Part Two

Legal Principles

6 Contracts

Many people think of a contract as a written agreement between people stating the exact details of promises they have made to each other. For example, when a farm agrees to supply fruit and vegetables to a supermarket, the two businesses will probably draw up a contract containing many clauses about what kind of goods are to be supplied, how often and in what quantities; who is to pay for transport and unpacking; what prices are to be paid, what happens if some of the vegetables arrive in a poor condition and just what is meant by poor condition, and what happens if delivery is made too late for the shop to sell the goods. The contractors will try to think of all the possible circumstances which may arise—even unlikely events such as the vegetables being stolen by a third party while they are being transported.

Different types

However, not all contracts are written. There are many kinds of unwritten agreements between people which the law of most countries describes as contracts. They may continue buying and selling things for years by relying on trust and common sense, and if sometimes there is a disagreement—for example, a supplier fails to deliver goods by the time he said he would—they manage to deal with the problem simply by discussion. However, if the disagreement becomes so serious that they cannot resolve it, they may decide it is necessary to take legal action. One of the most common kinds of legal action is to claim that a contract has existed and that one of them **is in breach of contract** (has broken the agreement). To win such an action it is necessary to show that the agreement can indeed be described as a contract.

There are many everyday transactions which most people never think of as contracts. When you buy a newspaper you simply pick up the paper, pay the price and walk away. But suppose something unusual happens—

perhaps, you discover that the newspaper is not today's but last week's; or there are some pages missing; or the newspaper seller charges you more money than the price written on the newspaper and tells you this is because his transport costs have increased. You may then start to think about what kind of transaction you made in buying the paper and what your rights are. In fact, the simple purchase of a newspaper can indeed be a contract: without writing anything down, maybe without even speaking, you agreed to buy a certain item from a certain person at a certain price.

The problem with unwritten contracts is that it may be very difficult to show evidence of the agreement you made. Can you prove that you bought the newspaper where you did, and not somewhere else? Can you prove how much you paid for it? If the seller claims that you agreed to buy an old newspaper, can you disprove his claim?

Figure 6.1 *Buying and selling in a London market.*

Of course, problems of evidence can arise even when there is a detailed written agreement. Indeed a court of law may decide that the contract consists not just of the written document you possess but includes things that were said but never written down. The contract may even include things that the contractors understood but never talked about. Sometimes an agreement turns out to be a contract even though the persons who made it did not realize this at the time. And sometimes people make agreements which they think are contracts, but when they try to take legal action the court declares that no contract was ever made. (In such a case they may find there is another legal claim they may make, such as an action in tort (see Chapter 8) or in breach of trust (see Chapter 9).

It is therefore important to know just what the law considers a contract to be. In many systems of law there is a written legal code stating exactly what is required to make a contract and what the rights and obligations of contractors are. In case law systems, there is no one code or law defining what a contract is. The law regarding contracts in general is to be found in judgments made by courts and even in legal textbooks. But there are statutes which clarify the law. For example, the Unfair Contract Terms Act, passed in Britain in 1977, specifies circumstances in which a contractor may avoid being obliged by some parts of a contract.

Essential elements

English law textbooks often describe a contract as an agreement which is made between two or more parties and which is binding in law. In order to be binding in law the agreement must include an offer and an acceptance of that offer. The parties must agree to contract on certain terms—that is, they must know what they are agreeing to (but they need not know that their agreement can be described in law as a contract). They must have intended to be legally bound; there would be no contract if, for example, they were just joking when they made the agreement. And **valuable consideration** must have been given by the person to whom a promise was made. In this case, consideration is a legal word to describe something a person has given, or done, or agreed not to do, when making the contract.

When a court is deciding if a contract has been made, it must consider all these elements. In common law countries, the judge will be guided by decisions made in previous cases. If the judge is dealing with a problem which has never arisen before he must make a decision based upon general legal principles, and this decision will become a precedent for other judges in similar cases in the future. The most important principle guiding a judge is whether a reasonable observer of the agreement would decide that it was a contract. But sometimes decisions seem very technical because lawyers try to explain exactly why a decision has been made, even when that decision appears to be obvious common sense. Of course exact explanations are even more important when the decision does not appear to be common sense! By looking at some of the elements of a contract, we can see how important cases have helped to develop English law.

One principle of English contract law mentioned above is that there must be **offer and acceptance**. An advertisement to sell something is not normally considered an offer. If I see an ad in a newspaper offering to sell a car, and I telephone the advertiser and agree to buy it, the seller is not

obliged to sell it to me. This is because the law considers that the real offer is when I contact the seller asking to buy the car. The seller may then decide whether to accept or reject my offer. This is the reason a store does not have to sell you goods it displays for sale. (If the seller does accept then one important element of a contract has been made, and if the other elements exist the seller may have an obligation to the buyer.) However, because of the 1893 case of Carlill vs. Carbolic Smoke Ball Company, English law does consider some kinds of advertisements as offers. Carbolic Smoke Ball advertised that they would pay money to anyone who used their medicine and still got the flu. A woman saw the advertisement, bought the medicine, but got the flu, so she asked for the money. The company tried to avoid paying by arguing that their advertisement was not an offer, since it is impossible to make a contract with all the people who might read the advertisement. But the court decided that when Mrs. Carlill saw the ad and bought the medicine she was accepting a specific offer made to her, and so there was a contract and the company was obliged to pay.

Another principle is that the terms being offered and accepted must be certain. However, in the 1932 case of Hillas Company vs. Arcos it was decided that a reference to previous agreements or usual agreements might be certain enough.

Another principle mentioned above is that there is no contract if one of the parties did not intend to be legally bound. This is supported by a case decided in 1605 (Weeks vs. Tybald) when a man joked that he would pay money to any man who would marry his daughter.

What is valuable consideration? The principle behind this phrase is that the law will not enforce an empty promise. For example, if a man offers to wash my car for $10 and I accept, but he goes away and never washes it, I will probably not be able to make him keep his promise unless I have already paid the $10. This is because I have given no consideration: I have not done anything or lost anything because of his offer. However, even if I haven't paid, I may still have given some kind of valuable consideration. For example, perhaps I left the car at home because of his offer to wash it and took a taxi to work. In this case a court might consider that there was an enforceable contract. As a result, I would be able to compel the man either to wash the car or to pay me the taxi fare I had spent. In the 1960 case of Chappel vs. the chocolate manufacturers Nestlé, it was decided that valuable consideration could be of as little value as the used chocolate wrappers which Nestlé asked people to send to them in return for a free record.

One very important form of consideration is an agreement not to sue someone. For example, my neighbor makes so much noise that I cannot sleep at night. I have the right to take legal action against her (perhaps in tort, see Chapter 8) but I agree not to do so because she offers to take my mother on vacation to Hawaii. If she then fails to take my mother to Hawaii she is breaking a contract with me and I could choose to take action against her either for breach of contract, or for the original tort. In making my choice I would consider which action would be of most benefit to me.

Most systems of law have similar requirements about offer and acceptance, legal intention, and consideration. They also consider the **capacity** of the contractors; that is, whether they were legally entitled to contract. In English law there are some special rules if one of the contracts is a company, rather that an individual (see Chapter 11), under the age of 18, or insane. Legal systems have rules for interpreting contracts in which one or more contractors made a mistake or was pressured or tricked into making an agreement, and rules for dealing with illegal contracts. For example, under English law a contractor cannot enforce an agreement against another party if the agreement was to commit a crime!

Damages

Once a court decides that there has been a breach of contract, it must then judge how the party in breach must compensate the other party, The usual award is **damages**—monetary compensation. The court must be satisfied that there was a contract, that one party is in breach, and that the other party has suffered some loss because of the breach. In addition to financial loss a plaintiff sometimes tries to claim damages for mental distress caused by the breach of contract. Such claims are less successful in Britain than in the U.S., except for holiday contracts (though often successful in tort actions—see Chapter 8).

A court will award damages only for loss closely connected with the defendant's breach. For example, in the 1949 English case of Victoria Laundry vs. Newman Industries, the defendants were five months late in delivering a new boiler for the laundry. The laundry claimed damages first for profits they would probably have made by being able to increase their regular laundry customers if they had had the boiler on time; and second, for profits they might have made if the the boiler had enabled them to take on new dyeing contracts. The courts decided that the first claim was reasonable, but that the second was too remote. **Remoteness** is an important concept in both contract and tort (see Chapter 8).

In deciding just how much in damages to award, English and American courts try to put the plaintiff into the same financial position that he would have been in if the defendant had carried out the contract properly. For example, in the example mentioned before of a man offering to wash my car and then failing to do so, the court would note that if the contract had been performed I would have a clean car and would not have spent money on a taxi fare. On the other hand I would not have the $10 I agreed to pay the man, nor the value of the gas I would have used in driving my car that day.

Other remedies

Instead of damages, a plaintiff sometimes asks the court to force the other contractor to carry out the contract. In English law this is called **specific performance**. The court will not agree to do this if it causes hardship to the defendant, however, or if it is no longer possible or practical to carry out the contract. Sometimes the court decides to award damages instead of specific performance, and sometimes it awards both. A plaintiff may also ask the court to award an **injunction** against the defendant, that is, to order the defendant not to do something which would be in breach of contract. Specific performance and injunctions are remedies which were developed by the courts of Equity because of inadequacies in the Common Law courts. (see Chapter 2).

Contract law is a central part of legal systems all over the world. It is especially important in international business, where the parties try to specify all the parts of their agreement in a clear written contract so that differences of law and custom between their countries can be avoided. It is sometimes said that some societies are much more "contractual" than others. For example, in the United States people are accustomed to signing written contracts connected with daily life. Some people even draw up a contract with a girlfriend or boyfriend when they start living together in the hope of reducing arguments if they part later. On the other hand, Japanese people rarely even sign contracts of employment when they take a new job, believing that custom and social obligation will be enough to resolve any differences. Perhaps it is not a question of one society being more contractual than another, but rather that in some societies people are more likely to use lawyers and courts to sort out their disagreements, and they therefore feel the need to have precise evidence of their agreements in the form of written contracts.