# *The Law of Contract*

By Paul Reeve FCII FCILA, Sedgwick International UK

CILA Education Committee

July 2020

We enter into contracts on a daily basis, often without realising that we have done so. We would all understand that if we buy a new car, upgrade our mobile phone or hire a wallpaper stripper we entered into a contract with the dealer, phone service provider or tool hire company. But we also enter into contracts when we buy a bus ticket on our commute to work, the sandwich at lunchtime or beer on the way home.

So, what is a contract? A contract was defined by the noted jurist Sir William Anson as being a legally binding agreement made between two or more parties by which the rights are acquired by one or more to acts or forbearances on the part of the other or others. More simply, a contract is a written or spoken agreement that is enforceable by law.

Contracts do not always have to be in writing, although the absence of a written agreement could prove to be problematic in the event of any dispute.

## Types of contract

Contracts may fall into three types

- Contract of record – these include judgements made by a court whereby previous rights under a contract are merged into a judgement if a dispute under the contract has been litigated, and recognizance where in criminal court an offender is required to comply with certain conditions imposed by the court or suffer a financial penalty
- Contract by deed – these usually relate to the sale or transfer of land or leases. A contract by deed must be in writing, signed by the parties to the contract and handed over from one party to the other
- Simple contracts – these may be in writing or oral, or the existence of the contract may be implied by the conduct of the parties.

An express contract is one where the terms are stated and agreed by both parties, either orally or in writing.

An implied contract is where the terms are not specifically expressed, but can be implied by the conduct of the parties. For example, a diner who takes a seat in a restaurant, places an order and eats the food supplied will, by their conduct, be implied to have entered a contract and the customer will be expected to pay for the meal.

A contract is considered to be executed when it has been wholly performed. An executory contract is one that is unperformed, or still has tasks to be completed.

Contracts are usually made between two or more parties. There may be instances where a contract is unilateral, where only one person is legally bound by the contract. An example of this is an owner of missing property promising to pay a reward for the return of the property.

Insurance contracts are bilateral agreements; each party makes a promise to the other and is legally bound by that promise. To illustrate this, the policyholder pays the premium to the insurer and in return the insurer agrees to pay claims under the policy.

If a contract is void, it has no binding effect on either party and the terms of the contract cannot be enforced. A voidable contract is one that can be cancelled by either party, perhaps because of a misrepresentation or mistake.

## Essential elements of a contract

Certain criteria must be met before an agreement becomes a contract that can be enforced.

**Intention to create legal relations**

A contract is an agreement that is intended to create a legal relationship. It is generally presumed that domestic, family and social agreements are not intended to have legal consequences. So, for example if John arranges to meet his friend Jack at the pub but doesn't attend, Jack would not have any recourse to legal action.

In commercial and business transactions, the expectation is that the agreement will be enforceable and provided that evidence of the contract can be verified by oral or written evidence the court will apply the provisions of the contract. This presumption can however be over-ridden if there are express terms in the contract to state that the agreement is not legally binding *(Appleson v Littlewood Ltd 1939)*

**Offer and Acceptance**

To form a contract one party (the offeror) has to make an offer, and the other party (the offeree) has to unconditionally accept the offer. Only then can a contract be formed.

The offer can be made orally, in writing or by conduct e.g. in a supermarket taking an item to the cashier. The offer can be made to one person, to a group of people or to the public as a whole. Where the offer is made to an individual or to a group, only the individual or members of the group can accept. Offers made to the public as a whole can be accepted by anyone who meets the conditions of the offer.

An offer is made when the offeror is prepared to be immediately bound by the offer if it is accepted. A statement made during the course of negotiation is an invitation to treat. A price label on an item in a shop is an invitation by the shopkeeper to the customer to make an offer to buy the item. If a price has been mis-labelled the shopkeeper does not have to sell the item at the price shown; he is merely indicating that he is prepared to accept offers for the item. *(Pharmaceutical Society of Great Britain v Boots Cash Chemists 1953).*

An offer is not made until it is communicated to the other party *(Taylor v Laird 1856).* Conditions can be attached to the offer, but for the conditions to be effective they must be communicated to the offeree *(Henderson v Stevenson 1875, Penton v Southern Railway 1931).*

In some instances advertisements may be found to be an offer, for example offering a reward for finding lost property or making a payment to a consumer if the product does not perform as promised *(Carlill v Carbolic Smoke Ball Company 1893).*

When an offer has been made it may terminate

- On the death of either the offeror or offeree before the offer is accepted
- By expiry of any time limit specified in the offer if acceptance is not made
- By expiry of a reasonable period of time. The time period that is reasonable will be determined by the court on the particular circumstance of the case
- By revocation of the offer. The offeror can revoke the offer at any time, even before expiry of any specified time limit. The revocation has to be communicated by the offeror to the offeree
- By rejection of the offer by the offeree
- If a counter offer is made by the offeree *(Hyde v Wrench 1840)*

An offer can be accepted orally, in writing or by conduct. If the offer stipulates that the offer has to be accepted by a particular method, that method must be followed. Only if the offeree makes unqualified acceptance to the offeror will the contract be made. The acceptance must match the terms of the offer *(Neale v Merret 1930),* and only trivial variations to the offer may be acceptable.

Acceptance has to be communicated by the offeree to the offeror, and the acceptance will not be effective unless communicated. An exception to this is if an acceptance is sent by post but not received by the offeror. In this case the contract is made when the acceptance is posted even if not subsequently delivered *(Household Fire Insurance Co v Grant 1879).* Where however an offer is made but then revoked by post, the revocation is only effective when received *(Byrne v Van Tienhoven 1880).*

Acceptance of an offer is only effective if the terms of the offer are agreed without amendment of qualification. If the acceptance is made subject to new terms or conditions are applied this would constitute a counter offer, and would have to be agreed by all parties before the contract becomes effective *(Hyde v Wrench 1840).*

Where land or property is being sold, agreement may be reached ‘subject to contract’. This means that neither party is bound by contract until the formal agreement is prepared and

signed. Until the agreement is signed the terms can be varied and amended or either party withdraw without penalty *(Eccles v Bryant 1948).*

**Consideration**

An agreement or contract will only be legally binding if there is 'consideration' provided by the party benefitting from the contract. Consideration was defined in *Currie v Misa 1875* as 'some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other'.

Simply, if a person who is performing the contract is doing so without payment, the contract is not legally binding. Consideration will usually be money, but it could also be the performance or promise of performance of a service, or the transfer or promise to transfer land or goods.

The consideration must be real and genuine, and of some value. The value need not be adequate and the Courts will not interfere simply because one of the parties to the contract has made a bad bargain.

The consideration must not be past, for example a promise to pay for services that have already been freely provided. If John offers to mend his neighbour's fence and does so, he cannot then request payment from his neighbour unless there was evidence of an express or implied promise of payment.

The consideration must be legal. *(Foster v Driscoll 1929)*

The consideration must move from the promise i.e. the person to whom the promise was made. A person cannot enforce an obligation unless they have given consideration, and only the parties to a contract can enforce that contract. A third party to the contract does not have rights under that contract *(Scruttons Ltd v Midland Silicones Ltd 1962).*

**Capacity**

The general rule is that any person may enter into any type of contract, with certain exceptions

*Minors*

The age of majority was set by the Family Law Reform Act 1969 at 18. A person under the age of 18 is legally a minor and contracts entered into by a minor are either

- Binding

- Void – in law there is no contract
- Voidable – the minor may apply or reject the contract as he wishes

Three types of contract are binding on a minor

1. Contracts for necessaries i.e. goods or services suitable to the condition in life of the minor and his/her actual requirements at the time of sale and delivery. Examples of necessaries would include food and clothing and also educational books, but the Courts will decide on the specifics of the case *(Nash v Inman 1908)*
2. Contracts of education service. These would include articles of apprenticeship and contracts of employment
3. Contracts of marriage, provided the minor has the consent of their parent, guardian or of the Court

All other contracts entered by a minor are voidable, unless the minor has repudiated the contract before he reaches the age of majority.

*Insanity or drunkenness*

Contracts entered into by an insane person are voidable by that person, but they have a liability to pay a reasonable price for necessaries

The person who pleads insanity has to prove that

1. They were insane at the time of making the contract, and that they were incapable of understanding the nature of the agreement and
2. The other party was aware of their insanity

Drunks are subject to similar rules as insane people.

*Statutory corporations and registered companies*

A contract entered by a statutory corporation or registered company may be invalid if the nature of the contract is ultra vires, i.e. beyond the powers of the corporation or company *(re Jon Beauforte Ltd 1953).*

**Legality**

A contract which involves the commission of a legal wrong cannot be enforced. Examples would be contracts for the commit a crime or civil wrong, contracts that are against public

morality or contracts that seek to interfere with the administration of justice. Illegal contracts are void under the principle of ex turpi causa non oritur actio (no action arises from a wrongful cause).

**Duress or undue influence**

A contract may be voidable by a party who entered the agreement under duress, such as violence or threat of violence to the party.

If undue influence is used to persuade one party to enter a contract then the contract may be voidable. Undue influence means where one party is in a position of dominance over the other and could apply pressure to enter the agreement. Relationships that give rise to a presumption of undue influence include

- Parent / child
- Doctor / patient
- Religious advisor / member of congregation
- Solicitor / client
- Trustee / beneficiary

In these cases the defendant would have to prove that undue influence was not used. In all other cases the plaintiff would have to prove that undue influence was used.

**Possibility of performance**

The subject of the contract must be capable of being delivered. If it cannot then the contract is voidable

**Mistake**

The general rule in common law is that a mistake in law will not make a contract void; ignorance of the law is no excuse. A mistake of fact will make a contract void, but only if it falls within the following categories

- Mistake as to the nature of the transaction – if one person is misled as to the fundamental nature of the agreement *(Foster v Mackinnon 1869)*
- Mistake as to the identity of the other party – if the identity of the other party is material, and one party was misled as to the identity of the other party *(Cundy v Lindsay 1878)*

- Mistake as to the identity of the subject matter – where the parties intend to contract for different things *(Scriven Brothers v Hindley & Co 1913)*
- Mistake as to the quality of the subject matter – the general rule of caveat emptor (let the buyer beware) applies if there is a mistake as to quality. If the mistake is common to both parties, and the absence of the particular quality makes the subject matter fundamentally different, the contract may be void *(Strickland v Turner 1852)*
- Common mistake as to the basis of the contract – where there is a mistake as to facts forming the basis of the contract, where the mistake is common to both parties *(Cooper v Phibbs 1867).*

**Misrepresentation**

A representation is a statement made with a view to inducing another to enter into a contract. If such a statement is false it is a misrepresentation. Misrepresentations may be made either innocently or fraudulently.

An innocent misrepresentation is a false statement made by a person who honestly believed it to be true. If that statement was material in inducing the other party to enter the contract and that party suffers loss as a result of reliance upon it the contract is voidable at his option.

A fraudulent misrepresentation is a false statement made by a person who knows it to be untrue, or does not believe it to be true, or is a statement made recklessly by a person not caring whether it is true or false. Where there is a fraudulent misrepresentation, the party who was induced to enter the contract is entitled to rescission of the contract and can also claim damages.

A party to a contract must not make misrepresentations, but is under no obligation to disclose information unless asked. He will not be liable if he says nothing, but if he makes a statement it should be true. The onus is therefore on each party to obtain the information they require. This is often described as caveat emptor – let the buyer beware.

The exception to the above is in respect of insurance policies. These contracts are ones of utmost good faith (uberrimae fidei). Here, both the insurer and insured have obligations to disclose material facts to the other party. A material fact is one which would influence the judgement of the prudent underwriter in deciding whether to accept the risk presented, and if so on what terms and conditions.

The law around utmost good faith and insurance contacts is influenced by the Consumer Insurance (Disclosure and Representations) Act 2012 in respect of consumer insurance, and the Insurance Act 2015 for non-commercial insurance. These topics fall outside the scope of this paper.

**Privity of Contract**

A contract is a private agreement between the contracting parties, and the general rule is that only a person who is party to the agreement can sue on it *(Dunlop v Selfridge 1915, Scrutton v Midland Silicones 1962).*

There may be exceptions to the doctrine of privity following the Contracts (Rights of Third Parties) Act 1999. This allows a third party to enforce contract terms if the contract states that they may do so, or if the contract specifically confers a benefit on the third party. Insurance contracts are included within the provisions of the Act, but operation of the Act can be excluded by a term within the policy.

## Assignment

As we have seen, a contract is a private agreement between the contracting parties. Assignment means the transfer of rights under a contract from one person to another. If a person has a right to receive something under a contract or a duty to complete a service, they can in some circumstances transfer that right or duty to another party.

Liabilities under a contract cannot be assigned without the agreement of the other party to the contract. Rights under a contract can be assigned to another party, unless the contract is for personal services, and personal performance by the promisor is expected, in which case the agreement of the other party would be required.

## Express and Implied terms

Express terms are those specifically stated within the contract, which have been agreed and accepted by both parties.

Implied terms are not set out in the contract but may be implied to exist by the nature of the agreement. Such terms could by implied by fact, implied by custom of the market, business or trade, or be implied by Statute. Such a Statute could include the Sale of Goods Act 1979 which notes that the seller of goods should have the right to sell, that the goods correspond with any description provided and that the goods will be of satisfactory quality and fit for the purpose intended.

## Discharge of the contract

A contract may be discharged, that is the rights and responsibilities of the parties come to an end, by:

- Performance – this is the usual way by which contracts are discharged, with each party to the contract completing their obligations within the terms of the contract. The contract will have to have been performed within any period stipulated, and payment made in the agreed manner
- Breach – where one party fails to perform his obligations under the contract, or repudiates liability under the contract before performance of the contract is due *(Hochster v de la Tour 1853)*
- Frustration – circumstance may change which prevent the performance of the contract through no fault of either party (Taylor v Caldwell 1863), or performance of the contract depends upon a specific event happening Krell v Henry 1903)
- Agreement or waiver – parties to a contract can, by mutual agreement bring the contract to an end, and release each other from their respective obligations
- Operation of law – the lapse of time will not discharge a contract, but under the provisions of the Limitation Act 1980 legal action on a simple contract must be commenced within 6 years, and under a deed within 12 years. In each case the time starts to run from the date that the plaintiff could have brought the action.

## Remedies

Where there is a breach of contract, the remedies available include

- Rescission – this is in effect annulment of the contract

- Damages – the intention of an award of damages is to compensate a party for the monetary loss suffered because of the breach of contract by the other party. A breach of contract is actionable without the need to prove any financial loss, but if there is no measurable financial loss any award of damages would be nominal. The damages award should put the injured party in the same position that he would have been had the contract been performed properly, and to compensate for the loss. Punitive damages, to punish the defendant, are not allowed in contract. Losses that are too remote from the breach of contract are also not recoverable *(Hadley v Baxendale 1854).*
- Specific performance – the remedy of specific performance requires that the party in breach of contract to fulfil their contractual obligations *(Carpenters Estates Ltd v Davies 1940).* A grant of specific performance cannot be claimed as a right, and can only be made by the court
- Injunction – similar to specific performance, but an injunction is an order of the court preventing the defendant from breaking his contract *(Warner Brothers Pictures Ltd v Nelson 1936).*

## Ambiguous terms

There may be occasions when the wording of contracts is ambiguous or unclear. In these cases, the court will follow rules of interpretation;

- The intention of the parties to the contract should prevail, where the intention can be deduced from the written agreement
- Where the contract is in a standard written form, any amendment which changes the standard wording, such as an endorsement to an insurance policy, will prevail
- The written document would be taken as a whole, with words or phrases not being taken in isolation
- An express term will override an implied term if there is inconsistency
- The ordinary rules of grammar will be followed
- Words will be construed in their normal sense. If a technical term is used it will be given that meaning throughout the document.
- Words will be construed literally, and if there is any ambiguity the contra proferentum rule will apply, and the court will find in favour of the party who did not draw up the contract. In the

context of insurance policies which are usually drafted by insurers, the courts will interpret ambiguous terms in the way that most favours the policyholder. The Financial Ombudsman Service will follow a similar interpretation.

In *Investors Compensation Scheme Ltd v West Bromwich Building Society 1998*, the court set out 5 principles for interpreting contracts:

1. Interpretation involves establishing the meaning that the document conveys to a reasonable person having all of the background knowledge that would reasonably be available to the parties at the time of the contract being made. This is often referred to as being the factual matrix
2. The factual matrix includes anything that would have affected the way in which the language of the document would be understood by a reasonable person
3. The law excludes from the admissible background knowledge the prior negotiations of the parties or subjective declarations made of their intent
4. The meaning that a document conveys to a reasonable person is not the same as the meaning of the words
5. Words should be given their ordinary meaning, reflecting the position that people do not generally make linguistic mistakes in formal documents

## Exclusion clauses

One party to the contract may seek to limit or exclude liability by incorporating exclusion clauses into the contract.

Courts will allow exclusion clauses to be incorporated but will apply them strictly according to a liberal interpretation. For one party to be able to rely on them provided

- The clause is properly incorporated into the contact, and the other party is aware of it
- The wording of the clause is clear and unambiguous
- There is no legislation that would render the exclusion invalid

Certain exclusion clauses are prohibited by Statute under the Unfair Contract Terms Act 1977. A clause that seeks to exclude liability for personal injury or death is not allowed. Other clauses that attempt to limit liability or allow performance of the contract in a different manner to that expected may

be prohibited if unreasonable. The Unfair Contract Terms Act 1977 does not apply to insurance policies.

Reasonable steps must be taken to bring exemption or exclusion clauses to the attention of the other party to the contract *(Thornton v Shoe Lane Parking Ltd 1971)*, and must be brought to the attention of the other party before or as the contract is made *(Olley v Marlborough Court Ltd 1949).* Exclusions printed on a receipt given after the contract is made are not enforceable *(Chapeltown v Barry UDC 1940).*

The Unfair Terms in Consumer Contract Regulations 1999 apply to contracts between consumers (a person acting for purposes outside his trade business or profession) and suppliers. These regulations are relevant to insurance contracts. Provided the risks covered or excluded by the policy are defined in clear language without ambiguity the fairness or otherwise of the terms should not be open to successful challenge. If a term or condition is found to be unfair then it will not be binding on the consumer. Following the principle of contra proferentum any ambiguity in the wording will be held against the party that drafted the contract.