss, so should receive no damages. Does that seem fair? Or should he receive enough damages to allow him to rebuild the pool to the contract depth? – this would mean completely demolishing the existing pool and starting again, at a cost of £21,560. Does that seem fair? If Mr Forsyth receives £21,560 but doesn't actually spend the damages on rebuilding the pool, then he has a fully functioning (6 foot deep) pool and £21,560 in his pocket. But should it matter how he spends his damages?

Can you think of an alternative way of measuring the damages?

2.3.1 Cost of cure

The usual method of calculating the expectation interest in contracts involving defective works (eg where a building is not built to the contract specification) is the cost of cure (*Birse Construction Ltd v Eastern Telegraph Co Ltd* [2004] EWHC 2512). The cost of cure represents the cost of substitute or remedial work required to put the claimant in the position they would have been in had the contract been properly performed.

It should be noted that the claimant must act reasonably in relation to the defective works. In *McGlinn v Waltham Contractors* [2007] EWHC 149 (TCC), the claimant was found to have acted unreasonably in demolishing and rebuilding an entire property to cure defective works for purely aesthetic reasons and limited the award to the costs which would have been incurred in remedying the defects in the original building.

In the case of *Ruxley*, the cost of cure was the cost of rebuilding the pool - £21,560. But the court refused to award this, for reasons we will encounter later.

2.3.2 Diminution in value

Alternatively, the claimant's expectation interest may be calculated by reference to the difference in value between the performance received and that promised in the contract. In *Ruxley* the diminution in value was £0 – the pool had the same value whether 6 or 7.5 feet deep. But the court did not use this approach to valuation either.

If the court in *Ruxley* did not award either the cost of cure or the diminution in value, what did it award?



Key case: *Ruxley v Forsyth* [1996] AC 344

Facts: the facts of this case are set out above.

Held: Their Lordships were of the opinion that it would be unreasonable for the claimant to insist on cost of cure because the expense of the work involved would be **out of all proportion to the benefit to be obtained**. Furthermore, the **claimant's lack of intention to carry out the remedial works** was relevant to the extent of the loss which was sustained since, if the claimant did not intend to cure the defect, he had lost nothing except the difference in value, if any. Where the diminution in value caused by the breach was nil, it was not correct automatically to award the cost of cure as an alternative to the difference in value, since it could not be right to remedy the injustice of awarding too little by unjustly awarding too much. Their Lordships went on to state that diminution in value and cost of cure were not the only available measures for recovery for breach of contract and considered an alternative – loss of amenity.

2.3.3 Loss of amenity

In *Ruxley*, their Lordships stated that the cost of cure and diminution in value were not the only available mechanisms of assessing the expectation interest. Their lordships awarded £2,500 in loss of amenity damages, reflecting the non-economic loss of pleasure Mr Forsyth suffered in not getting the pool he contracted for.

The loss of amenity measure developed in *Ruxley* is a reflection of the court's growing willingness to accept that a consumer should have an available remedy where their loss is not economic in value, but nevertheless has a value to them. In a commercial setting, it would be 'unusual, if not impossible' for damages to be awarded for loss of amenity (*Regus (UK) Ltd v Epcot Solutions Ltd [2007] EWHC 938 (Comm)*).

2.3.4 Summary – Applying the mechanisms for calculating the expectation interest

Three mechanisms for calculating the expectation interest have been discussed above. We have seen that loss of amenity arises in fairly rare instances. It should also be noted that distinguishing between the diminution in value and cost of cure measures is only relevant where there is a disparity between the two. A disparity is only likely to arise in circumstances similar to *Ruxley v Forsyth*, where the breach of contract relates to an asset where there is a dispute with regard to a particular specification required by the purchaser. In the vast majority of situations, the two measures will produce the same outcome, and in such instances it is sufficient to ask the following question: what is the claimant's expectation loss? Or to put it another way: in what position would the claimant have been had the contract been properly performed (*Robinson v Harman*)?



Example: Calculating the expectation interest

Evans Productions is creating a new TV show based in a museum in Birmingham.

It has sold it to a TV channel for £100,000 (income), but the show has not yet been created.

EP expects to spend £40,000 on production.

In addition, EP engages a particular museum to supply the venue and some staff for a £30,000 fee.

The museum pulls out, in breach of contract.

The TV channel cancels its contract with EP.

At the point of the museum's breach, EP has spent £10,000 on production.

EP claims against the museum for breach of contract.

What are the damages on the basis of the expectation interest?

	Expected	Actual
	£	£
Gross income	100,000	0
Less expenses		
Production costs	(40,000)	(10,000)
Fee	(30,000)	0
Net profit	30,000	(10,000)

Expectation damages = put the claimant into the position it expected to have been in if the contract had been performed.

Difference between expected net profit of £30,000 and actual profit which was a loss of £10,000 = £40,000.

The measure of damages is £40,000.

2.4 The reliance interest

An alternative basis for the assessment of damages is the reliance measure. This measure allows the claimant to recover the expenses which have been incurred in preparing for, or in part performance of, the contract which have been rendered pointless by the breach. The reliance measure is inherently more cautious in its approach. It is backward looking (unlike the expectation measure, which is forward looking) and aims to put the claimant in the position they would have been in had they never contracted.

On 1 February you agree to sell me a particular painting. We agree you will deliver it to me on 1 May. On 1 March, I pay a framer £400 to prepare a frame that is particularly suited to this painting. On 1 April, in breach of contract, you indicate that you will not be delivering the painting to me because you have carelessly destroyed it.

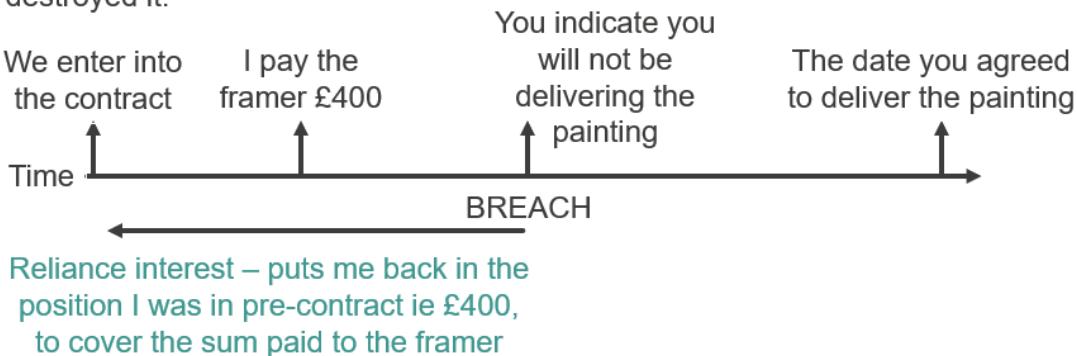


Figure 14.3: An example of the reliance interest

Reliance losses are most likely to become relevant because the courts will not award expectation damages if they are highly speculative; instead, the claimant will be limited to their reliance loss.

To consider the example above, it might be impossible to calculate the expectation interest, because it might be that there is no equivalent painting elsewhere that I want to buy (therefore no ‘cure’), and it could be hard to put a figure on the diminution in value or the loss of amenity. You can say with confidence, however, that the £400 is wasted: I can’t use the bespoke frame for anything else.

Note that the reliance interest only allows recovery of **wasted** expenditure, not all expenditure. So, if I am going to buy an alternative painting elsewhere and I can use the frame with that painting, I cannot recover the £400. It is expenditure in connection with the breached contract, but it is not **wasted** expenditure.

The case of *Anglia Television Ltd v Reed* [1972] 1 QB 60 considered next is perhaps the leading case on this measure.

Key case: *Anglia TV v Reed* [1972] 1 QB 60

Facts: The claimants engaged the defendant to star in a film which they were making. At the last moment, in breach of contract, the defendant refused to perform in the film, and the claimants had to abandon the film because they were unable to find a replacement actor. The claimants did not claim on the basis of the expectation measure (ie for the profit they would have made if the defendant had performed in the film) because they simply could not say what that would be – it was too speculative, too hard to predict. Instead, they claimed and obtained damages in respect of expenses of £2,750 in fees incurred for a director, a stage manager and others, which had been wasted by reason of the defendant’s refusal to perform, even though these expenses had been incurred before the contract was made.

Held: The claimants were entitled to these damages on the basis of the ‘reliance measure’.

As a final and important point, reliance losses are losses incurred prior to breach, not those incurred as a consequence of breach. Losses incurred remedying defective performance are not, therefore, reliance losses.



Example: Calculating the reliance interest

Let us revisit the scenario previously presented, but with one change – let us presume that EP has not yet sold its new TV show to anyone, and is entirely unable to say what it would obtain through doing so. The facts are:

Evans Productions is creating a new TV show based in a museum in Birmingham.

EP is unable to say what income it will generate from the TV show.

EP expects to spend £40,000 on production.

In addition, EP engages a particular museum to supply the venue and some staff for a £30,000 fee.

The museum pulls out, in breach of contract.

At the point of the museum's breach, EP has spent £10,000 on production.

EP claims against the museum for breach of contract.

As we cannot calculate the expectation interest (because we do not know what income the TV show would generate), what are the damages on the basis of the reliance interest?

	Expected	Actual
	£	£
Gross income	?	0
Less expenses		
Production costs	(40,000)	<u>(10,000)</u>
Fee	(30,000)	(0)
Net profit		(10,000)

The reliance damages = the amount incurred (underlined) = £10,000.

But – defendant might seek to prove expenditure would have been wasted in any event, in which case recovery will not be allowed.

2.5 Summary

- The aim of an award of damages for breach of contract is to compensate the claimant, not to punish the defendant.
- There are two main ways of doing this: awarding the expectation interest or awarding the reliance interest. The claimant can choose which.
- The normal measure is the expectation interest – damages to put the innocent party in the same position post-breach that they should have been in had the contract been performed. This is forward looking. This can be calculated by looking at:
 - The cost of curing the defective performance;
 - The difference in value between the performance received and that promised (but note: the cost of cure and difference in value are very often the same); or
 - The loss in amenity: a sum to represent that the performance received is less valuable to the innocent party than that promised, even if the economic value is the same.
- An alternative measure is the reliance interest. It is backward looking and aims to put the claimant in the position as if they had never contracted. It is more likely to be used when the expectation measure is hard to calculate.

3 Particular types of loss

The aim of an award of damages for breach of contract is to compensate the claimant for the damage, loss or injury they have suffered as a result of the defendant's breach. Usually (but not always) this means that damages should aim to put the defendant in the position they would have been in had the contract been performed.

The court has developed specific rules for certain kinds of loss when it comes to putting this expectation measure of damages into effect. In this section, we will consider special rules for the following:

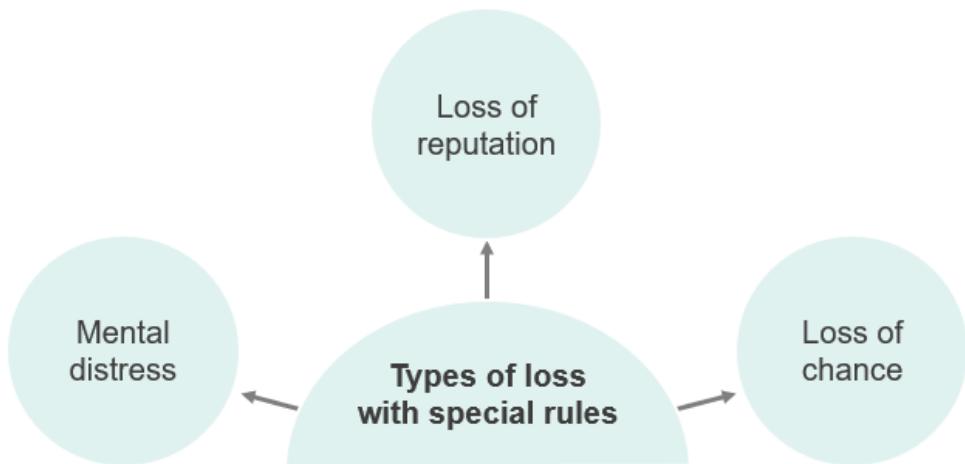


Figure 14.4: Particular types of loss

3.1 Damages for mental distress

The general rule is that damages will not be awarded in relation to mental distress, anguish or annoyance caused by breach of contract (*Addis v Gramophone Co Ltd* [1909] AC 488). In *Addis*, the House of Lords refused to uphold an award which had been made in relation to the 'harsh and humiliating' way in which the claimant had been dismissed from his job in breach of contract. *Johnson v Unisys Ltd* [2003] 1 AC 518 confirmed that damages for distress and injury to feelings resulting from the manner of dismissal are unavailable in the law of contract.

However, exceptions have developed to this general rule meaning that in a limited number of situations mental distress will be compensated:

- Initially, such compensation was limited to cases involving contracts whose whole purpose was the provision of pleasure, relaxation and peace of mind (*Jarvis v Swan Tours* [1973] QB 233).
- More recently, the House of Lords has allowed damages for non-pecuniary loss (in this case loss of amenity) where a major object (though not the whole purpose) of the contract was to provide pleasure, relaxation and peace of mind (*Farley v Skinner (No. 2)* [2001] UKHL 49).

3.2 Damages for loss of reputation

The general rule is that damages will not be awarded for loss of reputation.

However, in *Malik v Bank of Credit and Commerce International* [1998] AC 20, an employee had worked for the Bank of Credit and Commerce International (BCCI), which collapsed in 1991, amidst allegations that the bank had operated in a corrupt and dishonest manner. The employee claimed that having worked for BCCI had adversely affected his employment prospects. The House of Lords found that the employee did have the basis for a cause of action against his former employer for the loss caused by the way it was alleged that its business had been run. This was based on the fact that contracts of employment contain an implied term of trust and confidence such that the employer is under an obligation to carry out its work in an honest way. Damages were awarded but were limited to the claimant's financial loss, which was suffered due to an inability to obtain alternative employment resulting from breach of this implied term.

3.3 Damages for loss of chance

The loss of an opportunity is recoverable in damages if the lost chance is quantifiable in monetary terms and there was a real and substantial chance that the opportunity might have come to fruition. Otherwise, the loss of opportunity will be treated as too speculative. The courts are reluctant to treat the loss as too speculative and will award damages based on the expectation interest even if the precise quantification of loss may not be straightforward. The leading case on loss of chance, *Chaplin v Hicks* [1911] 2 KB 786, exemplifies this approach.

In *Chaplin v Hicks* [1911] 2 KB 786, the claimant was denied, in breach of contract, the chance to go through to the final round of a contest. The court held that she could be compensated for the loss of the chance of winning the competition. The courts have clarified that to claim loss of chance, the chance must be 'real and substantial'. Applying *Chaplin*, awarding loss of chance may be appropriate in the context of losing the chance of 'winning' along with other competitors. Note also that in *Chaplin*, the claimant had a less than 50% chance of winning. Where the chance of winning or obtaining the benefit is 50% or greater, the claimant should seek to recover their expectation loss in full and they will succeed if this can be proved on the balance of probabilities.

3.4 Damages on behalf of another

The general rule is that damages cannot be recovered on behalf of another party/for losses suffered by another party. There are exceptions to this general rule, but they are not considered in this section. If you have studied/go on to study privity of contract, that material relevant to privity will clarify this issue.

3.5 Summary

- The court has developed specific rules on the recoverability of particular kinds of loss.
- Damages for mental distress, anguish or annoyance are not generally recoverable.
- By way of exception, they may be recoverable where the whole, or perhaps a major purpose of the contract, is to provide pleasure, relaxation and peace of mind.
- It will be rare that a purely commercial contract has such a major purpose.
- Damages for loss of reputation are generally not awarded.
- Damages for loss of a chance are recoverable if the lost chance is quantifiable in monetary terms and there was a real and substantial chance that the opportunity might have come to fruition.

4 Causation, remoteness and mitigation

4.1 Introduction

Damages can only be recovered if they are caused by the breach.

Damages cannot be recovered if they are too remote from the breach.

Damages can be reduced if the claimant has failed to take reasonable steps to mitigate its losses.

This section will consider the principles of causation, remoteness and mitigation.

4.2 Causation

The claimant must establish a causal link between the defendant's breach of contract and its loss in order to recover damages. This means assessing:

- (a) Whether in fact the breach by the defendant has caused the loss suffered by the claimant (known as factual causation); and also
- (b) Whether as a matter of law the defendant should be held responsible for it (legal causation).



Factual causation: Whether the breach by the defendant has, as a matter of fact, caused the loss suffered by the claimant.

Legal causation: Whether the defendant should be held responsible for loss which has, as a matter of fact, been caused by its breach.

4.2.1 Factual causation

In contract the courts have treated the determination of factual causation in a broad way, advocating a 'common sense approach' (*Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360). The court in Galoo suggested that the defendant's breach should be a 'dominant' or 'effective' cause of the loss if that loss is to be recoverable.

4.2.2 Legal causation

Even if factual causation is established, the claim will fail if legal causation is not established, in particular if there is a *novus actus interveniens* – a particular category of intervening event which will be treated as having broken the chain of causation.

In *Lambert v Lewis* [1982] AC 225 a dealer supplied a defective trailer coupling to a customer who went on using it, after it was obviously broken, until there was an accident. The defect in the trailer coupling was an effective cause of the accident (so factual causation was established). But the question was whether, in terms of legal causation, the chain of causation was broken by the 'intervening act' of the customer's use of an obviously broken coupling. It was held that the customer's use of the coupling was not something which objectively one would deem 'likely to happen'. It therefore was treated as breaking the chain of causation and the dealer was held not liable for the accident.

If the intervening event was 'likely to happen' (*Monarch Steamship Co Ltd v A/B Karlshamns Oljefabriker* [1949] AC 196), it generally will not be held to break the chain of causation.

4.3 Remoteness of damage

The law of contract provides that not all losses flowing from (ie caused by) a breach of contract are recoverable. A line must be drawn somewhere dictating which loss is recoverable and which is not. The foundation of the law on remoteness in contract was set out by Baron Alderson in the decision of *Hadley v Baxendale* (1854) 9 Ex 341.



Key case: *Hadley v Baxendale* (1854) 9 Ex 341

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may [1] fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or [2] such as 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 of it.

The rule as stated in *Hadley v Baxendale* has two parts (as indicated by the numbers in the square brackets in the quotation).

The first limb – loss of a type ordinarily and naturally arising from the breach – is not based on actual knowledge of the particular parties. It looks at 'the usual course of things' and consequently what loss is liable to result from a breach of contract in that 'usual course'. If the loss is deemed a normal type of loss which would follow from the breach then it will be recoverable under the first limb of the *Hadley v Baxendale* test.

If losses are too unusual and far reaching to satisfy the first limb, then in order to recover those losses the claimant will have to establish, under the second limb of the *Hadley v Baxendale* test, that the particular defendant had sufficient actual knowledge of the particular and special circumstances to be aware of the risk of those losses.

Facts: The claimant, who was a mill owner, contracted with the defendant carrier to take a broken mill-shaft to the makers as a pattern for a new one. Owing to the carrier's neglect, there was a delay in the transport of the broken mill-shaft, which resulted in considerable losses for the mill owner, because no spare shaft was available.

Held: Applying the above two-stage test, the court held (considering the first limb) that in most cases of a breach of this kind, no such losses would have followed (as a spare shaft would be

available), so it could not be said that the losses followed naturally from the breach. Nor (considering the second limb) was the defendant aware, at the time of the contract, that the mill would not be able to function at all without this particular shaft, and so the loss could not ‘reasonably be supposed to have been in the contemplation of both parties’. Therefore, the losses were not recoverable. The losses might have been recoverable under the second limb if the special circumstances (that delay would cause a loss of profit) had been communicated to the defendant at the time of contracting, but they had not been.

The exact jurisprudential basis of the remoteness rules (ie their philosophical underpinning) is not addressed here. But most rationales point towards the remoteness rules limiting the recoverable losses to those losses that a contracting party would or should have been aware of as being likely to flow from the breach, because these are the risks that the contracting party could be said to have accepted upon entering into a contract. One example of such a rationale comes from Lord Hoffman in *Transfield Shipping Inc of Panama v Mercator Shipping Inc of Monrovia, The Achilleas* [2009] 1 AC 61:

It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken

Both limbs fit with this rationale – the first limb helping to identify risks that a contracting party should/would have known about because they usually materialise, and the second limb pointing to risks that a contracting party should/would have known about due to particular information communicated to them. This might help you to understand and/or remember the two limbs.

In the case of *Jackson v Royal Bank of Scotland* [2005] UKHL 3, the House of Lords, in applying *Hadley v Baxendale*, confirmed that what was in the contemplation (or knowledge) of the parties was to be judged at the time of contracting, as opposed to the time of the breach.

A good factual example of the application of the *Hadley v Baxendale* remoteness test can be found in the case of *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528. Victoria Laundry wished to expand their business, and they ordered a large boiler from the defendants, Newman Industries. Delivery was to take place on 5 June. The boiler was damaged before delivery, and delivery was delayed until 8 November. The claimant claimed for the profit that they would have earned with the boiler in the time between 5 June and 8 November. In particular, they claimed for the loss of, first, the extra laundry business that they could have taken on with immediate use of the new boiler, and, second, the loss of a number of highly lucrative dyeing contracts which they could have obtained with the Ministry of Supply.

The Court of Appeal held that the claimant could recover for the ordinary extra laundry business that they would have taken on. As the defendant knew at the time of contracting that the claimant was a launderer and dyer and required the boiler for immediate use in its business, these were losses occurring in the ‘usual course of things’ and satisfied the first limb of the *Hadley v Baxendale* test. The defendant must be presumed to have anticipated that some loss of profits would occur by reason of its delay, and these ordinary business profits were therefore recoverable.

The claimant’s loss of the lucrative dyeing contracts was considered too unusual and far reaching to satisfy the first limb of the *Hadley v Baxendale* test. It was therefore necessary for the claimant to prove that the defendant had sufficient actual knowledge of the particular and special circumstances to be aware of the risk. No notice had been given of the possible, highly lucrative, dyeing contracts. In the absence of special knowledge on its part, the defendant could not have reasonably contemplated the additional losses suffered by the claimant’s inability to accept the highly lucrative dyeing contracts, and so these losses also failed to satisfy the second limb of the *Hadley v Baxendale* test and were therefore irrecoverable.

4.4 Mitigation

Where one party has suffered loss resulting from the other party’s breach of contract, the injured party should take ‘reasonable steps’ (*British Westinghouse Electric and Manufacturing Co v Underground Electric Rail Co* [1912] AC 673) to minimise the effect of the breach.

Technically, there is no obligation to mitigate, but losses attributable to a failure to do so are not legally recoverable. The innocent party cannot, therefore, seek compensation by the party in

default for loss which is really due not to the breach itself, but its own failure to behave reasonably after the breach.

The question of what steps are ‘reasonable’ is one of fact. In *Pilkington v Wood* [1953] CH 770, it was held that there was no expectation that the claimant should embark on ‘a complicated and difficult piece of litigation’ in order to minimise the effects of the defendant’s breach.

The case of *Payzu v Saunders* [1919] 2 KB 581 demonstrates that reasonable steps to mitigate may, in some circumstances, include accepting the performance offered by the defendant under a new contract even when that performance amounts to a breach of the original contract.

In this case the defendant agreed to sell the claimants 200 pieces of silk. The goods were to be delivered as required and payment was to be made monthly following delivery. The first consignment was delivered and the claimants wrote a cheque for it which the defendant did not receive, and so the claimants sent another cheque. This delay caused the defendant to form the mistaken impression that the claimants were in financial difficulties, leading the defendant to refuse to make any further deliveries. This amounted to a repudiatory breach by the defendant. However, the defendant then offered to continue to supply the claimants under a new contract at the same price on the same terms, except for the single change that payment was to be made in cash on delivery. The claimants refused to accept this offer and sought damages for breach of contract. The market price of silk had risen and consequently damages of the difference between the market price and contract price were sought. It was held that the claimants should have mitigated their loss by accepting the defendant’s offer. Damages were confined to the loss that the claimants would have suffered if they had paid cash and acquired the goods at the contract price, ie the loss of a month’s credit which had originally applied under the contract.

If the defendant’s offer of performance remains the best substitute performance (as it was in *Payzu*) then it would seem unreasonable not to go to that source.

Banco de Portugal v Waterlow & Sons [1932] AC 452 establishes that when considering whether the claimant has taken reasonable steps to mitigate, the claimant’s actions ‘ought not to be weighed in nice scales at the instance of the party whose breach of contract has occasioned the difficulty’.

There is no duty to mitigate a claim for a payment of a debt. This includes a claim for liquidated damages. This is because the amount is payable as a contractual right rather than as damages.

4.5 Summary

- Damages can only be recovered if ‘factual causation’ can be established – if the defendant has, as a matter of fact, caused the loss suffered by the claimant.
- In addition, ‘legal causation’ must be established – there must be no unlikely, intervening act which breaks the chain of causation.
- Even if factual and legal causation are established, damages cannot be recovered for losses which are ‘too remote’ – ie losses which neither (1) arise naturally according to the usual course of things from the contract; nor (2) were or should have been in the contemplation of both parties.
- A party cannot recover losses which would have been avoided if that party had taken reasonable steps to mitigate its losses.

5 Remedies – advanced points

5.1 Introduction

This section will address some more advanced points concerning remedies available for breach of contract. We will address:

- (a) The reliance interest, and limits on the extent to which wasted expenditure can be recovered.
- (b) An alternative way of measuring damages – the restitution interest.
- (c) Basic principles of restitution and unjust enrichment.
- (d) A different approach to remoteness.

5.2 The reliance interest, and limits on the extent to which wasted expenditure can be recovered

You may recall that whilst damages are normally claimed based on the ‘expectation interest’, an alternative basis for the assessment of damages is the reliance measure. This measure allows the claimant to recover the expenses which have been incurred in preparing for, or in part performance of, the contract which have been rendered pointless by the breach.

Consider the facts of the case of *C & P Haulage v Middleton* [1983] 1 WLR 1461.

Facts: C & P Haulage contracted to allow Mr Middleton to use their premises for a vehicle repair business. Under the terms of the agreement (i) Mr Middleton’s licence was renewable every six months, and could be cancelled with one month’s notice, and (ii) any fixtures put into the premises by Mr Middleton were to be left on the premises. Mr Middleton carried out substantial work on the premises to make them suitable for use as a garage. The parties fell out and, on 5 October 1979, Mr Middleton was ejected from the premises and had to carry on his business from the garage at his house. Mr Middleton claimed £1,767.51 damages, to cover the money spent on putting the premises in a fit state to use as a garage (ie damages based on his reliance interest).

It was accepted by Mr Middleton that, under the contract, he was not entitled to take out any of the fixtures he had installed, and that he would not have been entitled to payment for the work he had done in relation to the premises. He also accepted that the agreement could have been lawfully terminated ten weeks after it was actually ended.

Exercise: Challenge yourself

Should Mr Middleton have been able to recover the sum of £1,767.51? Was this a sum he spent in preparing for/performing the contract? Does it matter that he could have been evicted after 10 weeks and that he would then have lost the benefit of that work anyway? Would it be fair to award him £0?

When you have considered this question, read the following extract from the judgment.

The present case seems to me to be quite different both from *Anglia Television Ltd. v. Reed* [...] in that while it is true that the expenditure could in a sense be said to be wasted in consequence of the breach of contract, it was equally likely to be wasted if there had been no breach, because the plaintiffs wanted to get the defendant out and could terminate the licence at quite short notice. A high risk of waste was from the very first inherent in the nature of the contract itself, breach or no breach. The reality of the matter is that the waste resulted from what was, on the defendant’s side, a very unsatisfactory and dangerous bargain.

[...] an aggrieved party cannot recover for expenses that would have been wasted whether or not the breach of contract occurred. The losses must flow from the breach, not from making a bad bargain. [...] Mr Middleton had made a bad deal – he spent a great deal of money improving premises that he had only a limited right to occupy. Mr Middleton was only entitled to stay for six months at a time, and had no right under the contract for compensation for the money he spent improving the premises as [...] all fixtures and fittings were to be left on the premises. Mr Middleton’s loss therefore came from making a bad bargain, not from the breach.

[...] no award of damages can put the claimant in a better position than he would have been in had the contract been performed.

The claimant was seeking its reliance loss (in a situation where it had no expectation loss); however, it did not succeed as it failed to show that, had the contract gone ahead properly, it would have been able to recoup this expenditure in any event. The claimant was therefore limited to recovering a nominal amount of damages in recognition of the technical breach it had sustained.

C & P Haulage v Middleton shows that it will only be possible for the claimant to claim their reliance interest if the contract would have enabled them to recoup those expenses had it been properly performed.

It is for the defendant to prove that the claimant would not have recouped the expenditure had the contract gone ahead (*Omak Maritime Ltd v Mamola Challenger Shipping Co Ltd* [2010] EWHC 2026).

Figure 14.5: Recovering the reliance interest

This is a logical resolution to the problem: it is a good example of the court resolving a case by reference to a key principle: the purpose of contractual damages is compensatory, no award of damages can put the claimant in a better position than it would have been in had the contract been performed (the ‘no windfall’ principle).

5.3 The restitution interest

Until quite recently it was assumed that in the event of a breach of contract, it was only the reliance and the expectation interests that were recognised for compensatory purposes. However, there now seems to be a third possibility: compensation for the ‘restitution’ interest.

Stated shortly, the restitution interest represents the interest a claimant has in the restoration to them of benefits which the defaulting party has acquired at their expense.

In general, the gain to a defendant from a breach of contract is irrelevant to the quantification of damages. However, as a result of the decision of the House of Lords in *Attorney-General v Blake* [2001] 1 AC 268, it is now clear that there are at least certain circumstances in which a claimant can recover the profit which the defendant has made from its breach of contract.

Key case: *Attorney-General v Blake* [2001] 1 AC 268

Facts: Blake, a former member of the intelligence services, undertook not to divulge any official information gained as a result of his employment and broke the undertaking by publishing his memoirs, *No Other Choice*. The Crown sought to recover the royalties he was to be paid by his publishers.

Held: Their Lordships confirmed that, in general, damages were measured by the claimant’s loss, but held that in an exceptional case the court can require the defendant to account to the claimant for benefits received from a breach of contract.

In determining whether to order an account for profits, Lord Nicholls (with whom Lord Goff and Lord Browne-Wilkinson agreed) stated:

An account of profits will be appropriate in exceptional circumstances. Normally the remedies of [compensatory] damages, specific performance and injunction, coupled with the characterisation of some contractual obligations as fiduciary, will provide an adequate response to breach of contract. It will only be in exceptional cases, where those remedies are inadequate, that any question of accounting for profits will arise. No fixed rules can be prescribed. The court will have regard to all the circumstances, including the subject matter of the contract, the purpose of the contractual provision which has been breached, the circumstances in which the breach occurred, the consequences of the breach and circumstances in which relief is being sought. A useful general guide, although not exhaustive, is whether the claimant had a legitimate interest in preventing the defendant’s profit-making activity and, hence, in depriving him of his profit.

The inadequacy of other remedies thus appears fundamental to the award of an account of profits. The claimant must also show that he has a ‘legitimate interest’ in depriving the defendant

of his profit. The Crown was held to have such a ‘legitimate interest’ in Blake and no other remedy was adequate on the facts. If restitutionary damages had not been awarded, the Crown would have recovered nothing, since they had suffered no loss.

Although their Lordships in *Blake* declined to give more clear guidance as to when an account of profits would be awarded, they did indicate that the existence of a so-called ‘efficient breach’ would not alone justify allowing an account of profits. An ‘efficient breach’ is one where:

- (a) the breach was cynical and deliberate;
- (b) the breach enabled the defendant to enter into a more profitable contract elsewhere; and
- (c) by entering into a new and more profitable contract, the defendant put it out of his power to perform the contract with the claimant.

An efficient breach puts the breaching party in a better position than if there had been no breach. It is therefore efficient for the breaching party to breach the contract. An efficient breach alone will not justify the award of damages on a restitutionary measure. Subsequent case law is so far equivocal as to the circumstances in which courts will find situations sufficiently ‘exceptional’ to justify using the *Blake* approach.

An example which fell short of the requirements is *Experience Hendrix LLC v PPX Enterprises Inc* (2003) EWCA Civ 323 in which the dispute concerned improper granting of licences in relation to recordings made by the guitarist Jimi Hendrix. The court decided that it was not an ‘exceptional’ case within the meaning of *Blake*, and the court therefore refused to order an account of profits (ie a claim based on the restitution interest to take away the profit made by the party in breach). In particular, Mance LJ pointed out that:

We are not concerned with a subject anything like as special or sensitive as national security. The State’s special interest in preventing a spy benefiting by breaches of his contractual duty of secrecy, and so removing at least part of the financial attraction of such breaches, has no parallel in this case.

In *Morris-Garner v One Step (Support) Ltd* [2018] UKSC 20 the exceptional nature of *Blake* was again emphasised, and the key point made by Lord Reed:

Common law damages for breach of contract cannot be awarded merely for the purpose of depriving the defendant of profits made as a result of the breach, other than in exceptional circumstances.

Exercise: Challenge yourself

One thing that makes the restitutionary measure particularly controversial is that it can arise where the innocent party has no financial losses when considering either the reliance or the expectation interest. In order to bring this development more into line with orthodox contractual theory, there have been attempts by both judges and academics to explain the new restitutionary payments as an oblique attempt to cover an element of the expectation interest. How do you think they have done this? What might the link be between your expectation that I perform our contract, and any profit I might make from breaching it?

One argument that has been made is that the relevant loss arises when the contract-breaker proceeds with the breach without giving the other party the opportunity to license the breach. On this view, the order for an account of profits is a way of compensating for the innocent party’s loss of bargaining opportunity.

Irrespective of whether this seems plausible in general, in *Blake* itself, this theory runs into the objection that there was no loss of bargaining opportunity because the Crown would never have agreed to license Blake’s breach. In *Blake*, the terms of contract that tied Blake to the Official Secrets Act were strictly non-negotiable. But, perhaps this is precisely what makes *Blake* such an exceptional case. In other words, compensation in *Blake* is not for a loss of bargaining opportunity but for an egregious breach of terms that were known to be fundamental and strictly non-negotiable. If this account makes sense, then perhaps *Blake* helps us to see where contract law needs an additional (restitutionary) resource to protect the legitimate interests of the innocent party.

Explore further these tensions in the following three papers by Craig Rotherham: ‘Wrotham Park Damages’ and Accounts of Profits: Compensation or Restitution?’ [2008] LMCLQ 25; ‘Gain-Based Relief in Tort After Attorney General v Blake’ (2010) 126 LQR 102; and ‘Deterrence as a Justification for Awarding Accounts of Profits’ (2012) 32 OJLS 1.

5.4 Restitution and unjust enrichment

The law of restitution addresses the unjust enrichment of the defendant at the expense of the claimant. We have just considered that the courts will exceptionally compensate the claimant based on the defendant’s unjust enrichment by holding the defendant to account for profit they have made as a result of breach. Below we consider a restitution claim that might arise where there is a total failure of consideration.

Total failure of consideration

Restitution provides a remedy when there is a total failure of consideration. A total failure of consideration occurs where one party has provided something of value under the contract but has received nothing in return. In such circumstances, the court may use the principles of restitution to prevent a party from benefiting from the lack of consideration. In such a case restitution will operate to reverse the unjust enrichment of one of the parties.

5.5 A different approach to remoteness

You will be familiar with the approach to remoteness set out in *Hadley v Baxendale*, that a party can only recover damages caused by the breach and which can reasonably be considered either:

- (a) arising naturally, ie, according to the usual course of things, from such breach of contract itself; or
- (b) such as 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 of it.

The case set of *Transfield Shipping Inc of Panama v Mercator Shipping Inc of Monrovia, The Achilleas* [2009] 1 AC 61 takes a different approach to remoteness. In this case, Transfield chartered ‘The Achilleas’ from Mercator. Transfield were late in the redelivery of the vessel. Mercator had entered into a subsequent charterparty to follow immediately upon the return of The Achilleas. Due to extreme volatility in the shipping charter market, the price of charters had fallen quickly and due to Transfield’s late return Mercator were forced to take a much lower price for The Achilleas for the subsequent charter than had previously been agreed. Mercator argued that they should be entitled to claim for the reduction in the rate of hire for the duration of the subsequent charter. Transfield argued that Mercator should be limited to the reduced rate of hire for the period of late delivery and that losses for the full period of the subsequent charter were too remote.

The initial arbitrator, High Court and the Court of Appeal all found that a claim for a reduced rate of hire during the duration of the subsequent charter fell within the first limb of *Hadley v Baxendale* (normal loss) and within the reasonable contemplation/imputed knowledge of the parties. However, the House of Lords found for Transfield. The precise basis on which the majority did so is a matter of some uncertainty. The principle described by Lord Hoffman was that a key question for remoteness in contract was whether in objective terms the defendant had ‘assumed responsibility’ for the loss in question (as opposed to whether the losses are ‘normal’ under *Hadley v Baxendale*). In this case the evidence was that it was not normal in the specific industry for a party to pay for losses for late redelivery for the full term of the subsequent charter, and therefore Transfield had not assumed the risk of liability in relation to this sum and would not be liable for the reduction in the rate of hire for the full duration of the subsequent charter.

The principle used in *Transfield* would mark a significant departure from the rule in *Hadley v Baxendale*. However, subsequent cases have shown that the courts remain committed to the rule in *Hadley v Baxendale* as the default or normal way of establishing ‘remoteness’. Transfield should be seen in the context of specific industries (*Supershield Ltd v Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7), where on examining the approach and the commercial background it becomes clear that the *Hadley* approach would not ‘reflect the expectation or intention reasonably imputed to the parties’ (*John Grimes Partnership Ltd v Gubbins* [2013] EWCA Civ 37).

The normal test for remoteness therefore appears to remain the approach explained in *Hadley v Baxendale*.

5.6 Summary

- When a party claims on the basis of its ‘reliance’ interest, it can only recover losses that could have been recouped had the contract been properly performed.
- As well as the possibility of damages being awarded on the basis of the ‘expectation’ interest or ‘reliance’ interest, exceptionally damages have been awarded on the basis of the ‘restitution’ interest instead. This measures damages on the basis of ‘restoring’ to the claimant a benefit which the defaulting party acquired at their expense. This will only be awarded in exceptional cases, when other remedies are inadequate: beyond this, the case law in this area is unclear and evolving.
- A restitution claim may arise where there is a total failure of consideration.
- One way to approach remoteness is not to adopt the two-limb test in *Hadley v Baxendale* but rather to ask whether in objective terms the defendant had ‘assumed responsibility’ for the loss in question. This approach has some merits, but should not be considered the default way of considering damages.

6 Remedies under the Consumer Rights Act 2015

6.1 Introduction

The Consumer Rights Act 2015 is a crucial piece of legislation regulating contracts between businesses and consumers. You may already have come across it in the context of:

- (a) Terms which it implies into certain contracts;
- (b) The way it regulates unfair terms.

Part 1 of the Act, which deals with consumer contracts for goods, digital content, and services, also provides certain remedies to consumers when those implied terms are breached.

Exercise: Read alongside

Access the Consumer Rights Act 2015. Read the sections referred to below as they are referred to.

6.2 Contracts for goods

The Consumer Rights Act 2015 provides that where goods sold to a consumer fail to meet any of the requirements in s 9 (satisfactory quality), s 10 (reasonably fit for their particular purpose) or s 11 (correspondence with description) then the goods are regarded as non-conforming. Where the goods are non-conforming, there are three remedial options available to the consumer, namely:

- (a) The short-term right to reject
- (b) The right to repair or replacement
- (c) The right to a price reduction or the final right to reject.

6.2.1 The short term right to reject

Broadly speaking, the short-term right to reject is available to the consumer for 30 days running from the time (i) that ownership has passed (or, in the case of contracts for hire or the like, possession has been transferred) and (ii) the goods have been delivered and (iii) in cases where the trader is required to install the goods or to take other action to enable the consumer to use the goods, the trader has notified the consumer that the required steps have been taken (s 22).

6.2.2 The right to repair or replacement

The right to repair or replacement is available unless repair or replacement is either impossible or disproportionate (in the sense that it imposes an unreasonable cost on the trader relative to the other remedies and the interests of the consumer) (s 23).

6.2.3 The right to a price reduction or the final right to reject

The consumer is not entitled to both a price reduction and final rejection; and, in either case, the remedy may only be exercised where:

- After one repair or one replacement, the goods do not conform to the contract;
- The consumer can require neither repair nor replacement of the goods (because it is impossible or disproportionate); or
- The consumer has required the trader to repair or replace the goods, but the trader is in breach of the requirement to do so within a reasonable time and without significant inconvenience to the consumer (s 24).

It should also be noted that s 24(10) provides that the general rule is that, where the final right to reject is exercised within six months (the clock running—as with the short term right to reject—from the time that ownership has passed, and so on), there should be a full refund with no deduction for use—but this does not apply to motor vehicles or any other goods that may be specified by statutory order.

Remedies in relation to contracts for goods

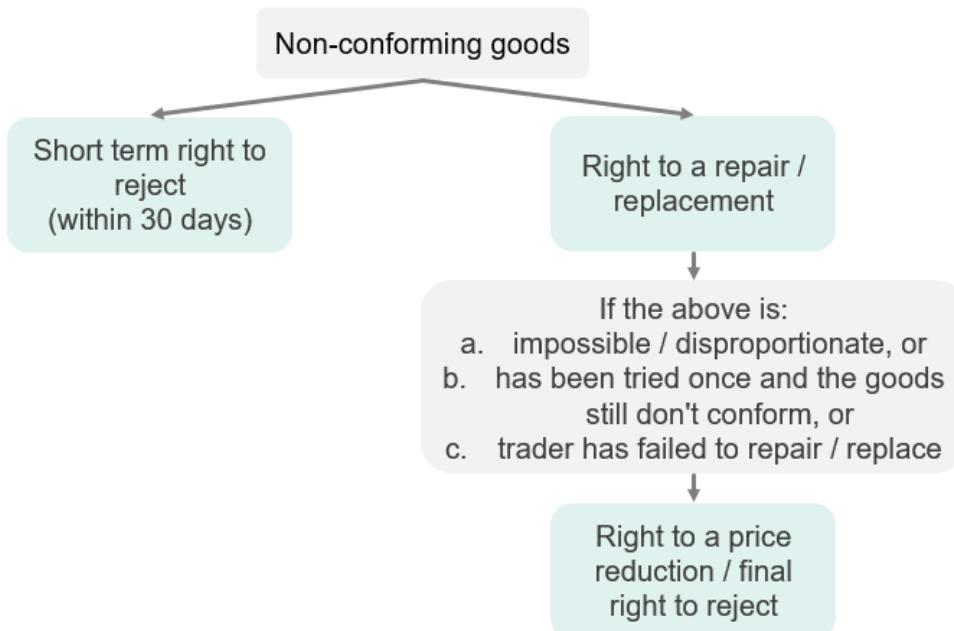


Figure 14.6: Remedies in relation to contracts for goods

6.3 Contracts for digital media

Section 42 provides that, where the digital content is non-conforming, there are two remedial options available to the consumer, namely:

- The right to repair or replacement
- The right to price reduction

In relation to these remedies, s 42(9) provides that ‘digital content which does not conform to the contract at any time within the period of six months beginning with the day on which it was supplied must be taken not to have conformed to the contract when it was supplied’.

6.3.1 The right to repair or replacement

Section 43 elaborates and qualifies the right to repair or replacement in the way that we have seen already in relation to contracts for goods. In particular, s 43(2)(a) requires the trader to repair or replace the digital content ‘within a reasonable time and without significant inconvenience to the consumer’; s 43(3) precludes the consumer from requiring repair or replacement where this would be impossible or disproportionate; and s 43(5) identifies the nature

of the digital content together with the purpose for which the digital content was obtained or accessed as material to judging ‘what is a reasonable time or significant inconvenience’.

6.3.2 The right to price reduction

Similarly, s 44 qualifies the right to price reduction, this right being exercisable only where the consumer either cannot require repair or replacement (because this is impossible or it would be disproportionate) or where the trader has failed to repair or replace the digital content within a reasonable time and without significant inconvenience to the consumer.

6.3.3 The right to a refund

Where the trader had no right to supply the digital content that it supplied, s 45 gives the consumer the right to receive a refund of all money paid for the digital content. A refund must be given within 14 days. The trader must give a refund using the same payment method that the consumer used to pay for the digital content, without imposing any fee in respect of the refund.

6.3.4 Damage to device or other digital content

What is the legal position if non-compliant digital content causes damage to a device or to other content? According to s 46, where:

- (a) A trader supplies digital content to a consumer under a contract;
- (b) The digital content causes damage to a device or to other digital content;
- (c) The device or digital content that is damaged belongs to the consumer; and
- (d) The damage is of a kind that would not have occurred if the trader had exercised reasonable care and skill, then the consumer is entitled to repair or to a compensatory payment.

Remedies in relation to contracts for digital content

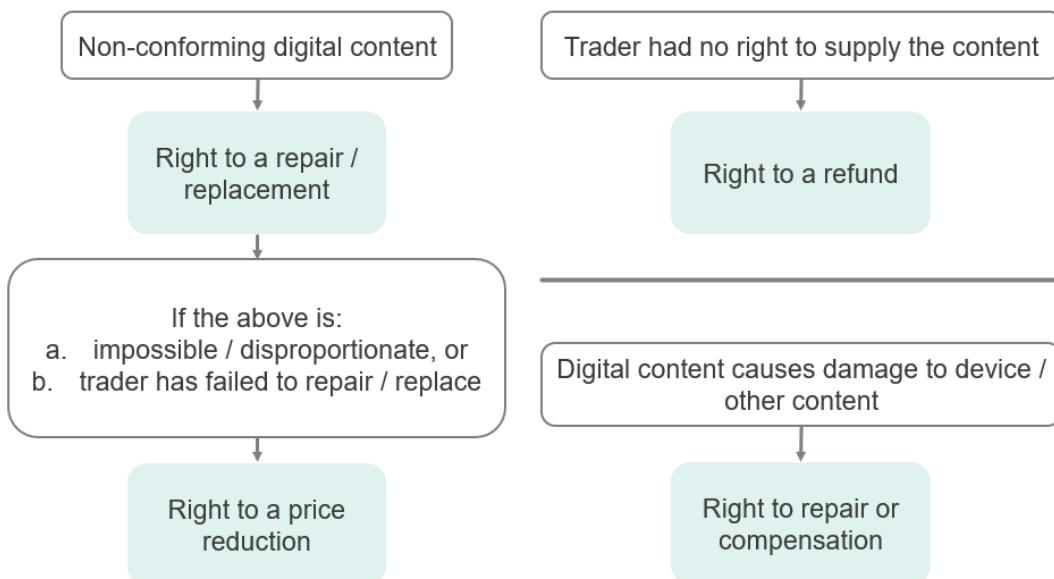


Figure 14.7: Remedies in relation to contracts for digital content

6.4 Contracts for services

Section 54 provides that, where the services are non-conforming, there are two remedial options available to the consumer, namely:

- (a) The right to require repeat performance
- (b) The right to a price reduction

6.4.1 The right to require repeat performance

The right to require repeat performance is elaborated and qualified in ways that are analogous to the parallel provisions in relation to goods and digital content. In particular, s 55(2)(a) requires the

supplier to provide the repeat performance within a reasonable time and without significant inconvenience to the consumer (s 55(4) offering the usual guidance on what, for this purpose, is reasonable and significant); and s 55(3) states that the consumer cannot require repeat performance if completion in conformity with the contract is impossible.

6.4.2 The right to price reduction

According to s 56(3), a price reduction becomes available only where repeat performance is impossible or where the trader has failed to provide repeat performance within a reasonable time and without significant inconvenience to the consumer.

Remedies in relation to contracts for services

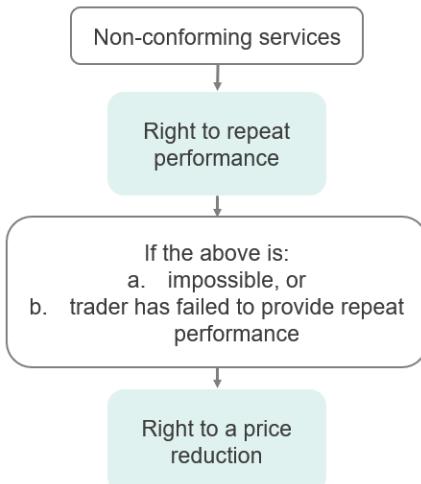


Figure 14.8: Remedies in relation to contracts for services



Example: Consumer buys kettle from trader

The kettle does not work (eg it will not switch on). What is the consumer's legal position under the Act? Clearly, the kettle is non-compliant (s 9) and it follows that, in principle, the consumer may (within 30 days) simply reject the kettle and get a refund of the purchase price, or accept a replacement (exchange) or insist on repair (unless it would be impossible or disproportionate). In practice the consumer is likely to be happy with either an exchange or a refund. Suppose, however, that the consumer does not use the kettle at once (perhaps it has been bought as a spare) and the problem only comes to light when the consumer first uses the kettle, this being at a time when the short-term right to reject is no longer available. In this scenario, the consumer's remedial rights are a bit more constrained. Here, the consumer must first give the trader the opportunity to repair or replace the kettle. Provided that the consumer is happy with this - and it is reasonable to assume that replacement will be an acceptable option - there is no problem. However, if what the consumer wants is a price reduction or rejection, this will not be available until the trader has had an opportunity to repair or replace the faulty kettle.



Example: Consumer buys laptop from trader

A consumer's laptop is faulty but the problem is intermittent. Each time the laptop goes for repair, the supplier reports either no fault or that the fault has been fixed - but the problem recurs. Does such a consumer, who no longer has any confidence in the reliability or durability of the laptop, have the right to reject the goods?

In this more complex case, resolution depends on standards of reasonableness and proportionality. So, for example, s 23(2)(a) requires the trader to repair or replace the goods 'within a reasonable time and without significant inconvenience to the consumer'. If the goods under repair are a consumer's one and only laptop, what would be a reasonable time for undertaking the repairs and at what point would the inconvenience to the consumer be

significant? According to s 23(5) these questions of reasonableness and significance are to be determined by taking into account '(a) the nature of the goods; and (b) the purpose for which the goods were acquired'— considerations which, while relevant, are hardly determinative. In our hypothetical laptop case, before we can determine what is reasonable or significant, we need to know more about the particular context.

6.5 Summary

- The remedies available depend on whether the contract is for goods, services or digital content.
- The remedies are summarised in the diagrams you have been provided with above.

7 Liquidated damages and penalties

7.1 What is a liquidated damages clause?

Contracts arise from the agreement of the parties – the starting point of contract law is to support parties' agreements on as many matters as possible.

In this context, it is unsurprising that the parties can in principle agree not only the terms of the contract, but also the nature and scope of the consequences of a breach of contract. The starting point is that the court will uphold such agreements. You may already have come across this in studying exemption clauses which limit or exclude liability in the event of breach.

An alternative approach is for the parties to agree that a certain sum will be payable on a particular breach of contract – no more and no less. This is called a 'liquidated damages' clause.



Liquidated damages clause: A clause which stipulates a certain sum which is to be payable on a particular breach of contract.



Example

Company A hires a van from Company B. The contract provides that if Company A is late in returning the van to Company B, Company A will pay damages of £160 for each day that it is not returned. This clause is a liquidated damages clause.

If Company A breaches the contract by returning the van three days late and the court upholds this clause, it will award Company B damages totalling £480 ($3 \times £160$).

In contrast, if there had been no liquidated damages clause, Company B would need to prove its losses, most likely by showing how it would have been better off had the van been returned on time (perhaps because it would have been able to lease the van out to someone else).

7.2 Why have a liquidated damages clause?

It can be commercially advantageous for a party because it fixes the amount that will be due for breach as a debt arising under the contract without the claimant having to deal with the uncertainty of establishing its case for damages in accordance with the principles that apply to damages generally.

Equally, a liquidated damages clause makes clear to a party what is at stake if it fails to comply with its obligations ie the risks involved in the contract. A party can then take the risk into account when determining the price for the contract. Liquidated damages clauses are very common in the construction and technology industries to deal with the consequences of non-performance such as delay (eg you will pay £x for every day you are late in delivering the building).

7.3 Can the court intervene in relation to liquidated damages clauses?

Whilst the starting point of contract law is to support parties' agreements on as many matters as possible, there are instances where the court will intervene. You may already have come across the various statutory and judicial limitations on clauses which limit/exclude liability in the event of breach.

In a similar vein, the courts have, over time, developed a jurisdiction to intervene in a contract to strike down a liquidated damages clause which requires the party in breach to pay an excessive sum such that it becomes a 'penalty'. This is known as the law on penalties or penalty clauses. If a clause is regarded as a penalty then it will be struck out by the Court and the claimant will only be entitled to 'unliquidated' damages (ie damages assessed in the normal way) as compensation for the breach.



Penalty clause: A liquidated damages clause which requires the party in breach to pay an excessive sum, such that it becomes a penalty, and therefore the clause will not be upheld.

The test for determining whether a clause is a valid 'liquidated damages' clause or a 'penalty' is derived from the Supreme Court decisions of *Parking Eye Limited v Beavis* [2015] UKSC 67 and, in particular, *Cavendish Square Holdings BV v Talal El Makdessi* [2015] UKSC 67. These two cases were based on the same legal issue and were therefore heard together. The test is set out below.



Key case: *Cavendish v El Makdessi* [2015] UKSC 67

- (a) Is the clause a primary or secondary obligation?
- A clause will be primary if it is part of the primary obligations in the commercial context of the contract, ie furthers the commercial objective of the contract.
 - A clause will be secondary if it is an obligation triggered by breach of contract to compensate the innocent party.

If primary, the clause will not engage the penalty rule at all (so it will be valid).

- (b) If secondary, the clause **will be a penalty if it imposes a detriment out of all proportion to any legitimate interest of the innocent party in the performance of the primary obligation.** To determine this the Supreme Court gave two steps:
- What (if any) legitimate business interest is served and protected by the clause?
 - Is the detriment imposed to protect that interest extravagant, exorbitant or unconscionable?

The burden of proof is on the person alleging that the clause is a penalty to prove this.

In terms of applying this test, the court made it clear that the law on penalties is an interference with freedom of contract, so will not be invoked lightly by the court to strike down a clause in a contract freely negotiated between parties of equal bargaining power.

Criteria 2 above is at the heart of the test – it explains the test for deciding whether the damages stipulated in the clause in question are excessive. Via this second criteria, *Makdessi* made clear that that a party can sometimes have a legitimate interest in enforcing performance which goes beyond simply being compensated for losses, and that a clause which was not disproportionate to that protection of that legitimate business interest would be upheld.

Facts: Mr Makdessi agreed to sell Cavendish a substantial stake in his advertising company in the Middle East, but the contract provided that Mr Makdessi would retain a 20% shareholding in the holding company after the acquisition. Cavendish had an option to purchase this retained shareholding subsequently as part of the deal. Part of the purchase price was to be paid by Cavendish in instalments after completion (known as deferred consideration).

Mr Makdessi had built a considerable amount of personal goodwill through the company over the years, which meant that the company would be worth less to Cavendish if he competed against it. Accordingly, the sale and purchase agreement contained a clause (a 'restrictive covenant'), which prevented him competing with the business following completion of the sale. If Makdessi breached the covenant, the sale and purchase agreement contained default clauses saying that:

- (a) Mr Makdessi would not be entitled to receive the final two instalments of the deferred consideration; and further
- (b) Cavendish could exercise the option of purchasing Mr Makdessi's retained shareholding but at a much reduced price.

Mr Makdessi did compete against the company in breach of this clause. Accordingly, Cavendish tried to exercise the default clauses. The potential impact of this for Mr Makdessi was to deprive him of deferred consideration of \$44 million and to allow Cavendish to purchase his shares under the option for a price which was tens of millions of dollars lower than otherwise. In contrast, the damage he had actually caused to the company by competing was valued at just \$500,000.

As a result of this disparity Mr Makdessi asked the Court for a declaration that Cavendish's rights under the default clauses were unenforceable penalty clauses.

Held: The Supreme Court determined that the default clauses were not penal.

It considered first whether the clauses in question were primary or second obligations. It held that, notwithstanding that they were triggered by 'breach', they were in effect primary obligations – the withholding of the final payments was a 'price adjustment' mechanism adjusting the price payable to Mr Makdessi, and the transfer of shares was a way for the company and Mr Makdessi to part company in circumstances when Mr Makdessi started competing with it.

You can see how, once the court determined that the clause was part of a price adjustment mechanism, it was not appropriate to intervene – the court has no power to intervene in a contract just because it considers the price agreed is unfair.

Exercise: Challenge yourself

We have simplified the Makdessi decision in the summary above. The various judgments have different nuances and do not separate out the sections of the test in a clear way, rather they show how they are all, to an extent connected. If you want to understand this better, you can of course consider the whole judgment, but reading just paragraphs 79-88 and 182-187 will still enhance your understanding.

Key case: *ParkingEye Limited v Beavis [2015] UKSC 67*

The appeal for *ParkingEye* was heard at the same time as the Makdessi decision and illustrates the new test more clearly.

Facts: *ParkingEye* managed a car park for the owners of a riverside retail park. *ParkingEye* displayed numerous signs at the entrance to the car park and at frequent intervals throughout it. The notices stated that a failure to comply with a two-hour time limit would result in a parking charge of £85. Mr Beavis parked his car at the car park; he exceeded the two-hour limit. *ParkingEye* demanded payment of the £85 charge. Beavis refused to pay on the basis that the £85 charge was unenforceable as a penalty.

Held: the obligation to pay the sum of £85 was a secondary obligation – it was triggered by breach of the contract. This meant that court had to consider whether the clause was penal. The court concluded that the £85 charge was not a penalty. The Lordships agreed that *ParkingEye* had a legitimate interest in charging motorists for any period they occupied the car park beyond the two hours. Although the amount of the charge exceeded any likely loss (the loss was whatever a motorist would need to pay to use the parking space for the extra time – much less than £85), *Parking Eye* had a responsibility to manage the car park effectively and it was legitimate to use the charges as a means of influencing the conduct of motorists in order to ensure they did not overstay. In this context the £85 charge was proportionate to that interest.

7.3.1 Summary of the Makdessi decision

In light of the decision in Makdessi, it seems that where parties have negotiated a contract, on a level playing field and with the assistance of professional advisors, it will be hard for the party paying liquidated damages to challenge the validity of those provisions on the basis that they are

a penalty. If a clause is a primary obligation, it will not be a penalty clause. If a clause is a secondary obligation, the clause will not be a penalty if it protects a legitimate business interest and imposes a detriment which is not disproportionate to protect the legitimate interest. The courts will hold this to be a valid liquidated damages clause.





Exercise: Challenge yourself

The fact that Makdessi places a clear boundary between primary and secondary obligations in terms of the ability of the Court to strike down a clause as ‘penal’ may be of assistance for practitioners drafting contracts. Careful drafting to frame provisions as ‘primary’ rather than secondary obligations can reduce the chances of a party falling foul of the law on penalties (see for example *Holyoake v Candy* [2017] EWHC 3397 (Ch)). The key is to prevent an allegation that the clause is a secondary liability payable on breach in either substance or form.

For example, taking a scenario where Brett agrees to build a house for Damon at a price of £100,000 by 15 May:

- (a) A clause requiring payment of a sum of £1000 per day for late completion might be regarded as secondary and subject to the law on penalties; alternatively
- (b) The obligation could be redrafted so that the price payable is lower but Brett receives a ‘bonus’ for delivery on time. This provision might be regarded as a primary obligation intended to set the price and so not subject to the law on penalties.

7.4 Summary

- A liquidated damages clause is a clause which stipulates a certain sum which is to be payable on a particular breach of contract.
- A penalty clause is a liquidated damages clause which requires the party in breach to pay an excessive sum, such that it becomes a penalty. The court will not uphold a penalty clause, and will assess the claimant’s damages on normal principles instead.
- The Makdessi approach to determining whether a clause is a penalty clause is:
 - Is the clause a primary or secondary obligation? If primary, it will not engage the penalty rule at all (so it will be valid).
 - If secondary, the clause will be a penalty if it imposes a detriment out of all proportion to any legitimate interest of the innocent party in the performance of the primary obligation. Identify the legitimate business interest, then consider whether the detriment imposed is extravagant, exorbitant or unconscionable.
- The burden of proof is on the person alleging that the clause is a penalty to prove this.

8 Specific performance and prohibitory injunctions

An award of damages is not the only remedy potentially available in the case of breach of contract.

This section looks at two other remedies: orders for specific performance and prohibitory injunctions.

In order to understand the remedies of specific performance and prohibitory injunctions, you need to first understand that the terms of a contract can be classified as negative terms or positive terms.



Positive term: A term which requires a party to do something.

Negative term: A term which requires a party not to do something.



Example

Positive term (a term which requires a party to do something)	Negative term (a term of a contract which requires a party not to do something)
Party A must work between the hours of 9am and 5pm.	Party A must not work for a named competitor.
Party A must paint the outside of her house every 24 months or more frequently.	Party A must not use her garden for parties on weekdays.
Party A must purchase at least 25 tonnes of steel from Party B each month.	Party A must not purchase steel from any party other than Party B.

8.1 What is specific performance?

An order (or ‘decree’) of specific performance is issued by the court to the defendant, requiring it to carry out its obligations under a positive term of the contract.

What is the advantage of the court telling a party to do something which the contract already tells them to do? Breaching a court order for specific performance has more severe consequences than breaching a contract: it can be treated as contempt of court and lead to imprisonment. These serious consequences make it unlikely that a party will refuse to comply with an order for specific performance.



Specific performance: An order (or ‘decree’) issued by the court to the defendant, requiring it to carry out its obligations under a positive term of the contract.

8.2 What is a prohibitory injunction?

A prohibitory injunction is a court order restraining a party from breaching a negative term.

As with an order for specific performance, breach of a prohibitory injunction can be punished as contempt of court.



Prohibitory injunction: A court order restraining a party from breaching a negative term.

8.3 Is an order for specific performance/prohibitory injunction always available in the case of a breach of a positive term/negative term?

The **most important point** is that an order for specific performance or a prohibitory injunction **will not** be granted if damages are an appropriate and adequate remedy: *Adderley v Dixon* (1824) 3 S & S 607.

To show that damages are inadequate in the specific performance context, it will need to be proved that the subject matter of the contract is unique or irreplaceable, or that an award of damages would be ineffective to provide adequate compensation. So, for example, an order for specific performance is unlikely to be appropriate for the failure to deliver a commonly available car – damages will be perfectly adequate to allow the innocent party to purchase a practically identical car elsewhere. On the other hand, specific performance might be an appropriate remedy in cases of breach of a contract for the sale or lease of land, because in many cases land is unique.

Damages can usefully be seen as the ‘default’ remedy (and by far the most common remedy).

In addition, both specific performance and a prohibitory injunction are **discretionary** and **equitable** remedies.

In this context, discretionary means the court can consider all relevant circumstances and there are **no clear criteria which, if satisfied, entitle a party to an injunction**. The discretion is, however, exercised on certain well-established principles.

Equitable means that the remedies originate from the courts of equity, and equitable principles apply, including:

- (a) The court will take into account the conduct of the claimant – because ‘he who comes to equity must come with clean hands’: *Coatsworth v Johnson* (1886) 55 LJQB 220. For example, a claimant which is itself also in breach of contract, or which gives an incomplete account of events to the court, is less likely to succeed in obtaining an order for specific performance or prohibitory injunction; and
- (b) The action must be brought with reasonable promptness, as ‘delay defeats the equities’: *Eads v Williams* (1854) 4 De G Mac & g 674.

The principles above apply to both prohibitory injunctions and to orders for specific performance.

We now turn to principles specific to each remedy.

8.4 Specific performance

In addition to the principles set out above, the following principles (not rules!) apply to the grant of an order for specific performance:

- (a) Specific performance will not be awarded where it would cause undue hardship on the defendant: *Patel v Ali* [1984] Ch 283.
- (b) A promise given for no consideration is not specifically enforceable, even if made as a deed.
- (c) Specific performance will not be awarded for breach of contracts of employment: s 236 Trade Union and Labour Relations (Consolidation) Act 1992. For other contracts involving services, specific performance will not be awarded if there has been a breakdown of trust and confidence between the parties, or if the court would need to consider subjective opinions regarding performance: *CH Giles & Co Ltd v Morris* [1972] 1 WLR 307.
- (d) Specific performance will not be awarded for breach of an obligation to perform a series of acts which would need the constant supervision of the court (*Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1).
- (e) Specific performance will not be awarded for breach of a contract which is not binding on both parties. Thus where a contract is voidable at the option of party A, party B will not get specific performance against Party A. This principle is of particular importance in connection with minors’ voidable contracts.

8.5 Prohibitory injunctions

The court has the power to decide the extent of any prohibitory injunction it wishes to grant, and accordingly, the court may limit an injunction to what the court considers reasonable in all the circumstances of the case.

Prohibitory injunctions are granted only where ‘just and convenient’ (s 37 Senior Courts Act 1981).

For example, in *William Robinson & Co Ltd v Heuer* (1898) 2 Ch 451, a term forbade the defendant to engage in ‘any trade, business, or calling, either relating to goods of any description sold or manufactured by the claimant or in any other business whatsoever’. The court granted an injunction but on more limited terms: it did not restrain the defendant from engaging in ‘any other business whatsoever’, it only restrained the defendant from engaging in a narrower class of business. That gave the claimant reasonable protection but no more.

8.6 Substance not form

The court will look at the substance of the proposed remedy when deciding whether it would amount to a prohibitory injunction or specific performance, not the superficial wording of the injunction.

For example, in *Sky Petroleum Ltd v VIP Petroleum Ltd* [1974] 1 All ER 954, the defendant agreed to supply petrol to the claimant for a set period of time. In breach of contract, the defendant terminated the agreement early. The claimant sought an interim injunction preventing the defendant from terminating and withholding the supply.

The court held that although the injunction requested appeared to be in ‘negative’ terms (broadly, the defendant must not terminate the agreement/withhold supply), the effect of the injunction would be to require the defendant to supply petrol to the claimant. This is a requirement that the defendant should do what the contract says it must do, and so in substance is an order for specific performance. Accordingly, the court decided the case according to the principles that apply to orders for specific performance, not those that apply to interim injunctions (and on the particular facts, the court found in the claimant’s favour).

8.7 Summary

- An award of damages is not the only remedy potentially available in the case of breach of contract. Two other remedies to be considered are prohibitory injunctions and orders for specific performance.
- A positive term in a contract is a term which requires a party to do something, and a negative term is a term of a contract which requires a party not to do something.
- An order for specific performance requires a defendant to carry out its obligations under a positive term of the contract.
- A prohibitory injunction is a court order restraining a party from breaching a negative term.
- Breaches of these orders can be punished as contempt of court.
- These remedies are only available when damages are not an appropriate remedy.
- These are discretionary and equitable remedies.

9 Guarantees and indemnities

9.1 Introduction

Guarantees and indemnities have something in common. Assume that A owes an obligation, generally a contractual obligation, to B. Guarantees and indemnities given by C can both be ways of C supporting that obligation and providing additional protection to B.

This section will give a brief definition of each concept and provide an example, as well as articulating the differences between a guarantee and an indemnity.

It is possible for both a guarantee and an indemnity to be given at the same time.

In the examples in the following discussion, we assume that A has borrowed money from B, and therefore **A owes a contractual obligation to repay that money to B**.

9.2 Guarantee



Guarantee: A promise by a party to ensure that another party carries out its obligations, or a promise to fulfil those obligations itself if that other party does not do so.



Example

A has an obligation to repay a loan to B.

If C provided a guarantee, this would mean C promising that A will repay the loan, and that if A does not do so, C will perform this obligation on A’s behalf ie will make the payment to B.

Note that C’s obligation is effectively defined by A’s obligation: so C cannot face any obligation that is greater than A’s obligation.

Example wording: ‘C guarantees to B that if A fails to pay the loaned sum when due, C will pay the loaned sum on demand.’

9.3 Indemnity



Indemnity: A promise to reimburse someone in the event that they suffer a stated loss.



Example

A has an obligation to repay a loan to B.

If C provided an indemnity in relation to this, C would be saying that in the event that B suffers the non-payment of the loan, C will reimburse B in relation to this loss.

Note that C's obligation is a primary obligation. C's obligation is legally independent of A's obligation, although what C has to pay will be affected by what A pays. C's obligation stands by itself, so to speak, which is what we mean by it being a primary obligation, and this could mean C's liability might ultimately be even more than A's was.

Again, this provides greater protection for B – ultimately, it can look to either A or C for payment.

Example wording: 'Party C agrees to indemnify Party B from any losses which arise from the failure to recover the sum loaned to Party A.'

9.4 Practical implications of these differences

First, keep in mind that trying to ascertain whether a provision is a guarantee or an indemnity, what matters is the substance of the provision, not whether it is headed 'guarantee' or 'indemnity'.

Secondly, there is an important difference if A's obligation ceases, for example because the contract between A and B is set aside. If C has provided a guarantee, then C's obligation under the guarantee will also cease, because it is dependent on A's obligation. If C provided an indemnity, this would remain in place.

Thirdly, there is a further difference if there is a change to the contract between A and B after the guarantee/indemnity is given. In those circumstances, a guarantee would almost always be discharged. However, an indemnity would remain in force.

Finally, there are certain formalities that need to be followed to execute a guarantee – it must be in writing and signed by the guarantor. This is not the case in relation to an indemnity.

Do remember that C could give both an indemnity and a guarantee in relation to the loan by B to A, in which case B has the benefit of both!

9.5 Indemnities in other contexts

When we introduced indemnities two pages ago, we explained that an indemnity is a promise to reimburse someone in the event that they suffer a stated loss. We gave as an example of the loss the failure by A to pay money owed to B.

But note that indemnities do not need to be in a three-party scenario like this. Indemnities can also exist in a two-party scenario.



Example

A agrees to deliver goods to B. A agrees to indemnify B in relation to any loss suffered by B as a result of late delivery.

This is still a promise to reimburse someone for loss, but the obligation to deliver and the indemnity are coming from the same party. B would be entitled to damages from A anyway, but an indemnity can be drafted in a way that avoids some of the rules of causation, mitigation, remoteness and proof that might limit a claim for damages – much will depend on the drafting (which should be more detailed than our example!).

9.6 Summary

- Where A owes an obligation, generally a contractual obligation, to B, guarantees and indemnities given by C can both be ways of C supporting that obligation and providing additional protection to B.
- It is possible for both a guarantee and an indemnity to be given at the same time.

- A **guarantee** is a promise by C to ensure that A carries out its obligations, or a promise to fulfil those obligations itself if A does not do so.
 - If A's obligation ceases, C's obligation also ceases.
 - If there is a change to the contract between A and B, the guarantee will almost always be discharged.
 - A guarantee must be in writing and signed by the guarantor.
- An **indemnity** is a promise by C to reimburse B in the event that they suffer a stated loss, for example because A fails to carry out its obligations.
 - If A's obligation ceases, C's obligation remains in place.
 - If there is a change to the contract between A and B, the indemnity will remain.
 - An indemnity can also arise in a two-party context.

