Chapter 9 – Core Subjects: Contract law

Now that we have looked at the English legal system, we can move on to consider some of the key areas of English law. The first area I have chosen is contract law. The reason for this is that it is a subject which tends to be taught in the first year of a law degree course and is a central part of many other legal qualifications and it is also fundamental to many other areas of law. For example, most commercial transactions are based on contract law, as are consumer transactions, banking deals and property transactions amongst others. All these things involve a contract and it is therefore essential to have a basic grasp of the issues. A book of this nature can do no more than give a very brief introduction to the topic. There are plenty of other books available which will help you further your study of contract law, such as the excellent "A Really Basic Introduction to English Contract Law" (!)

English contract law is largely a common law subject. We talked earlier in the book about some areas of law being formed and developed by a series of case decisions made by judges, and contract law is one of those areas. There are some relevant statutes, many of which cover consumer protection issues, but many of the key rules stem from the decisions of judges. It is also a civil law topic, rather than criminal law. That means that disputes that go to court are resolved in the civil court system that we looked at earlier. Court action will therefore generally be started in the County Court or possibly in the High Court.

English contract law is based on agreement. In other words, we choose to enter into a contract or not. Only when we have committed to such an act do contractual obligations become binding on us. It is worth noting at this stage that a legally binding contract can be entered into in writing or it can be made orally – by spoken words. The advantage of writing is that it provides a record of what was actually contained in the agreement. Oral contracts can be problematic when it comes to proving what was agreed in the first place.

For a contract to exist the courts have said that there needs to be an offer made by one party to the contract which is then accepted by the other party. The offer should set out all the terms which the person making the offer is willing to agree to in the contract. The other party should then simply accept those terms without further amendment. We make offers like this every day. When I go into a shop to buy something, the courts have said that I am offering to buy the product and that the shop

accepts my offer by recording the sale at the counter and accepting my money. This was confirmed in the case of *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Limited* (1952). The court said that a display of goods in a shop is generally an invitation to treat and not an offer for sale. This means the shop is inviting the customer to make an offer, which the shop can then accept or decline as it chooses. It also means that if a shop mistakenly prices goods too low, we cannot force them to sell at that lower price, despite popular belief to the contrary!

As well as an offer and an acceptance, there are a few other requirements which the courts look for to create a legally binding contract. The first of those is a concept known as "consideration". Once again this is something which tends to cause some confusion to those new to the subject. Consideration has been defined by the courts in various cases. One of the most well-known is the case of *Currie v Misa* (1875) in which the court defined consideration as a right or benefit accruing to one party or a loss or detriment suffered by the other. An obvious example of consideration is the price paid under a contract for the purchase of goods or services. For the contract to be valid, both parties generally need to provide consideration and that means that the promise of a gift or to do something for "free" is generally not legally binding. If I agree with the window cleaner that he will clean my windows for £10, then the consideration I give is the £10. That is both to his benefit and to my detriment. The consideration he provides is that he cleans my windows, therefore giving up his time, skill and presumably, his cleaning products. That is to his detriment and to my benefit, therefore satisfying the definition of a valid consideration.

It is fair to say that consideration is a controversial topic. Some lawyers believe that it is unnecessary and that tests based on whether the parties intended to be bound by the contract are enough to sidestep the need for consideration. Indeed, many other legal jurisdictions in the world do not have such a concept. The courts are still trying to sort out exactly what is included within the definition and it is a concept which gives judges scope to be "creative" in their search for justice.

The next thing judges look for in their search for a binding contract is certainty. The original offer should contain all the terms of the contract, and the other party should just be able to accept it. Those terms need to be clear and all-encompassing. It should be apparent to anyone "looking in" at the contracting stage what the terms of the contract are and what they mean.

The courts do have some scope for implying terms into a contract, which means that they can decide that a clause exists in a contract even though the parties did not actually include it when they entered into the contract. However, they are generally reluctant to do so due to the doctrine of freedom of contract. This doctrine provides that people are free to enter into contracts as they choose and they should be bound by what they have agreed to do. Having said this, the courts will on occasion imply a term into a contract to make the contract work in the way that the court thinks the parties intended it to work.

The final basic requirement for a valid and binding contract is intention. What this means is that the parties must have intended to be legally bound by the contract. The test is whether they appeared to intend to be bound, rather than that they actually intended to be bound. The courts do not therefore ask the parties whether they intended to be legally bound, they look at their words and conduct to see if a "reasonable" person would think they so intended. There are two presumptions which the courts make to help them assess the case before them.

Firstly, they assume that people who make agreements in a social or domestic setting do not intend to be legally bound by that agreement. This can be seen in operation in the case of *Balfour v Balfour* (1919) in which the court decided that an agreement between husband and wife was not binding.

Secondly, they assume that people who make agreements in a business or commercial setting *do* intend to be legally bound by the agreement. An example is the case of *Esso Petroleum Co. Ltd v Commissioners of Customs and Excise* (1976).

Now we have considered briefly the way that contracts are made, we should look at how they can come to an end or, to use the technical term, how they are discharged. The obligations that two parties owe to each other under a contract can come to an end in a variety of ways. The most obvious is by performance of those obligations in accordance with the contract. If I employ a decorator to paint my dining room, then the contract will come to a natural end when the decorator has finished painting my dining room to an acceptable standard and I have paid the money I owe under the contract. The obligations that we both had have been performed as envisaged in our contract and so it has now ended.

Another way that the contract may come to an end is by agreement. This could be before perfor-

mance has started. For example, if the decorator telephones me to say that he is not very well and will not be able to complete the job for a few weeks, then we may agree to release each other from our respective obligations. I agree that he does not need to decorate my dining room and he agrees that I do not need to pay him.

Another method by which a contract is discharged is through "frustration". A contract becomes frustrated when it becomes impossible to perform or when performance becomes something very different to what was envisaged when the contract was entered into. Generally the circumstance which alters things must be something which was outside the control of the contracting parties. The common example used to explain frustration is the case of *Taylor v Caldwell* (1863). In that case an agreement for the hire of a concert hall was frustrated when the concert hall burnt down in a fire which was not the fault of either party to the contract. You can see that the contract could no longer be performed as agreed because the concert hall no longer existed. It therefore effectively comes to an end.

Along with full performance of the contract, perhaps the most important way in which a contract can come to an end is due to a breach of contract. This is where one party to the contract fails to perform their contractual obligations as agreed. Let's look at an example to round off this chapter, which we can also use to cover the remedies available when a breach of contract occurs.

Davina runs her own bakery business and contacts Ed, a local ingredient supplier. He offers to supply ingredients to Davina on the first working day of each month for the next 12 months for a fixed price of £300 per month, payable within seven days of each delivery. Davina agrees with these terms and so accepts his offer.

As a reminder, this amounts to a valid contract. Ed made an offer containing the terms of the contract, which Davina accepted. The terms were certain (let's assume the detail of what exactly was being delivered was agreed), and both parties clearly provided the necessary consideration; Ed has promised to deliver baking ingredients, and Davina has promised to pay £300 for them each month. There is also an intention to create legal relations. This is a business or commercial transaction and therefore a court would assume that the parties intended to be legally bound by their actions.

Everything goes to plan for the first three months of the contract which sees Ed deliver good quality produce and Davina paid for them as agreed. However, in the fourth month Ed's delivery is a few days

late. Davina agrees to overlook this and pays for the ingredients as usual. On the fifth month, Ed's delivery is three weeks late and Davina is now considering her options.

In contract law terms, what we saw for the first three months of the contract was full performance by both parties. In other words, they were both doing what they agreed to do. Had they continued to behave in this way, the contract would have run its course and ended after 12 months; the obligations of the parties would have been discharged by performance. However, in month four it appears that Ed breached his side of the bargain. He did deliver the produce to Davina but it was late. Note that the reasons why it was late are not generally relevant; he promised to deliver on the first working day of each month and he did not do that, therefore he breached the contract.

The first thing to note about a breach of contract is that it always gives the "innocent" party a right to claim damages (compensation) for any losses caused by the breach. Therefore Davina could, after the late delivery in the fourth month, have taken Ed to court and sued him for any losses she could show had arisen. For example, if she had run out of ingredients and could therefore not do any baking for a few days, she may well lose out on orders from her own customers. If so, she could sue for the lost profit from those orders. In reality, minor breaches of contracts occur very often. Assuming Davina carries a stock of ingredients and therefore had enough left over from the previous month, she probably wouldn't lose out and therefore is content to accept Ed's apology and leave it at that. Even if it caused her some inconvenience and a lost sale or two she may still choose not to take any further action. She could try to settle things without going to court, perhaps by asking for a reduction in the price for that month to reflect the fact that the delivery was late.

When it comes to the fifth month, Ed's delivery is three weeks late. This is clearly a much more serious breach of the same term of the contract than when he was a few days late. It may well be that Davina will want to bring the contract to an end now because she thinks that Ed will continue to deliver late and it will no doubt cause problems to her business.

Whether she can do this or not depends on what kind of term has been breached. In law there is an important distinction between contractual terms which are classed as "conditions" and contractual terms which are classed as "warranties". A condition is a term of the contract which goes to the heart of what the contract is about. In other words, it is a key contractual term involving an important aspect

of the contract. A warranty is a term which is less important and not central to the main purpose of the contract.

The importance of the distinction between conditions and warranties is in the remedy which is available. The breach of a warranty allows the other party to sue for damages (compensation), whereas the breach of a condition allows the other party to terminate the contract.

So what type of clause is the delivery clause? This could conceivably be a condition, especially if Davina has highlighted it as being particularly important for good reasons (such as the fact that she tended to run her stock right down to nothing each month to keep things fresh). It is probably unlikely to be a warranty because it is certainly of some importance, which brings us to the third and final classification of contractual terms, known as "innominate terms". This idea was developed in the case of *Hong Kong Fir Shipping Limited v Kawasaki Kisen Kaisha* (1962) and refers to a contractual term which is somewhere between a warranty and a condition. It is basically a term, the status of which really depends on the nature and effect of the actual breach that occurs. As we have seen in Davina's case, Ed could breach the delivery term by a very short period which may not have too much effect on her business. On the other hand he could breach it quite significantly (the fifth month delivery is now three weeks late) and this could have a serious impact on her business.

If the delivery clause is an innominate term, then the breach in the fourth month is probably only going to lead to a claim for compensation (in fact Davina overlooked the breach entirely) and the breach in the fifth month may well give rise to a right to terminate the contract. Davina could then find an alternative supplier for the remainder of the period if she wished to. It is worth noting that she does not *have* to terminate the contract, but if she does continue with it, then both parties remain bound to complete all their outstanding obligations.

This chapter has tried to give you a very brief overview of contract law. We have seen how contracts are formed and how they are discharged and had a quick look at remedies, the main one being a claim for compensation to cover any loss incurred by an innocent party who suffers a breach of contract.