

# LEGAL ASPECTS OF INSURANCE

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## CHAPTER TWO – LAW OF CONTRACT

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Principles that govern all contracts

# What is a contract

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- A contract is a legally binding agreement, that is, one which the courts will recognize and enforce.
- A contract creates rights and obligations.
- It is the binding nature of contracts which provides a solid foundation for the practice of insurance and enables people to buy policies with confidence.
- Note that contracts are made for many purposes besides insurance e.g. contracts for the sale of goods and land, contracts of carriage, contracts of hire, contracts of employment and many others.

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# TYPES OF CONTRACTS

# 1. Specialty contracts/contracts under deed

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- Formal contract
- Must be in writing, signed, witnessed, sealed and delivered.
- Such contract is also referred to as a contract under seal/deed.
- Where delivery takes place at a future date, the deed is known as escrow.
- Examples of contracts under seal include conveyances of land, leases of over 3 years and conditional bills of sale among others.
- Section 2(1) of the Law of Contract Act provides that no contract in writing shall be void or unenforceable by reason only that it is not under seal.
- Such contracts will still be binding in the absence of consideration.

## 2. Simple contracts

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- Simple contracts are informal in nature
- can be made orally, in writing, partly oral and partly written rather than a contract made under seal.
- A simple contract can be implied by conduct of the parties.
- For simple contracts to be valid, they need to be supported by consideration.
- Insurance contracts are mainly simple contracts.

### 3.Contract of record

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- A contract that is declared by a court and entered into the court's record is known as a contract of record.
- The records are conclusive proofs of the facts appearing therein and are enforceable
- Examples include court judgments in civil matters and personal cognizances in criminal cases.
- They are not true contracts since the obligations are imposed by the courts.

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Other terminologies used to describe  
contracts



## 4 & 5 Unilateral and bilateral contracts

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- Unilateral contracts refer to contracts which only binds one party to the contract e.g. where one promises a reward for whoever finds their lost property.
- In bilateral contracts, each party makes promises and both are legally bound by their promises e.g. insurance contracts

## 6. Void contracts

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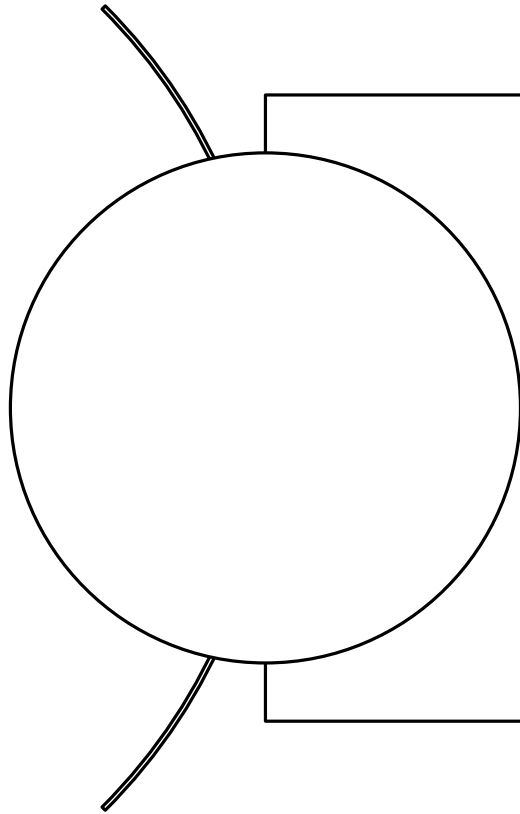
-A void contract is one which has no binding effect on either party. A void contract is no contract at all since neither party can fully enforce it in a court of law.

What are the circumstances that may give rise to void contracts?

- A basic ingredient is lacking e.g. offer, acceptance
- Those contracts made under mistake
- Those made with minors and are disallowed under the Infant's Relief Act
- Where the consideration or the object is unlawful

## 7. Voidable contract

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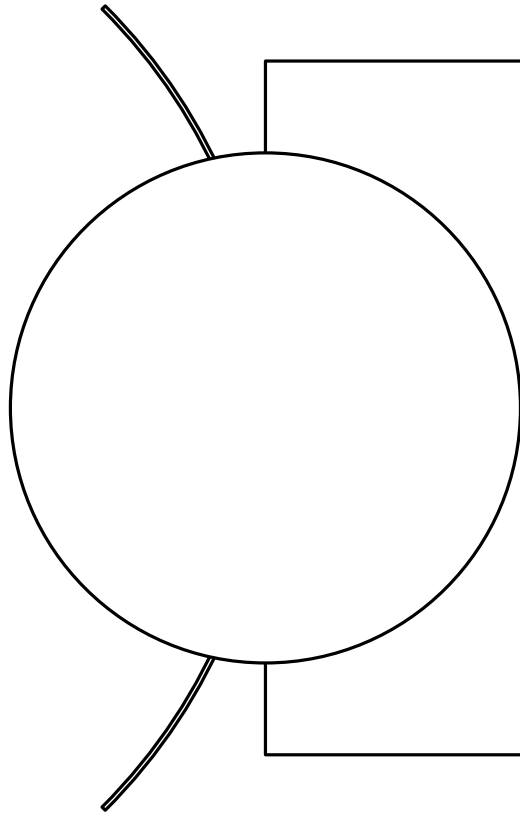
**Voidable contracts on the other hand are binding and enforceable on either one party or both parties.**

**A contract may be voidable because of misrepresentation, insanity among other reasons.**

**It may be set aside at the option of the aggrieved party. The aggrieved party must however do this within a reasonable time**

## 8. Unenforceable contract

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**Unenforceable contracts are generally valid contracts.**

**They cannot be enforced if one party refuses to keep the agreement. Such a contract can be useful for other purposes e.g. it can be used as a defence to a claim**

# **contracts that must be in writing otherwise they will be declared void.**

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**Examples of these contracts include:**

- **Those that require to be stamped e.g. bills of exchange, promissory notes**
- **Acknowledgment of statute barred debts**
- **Transfer of immovable property**
- **Representation of character of creditworthiness**

**Contracts must be supported by written evidence otherwise unenforceable.**

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### **Examples**

- **Contracts of guarantee**
- **Contracts for sale of land**
- **Contracts for sale of goods**
- **Hire purchase agreements**
- **Contracts of employment**
- **money lending contracts**

# Details in a written contract

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- **Details of the parties**
- **Description of the parties**
- **Description of the subject matter**
- **Signature of the parties**
- **Consideration**

## **A written contract must contain some of the following details:**

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- **Details of the parties**
- **Description of the parties**
- **Description of the subject matter**
- **Signature of the parties**
- **Consideration**



# Ingredients of a Valid Contract

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**NOTE:** A valid contract has all the ingredients of a contract and is therefore binding and enforceable in law. The essentials (ingredients) of a valid contract are the key elements which must be present in such a contract for it to be legally enforceable. They are:

- Offer and acceptance (agreement)
- Intention to create legal relations
- Consideration
- Contractual capacity
- Form
- Legality

# 1. Offer & acceptance

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## Offer

- It is a proposal made by one party known as the offeror to another party known as the offeree.
- It can be made orally, in writing or implied by conduct. Note that an offer can be made to one person, a group of persons or to the public as a whole.
- An offer has to be accepted unconditionally for an agreement to be come into existence.

# Offer and invitation to treat

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- An invitation to treat is a statement made during negotiations while an offer is a proposal to buy or sell.
- Acceptance of an invitation to treat does not amount to an agreement while an offer is legally binding.

# Case example

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## **Carlill vs. Carbolic Smoke Ball Co. (1893)**

Facts: the defendants were manufacturers of smoke balls, a medicine which they claimed would prevent all sorts of illnesses.

They promised in an advert to pay 100 pounds to anyone who caught influenza after using the smoke ball.

The plaintiff relied on the advert, bought the smoke ball, and used it as prescribed but caught influenza. The defendants argued that they did not make an offer to anyone specifically and secondly that their advert amounted to an invitation to treat. It was held that the advertisement amounted to an offer made to the whole world and the defendants were therefore liable.

## **Fisher v. Bell (1960)**

Facts; This is a criminal case where a shopkeeper was charged with offering for sale a flick Knife contrary to the Restriction of Offensive Weapons Act (criminal offence). It was held that displaying the knife in his shop window was not an offer but a mere invitation to treat. He was not found not guilty and set free.

# Essentials of a valid offer

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- The terms of the offer must be clear
- It must be communicated so as to make the other party aware
- The offer must contemplate to give rise to legal relations
- The offeror can not bind the offeree without his consent
- The offeror may attach any conditions to the offer but must communicate them to the offeree before they bind him by his acceptance of the offer

## Ways/circumstances in which an offer terminates

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**1. A time limit or a reasonable time:** Where the offeror imposes a time limit for acceptance and the offeree does not accept within that time, the offer terminates. Example is an offer to buy shares in a stock exchange market which remains open for a stipulated period of time. Where the offer is silent about time, it lapses after a reasonable time and this will depend on the nature of the contract and the circumstances of each case.

**2. Death:** The death of either party before acceptance will terminate the offer. Death after acceptance will not affect most contracts except contracts for personal services

**3. Acceptance of offer:** Acceptance of an offer will complete the contract and bring the offer to an end. An offer lapse by not being accepted in the manner prescribed

**4. Revocation:** An offer may be revoked (withdrawn) by the offeror at any time before acceptance. This can be done even where the offeror has promised to keep the offer open for a definite period of time. However, where the **offeree has paid money** or given something of value in return for the promise to keep the offer open (known as the buying option), the offeror will be liable to pay damages.

# Rules that govern revocation

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- Revocation of an offer must be communicated to the offeree either by words or conduct. It can be made to the offeree directly or through a reliable source.
- Revocation by post does not take effect until it is received by the offeree
- Where the offeror promises to keep the offer open for a specified time (option) either orally or in writing, he is not bound unless there was acceptance, the promise is supported by consideration or the promise was made under seal.
- No revocation after acceptance
- No revocation if something of value has been paid/given



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### **5. Counter offer or rejection:**

If an offeree rejects the offer, it automatically terminates. If the offeree later changes and makes a counter offer, and then the offeree becomes the offeror. If the acceptance is subject to conditions, then [t amounts to a counter offer which has the effect of destroying the original offer. A counter offer operates as a rejection as well as a fresh offer.

# Acceptance

Rules governing acceptance/essentials of valid acceptance

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- Acceptance can either be through words either spoken or written or can be implied by conduct.
- For a contract to be formed, acceptance **must be unqualified** meaning that it must exactly match the terms of the offer.  
If the offeree tries to vary or add conditions of their own, it is ineffective as acceptance.
- There must be **some positive act** of acceptance. Acceptance cannot be by silence or doing nothing.
- Acceptance must be made in the **manner prescribed**
- **the time stipulated** by the offeror.

- Acceptance is not effective until it is **communicated** by the offeree or their authorized agent. However, there are two exceptions to this:
  - (i) Where the offer dispenses with communication i.e. the terms of the offer indicates that the other party can accept by carrying out their part of the agreement
  - (ii) Where the offer is made through the post

# The posting rule

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- Acceptance will be governed by the posting rule which provides that a letter of acceptance is effective the moment it is posted and a binding agreement is entered into from that time.
- Note that a contract can be made even where the letter of acceptance never arrives.
- For the posting rule to apply, the letter must be properly addressed, stamped and posted.
- Offer is effective when the offer letter is received

# 2 Intention to Create Legal Relations

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- It is important to note that there may be no contract if the parties did not intend their arrangements to be legally binding and enforceable.
- Courts will also not enforce agreements coming before them unless there is sufficient evidence to prove existence of intention to create legal relations. Whether or not parties intend to create legal relations is a question of fact to be inferred from the circumstances of the case.
- In a situation where the parties insert an express term of the agreement to the effect that it is not legally binding, courts may not enforce but this will depend on the nature of the contract and the intention of the parties.

## Case example

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### **Rose & Frank v. J R Crompton & Bros Ltd (1925)**

Words in the agreement, 'this arrangement is not entered into.....as a formal or legal agreement and shall not be subject to the legal jurisdiction of the courts.' The court held that the agreement was not legally enforceable.

### **Will the courts enforce the following agreements?**

#### **(i) Social and domestic arrangements**

It is assumed that social arrangements and day to day family matters are not intended to have legal consequences.

They are not legally binding unless strong evidence of contractual intention can be found.

# Case example

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## Balfour vs Balfour (1919)

It was held that the husband's promise to pay monthly allowance to the wife was not legally binding even though his work had taken him abroad.

It would not be implied from the circumstances that it was meant to be legally binding

# Case example

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## Simpkins vs Pays

**Facts:** The defendant, her grand-daughter and the plaintiff agreed to submit in the defendant's name a weekly coupon in the newspaper and share the prize.

When the defendant received the prize, she refused to share. It was held that the arrangement was intended to be legally binding.

(ii) Collective agreements between trade unions and employers are assumed not to be legally binding unless there is a written contract stating the contrary

(iii) Contracts of engagement (promise to marry) are not intended to create legal relations

For commercial or business agreements, courts assume them to be legally binding unless there is strong evidence to the contrary.



# 3 CONSIDERATION

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What is consideration?

Consideration has been defined in the case *Currie vs. Misa* (1875) as some right, interest, profit or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.

A contract should be seen as a promise and courts will not enforce a promise not supported by consideration.

We have seen that **simple contracts, they are not binding unless supported by consideration.**

Consideration is therefore **a price which supports a promise.**

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Consideration signifies some **benefit or advantage going to one party or some loss or detriment going to another party.**

It may be a benefit or a profit to the promisor and a detriment to the promisee e.g. as seen in unilateral contracts.

However, in many cases the detriment to the promisee is also a benefit to the promisor and vice versa-each party gains a benefit and suffers a detriment.

Note that consideration in simple contracts may either be **executed** i.e. value has already been given by the promise e.g. sale of goods on credit or can be **executory** i.e. to do something in future.

However, a legally binding agreement may come into effect before the benefit of the consideration is conferred on the other party provided there is a firm promise to do so.

# Rules that govern consideration

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## 1. Consideration must be real or genuine

This means that courts will not enforce vague promises or where there is no real benefit or detriment at all.

The consideration sought need to be capable of financial valuation.

# Case example

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## White vs. Bluett (1853)

**Facts:** The plaintiff sued the executors for a promise by his father to pay him some money to cease complaining that he was not treated well as his brothers.

The father had made the promise while he was alive but died before fulfilling the promise.

The court held that the promise was too vague for a real consideration.

## 2. Consideration need not be adequate

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**This means that the value given need not be worth or equivalent to what is given in exchange.**

**If one makes a bad bargain, courts will not step in to help.**

# 3. Consideration must not be past

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Consideration must be given in exchange for the promise which it supports i.e. the two must be linked from the beginning. It follows that when services have already been given for free, a promise to pay for them made afterwards is not good consideration.

However, there are exceptions to this rule.

- (i) If the act was done at the request of the promisor and the understanding was that payment was to be made
- (ii) When a debt the payment of which is statute barred is revived by a fresh promise in writing
- (iii) The Bills of Exchange Act provides that antecedent debt or liability on the part of the promisor or drawer of the bill is regarded for this purpose as valuable consideration.

## 4. Consideration must move from the promisee

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A contract is an agreement between two or more persons. Under the doctrine of privity of contract, the duties arising under the contract can only be enforced by or against the original parties to the contract. This rule therefore provides that a third party cannot enforce a promise if he was not a party to the contract.

Consideration can only move from the promisee. However, there are circumstances under which a third party may enforce a contract and may include the following:

- (i) Under the law of trust, a beneficiary may enforce a contract entered into by a trustee.
- (ii) The Insurance (Third Party Risks) Act Cap. 405 of Kenya makes provisions that allows authorized drivers and injured third parties to enforce motor insurance contracts
- (iii) The doctrine of assignment allows an assignee of a debt to enforce a contract as provided for under statute or under equity.
- (iv) A holder of a bill of exchange can also sue if the drawee fails to pay

# 5.Consideration must be legal

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The purpose for which the consideration is being given must not one prohibited by the law or against public policy.



## 6. Consideration must not be something which the promisee is already bound to do

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The purpose of this rule is to prevent extortion by people who threaten to break their contracts unless they are paid extra.

*Stilk vs. Myrick* (1809)

Employees were unable to enforce a promise by the employer to the effect that salaries for their colleagues who deserted work would be shared among those who remained after completion of work

# The doctrine of equitable/promisory estoppel

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This is used by courts to minimize the harsh effects of the requirement in simple contracts that they must be supported by consideration.

The doctrine means that where one has made a promise and the other acts on the basis of the promise, the court will treat the promise as binding upon the promisor though not supported by consideration.

The doctrine can be used as a defence. However, the defendant will not be allowed to claim unless they acted fairly.

# Case example

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## Central London Property Trust vs. High Trees House

**Facts:** The plaintiffs who were landlords rented out a block of flats at 2,500 pounds a year.

When the world war broke out, they agreed to reduce the rent to 1,250 pounds a year from 1941.

After the war in 1945, they moved to court seeking full rent from 1941 arguing that there was no fresh consideration for their reduced rent.

The court held that it would be inequitable to allow them go back on their promise. They were only entitled to full rent from 1945.

# Point To Note

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**Equitable estoppel operates as a shield (defence) and not a sword** (a weapon of attacking the other party). For one to plead equitable estoppel, the following must be proved:

- (i) That there existed an original agreement between the parties
- (ii) There arose a new agreement out of the original agreement and there was no consideration given by the promisor
- (iii) The promisee relied on the promise and acted to his detriment

# 4. Contractual Capacity

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Who can enter into contracts?

The law presumes every person to be competent to enter into contracts. However, some persons are subject to special rules that restrict their capacity to contract.

Note that **lack of contractual capacity renders a contract void, voidable or unenforceable.**

Certain legal persons have limited contractual capacity.

# Minors

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The Age of Majority Amendment Act of 1974 places the age of majority at 18 years.

The Infants' Relief Act of 1874 of England governs contracts entered into by minors in the UK.

'The purpose of the Act is to protect minors from being exploited by traders and money lenders who may take advantage of their inexperience.

The Act also protects adults from hardships caused to them when they deal with minors

# Contracts entered into with minors fall into four categories:

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## 1. Contracts which are binding (valid)

- A minor is bound by contracts for necessities and beneficial contracts.
- Necessaries are goods and services that are suitable to the condition in life of the infant and his actual requirements at the time of sale and delivery.
- Necessaries include food, clothing, shelter, education, legal advice etc.
- The law requires that a minor should only pay a reasonable price for the goods
- The necessities that a minor may purchase must be appropriate to their station in life.

# Case example

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Clyde vs. Hargreaver (1898) where a racing bicycle was held to be a necessary.

**Beneficial contracts** on the other hand refer to those entered into for purposes of education and training.

However such contract is binding on the minor provided it is as a whole beneficial to the minor.

**Doyle vs. White City Stadium**

Facts: An under age boxer was held to be bound to a clause in his contract which stated that he would loose his prize money if for certain reasons he was disqualified.

It was held that the contract was whole for his benefit and therefore binding.



## 2.Contracts not binding on the minor (void)

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Examples of these contracts include:

- ✓ Contracts to buy goods which are not necessities
- ✓ Contracts to lend or borrow money
- ✓ Accounts stated with infants i.e. acknowledgement of debts
- ✓ Where a minor orders for goods but subsequently refuses to take them
- ✓ Trading contracts where infants buys goods on credit for sale

### 3. Voidable contracts (those binding unless repudiated)

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- These are contracts of continuing nature on both parties e.g. leases, partnership or holding of shares in a company.
- The minor may repudiate the contract during minority or within a reasonable time thereafter.
- Repudiation frees the minor from further liability under the contract but existing liabilities are not removed e.g. rent owing.
- A minor can also not claim money already paid under contract if he received something of value (consideration)

# 4. Unenforceable contracts on minors

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- All other contracts except for necessities, beneficial and voidable contracts are unenforceable against a minor.
- This is because a minor cannot be compelled to honour obligations in a contract which is not binding on them.
- The law does not allow a minor to ratify contracts made during infancy even where fresh consideration is given

# Case example

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## Smith vs. King (1892)

**Facts:** The defendant, a minor owed the plaintiff money.

After he attained age of majority, he acknowledged that he owed the money and the court held that he was not liable since the act amounted to ratification of a void contract.

If the minor makes fresh promises on attaining the age of majority, he will be held liable.

# Case example

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**Dicham vs. Worrall (1880)**

**Facts:** The defendant, a minor was engaged to the plaintiff.

On attaining the age of majority, he requested the plaintiff to fix a fresh wedding date.

He then refused to marry the plaintiff. It was held that the renewal of the promise amounted to a new contract and was enforceable.

## Where a minor takes advantage of an adult

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A minor may acquire property from another under a contract either with a honest or fraudulent intent. The other party cannot enforce the contract because it is void e.g. goods bought on credit which are not necessities. **Equity** will however come to the aid of those who have traded with the minor and demand that the minor restores the property to the owner because it is just and equitable to do so.

# What is the position of a third party who purchases items from the minor?

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Generally a contract entered into with minors that is not for necessities is void. The right of ownership is however passed to the minor.

A third party who buys the property from the minor in good faith gets a good title.

# Insane persons

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Can persons with mental disabilities enter into contracts?

Generally, contracts made by insane persons other than those for necessities are voidable. Contracts entered into by insane persons during lucid moments are also valid. They should however be charged reasonable price. What then must an insane person prove in a court of law for the contract to be repudiated?

- ✓ That they had a mental disability but with relevant supporting evidence
- ✓ That at the material time of entering the contract, they were unable to understand the nature of the contract
- ✓ That the other party was aware of their condition and took advantage of the same



# **Drunken Persons**

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- **Contracts that are entered into by drunken persons are given similar treatment as those with mental patients.**
- **However, partial or ordinary drunkenness is not a sufficient ground to render a contract voidable.**
- **Just like the case of insane persons, drunken persons should be charged reasonable price.**
- **For a contract to be avoided by the person, one must prove that he did not understand the implication of the contract and that the other party was aware of their condition and took advantage.**

# Terms in Contracts

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- Terms are provisions, requirements, rules, specifications and standards that form an integral part of an agreement or contract.
- They refer to detailed provisions contained in an agreement that governs the rights and obligations of parties to a contract.
- The law was originally based on the theory of freedom to contract.
- This is because it is primarily upon the parties to negotiate and agree on the terms to a contract.
- However, courts and parliament have increasingly stepped in to regulate and control contracts through implied terms.
- The intention is to protect consumers and those whose bargaining position is weak. Some of the Acts of parliament are the Sale of Goods Act and the Hire Purchase Act.

# Classification of Terms

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Contracts contain both express and implied terms.

## Implied terms

Implied terms relates to something which is so obvious that 'it goes without saying' Implied terms to a contract must be certain and not ambiguous.

The main purpose of these terms is so implement the presumed intention of the parties to give business efficacy to the contract.

# Case example

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**British School of Motoring vs. Simms (1971)** where it was held that a contract for driving lessons was subject to an implied term that the vehicle provided would be covered by insurance and that it was the driving school to insure the vehicle.

**Note:** Implied terms must be reasonable.

# Sources of implied terms

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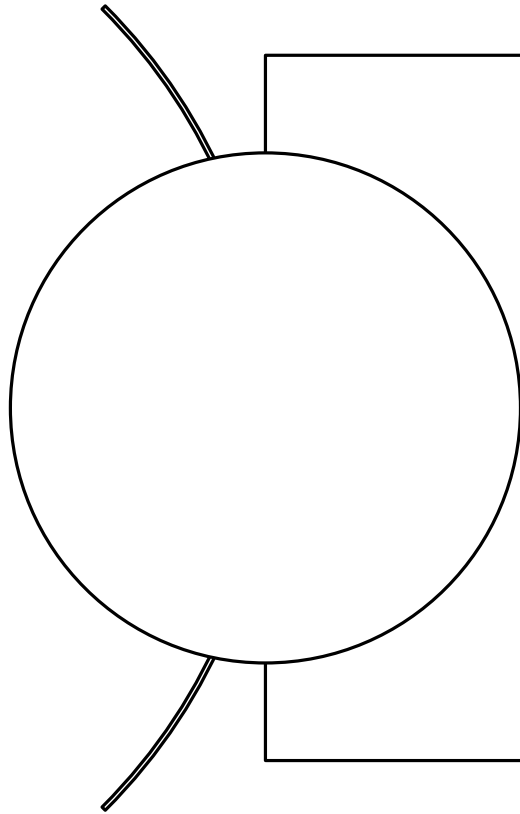
- (i) Terms may be implied by custom or trade depending on the market in which the parties to the contract operate or the usages of a particular trade. The term however must not be unreasonable or inconsistent with the rest of the contract.
- (ii) Terms may also be implied by statute. The aim of this is to create certainty by standardizing a particular type of contract and protect weaker parties from exploitation and restore balance where one party is in a stronger bargaining position.

## Examples of implied terms under the Sale of Goods Act

- An implied condition that the seller has a right to sell the goods
- Where goods are sold by description, there is an implied condition that the goods will correspond with the description
- There is also an implied warranty that the buyer has and enjoys quiet possession of the goods

# Express terms

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**Express terms on the other hand arise from the words used by the parties in reaching or recording their agreement whereas implied terms are those which form part of the agreement even though the parties never put them into words.**

## Terms can also be warranties and conditions

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### Warranty

- ❖ A warranty is a term that affects only some relatively minor aspects of the agreement and where it is broken, the aggrieved party can only claim damages but not avoid the contract.

Such terms are not vital and do not go to the root of the contract.

# Conditions

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This is a term that affects an important aspect of the contract as it goes to the root.

Where such a term is broken, one can claim for damages and also avoid the contract.

A condition may be precedent or subsequent.

A condition precedent is an express provision that a contract will not be binding unless the condition is fulfilled whereas a condition subsequent is a provision in the contract that the contract will cease to be binding upon the happening of a certain event.

In the next lecture, we will discover that the term warranty as used in insurance contracts refers to a major term of the contract.



# Exemption/Exclusion Clauses

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- Most contracts made are usually on standard terms contained in printed forms e.g. insurance policies.
- The intention is to save time and simplify dealings of day to day nature.
- The printed forms normally contain exclusion clauses which exclude or reduce liability to the customer.
- The main disadvantage of this is that the consumer may not negotiate the terms or read the contents and if things go wrong, he/she has no redress.
- Because of the abuse that may arise from exclusion clauses, courts and parliament have developed rules to control the use of these restrictive clauses.

# Rules governing exclusion clauses

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- Courts will enforce the exclusion clause if it was part of the written document and the other party signed.
- Courts will also enforce the clause where reasonable care was taken to bring the clause to the attention of the other party during negotiations and at the time the contract is being entered.
- Where the obligation was so fundamental that liability cannot be excluded, courts will not allow their application. In the UK, Section 2 of the Unfair Contract Terms Act of 1977 provides that no one acting in the course of business can by means of contractual terms or by any notice given or displayed exclude his liability for death or bodily injury arising from negligence.
- Exclusion clause on the reverse of the paper is not valid if it was not brought to the attention of the other party.

- Where the party relying on the clause misrepresented the contents, the clause will not bind the other party.
- Courts will not enforce a clause if it was brought to the attention of the other party after the contract has been entered into.
- Exceptionally, the courts may also allow an exclusion clause to be incorporated in a contract as a result of past dealings between the parties in which the exclusion clause was regularly used. such cases the party who alleges that he is prejudiced by the clause may be held to be 'fixed with knowledge' of it even though it was not included in the transaction in question.

# Vitiating Factors

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❖ These are factors that may destroy the validity causing them to be defective.

They include the following:

- Illegality
- Mistake
- Misrepresentation
- Non-disclosure
- Improper pressure

# 1. Illegality

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- Although people are generally free to make whatever agreements they wish, contracts which directly involve the commission of a legal wrong should obviously be discouraged.
- Here, we use the term 'illegality' in a broader sense to include those agreements which are against public policy, that is, agreements which do not involve the commission of a distinct legal wrong
- They cannot therefore be enforced in law.

# Classification of Illegal contracts

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## 1. Contracts contrary to the law

These are contracts which involve commission of a crime or a tort e.g. forging bank notes, agreement to steal or kill, wagering or gaming contracts among others.

Note that some contracts may be prohibited by the law but making such contracts does not amount to a criminal act.

## 2. Contracts contrary to public policy

❖ Those tending to sexual immorality-those in furtherance of prostitution

# Case example

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## Pearce vs. Brooks (1866)

**Facts:** A prostitute bought a carriage for use in attracting customers on hire purchase terms but failed to keep up payments.

The owner knew the purpose for which it was bought. It was held that the contract was illegal and therefore void and the owner could not recover the outstanding balance.

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## ❖ Those affecting sanctity of marriage

- Examples are those agreements between a husband and a wife for future separation and those where promises to marry are made by one who is already married.

### Wilson vs. Carnley

**Facts:** The defendant promised to marry the plaintiff after the death of his wife. The wife was seriously ill at the time.

He married somebody else after the wife died and the court held The contract was void.



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❖ Those in restraint of marriage for example agreements not to marry. Partial restraint if reasonable may be upheld

- ❖ Contracts to commit a crime
  - Contracts to commit fraud on public revenue
  - Contracts to break laws of a friendly state

# Case example

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## Foster vs. Driscoll

An English partnership formed to smuggle whisky into the USA when alcoholic drink was prohibited in the US held to be illegal

- Contracts to trade with an enemy
- Contracts to corrupt public life for positions of honour or title
- Contracts which pervert the course of justice
- Contracts that hinder prosecutions e.g. paying someone not to report an offence or not to co-operate with the prosecution
- Contracts to oust jurisdiction of the courts

# Case example

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- Contracts that abuse the legal process and there are two types of agreements.
- ✓ Maintenance-Promotion of litigation through financial assistance where one has no financial interest

There are exceptions where this arrangement can be held to be legal. They are:

- Where one is related, they can recover the money
- If one lends money on humanitarian grounds
- Where one has common interest
- ✓ Chamberty which arises where a person assist another with money or evidence with intent to share the proceeds

# Contracts in restraint of trade

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- These are contracts entered into that restrain one from exercising a lawful profession, business or trade.
- They are prima-facie void but can be upheld if they are reasonable. There are two examples of contracts where restraint of trade may apply and they are:

# Examples

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## **Contracts of employment:**

- These are contracts where an employee is restrained from working for a competitor on termination of employment or setting up a competing business.
- If the restraint is reasonable, courts will allow it e.g. restraints relating to the employer's trade secrets or confidential information.
- Certain factors are taken into consideration to determine whether a restraint is reasonable or unreasonable. They include the nature of the business, the position of the employee, the area and the duration covered by the restraint.

# Case example

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**Mason vs. Provident Clothing & Supply Company (1913)** where an employee of a firm of tailors agreed that he will not become employed in a similar business within 20 miles of London.

It was held that the restraint was unreasonable because the skills acquired were for the employee's own benefit even though he learnt them at the employer's business.

## **Restraints on the seller of business contracts:**

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These are constraints that restrain a seller of business from starting a similar business since the purchaser buys even the goodwill.

Courts do not interfere on this since parties are assumed to be of equal bargaining position

# Effects of Illegality

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- Illegality renders contracts void and unenforceable
- Any money paid or goods transferred cannot be recovered

However, recovery is possible in the following circumstances:

- where both parties are not in pari delicto (equal wrong doing)
- where the illegal purpose of the contract has not been performed and one party honestly repents
- money paid under a marriage brokage is recoverable where the marriage does not take place
- money or goods paid in pursuance of an illegal contract is recoverable where the statute intends to protect a given class of persons



## 2. Mistake

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- A mistake in a contract can either be a mistake of fact or a mistake of law.
  - A mistake of law is not a ground for avoiding a contract.
  - A mistake of fact however renders a contract void if it is so fundamental and goes to the root of the contract and undermines the entire contract.
  -
- ❖ Mistakes affecting the validity of the contract include the following:
1. Common mistakes regarding the **existence of the subject matter**: This occurs where both parties assume the existence of the subject matter which unknown to them has ceased to exist.
  2. Mutual mistake regarding the **identity of the subject matter**: This is where there is no consensus ad idem (meeting of the minds).

### 3. Mistake regarding the quality of the subject matter

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- . However, this does not render the contract void. This is because the doctrine of caveat emptor i.e. buyer be aware will apply which governs sale of goods contracts. It can only render the contract void if the mistake is such that to render the contract impossible to perform. However, if one proves misrepresentation, the contract can be avoided.

**4. Mistake as to the identity of the other party:** This is where the other party impersonates or uses false identity with the intention of persuading the other party into a contract. This will render the contract void.

# Case example

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## Cundy vs. Lindsay (1878)

**Facts:** A fraudulent person (Blenkarn) ordered for handkerchiefs from the defendant (Lindsay) using the name of a reputable firm which he had no association with.

Lindsay delivered the goods to him on credit.

The fraudster resold the goods to the plaintiff. It was held that the original contract was void for mistake and the defendant remained the owner of the goods

## **5. Unilateral mistake:**

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**This is where only one party is mistaken.**

**This does not render the contract void unless the other party is aware of the erroneous belief**

## **6. Mistake of signing written documents.**

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**Where one party who is illiterate signs a written document, this does not relieve the party from the consequences of signing the document.**

**The party may however raise the defense of non est factum (this is not my act) where he was induced to sign the document through fraudulent misrepresentation.**

**The defense will succeed even where he was negligent**

# Case example

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**Carlisle & Cumberland Banking Co. vs. Bragg (1911)**

**Facts: The defendant was fraudulently induced to sign a document which he was told was an insurance document.**

**The document was however a guarantee for his overdraft with the plaintiff. It was held that he was not liable even though he was negligent**

## 7. Mistake in typing/recording agreements.

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- Where there is a typing error the court may rectify the document to reflect the true agreement.
- However, the mistake must be for both parties  
Where rectification is not available, courts may declare it void of mistake or enforce it the way it is.

Equitable remedies for mistake

- ✓ Rectification where there are fundamental terms omitted due to a typing error
- ✓ Rescission (cancellation) i.e. setting aside the terms

Refusal to grant specific performance-where one party makes a mistake of fact and the other party is aware of it

# 3. Misrepresentation

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## What is a misrepresentation?

- Representations are statements made with intent to persuade the other party to buy.
- Some representations become part of the contract while others do not. Some are true while others are false.
- A misrepresentation is a false statement of fact made by one party to induce the other party to enter into the contract.
- The effect is to render the **contract voidable**.
- Misrepresentations may be fraudulent, innocent or negligent. A fraudulent misrepresentation is one which the maker knows to be false, does not believe in its truth or makes it recklessly



- ❖ **An innocent misrepresentation is one which the maker honestly believes to be true.**
- ❖ **Negligent misrepresentation is one that is made without reasonable care being taken.**

# Conditions necessary for a misrepresentation to have effect.

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For a misrepresentation to affect the validity of a contract, the following elements/conditions must be present:

- The statement must be untrue
- It is one of material fact and not law or opinion
- That it was meant to induce
- That the other party relied on it
- The statement must be made before or at the time of entering into the contract
- That the person relying on the statement suffered damage

# Remedies for Misrepresentation

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- **Rescission (cancellation):** This remedy is available in all types of misrepresentations. The contract is declared voidable at the option of the aggrieved party. The court may award damages in lieu of rescission if the misrepresentation was minor or innocent. However, in innocent misrepresentation, one may avoid the contract by proving that the statement was untrue and it induced him to enter into the contract. The right to seek for the remedy of rescission may be lost in the following circumstances:
  - ✓ where it is not exercised promptly and delay may imply affirmation. The option is to claim damages
  - ✓ Where the aggrieved party cannot be restored to their original position
  - ✓ Where a third party has acquired rights

## Damages

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- With fraudulent misrepresentation, action is based on the tort of deceit and not on contract.
- One can therefore bring an action for rescission in addition to damages. With innocent misrepresentation, damages are given in lieu of rescission.
- Damages and rescission are alternatives where there is no fraud

## Refusal to further performance

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- This remedy is given where one has not performed.
- One can also use refusal to further performance as a defence.

## Affirmation

- This is where the aggrieved party opts to treat the contract as binding. One can not seek rescission after affirmation.

## 4. Non-Disclosure

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In contracts generally, parties are under no positive duty to disclose. In a contract for sale of goods, the caveat emptor (buyer be aware) rule applies.

However, a positive duty to disclose exists in the following circumstances:

- A true statement made in the course of negotiations but becomes untrue due to a major change in circumstances as in: Case: With vs. O' Flanagan where the defendant who was a doctor wanted to sale his business and his monthly income was high at the commencement of negotiations but declined when he become sick. He did not disclose the decline to the buyer. The buyer sued and the contract was rescinded the contract.

# Cont'd

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- Where a statement is literally true but with a misleading impression. In *R vs. Kylsant*, a statement was made to the effect that the company pays dividends every year creating an impression that the company only makes profits
- A honest statement made believed to be true but discovered to be untrue later by the maker
- Contracts of *uberrimae fidei* (utmost good faith): The duty to disclose exists where one party is likely to know more than the other about the subject matter

# Examples of contracts of utmost good faith

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- Insurance contracts-insured knows more than the insurer on issues regarding the subject matter that may influence the insurer
- Family arrangements where there is a disagreement property
- Sale of land contracts where there is a defect in title
- Partnership agreements and issuance of a prospectus
- contracts of guarantee-employer to disclose previous dishonest acts of the employee



# 5. Improper Pressure

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- Improper pressure can either be where duress or undue influence is used to cause one to sign a contract.
- **Duress:** This is actual or threatened physical violence one of the parties who agrees to enter into a contract against their will.
- It can also be threats to one party's family member, to one's property or business interests or own life threatened.
- Contracts entered into under these circumstances render them voidable at the option of the aggrieved party.

## Undue influence

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- This is a product of equity where there are indicators of more than persuasion.
- This occurs where one party holds a dominant position over the other and takes unfair advantage of the relationship of trust to influence the other and the transaction will therefore be substantially unfair.
- It renders the contract voidable and the burden of proving undue influence is on the party alleging it.
- Delay in seeking a remedy may imply that the other party has affirmed.

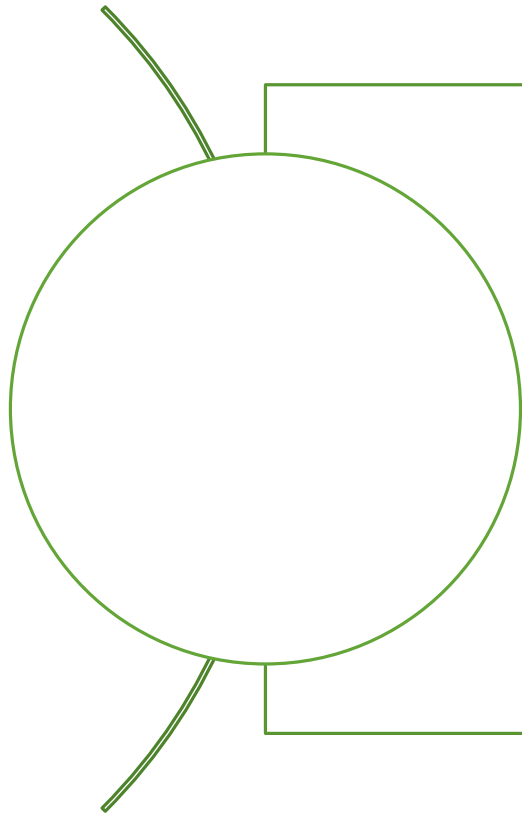
# Undue influence is presumed in the following relationships

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- Parent/child- case of Ottoman Bank vs Mawani where a son signed a contract of guarantee in favour of a company owned by the parents. The court held that although the son was an adult, he was still under the father's authority and immature and therefore the defence of undue influence stood
- Doctor/patient
- Advocate/client
- Trustee/beneficiary
- Teacher/pupil
- Religious leader/follower

# Discharge of contracts

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**The sub-topic discusses the circumstances that may lead to termination/discharge of contracts.**

# A contract may be discharged/come to an end by;

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## 1. Performance

- This is where the parties have fulfilled their obligations under the contract.
- Each party has to completely and exactly do what they were required to do. Failure to perform or doing anything different will amount to a breach.
- Note that liability in contract is often strict e.g. requirements under the Sale of Goods Act as to quality, quantity, description etc.

# Case example

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**Moore & Co. vs. Landauer & Co. (1921)**

**Facts:** The defendant entered into a contract with the plaintiff for the supply of tins of fruit packed in crates of thirty.

The plaintiff delivered the goods packed in crates of twenty four and the plaintiff refused to take delivery.

The plaintiff sued for breach of contract.

❖ It was held that Performance was not within the strict terms of the contract and the defendant was therefore entitled to refuse.

# Exceptions to the rule of strict performance

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- Substantial performance with minor details.

Where there is substantial performance, the contractual price is recoverable.

## Case law: *Shipton, Anderson & Co. vs. Weil Bros.* (1912)

Where the contract was for the supply of 4950 tons of wheat. Delivery was made less 55 tons and the court held that this did not amount to a breach.

# Cont'd

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- Where a party voluntarily accepts partial performance and pays for work done (quantum meruit)
- Where one party refuses to perform
- Where performance is prevented by one party
- Where a party promises to take reasonable care e.g. doctors
- If there is a clause excusing non-performance due to illegality or impossibility, then non-performance will be pardoned
- Divisible contracts-installments
- Refusal to accept performance



## 2. Expiry of time

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- Note that time of performance may be agreed in the contract.
- Time may be of essence as expressed in the contract or implied from the circumstances.
- Failure to adhere may lead to an award of damages. Where no time limit is set, performance will be within reasonable time decided by the court

### 3. Agreement

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- A contract is created by mutual agreement and can be terminated by agreement.
- Note that a further agreement must be made to discharge each other from the obligations of the original agreement.

# Ways of discharging a contract by agreement

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- The agreement can be by **waiver** where parties mutually release each other from their rights and obligations. The new agreement can take any form although the original contract was in writing.
- Agreement can also be by **accord and satisfaction** where a party accepts less than what was due under the contract agrees to release the other party from their obligations. Accord is the new agreement to discharge and satisfaction is the new consideration.
- Thirdly an existing contract may be discharged when a new one substitutes it. This is known as **novation** which can either between same parties or different parties and terms may change.

## 4. Discharge by operation of the law

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There are circumstances where the law may apply in such a manner so as to discharge a contract. Some of these situations may include:

- **Merger:** Where an existing simple contract is replaced by a specialty contract (under deed) with existing terms. The original contract is automatically terminated.
- **Death:** Contracts for personal services are automatically terminated by death of one party. However, other contracts survive the benefit.
- **Bankruptcy:** When one obtains a bankruptcy order against himself, a trustee in bankruptcy is appointed to run his affairs.
- **Unauthorised alterations:** Where there is unauthorized material alteration to the terms of the contract by one party without the knowledge and consent of the other, this will discharge the contract.

## 5. Discharge By Breach

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- Breach occurs where there is failure by one party to perform his obligations under the contract.
- For the contract to be discharged, the breach should be one that goes to the root of the contract e.g. breach of a condition. If it is breach of a warranty, the innocent party will be entitled to damages.

# Cont'd

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Breach may occur in the following ways:

**Failure to perform:** Either there is no performance at all or the performance is inadequate

**Anticipatory breach:** Anticipatory breach takes place before the time of performance. One can do this by expressly renouncing the contract or disabling themselves by doing something that makes performance impossible. An example is where a seller disables himself by selling the goods to another person before the time of delivery.

## Case example:

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Frost vs. Night where the defendant promised to marry the plaintiff after the death of his father. He however married somebody else while his father was alive. It was held that the defendant had disabled himself as English law allowed a person to take only one wife.

- Note that one may ignore the anticipatory breach and keep the contract alive until the time of performance in the hope that the other party may perform their obligations.
- However, there is a risk in doing this as the right to sue may be lost if the contract is discharged by some unexpected turn of events.
- The right to sue in anticipatory breach should be exercised promptly

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# Remedies for breach of contract



# 1. Rescission

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- This is an equitable remedy and refers to the cancellation of the contract.
- Under misrepresentation, the injured party on rescinding the contract is freed from his duties and entitled to recover any property that they have transferred.
- Such party can however lose the right to rescind the contract if:
  - (i) They cannot be restored back to their original position
  - (ii) If a third party has acquired rights under the contract
  - (iii) If they knew the misrepresentation and affirmed
  - (iv) If they take unreasonable delay in seeking rescission
- Under breach of contract, if the breach is serious, parties will be entitled to rescind. They can do this by either refusing to perform or refusing to further performance. If the breach is not serious, the court will award damages

## 2. Damages:

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- This is a remedy under common law.
- It is an award for financial compensation and can be claimed as of right where a contract is broken.
- The purpose of damages is to place the claimant to the position they would have been in had the contract been performed fully.
- They are not expenses incurred by the defendant in performing the contract. If no real loss was suffered, nominal damages will be awarded.
- Damages are meant to compensate the claimant and not to punish the defendant.
- Note that punitive damages cannot be awarded for breach of contract

# Factors that guide/govern the award of damages

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- Damages are assessed based on the **nature of loss**. The common types of losses include personal injury, property damage, financial loss, distress, injury to feelings among others.
- The amount of damage will also vary depending on the **circumstances** giving rise to the loss. An example may be where an unpaid seller fails to deliver the goods and the buyer has not paid, the court will award based on the cost of substitute goods whereas if the seller is paid and fails to deliver, the court will give an award based on the market value of substitute goods.
- **Mitigation of loss**: The aggrieved party in breach of contract is under duty to take reasonable steps to minimize the loss suffered. Failure to do this, the court will not award the extra costs.
- Action for breach of contract is usually for **unliquidated damages**. There may be instances where the parties make provisions in advance regarding the amount payable and in case of a breach, courts will allow them if they are reasonable.

- **Remoteness of damage:** Damages will not be awarded for losses that are considered too remote to the original contract i.e. they are not foreseeable. Case example: Hadley vs. Baxandale where a mill operator requested a common carrier to deliver a crankshaft to the manufacture and they took too long to deliver it back. The plaintiff sought to recover loss of income and profits from the defendant. It was held that the defendant was not liable because for loss of profits because it would not be reasonably be considered as arising naturally from the breach and secondly that it would not be reasonably be supposed to be in the contemplation of the parties of the parties at the time they made the contract.
- **Causation:** Damages can also be recovered if there is a direct causal connection between the wrongful act and the loss (proximate cause) with no intervening causes.

# Types of damages

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- There are two main types of damages ,that is, general and special damages. You are required to understand them and identify circumstances under which each type is claimed.
- **General damages** do not require such strict pleading and proof because they relate to losses which the law automatically presumes to result from the breach. General damages are unliquidated and are therefore ascertained by courts depending on the circumstances of the loss.
- **Special damages** on the other hand are those of which the claimant is required to give notice when they make their claim against the defendant and which they must prove strictly at trial. They are liquidated claims and do not arise directly from the breach.

## 6. Discharge by Frustration

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- This is when a contract becomes impossible to perform, illegal or futile due to -\*unexpected change of events.
- The effect is to release the parties from their obligations.
- For courts to allow discharge, the event must have been unforeseen.

# Circumstances which may be deemed to frustrate a contract

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- Change of law/operation of law
- Destruction of the subject matter of the contract
- Non-occurrence of an event which the contract depends
- Government interference
- Death or personal incapacity

# Privity of Contract

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- This is a doctrine that restricts the rights and duties created by a contract to the persons who originally made it.
- The contract cannot therefore confer any legally enforceable benefit or duty on a third party.
- Strict application of the doctrine of privity of contract hinders useful and sensible commercial transactions.
- Because of this, a number of exceptions have become established over the years either by statute or common law.



# Exceptions to privity of contract

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- 1. Agency:** A third party can gain the right to claim on an insurance policy under the rules of agency. A mercantile agent (explained in lecture six) acquires insurable interest on the property of the principle. An agent may also be given the power of attorney to run the affairs of another and acquire rights. The principal however may enforce a contract entered into by an agent on their behalf.
- 2. Trust:** A trustee may insure the trust property. The beneficiary may enjoy the benefits payable under an insurance policy.
- 3. Insurance (Third Party Risks) Act Chapter.405:** This Act protects injured third parties in road accidents when vehicles are being driven on public roads. Third parties and authorized drivers may benefit from motor policies yet they were not parties to the original contract.

## 4. Assignment

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- Assignment occurs where an original party to a contract transfers their rights and liabilities under the contract to another (a third party who is not a party to the original contract) who stands in their place.
- A contractual right is a chose in action (a valuable but intangible piece of property) and it cannot be physically seized but can be enforced through an action in court.
- Originally under the common law system, one could not transfer rights/benefits under a contract but equity allowed assignment. The person who assigns is known as the assignor whereas the one who is assigned is known as the assignee.
- Note that the assignor cannot recover anything more than they themselves possess. Assignment is subject to all liabilities and equities existing between the original parties to the contract.

# Ways in which assignment may take place

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## 1. Statutory assignment

The Indian Law of Property Act section 130 provides that all debts and other legal choses in action e.g. patents, copyrights may be assigned. Rights and obligations can therefore be assigned,

For a statutory assignment to be effective, the following essentials must be present:

- The assignment must however be absolute/unconditional
- It must also be in writing and signed by the assignor
- A written notice must be given to the debtor
- Consideration is not necessary to support a statutory assignment

## Cont'd

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- In legal assignment, the assignee can sue the debtor in his name but in equitable assignment, the assignee must join the assignor as a party to any action against the debtor.
- Note that where a notice has been given, payment to the original party will not discharge the debtor

## 2. Equitable assignment

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- This will be possible if an assignment does not comply with all the requirements for a statutory assignment.
- It may therefore take effect as an equitable assignment provided the intention to assign is clear from the circumstances.
- Note that no formality is followed or notice given.
- Equitable assignment unlike legal assignment must be supported by consideration.
- If the assignee wishes to enforce the contract, the assignor must be enjoined into the case as a co-plaintiff and in the absence of consideration, the assignee cannot compel the assignor to join him.

### 3. Assignment by operation of the law

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- The law operates in such a way as to automatically affect contracts. Under assignment through operation of the law, involuntary assignment occurs.
- Death of a party to the contract does not discharge the contract as rights and liabilities will be vested in the personal/legal representatives of the deceased who will now be the assignee. Contracts for personal services are however discharged by death of one party.
- Voluntary assignment also takes place where one is declared bankrupt through a court order. A trustee in bankruptcy takes the place of the original party.

# Cont'd

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**Note that there are rights which can not be assigned and they are:**

- **Under contracts for personal services**
- **Insurance contracts**

# Transfer of Obligations

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- Note that obligations under a contract cannot be transferred without the consent of the other party and the assignee.

The transfer of obligations may occur in the following ways:

**By novation:** This is where the original contract is rescinded and substituted with a new one

**By vicarious performance:** Contracts can be performed by another provided there is no provision requiring personal performance by one party. An example is where a contractor sub-contracts his duties to a sub-contractor and shoulders responsibility for the acts and omissions of the sub-contractor though vicarious liability (to be discussed further in lecture five)