

# Law of Contracts

## AAT Level II BLA - Business Law

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# Contract Law

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## 1) What is a Contract?

- A contract is an agreement between two or more persons with the intention to be legally bound.
- We make contracts every day whether knowingly or unknowingly.
- For example, when you buy groceries from a shop or when you take the bus to get to work.

## 2) How to form a contract?

- There are three main ways of forming a contract;
  1. Verbally
  2. In writing
  3. By Implication
- However, certain laws such as the partnership law or the prevention of frauds ordinance requires certain contracts to be in writing to be legally recognized. Ex: to sell a land, a deed is required, and it must be in writing.

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## 3) Elements of a contract

- Although a contract is formed, it requires certain elements for it be considered as a 'valid' contract.
- The validity of a contract is determined by the elements of a contract, and they are;
  - a) Offer
  - b) Acceptance
  - c) Consideration
  - d) The intention to create a legal relationship
  - e) The legal capacity of the parties
  - f) The legality of the object
  - g) The genuineness of the consent

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## a) Offer

- An offer is an expression of one's intention to form a contract with another.
- It is a definite promise to be bound on specific terms.
- The one who makes the offer is called the offeror.
- The one who receives the offer is called the offeree.

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- For an offer to be valid,
  1. The offer should be made with an intention to be bound by it.
    - This means the person making the offer should be ready to be bound by the terms and conditions he expressed. An opinion or a future expectation is not an offer.
    - In **Gibson v Manchester City Council**, it was held that the Manchester City Council only expressed their "intention" or in other words the expectation to sell the building and that they had **not** in fact made an offer.
  2. The offer should be definite and firm
    - In **Guthing v Lynn**, an offer was made to buy a horse while promising to pay an additional amount of 30 pounds if the horse was lucky. The horse was not upto the expectation of the buyer, but seller wanted the additional amount. Court held that the offer was too vague thus it cannot be enforced.

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3. An offer becomes valid only after it is communicated to the offeree and before he accepts it.

- This means the offeror must communicate the offer either orally or in writing and the offeree can accept the said offer only after it is communicated because the offeree cannot accept an offer that didn't exist, or he wasn't aware of.
- For example, in the case **Bloom v American Swiss Watch Company** it was held that the reward for the information about robbers were not known initially by the Mr. Bloom. He gave an eyewitness testimony to the police without knowing about the reward for information. He cannot now accept the offer for the reward because he was not aware of it in the first place.

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- An offer can be made;

- Orally
- In writing
- By impliedly

- An offer can be made to the following class of persons;

- An individual
- To a group of people
- To the world at large

- **Carlill v Carbolic Smoke Ball Company (1892)** is a case where an offer was made to the world at large.

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### • **Carlill v Carbolic Smoke Ball Company (1892)**

- A medical firm advertised that its new wonder drug, a smoke ball, would cure people's flu, and if it did not, buyers would receive £100. They advertised this in the newspaper and even published the deposit receipt of the money to show their sincerity.
- Carlill used the drug, but it had no benefit as advertised. She sued for the reward. The company argued the offer was not made specifically to her and that it was an advertisement.
- However, the court held that in fact the offer was made to the world at large and not to any specific person. Therefore, the company has a legal obligation because a contract has been established between the two parties so they should comply with the reward as offered.

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- While anybody can make an offer, it is also possible to make an **invitation to treat / invitation to offer**.
- Invitation to treat/offer means the person is inviting others to make an offer.
- Invitation to offer is not an offer, therefore it cannot be accepted.
- For example, I invite you to make me an offer on my house. You offers 50 million as an offer, now I can decide whether to accept your offer or not.
- The person who invites to offer can accept or reject offers made by others.
- It is a way to start negotiations with a view to entering into a contract in the future.

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- The recognized invitations to offer are;

- I. Display of goods in a shop window with a price marked on them.

Ex: **Fisher v Bell**, it was held that the shopkeeper did not offer knives to sale, instead he made an invitation to treat by displaying the knives in the shop window. Court held that the display of goods is an invitation to treat.

- II. Display of goods in supermarkets

- III. Advertisements for the sale of goods

- IV. Auctions

Ex: **Harris v Nickerson**, an auctioneer advertised an auction. He later cancelled the auction, but one person was unaware of it and travelled to reach the auction. He claimed traveling expenses. The court claimed that advertisement to an auction is an invitation to offer.

In **Payne v Cave**, it was held that the bidder is only inviting to offer, it is the auctioneers who makes the offer. When the hammer falls three times, the offer made by the auctioneer is accepted by the bidder.

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- An offer can be terminated as follows;

- I. By lapse of time

- II. By revocation

- III. By rejection ( expressed rejection & counter-offer)

- IV. By frustration

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## I. By lapse of time

- The offer can be made with a specified time for which it is open.
- If there is not specific time period, then the offer is expired automatically after a reasonable time period.
- In the case of **Ramsgate Victoria Hotel Co. Ltd v Monte Fiore**, a person offered to buy shares of a company in June and paid deposit. He heard nothing until the end of November. The company in November informed to pay the balance.
- He argued in the court that as there was no specific time period, then after a reasonable time period the offer would be expired. The court agreed and stated that the time between June to November is excessive therefore the offer has expired.

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## II. Be revocation

- The offeror can revoke the offer at anytime before acceptance.
- The offeror has the freedom to revoke the offer even if he has promised to keep it open for a specific time period.
- He can't revoke if he has received some reward or benefit to keep it open until promised time period.
- In **Routledge v Grant**, the seller offered to sell his house to the buyer and promised to keep it open for six weeks. The seller withdrew the offer after two weeks. The court held that the offeror could revoke his offer at anytime even before the specified time.
- However, as held in **Dickinson v Rodd**, the revocation becomes effective only after it is communicated to the offeree by the offeror.

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### III. By Rejection

- Rejection can happen in two ways;
  - a. Expressed rejection
    - Expressed rejection is when one rejects the offer without willingness to accept it.
  - b. Counter-offer
    - Counter-offer is when a person makes another or separate offer instead of accepting the offer he received.
    - In **Hyde v Wrench**, A offered to sell his property to B for 1000 pounds. In reply, B made his consent for 950 pounds, A refused this. However, B Again stated that he was prepared to buy for 1000 pounds. By this time A refused that as well. B filed for a breach of contract.
    - The court held that B rejected A's offer for 1000 pounds when he made a 'counter-offer' for 950 pounds. Therefore, initial offer by A was rejected by B.

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### IV. By frustration

- This is when an offer cannot be subsequently performed because something has happened beyond the control of the parties.
- For example, before accepting, if the offeror dies, then the offer cannot be performed as the one who made it has passed away.

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## b) Acceptance

- Acceptance is unconditional consent given by the offeree to the offeror.
- When accepting the offer, the offeree should accept the entire terms of the offer.
- Acceptance can be made in writing, verbally or by implication.
- It is important to communicate the acceptance either in the manner prescribed by the offeror or in some official manner.
- This means until the acceptance is communicated effectively no contract will come into existence.

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- In **Powell v Lee**, the plaintiff applied for the post of a principal in a school. The board of managers passed a resolution to appoint him, however this was not yet officially communicated.
- A board member who was a friend informed of this decision in an unofficial manner. However, the board later rescinded the resolution.
- The court held that there was no contract because the acceptance was not communicated officially.
- Based on this principle, when contracts are made based on instant communications, acceptance should be “received” by the offeror, mere transmission will not amount to communication of acceptance.

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- Communication of acceptance using letters are governed by the “Postal Rule”.
- This is when a contract is made by post, the acceptance is deemed to be communicated the moment the letter is posted to the correct address.
- Even if the letter gets delayed due to other factors, as the letter has been submitted and posted, acceptance is deemed to have been communicated.
- For example, in **Adams v Lindsell**, **A** offered to **B** to sell goods by posting a letter on 2<sup>nd</sup> September and required an answer by return post. On 5<sup>th</sup> September **B** posted his acceptance letter but it reached **A** only on the 9<sup>th</sup> of September. On 8<sup>th</sup> September **A** had sold the goods to **C**. It was held that the real contract is between **A** and **B** because **B** had posted the acceptance letter on an earlier date. The date of posting is the date of acceptance as per the postal rule and not the date it was received.
- To overcome the postal rule, the offeror can expressly state that acceptance made through letters should be received by him for it be valid and that the posting date would not be considered.

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## C) Consideration

- This means that there should be something of value measurable by money.
- In English law, it is called valuable consideration.
- In Roman Dutch law it is called “Justa Causa”.
- This element requires that goods be exchanged for consideration that is valuable, which can be measured by money.
- For example, **A** offers to sell his phone to **B** for Rs. 50,000 and **B** agrees to buy that phone. **A**'s consideration is the phone and **B**'s consideration is the money that he is willing to pay. They will exchange their considerations.
- In Roman Dutch law if there is a ‘just reason’ the seriousness of the intention may or may not be measurable by money but will still be considered as *justa causa*.

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- Valuable consideration is of three types

- i. Executed consideration – Consideration agreed and provided by the parties at the time of the contract
- ii. Executory consideration – consideration agreed by the parties but not yet provided
- iii. Past consideration – past consideration is not valid or recognized.

Ex: In the case of *Mc. Ardle* (1951), a widow made improvements before her children made the payments or agreed to make payments. After doing the repairs she asked for payment. The court held that since she had already done the work before the children mention payment, the consideration was past.

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- The adequacy of the consideration is a matter which the courts have already decided.
- This means, although the valuable consideration is something of value measurable by money, it does not have to be proportionate with each other's consideration.
- In **Thomas v Thomas**, after the death of the husband the executor let the wife stay in the house for a lease of 1 pound. Later, he claimed that the agreement is not valid because a lease rental of 1 pound a year during the lifetime is not adequate.
- The court held that consideration should not necessarily be adequate if parties have satisfied the consideration at the time of the contract.

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- According to the doctrine of privity, no person can claim any contractual right under a contract, or no person is liable under a contract unless such a person has privity in the contract.
- This means, unless you are a party to the contract, contractual rights and obligations will not be applicable.
- In **Dunlop Tyre Company v Selfridge**, the company had sold some tyres to wholesale shop on the condition that the wholesale shop would not sell below a minimum price and the shop agreed that the retailers to whom they sell the company products should also not sell below the minimum price.
- However, this wholesale shop had sold some tires to a retailer below the minimum price, the company sued for breach of contract against the retailer.
- The court held that the company cannot claim contractual rights under contract because the retailer is not a party in that contract.

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## d) The intention to create a legal relationship

- To create a valid contract, parties should have intended to create legal relationship.
- It is said that domestic contracts are not valid contracts.
- For example, in **Balfour v Balfour**, the husband was a civil engineer employed in Ceylon and went back to England with his wife. his wife could not return to Ceylon because of illness. the husband promised to pay 30 pounds per month, but he failed to pay it.
- Wife took legal action against husband, however, the court held that objective of this contract is to perform or manage duties. Therefore, the parties did not have intention to create legal relationship thus it is not a valid contract.
- In the above case, the contract was made while they were in marriage, therefore it is considered a domestic contract.

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- In **Meritt v Meritt**, the husband and wife separated and thereafter they made an agreement. Mr Merritt agreed to pay Mrs Merritt £40 per month.
- He failed to pay this, and the husband argued that this was a domestic contract therefore not enforceable.
- However, the court held that as they were separate at the time of the contract sufficient intention is there to make the contract valid and that it is not a domestic contract.

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## e) The legal capacity of the parties

- To enter a contract, both parties need to have contractual capacity.
- Certain persons in the society don't have contractual capacity, such as;
  - i. Minors
  - ii. Intoxicated persons
  - iii. Persons suffering from unsoundness of mind
  - iv. Bankrupt/ insolvent persons

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- However, minors (who are less than 18 years old), can enter contracts even if they don't have the full contractual capacity.
- This can be done in two ways
  - i. Assisted contracts – These contracts are entered by minors with the permission or consent of guardians; therefore, they are valid because a person with contractual capacity assists the minor to enter into the contract.
  - ii. Unassisted contracts – When a minor enters a contract without the assistance of a parent or a guardian. These contracts are generally not valid unless the unassisted contract offer the following;
    - a. Contracts for necessities such as for food, clothes, medicine and other reasonably required things for life of the child. Ex: **Nash v Inman**, The minor had entered a contract for clothes, but failed to pay. the tailor sued the minor Because he had supply necessities (clothes). However, the court held that this contract cannot be enforced because the minor sufficiently had enough clothes, therefore they were not a necessity at that point.

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#### b. Beneficial service contracts for minors

– if the minor is receiving an education, training, apprenticeship or an employment required for the future life, the minor is bound by that contract.

- In **Attorney General v Costa**, a minor had entered a contract to undergo a training in a teacher training college for a period of three years and agreed to serving a government school for a period of five years after the completion of the training. The minor who completed the training refused to serve in the government school. The court held that the minor is bound by the unassisted contract because it was a beneficial service for the contract of minor.

- It is important to note that when a minor becomes an adult (reaches 18 years as per Sri Lankan law), the minor can ratify unassisted contracts within a reasonable time after being an adult.

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## f) The legality of the object

- The object of the contract should be legal.
- A contract is said to be invalid if;
  - i. The contract is contrary to the requirement of a statute. Ex: selling liquor without a license because as per the excise ordinance, liquor vendors need a license to sell liquor.
  - ii. The contract is contrary to the public policy and morality under the common law.
  - iii. The contract conflicts with the interest of national security or public service or the existence of the government.
  - iv. The contract restricts the freedom to carry on a person's business trade or profession (restraining trade).
- In **Napier v National Business Agency Ltd**, person **A** rented his house to **B** knowing that B would run a brothel house. It was illegal. **B** failed to pay rent. **A** sued for rent under their contract. The court held that it cannot be enforced because the object of the contract was illegal.

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## g) Genuineness of the consent

- The genuineness of consent given by the parties is an essential element.
- The genuineness will determine whether the contract becomes void or voidable.

Void contract	Voidable contract
Contract is void/ invalid from the beginning ( <i>Void ab initio</i> )	The contract is valid until decided as invalid/void by courts
When a property subject to a void contract is transferred to a third party, who had accepted it in good faith and for a valuable consideration will not get a good title for that property.	When a property subject to a voidable contract is transferred to a third party, who had accepted it in good faith and for a valuable consideration will get a good title for that property.
Example - <i>Cundy v Lindsay</i>	Example - <i>Philip v Brooks Ltd</i>

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- The genuineness of the contract would be affected by the following;

- i. Misrepresentation
- ii. Mistake
- iii. Duress
- iv. Undue influence

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### **i. Misrepresentation**

- Misrepresentation is an untrue statement of facts made by one of the parties to the other party to induce the other party to enter contract and the other party has been really induced for entering the contract.
- Misrepresentation occurs when;
  - an untrue statement of facts has been made by the parties to the other party during negotiations;
  - it has been stated by that party with an intention to induce the other party;
  - that the other party has been really induced for entering the contract.
- In **Smith v Land and House Property Corporation (1885)**, the seller while negotiating describes that the tenant on the land to be a reliable person. the buyer purchased the land with the tenant, but the tenant did not pay rent to the buyer. he learned that the tenant had not even paid rent to the seller.
- The court held that the statement made by the seller it's a misrepresentation they are for the contract has become voidable and the buyer can terminate the contract

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- Misrepresentation can occur in three ways
  - innocent misrepresentation - if the person was not careless in making the statement, the court may terminate the contract or may give damages
  - negligent misrepresentation – can rescind the contract and give damages
  - Fraudulent misrepresentation – can rescind the contract and give damages.
  
- The following are **not** considered as misrepresentations;
  - statements regarding law (everyone is presumed to know the law).
  - statements concerning future intention.
  - Tradesmen puff (when seller describes the product as the best to attract customers).
  - Untrue opinions (Bisset v Wilkinson – seller sold the farm stating “the farm is large enough to feed 2000 sheep”. But land was not sufficient to do so. Court held it was only an opinion which was untrue.
  - Mere silence is not misrepresentation

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## II. Mistake

- Mistake is a misunderstanding about a matter of fact.
- mistakes can occur in three ways;
  - common mistake – both parties of the contract make mistakes regarding the same thing.
  - mutual mistake - both parties of the contract make mistakes regarding different things.
  - unilateral mistake – one of the parties of the country makes a mistake and the other party is aware of it.

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- Examples for common mistakes are;
  - Non-existence of the subject matter
  - Buyer purchases own goods
- In **Couterier v Hastle**, The seller entered a contract with the buyer to sell wheat and send it in a ship. Unknown to both of the parties the master of the ship had sold the good because they were becoming decomposed.
- The court held that the seller and the buyer both believed that the subject matter existed at the time of the contract.
- Therefore, there has been a mistake for both parties regarding the same thing (regarding the existence of the good).
- In **Cochralle v Wills**, the two brothers agreed that if one dies, the other becomes the owner of the remaining property. One brother appointed another person to sell his property before he died. the person who was appointed sold the property to the brother of the dead person. The court held that the buyer had purchased his own goods on common mistake

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- An example of mutual mistake can be found in the case of **Raffles v Wichelhaus**.
- Under the terms of the contract, the cotton was to arrive from Bombay via the ship 'Peerless'. Raffles delivered the cotton to a ship named 'Peerless', which departed from Bombay in December.
- Wichelhaus refused to pay. Wichelhaus argued that the cotton was to be delivered by a different ship also called Peerless, which had departed Bombay in October. Raffles sued for breach of contract.
- The court held that the contract becomes void due to mutual mistake.

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- Example of unilateral mistake can be found in **Cundy v Lindsay** where the seller sold the goods to a fraud and that fraud had sold it to a third party.
- The seller did not receive payment so demanded from the third party to return the product. the third party had no idea about this fraud. Therefore, the seller had to establish that the contract was void because of a unilateral mistake.
- However, in **Philips v Brooks**, it was held that the mistake of identity will not necessarily make a sale invalid under the sale of goods ordinance.

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### III. Duress

- If a person is forced into a contract by fear for the physical well-being of himself for his immediate family members or for the safety of the goods it is called duress.
- The consent obtained from duress is not genuine. For example, using power or threat of using power or threat of illegal imprisonment to obtain consent for a contract is not valid.
- For example, in **Cumming v Ince**, an elderly woman was threatened that she would be admitted into a mental hospital unless she transferred her property in favor of the person threatening. the court held that the contract entered can be set aside because of duress.
- Duress does not have to be limited to threat of physical harm it may include economic threat too.
- For example, in **Atlantic Baron case** the court held that the threat to discontinue the business was economic due race and therefore the contract should be rescinded on duress.

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#### IV. Undue influence

- Undue influence is set to exist when there is some kind of social relationship.
- For example, parents and children; religious leaders and followers.
- This involves pressuring or influencing someone in such a way that they don't make a free choice.
- In **Allcard v Skinner (1887)**, a woman became a follower of a specific religion, and the religious leaders ordered her to transfer her properties to obtain favor so that she can see God. she was not able to see God even after transferring her properties and she left the religion after 10 years. She filed a case to recover the property.
- The court held that the contract becomes voidable because of undue influence from the religious leaders. (However, the woman had failed to file the case within the time limit, so it was dismissed).

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#### 4) Terms of a contract

- The terms of a contract can consist of three types and they may be expressed or implied.
  - i. Conditions - this is the foundation of a contract and it's related with the objective of the contract. a breach of a condition will allow the innocent party to terminate the agreement claim damages; order specific performance and obtain order of injunction.
  - ii. Warranties - This is a subsidiary of collateral term in the contract. when there is a breach of warranty the only remedy available is claim of damages.
  - iii. Innominate terms – terms that cannot be classified immediately as conditions or warranties. If such a term is breached the remedy will depend on the seriousness of the consequences.

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- In **Poussard v Spierce**, a person agreed to sing in a series of operas. She came few days late from the opening date. the court held that the opera singer's failure to sing on the opening night and few days was a breach of a condition.
- In **Bettini v Gye**, an opera organizer entered a contract with an opera singer to perform at a theatre. They agreed to come for six rehearsal days. She couldn't participate for three rehearsal days. She was not allowed to perform at the opera. The court held that she had only breached the warranty and that the organizer cannot terminate the contract with her.

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## 5) Exemption Clauses

- This is a term in a contract which excludes the contractual liability of the parties.
- There are three requirements for a valid exemption clause.
  1. At the time of the contract, they should enter that exemption clause.
  2. It should be included with adequate communication.
  3. It should be included with correct interpretation.

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## 6) Termination of a Contract

- The parties or one of them may be discharged from contractual obligations in any of the following ways;
  1. **Termination of a contract by performance** - this is when both parties perform all the terms of the contract, and the contract has ended simply by performance.
  2. **Termination of a contract by an agreement** – both parties agree and terminate the contract.
  3. **Termination by frustration** – if a party has been unable to perform the contract because something has happened beyond the control of the parties such as destruction of the subject matter; personal incapacity ; subsequent illegality or non-occurrence of the event.
  4. **Termination of a contract by breach** - a breach occurs when one party fails to perform the contractual obligations. A breach can be waived if the innocent party decides to do so.

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## 7) Remedies for breach of Contract

- There are few remedies when there is a breach of contract.
  1. **The termination of the contract** – Available only when a condition is breached.
  2. **Claim of damages** – available in case of breach of condition and warranty both.
  3. **Order for specific performance** - if a party in a contract has agreed to perform something and subsequently refuses to perform it, then the innocent party can request the court to order that party to perform the promised task. This is not granted if there is a negative aspect; breach can be sufficiently remedied using compensation; court cannot supervise the subsequent performance; the party who seeks the order of specific performance has induced the other party to breach the contract.
  4. **To order injunctions** - this is to prevent the other party from doing the same action that breached the contract again.

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## 8) Prescription

- As per the prescription ordinance No. 22 of 1871, there is a time limitation when bringing an action or filing a case.
  - Section 6 – An action for written contract must be brought within six (6) years from the date of the breach.
  - Section 7 – An action for an unwritten contract (oral/verbal contracts) must be brought within three (3) years from the date of the breach.

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## Summary

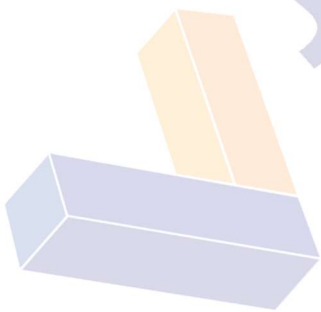
1. Formation of a contract
2. Elements of a contract
3. Terms of a contract
4. Exemption clauses
5. Termination of a contract
6. Remedies for a breach of contract
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