UNIT 2 - CONTRACT LAW

Suggested Answers – January 2009

Note to Candidates and Tutors:

The purpose of the suggested answers is to provide students and tutors with guidance as to the key points students should have included in their answers to the January 2009 examinations. The suggested answers do not for all questions set out all the points which students may have included in their responses to the questions. Students will have received credit, where applicable, for other points not addressed by the suggested answers.

ILEX is currently working with the Level 3 Chief Examiners to standardise the format and content of suggested answers and welcomes feedback from students and tutors with regard to the 'helpfulness' of the January 09 Suggested Answers.

Students and tutors should review the suggested answers in conjunction with the question papers and the Chief Examiners’ reports which provide feedback on student performance in the examination.

SECTION A

Candidates were required to answer all questions in Section A, which is designed to test breadth of knowledge of the subject by way of short answers questions.

Question 1

Candidates were required to identify two factual indicators necessary for the formation of a contract.

They should have given in answer:

- offer and
- acceptance.

In the alternative, credit was given to those who indicated:

- performance and
- consideration and/or the intention to create legal relations.

Question 2

This question required candidates to identify three ways in which an offer may be terminated. They should have given in answer three from the following list:

- Counter offer
- Rejection
- Revocation
- Passage of time
- Acceptance
Question 3(a)
Candidates were required to define consideration.
They should have given in answer:

It is the price for which the promise of the other is purchased (see *Dunlop v Selfridges* (1915), *per Lord Dunedin* (HL)) or other appropriate definition.

Question 3(b)
Candidates were required to explain what constitutes valid consideration.
They should have given in answer:

- must be capable of being valued in money
- consideration must move from the promisee
- consideration must be real:
  e.g. past consideration is no consideration: see, (e.g.), *Re McArdle 1951 etc*
  e.g. performance of an existing duty is not good consideration: see *Stilk v Myrick* (1809), but see (e.g.) *Hartley v Ponsonby* (1857) and *Williams v Roffey & Nicholls (Contractors)* (1990)

Question 4
Candidates were asked to explain how the court approaches questions of intention to create legal relations in contract cases.
Candidates should have given in answer:

- a brief explanation of the legal device of the rebuttable presumption.
- the presumption in social and domestic situations: the court presumes that there is no intention to create legal relations: see (e.g.) *Balfour v Balfour [1919]*.
- such a presumption may be rebutted by contrary evidence: that is, there is evidence of an intention to create legal relations: see (e.g.) *Merritt v Merritt [1970]*.
- the presumption in commercial situations there is an intention to create legal relations.
- the presumption can be rebutted by contrary evidence: see (e.g.) *Rose & Frank v Crompton Bros [1924]*.

Question 5(a)
An ‘express term’ is a term of a contract that is distinctly or overtly stated rather than implied.

Question 5(b)
An ‘implied term’ is a term of the contract that is not expressly or overtly stated by the parties.

Question 5(c)
Candidates were asked to explain two methods by which terms are implied into contracts.
Terms may be implied by reason of law or fact. They should have selected any two from the following:
- statute (e.g. Sale of Goods Act 1979)
- custom
- implied by the courts (e.g.) the use of the business efficacy test and/or officious bystander test

**Question 6**

A condition is a fundamental term of the contract. It goes to the root of the contract. A breach of condition entitles the innocent party to repudiate the contract and claim damages: see (e.g.) *Poussard v Spiers & Pond* (1876). A warranty is a less important term, breach of which sounds in damages only: see (e.g.) *Bettini v Gye* (1876)

(Candidates were not required to provide examples of cases to achieve the full marks.)

**Question 7**

A misrepresentation is:
- an untrue statement of fact or possibly law
- made by one party to the contract to the other party to the contract
- that is intended to,
- and does, induce the other party to enter into the contract

**Question 8**

Candidates were asked to explain the practical implications of frustration of contract.

In answer, they should have explained:
- the position at common law: the contract is discharged and the loss lies where it falls. This is still the case for contracts excluded from Law Reform (Frustrated Contracts) Act 1943.
- the position under Law Reform (Frustrated Contracts) Act 1943:
  - money actually paid or payable before the frustrating event is recoverable/ need not be paid
  - expenses of payee may be offset against money to be returned
  - Any valuable benefit obtained before the frustrating event may be taken into account by the court.

**Question 9**

Candidates were asked to define ‘specific performance’.

In answer they should have given:
- it is an equitable remedy;
- it is an order from the court to a contractual party to perform contractual obligations.
SECTION B

There are three scenarios in Section B. Candidates were required to answer the questions relating to one of the scenarios only.

Scenario 1 Questions

Question 1(a)

Candidates should have identified and explained the following factors:

- Importance attached to representation by the parties: see (e.g.) *Bannerman v White* [1861].
- Whether there had been a reduction into writing of oral statements: see (e.g.) *Routledge v McKay* [1954]; *Birch v Paramount Estates Ltd* [1956].
- The passage of time between statement and entering into the contract: see (e.g.) *Routledge v McKay*
- The relative expertise of parties: see (e.g.) *Oscar Chess v Williams* (1957)

Question 1(b)

Candidates should have identified the following:
- The price
- The subject matter (the furnace)
- Capacity
- Reliability (arguable)

Question 1(c)

Having identified the contract as one for the sale of goods, candidates should have identified and explained the following implied terms under the Sale of Goods Act 1979:

- s 14 (2) goods are of satisfactory quality
- s 14 (3) goods are fit for purpose
- s 13 goods comply with their description

Question 1(d)

Candidates should have identified and explained the following breaches:

- Breach of an express term as to the capacity of the furnace
- Breach of Implied Terms:
  - o S 14 (2) Sale of Goods Act 1979: arguably the goods were not of satisfactory quality. Candidates should have considered factors such as durability and fitness for purpose.
  - o S 14 (3) Sale of Goods Act 1979: arguably the goods were not fit for the buyer’s purpose. Candidates should have considered whether that purpose had been expressly or impliedly made known to the seller.
  - o Arguably the sale of goods is by description. If that is the case there is a breach of the implied term that the goods comply with their description under S 13 Sale of goods Act 1979.

Question 2(a)

Candidates should have identified as express terms:
Manufacture of 1,000 lead soldiers by Stephen for sale to Teresa
Price of goods: £20,000
Delivery date: last day of November

Question 2(b)
Candidates should have identified the failure to deliver by the agreed date as a breach of contract.

Question 2 (c)
Candidates should have identified and applied the appropriate legal criteria for assessing whether Teresa was justified, they are:

- If the breached term is a condition, it entitles Teresa to repudiate the contract and claim damages: see (e.g.) Poussard v Spiers (1876).
- If the breached term is a warranty, it sounds in damages only; Teresa is not entitled to repudiate the contract: see (e.g.) Bettini v Gye (1876).
- If it is not possible to classify the term as either a condition or a warranty at time of formation of contract, it is an innominate term. The appropriate remedy then depends on the effect of the breach upon the innocent party: see Hong Kong Fir Shipping v Kawasaki Kisen Kaisha (1962).

The criteria should then have been applied to the facts of scenario. Candidates should have considered:

- Whether the term breached went to root of contract, as in Poussard v Spiers; if it did Teresa was justified in her action.
- Whether the term did not go to the root of the contract and was a minor term, as in Bettini v Gye; if it was a warranty Teresa was not justified.

Alternatively, candidates may have based their analysis on that in the Hong Kong Fir: did the breach effectively deprive Teresa of what was legitimately expected under the contract?

- If the answer is ‘yes’, the breach is to be treated as a breach of condition and Teresa is justified.
- If the answer is ‘no’, the breach is to be treated as a breach of warranty and Teresa is not justified.

Question 3(a)
Candidates should have explained the requirements for the existence of four factors:

- That the breach caused loss (e.g.) Smith, Hogg & Co Ltd v Black Sea Insurance [1939].
- That the loss suffered was not too remote in law.
- That the innocent party attempted to mitigate the loss e.g. Payzu v Saunders [1919].

Question 3(b)
Candidates should have identified the following losses:

- the cost of repair of the furnace and
- the loss of profit on Stephen’s contract with Teresa.
They should then have identified the breaches of contract by William and assessed:
- whether the breach caused the losses complained of;
- whether the losses were too remote in law;
- whether Stephen had attempted to mitigate his losses.

It is possible to establish all of these factors in relation to the repair of the furnace. Stephen may therefore have a successful claim for substantial damages.

In relation to the loss of profit on Stephen’s contract with Teresa, part or all of Stephen’s loss may be too remote in law. Whether they are or not depends on:
- should such losses have been within reasonable contemplation of the parties as arising from the breach of such a contract and
- whether William possessed any special knowledge that should have brought the additional losses associated with Stephen’s breach of contract with Teresa into his reasonable contemplation: see Hadley v Baxendale (1854), Victoria Laundry (Windsor) v Newman Industries [1949] etc.

There was no obvious attempt by Stephen to mitigate his loss resulting from the contract with Teresa, for example by trying to sell the goods elsewhere.

Stephen may therefore be unable to recover substantial damages in respect of this loss.

**Question 3(c)**

Candidates should have:
- identified the breach in question as Stephen’s failure to deliver the goods to Teresa by the agreed date.
- identified Teresa’s loss as that of loss of profit on potential sales at pre-Christmas collectors’ fairs or loss of chance to make such a profit.
- considered whether Stephen’s breach caused Teresa’s loss of profit or whether it was Teresa’s own action in repudiating the contract that caused the loss.
- considered the rules of remoteness of damage for breach of contract.
- considered whether Teresa had attempted to mitigate her loss.

Teresa’s loss is not too remote; Stephen knew the purpose of the contract: see Hadley v Baxendale.

Teresa does not, however, attempt to mitigate her loss: see, for example, Payzu v Saunders [1919]

Her claim for substantial damages is therefore likely to fail.

**Question 4(a)**

Candidates should have identified damages in misrepresentation as being awarded on a tortious basis. Consequently their purpose is to place the innocent in the position s/he would have been had the tort not been committed.

**Question 4(b)**

Stephen may claim for all losses flowing directly from the misrepresentation, whether foreseeable or not: see, for example, Naughton v O’Callaghan (1990),

He may therefore claim for the loss resulting from his inability to comply with his contract with Teresa. That is, he may claim for loss of profit and the cost of meeting any claim Teresa might bring against him.

Scenario 2 Questions

Question 1(a)

Candidates should have:
  ▪ explained that the frustrating event must render performance of the contract impossible or, at least, radically different from that agreed: see Taylor v Caldwell (1863), Metropolitan Water Board v Dick Kerr (1918).
  ▪ the event must be the fault of neither party to the contract.
  ▪ the event must not have been provided for in contract.

Question 1(b)

Candidates should have considered:
  ▪ whether the flood rendered performance of the contract either impossible or radically different from that agreed
  ▪ whether it was the fault of either party.
  ▪ Whether it had been provided for in the contract.

The flood rendered performance either impossible or at least radically different from that agreed. Neither party was at fault. There is nothing to suggest that such an event had been provided for in the contract.

Question 1(c)

Candidates should have:
  ▪ identified the contract as falling within the Law Reform (Frustrated Contracts) Act 1943.
  ▪ stated the rules provided for in the Act (the payee rule, the payer rule, and the valuable benefit rule)
  ▪ applied the rules to the facts of the situation.

Question 2(a)

Candidates should have:
  ▪ stated the rule in Pinnel’s Case (1602): part payment of debt is not good consideration for discharge of the whole debt.
  ▪ explained the reason for rule: there is no consideration to support the second promise. It is therefore unenforceable.
  ▪ explained that the rule can be overcome by the provision of consideration for the second promise, at creditor’s request: see the exceptions in Pinnel’s Case.

Question 2(b)

Candidates should have:
  ▪ identified Eva’s letter as an attempt to discharge her debt by way of part-payment.
considered whether IGC’s cashing of the cheque amounted to an undertaking not to pursue Eva for the balance.

applied the rule in Pinnel’s Case: there is no consideration to support the promise (if there is such a promise).

**Question 2(c)**

Candidates should have:

- observed that a part-payment of Eva’s debt had been made by Maria (a 3rd party) on condition that it discharged Eva’s entire debt.
- observed that payment was accepted by SWL.
- explained that were SWL to attempt to recover the balance of the debt from Eva, it would amount to a fraud on Maria, the 3rd party: see *Welby v Drake* (1825), *Hirachand Punamchand v Temple* [1911].

**Question 3**

Candidates should have identified and explained the general presumption on intention in social and domestic relationships: see *Balfour v Balfour* [1919].

They should then have identified and explained evidence tending to rebut presumption:

- the subject matter is business
- the context is business
- there is an offer of consideration

Candidates should then have advised Eva, basing that advice on the criteria set out above.

**Question 4(a)**

Candidates should have:

- provided a definition of consideration. It is the price for which the promise of the other is purchased: *Dunlop v Selfridge* (1915), per Lord Dunedin.
- explained that a promise is capable of being good consideration providing that it is capable of being valued in money: (e.g.) *White v Bluett* (1853).
- advised accordingly on whether Eva’s promise was capable of amounting to consideration.

**Question 4(b)**

Candidates were required to:

- identify the significance of Eva’s offer and the preparation and supply of food after Christoph had performed his part of the bargain: it might amount to past consideration.
- explain the rule on past consideration: past consideration is no consideration: see (e.g.) *Re McArdle* [1951].
- consider the position if, at the time of Christoph’s performance there was an implied promise to pay: see (e.g.) *Re Casey’s Patent* [1892].
- advise Eva accordingly.

**Question 5**

Candidates should have:
• identified the contract as one for the sale of goods and thus falling to be considered under the Sale of Goods Act 1979.
• stated the relevant law: s 14 (2) of the 1979 Act implies a condition that goods sold in the course of business are of satisfactory quality.
• applied s14(2) the wine was undrinkable and so not fit for its purpose. This amounts to a breach of the implied term that it is of satisfactory quality.
• Eva had already accepted the goods. Her remedy is therefore likely to be in damages.
• Credit was given to those who addressed the problem by way of s14(3) of the Sale of Goods Act 1979, which implies a term, in certain circumstances, that goods should be fit for purpose.

**Scenario 3 Questions**

**Question 1(a)**

Candidates should have described a valid offer as being an indication of terms upon which the offeror is prepared to be bound. It is conditional upon acceptance by the offeree.

**Question 1(b)**

Candidates should have indicated that a valid acceptance must be a final assent to an offer and that it must mirror the offer exactly and without qualification

**Question 1(c)**

Candidates should have given one of the accepted definitions of consideration: see (e.g.) *Dunlop v Selfridge* (1915). They should have explained that consideration must be real and must be capable of being valued in money.

**Question 1(d)**

Candidates should have applied the law established in parts (a), (b), and (c) of the question to the facts of the scenario with a view to advising Iris on whether (i) a contract existed between her and David and (ii) whether she might succeed against David in action for breach of contract.

With regard to agreement, David’s advertisement is no more than an invitation to treat. Iris’s statement that she is ‘Interested in buying’ is insufficient to amount to an offer by Iris.

However, David’s promise not sell the car until Iris’s return from holiday may be enough to constitute an offer by David. However, there is an apparent lack of acceptance by Iris. David may withdraw his offer at any time until acceptance: see *Routledge v Grant* (1828).

There is also a lack of consideration by Iris: as promisee, she must provide consideration if she is to enforce David’s promise not to sell the car until her return. An example of such consideration would be the payment of money for David to keep the offer open.

**Question 2(a)**

Candidates should have included the following in the answer:
- the importance attached to the representation by the parties: e.g. *Bannerman v White* (1861),
- whether there had been a reduction into writing of oral terms: e.g., *Routledge v McKay; Birch v Paramount Estates Ltd* (1956),
- the passage of time between the statement and entering into the contract: see *Routledge v McKay* [1954],
- the relative expertise of the parties: see *Oscar Chess v Williams* (1957).

**Question 2(b)**

Candidates should have identified the contract as a sale of goods contract, falling under the Sale of Goods Act 1979. Specifically, they should have identified it as a sale by description: see *Beale v Taylor* [1967]. They should have stated the relevant law: S 13(1) Sale of Goods Act 1979 provides that where there is a sale of goods by description there is an implied term that the goods correspond with the description.

**Question 2(c)**

Candidates should have stated the law on misrepresentation and applied the law to the facts.

That is: in order to establish misrepresentation it is necessary to demonstrate that there was a false representation of fact (or possibly law), made by one party to the contract, to the other party to the contract, with the intention of inducing the other to enter into the contract, and which does induce the other.

They should then have diagnosed the nature of David’s misrepresentation. It is apparently innocent: David’s state of mind is without blame (either fraud or negligence). He told the truth as he saw it and had no reason/opportunity to know of any falsehood.

Candidates should then have advised on the remedies for innocent misrepresentation: rescission or damages in lieu of rescission.

**Question 3(a)**

Candidates should have defined fraud: it is a false statement ‘made (1) knowingly or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false:’ *Derry v Peak* (1889), per Lord Herschell.

They should have identified and explained the relevant states of mind: knowingly, without belief in the truth, recklessly and applied the law to Pete’s (Fred Appleby’s) position.

**Question 3(b)**

Candidates should have observed that misrepresentation is a civil action – so generally the action is tried on the balance of probabilities. Allegations of fraud are however taken more seriously and so a higher standard of proof is applied - ‘[A] charge of fraud is such a terrible thing to bring against a man that it cannot be maintained in any court unless it is shown that he had a wicked mind’, *Le Lievre v Gould* [1893] per Lord Esher.
Question 3(c)

The remedies are damages and rescission. Damages are based upon the tort of deceit. These are intended to put the Claimant in position he would have been but for the tortious act. The innocent party may claim all damage flowing directly from the misrepresentation. Rescission is also available.

Question 4(a)

Candidates should, first, have identified the contract as a sale of goods contract; the Sale of Goods Act 1979 therefore applies. Specifically, they should have identified the implied term under s12 (1) of the Sale of Goods Act 1979 as relevant. It implies a condition on the part of the seller that he has the right to sell the goods. They should have explained meaning of ‘right to sell’: that is, that seller has good title and can pass good title to the buyer.

Pete (Fred Appleby) will, initially, have obtained good title. Because he obtained it by way of fraudulent misrepresentation, the title is, however, voidable. Pete (Fred Appleby) may therefore not have the right to sell if David had avoided the contract before the sale of the goods to Annabel.

Question 4(b)

The right to rescind is the right of a party to have the contract set aside and to be restored to his former position.

The right to rescission may be lost if the contract is affirmed, *restitutio in integrum* is not possible, or third party rights are affected.

Question 4(c)

Annabel’s claim for breach of contract against Pete (Fred Appleby) would be based on the breach of the term implied under S 12 (1) of the Sale of Goods Act 1979. The term in question is a breach of condition. The normal remedies for breach of condition apply.

They are: damages and the right to repudiate the contract (distinguish rescission). If, as seems to be the case, Annabel has already performed her part of the contract by making payment, repudiation of the contract has little relevance. Damages are therefore the appropriate remedy.