Business Management
Study Manuals

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Diploma in
Business Management

PRINCIPLES OF BUSINESS LAW

The Association of Business Executives

Diploma in Business Management

PRINCIPLES OF BUSINESS LAW

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Introduction to the Study Manual

Welcome to this study manual for Principles of Business Law.

The manual has been specially written to assist you in your studies for the ABE Diploma in Business Management and is designed to meet the learning outcomes specified for this module in the syllabus. As such, it provides a thorough introduction to each subject area and guides you through the various topics which you will need to understand. However, it is not intended to "stand alone" as the only source of information in studying the module, and we set out below some guidance on additional resources which you should use to help in preparing for the examination.

The syllabus for the module is set out on the following pages and you should read this carefully so that you understand the scope of the module and what you will be required to know for the examination. Also included in the syllabus are details of the method of assessment – the examination – and the books recommended as additional reading.

The main study material then follows in the form of a number of study units as shown in the contents. Each of these units is concerned with one topic area and takes you through all the key elements of that area, step by step. You should work carefully through each study unit in turn, tackling any questions or activities as they occur, and ensuring that you fully understand everything that has been covered before moving on to the next unit. You will also find it very helpful to use the additional reading to develop your understanding of each topic area when you have completed the study unit.

Additional resources

- ABE website – www.abeuk.com. You should ensure that you refer to the Members Area of the website from time to time for advice and guidance on studying and preparing for the examination. We shall be publishing articles which provide general guidance to all students and, where appropriate, also give specific information about particular modules, including updates to the recommended reading and to the study units themselves.
- Additional reading – It is important you do not rely solely on this manual to gain the information needed for the examination on this module. You should, therefore, study some other books to help develop your understanding of the topics under consideration. The main books recommended to support this manual are included in the syllabus which follows, but you should also refer to the ABE website for further details of additional reading which may be published from time to time.
- Newspapers – You should get into the habit of reading a good quality newspaper on a regular basis to ensure that you keep up to date with any developments which may be relevant to the subjects in this module.
- Your college tutor – If you are studying through a college, you should use your tutors to help with any areas of the syllabus with which you are having difficulty. That is what they are there for! Do not be afraid to approach your tutor for this module to seek clarification on any issue, as they will want you to succeed as much as you want to.
- Your own personal experience – The ABE examinations are not just about learning lots of facts, concepts and ideas from the study manual and other books. They are also about how these are applied in the real world and you should always think how the topics under consideration relate to your own work and to the situation at your own workplace and others with which you are familiar. Using your own experience in this way should help to develop your understanding by appreciating the practical application and significance of what you read, and make your studies relevant to your personal development at work. It should also provide you with examples which can be used in your examination answers.

And finally …

We hope you enjoy your studies and find them useful not just for preparing for the examination, but also in understanding the modern world of business and in developing in your own job. We wish you every success in your studies and in the examination for this module.

The Association of Business Executives

September 2008

Unit Title: Principles of Business Law	Unit Code: PBL
Level: 5	Learning Hours: 160

Learning Outcomes and Indicative Content:

The candidate should have a knowledge of the principles of law, common law, statutes and primary cases and be able to use this knowledge in the examination.

Candidates will be able to:

1. Understand and explain the Sources of Law and Types of Law

1.1 Describe the Common Law; usage and the law pre 1066; Time Immemorial: 1189 the cut off point for common law

1.2 Explain equity; a gloss on the common law; Specific Performance and Injunction

1.3 Define different types of cases – be able to give their ratios; civil cases; standard of proof – balance of probabilities; criminal cases; standard of proof – beyond reasonable doubt

1.4 Describe and explain statutes - the parliamentary process; delegated legislation; EC regulations, directives, decisions, opinions; statutory interpretation; the rules of interpretation

1.5 Describe and explain the types of law; civil law; terminology of parties who are involved in proceedings; who brings and defends proceedings; outcomes of proceedings: discharge and remedies; criminal law; parties to an action; terminology of the parties who are involved in proceedings; who brings and defends proceedings; outcomes of proceedings; the application of cases to a given case study; cite and discuss ratios; extrapolate from case law decisions into hypothetical situations

2 Describe and explain Common Law reasoning and institutions

2.1 Describe the administration of law: the court system both civil and criminal; the court system may be that of England and/or the candidate's own country

2.2 Describe alternative dispute resolution; tribunals; conciliation; mediation

2.3 Describe the Personnel of the Law: Officers of the State: Lord Chancellor, Attorney General, Solicitor General DPP; Judges of the various courts: House of Lords, Court of Appeal, High Court, Crown Court, County Court, Magistrates' Court; Barristers, QCs, Junior Barristers; Solicitors; Legal Executives / Para-Legals (within the sense of other jurisdictions); Para-Legals (within the UK sense)

2.4 Describe and explain the application of courts' decisions: read, cite and apply the facts and the ratio decidendi of any given case; differences between the standard of proof in civil and criminal law; extrapolate from cases cited to hypothetical situations

2.5 Describe and explain application of statutes: the structure of a statute and delegated legislation; to cite name, date, section of statute and be able (if possible) to quote from it verbatim or at least in synopsis form; the elements of regulations, directives; cite name, date, section of instrument and be able (if possible) to quote from it verbatim or at least in synopsis form

3 Describe and explain the different types of business organisation

3.1 Describe and define the Sole Trader/Sole Proprietor: trade under own name or subject to the Business Names Act 1985; formation of a business as a sole trader; legal formalities for setting up as a sole trader; legal liabilities of a sole trader; advantages and disadvantages of being a sole trader

3.2 Describe and define partnership: Partnership Act 1890 s1; Partnership agreement – Articles of Partnership; Discharge of Partnership; legalities of partnership status; Limited Partnership Act 1906, Limited Liability Partnerships Act 2000, Regulatory Reform (Removal of 20 Limit from Partnerships) Order 2002; dissolution and discharge of members from partnerships; liabilities of partners in partnerships both unlimited and limited

3.3 Describe and define limited companies: common law (Salomon v Salomon Ltd) and statutory authority (Companies Act 1985, 1989) their structure and administration; memorandum of association; articles of association; membership, directors, Company Secretary; types of membership and shareholder: holdings founder, ordinary, debentures and others; membership and directors' liability; meetings: Annual General Meeting, Extraordinary Meeting, special meetings, directors' meetings; agendas, minutes, resolutions, questions from the floor; statutory provision for the protection of minority interests, insider dealing, administration orders; dissolution of companies – liquidators; liabilities towards debtors and members; Private Limited Companies and Public Limited Companies – be able to name and distinguish between each; Private Limited Companies – membership, directors, company secretary; Public Limited Companies – membership, directors, company secretary

3.4 Define and describe other types of business organisation: cooperatives; franchises

4 Define and explain contract law

4.1 Define offer (treitel) and be able to distinguish between other areas of the law: tort and criminal law

4.2 Offer – define and discuss on willingness to make an offer, to whom and in what way. Bilateral and unilateral contracts. Vague offers, counter offers, revocation of offers. Cite cases and know Carlill v Carbolic Smoke Ball Company

4.3 Distinguish between invitation to treat with an offer. Cite cases

4.4 Acceptance - define comment on willingness to accept an offer, to whom and in what way. Bilateral & unilateral contracts. Vague acceptance. Postal and Instantaneous communication rules. Cite cases

4.5 Consideration – define and explain, use Sir Fredrick Pollock's definition in Currie v Misa; executory, executed and past consideration. Cite cases; sufficiency of consideration. Cite cases; performances of a contract. Part performance of a contract, waiver, promissory estoppel Cite cases and know Central London Property Co v High Trees House; privity of contract, contracts (rights of third parties) Act 1999, Beswick v Beswick

4.6 Capacity – define and explain; minors - Family Law Reform Act 1969 s1; Minors' Contracts Act 1987; Void, voidable and unenforceable (explain the differences) contracts against a minor; intoxicated persons; patients (mental incapacity)

4.7 Define and explain intention to create legal relations; commercial; collective agreements; social and domestic

4.8 Define and explain Concensus ad Idem

4.9 Define and explain illegality

5 Define and explain vitiating terms

5.1 Mistake: discuss principles and apply case law: common, mutual, unilateral; outline sample cases: Phillips v Brooks. Ingram v Little, Lewis v Averay, Saunders v Anglia Building Society

5.2 Distinguish between representation and misrepresentation: define fraudulent, negligent, innocent, cite cases to illustrate each point and their contrasts; misrepresentation Act 1967 s2(1)

6 Describe and explain terms of contract

6.1 Define and explain express terms - those which are agreed before or at the time of the making of a contract and which must be freely agreed, cases: for example Thornton v Shoe Lane Parking
6.2 Define and explain condition - an important term which goes to the root of the contract which if breached will nullify the contract
6.3 Define and explain warranty - a minor term of the contract which if breached will attract damages
6.4 Define and explain innominate terms
6.5 Define and explain exclusion clause – contra proferentem rule
6.6 Define and penalty clauses
6.7 Define and explain liquidated damages
6.8 Define and explain implied terms, those, which as a result of custom, trade, practice or statute are automatically incorporated into the contract
6.9 Outline and explain Common Law practice within an industry or commerce; statutes
6.10 Outline and explain Sale of Goods Act 1979, Unfair Contract Terms Act 1977, Consumer Protection Act 1989, Unfair Terms in Consumer Contracts Regs 1999, Sale and Supply of Goods to Consumers Regs 2002 - these are examples of statutes to be discussed
6.11 Define and explain Illegal contracts and contracts again public policy
6.12 Define and explain contracts in restraint of trade (the possible effects on a person's or company's ability to make a living or continue trading.)

7 Define and explain discharge of a contract

7.1 Discharge by performance
7.2 Complete performance
7.3 Part performance of a contract - Equitable Estoppel
7.4 Discharge by agreement
7.5 Discharge by frustration
7.6 The effect of Common Law
7.7 The effect of statute
7.8 Discharge by breach of contract; anticipatory breach of contract

8 Define and explain remedies for breach of contract

8.1 Damages: liquidated and unliquidated
8.2 Injunction
8.3 Quantum Meruit

9 Define and explain consumer law

9.1 Sale of Goods Act 1979, Supply of Goods and Services Act 1982, Consumer Protection Act 1987, Unfair Contract Terms Act 1977, Trade Descriptions Act 1968, Consumer Credit Act 1974 these are the main enactments but this is not a definitive list, it is merely by way of example. Be able to cite and quote refer to sections

10 Define and explain agency (relevant cases should be cited and discussed)

10.1 Define agency, agent and principal
10.2 Distinguish between the different types of agency express appointment, ratification, implication, necessity and Estoppel; suitable cases to link with these concepts: for example Great Northern Railway v Swaffield
10.3 Define and explain the authority and the relationship between principal and agent
10.4 Rights of an agent
10.5 Rights of a principal
10.6 The duties owed by principal to agent and vice versa; carry out duties and follow instructions personally, with skill and care, no conflict of interests, not make a secret profit, not accept bribes
10.7 Define and explain entitlements to remuneration and expenses, indemnity, insurance
10.8 Define and explain lien
10.9 Liabilities between principal and agent
10.10 Agency in terms of common law
10.11 Agency in terms of the Law of Tort
10.12 Termination of an agency

11 Describe and explain employment law

11.1 Discuss the concepts of employment law; The various tests: control, integration, multiple, entrepreneurial; hiring out of employees; difference between employee and self-employed
11.2 Describe and explain the contract of employment; the agreement: hours of work, working conditions, salary, holiday entitlements, pensions, other benefits; cite health and safety issues: Health and Safety at Work Act 1974 and regulations and directives emanating from it. Safe system of work, relations with other employees; dismissal, redundancy, constructive dismissal, resignation, notice
11.3 Explain employers' responsibilities
11.4 Explain employees' responsibilities
11.5 Describe and explain employment enactments and regulations
11.6 Analyse the Heath and Safety at Work Act 1974
11.7 Discuss the effects of Equal Opportunities, race relations, human rights on employers and employees; be familiar with relevant legislation
11.8 Define and explain the Tort negligence; apply the principals in Donoghue v Stevenson; apply the principals: duty of care, standard of care, breach of the duty of care, damages – foreseeability, remoteness; cite and apply the statutes and case law

12 Describe and explain banking, bankers and customers

12.1 Define negotiable instruments, Bills of Exchange Act 1882; distinguish between bills of exchange, cheques, credit cards and debit cards; describe the different types of crossing and know the most popular current one: 'a/c payee'
12.2 Draw distinctions between the parties involved in the passing of bills or cheques
12.3 Explain the rights and duties of a banker towards the customer both private and business
12.4 Explain the rights and duties of the customer towards the bank

Assessment Criteria:

- Assessment method: written examination
- Length of examination: three hours
- Candidates should answer four questions from a choice of eight, each question carrying equal marks

Recommended Reading

ABE, *ABE Study Manual – Principles of Business Law*, ABE

Kelly D, Hayward R, *Business Law* (2005), Cavendish
ISBN: 1859419623

Kelly D, Holmes A, *Questions and Answers Series: Business Law* (1997), Cavendish
ISBN: 1859412750

Study Unit 1

Nature and Sources of Law

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A. NATURE OF LAW

Definition

The word "law" is difficult to define, particularly as it is used in many different ways. It contains, however, the concepts of orderliness, universality and objectivity. It is concerned with behaviour and not with causes, and either contains an element of inevitability, e.g. scientific laws, such as the laws of gravity, or of sanction, e.g. divine laws.

Some philosophers have postulated the existence of **natural law** by which they mean the Law of God which regulates the actions of mankind. This concept is often known as the **principles of natural justice**.

In the narrower concept of law, there must be a set of rules which can be applied objectively with someone to enforce them.

There have been many attempts to put these into a workable definition, some more successful than others. One of the better is that of **Salmond**:

> *"Law consists of any principle which is recognised and enforced by the courts in the administration of justice".*

Another, which is possibly superior to that of Salmond, since it has a slightly wider application, is that of **James**:

> *"A body of rules for the guidance of human conduct which are imposed upon and enforced among the members of a given state".*

Classification of Laws

Salmond, after stating that law in its general sense includes any rule of action, says that it includes the following categories:

- **Imperative law**

  These are rules of action imposed on men by authority, e.g. by the state.

- **Physical or scientific law**

  These are rules which formulate the uniformities of nature, e.g. the law of gravitation. You can distinguish them from man-made laws, in the sense that they merely state observations on a state of affairs that already exists.

- **Natural or moral law**

  These are rules formulating the principles of natural justice. This conception of law is derived from Greek philosophy and Roman law, and has found more favour with Continental jurists than in English jurisprudence. It overlaps to some extent with physical or scientific law. In the English language, law and justice are two separate words, showing that we recognise them to be two separate things – a distinction that is not made in most other languages.

- **Conventional law**

  These are rules agreed upon by persons for the regulation of their conduct towards each other. Agreements entered into by, for example, the parties to a contract or members of a company (who agree to be bound by the rules of its Articles of Association) are enforceable under the law of the land. Other agreed systems of rules, e.g. the rules of a football club or the laws of chess, may not be enforceable by law.

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- **Customary law**

  These are rules of action embodied in custom. We shall consider later the importance of custom in the development of the English legal system.

- **International law**

  These are rules which govern sovereign states in their relations with each other.

- **Civil law**

  This is the law of the state, as applied in the state's courts of justice. It is into this category that English law falls.

Criminal and Civil Liability

In essence, it can be said that a **crime** is a wrong **against the state**, while a **civil wrong** is one **against an individual**.

You should note the following major distinctions:

- **State action and private action**

  In the case of a crime, while under certain circumstances an individual may prosecute, the prosecution will normally be brought by the state. In a civil wrong, such as breach of contract, the injured party may bring an action against (or "sue") the party liable, and may recover damages or other forms of satisfaction.

- **Redress and punishment**

  The purpose of a civil action is to redress a wrong, whereas the aim of a criminal prosecution is to punish the wrongdoer, to prevent him or her from repeating the crime and to discourage others from committing similar crimes.

- **Settlement and withdrawal**

  A criminal action can be withdrawn only with the leave of the Crown, whereas the claimant in a civil action can settle out of court or withdraw his/her claim at any time.

- **Indictment and writ**

  Criminal proceedings are initiated by indictment or summary procedure, whereas civil proceedings are commenced by action resulting from the issue of a Claim Form.

A fundamental difference thus exists between **criminal law** (dealing with crimes) and **civil law** (dealing with civil wrongs) and each branch is, in general, administered by different courts on different principles.

Criminal law

Criminal law is concerned with offences against the state, i.e. crimes such as murder, burglary, theft. The more serious criminal cases are dealt with by a judge and jury; less serious offences (the overwhelming majority) are dealt with by magistrates. The two parties are the **prosecution** and the **accused**. The prosecution is conducted on behalf of the Crown via the Crown Prosecution Service, in important cases by the Attorney-General. If the accused is found guilty by the jury, he/she is convicted and sentenced by the judge; if not, he/she is acquitted.

Civil law

Civil law is concerned with private litigation, e.g. breaches of contract, disputes concerning property. The claimant issues a Claim Form, setting out the facts he/she alleges against the defendant and asking for damages or other remedy. The defendant puts in a defence to the allegations of the claimant. The case is then tried by a judge and jury, or by a judge sitting alone, without a jury. Today, there is normally no jury in civil cases, unless one of the parties

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makes special application that a jury should be summoned. If there is a jury, it decides the facts of the case and the judge decides the law. Then, the judge, if the jury has found for the claimant, will make the appropriate order, and usually award the claimant his/her costs. It is the jury, however, which fixes the amount of the damages. If the case goes in favour of the defendant, the judge will normally award costs to be paid by the claimant. Should the judge be sitting alone without a jury, he/she decides both fact and law, the amount of damages, and all other matters.

The Set of Rules

Law, then, must consist of a set of rules which are known or readily discoverable by those who must obey them. It is, of course, a maxim of English law that "ignorance of the law is no defence". However, this does not mean that each citizen is expected to know all the rules which are in force – which is clearly impossible – but that knowledge of them is available, since they are all published. The citizen, therefore, must have a general idea of the principles upon which English law is built, e.g. rights of property, person, contract, and must be prepared to consult an expert in law for finer points, when necessary. A permitted defence of ignorance of the law would, clearly, make the administration of justice impossible.

Objectivity

"No man can read the thoughts of another" is a principle of wide application in law. Clearly, no authority can impose sanctions upon the thoughts of its subjects, although in some societies in the past this has been attempted. The law will recognise motives but only as far as they are apparent and can be imputed from the actions following them. In other words, it is with actions, and not with thoughts and feelings, that law is concerned.

Enforcement

It is essential, if law is to operate efficiently, that it should operate only within an area controlled by an effective government. This may vary for different laws, since there may be different authorities operating within the same area, e.g. state law and federal law in the United States of America, and bylaws of local authorities in England – but, nevertheless, the principle of territorial limits is preserved. If a government loses control of an area of its territory, in that portion its law will not prevail.

It is the duty of the government of the area concerned to make its laws effective by establishing a judicial machinery for the investigation of alleged breaches of the law and for the enforcement of the law by sanctions, i.e. penalties or rewards designed to influence the human will to conform to the law.

Impartiality

Although it is not an essential component of law, in most civilised countries it is regarded as fundamental that the rules of law should apply to all citizens alike. This principle of impartiality is one of the principles of natural justice which has influenced English law in particular.

The Rule of Law

The rule of law is an essential doctrine of the British constitution. It is not a written code of rules but a general principle implicit in the common law which the courts will apply, unless some statute can be quoted modifying its application. It has three important aspects:

(a) No person can be punished except for a definite breach of the law, established in the ordinary law courts of the land.

(b) No person is above the law and everyone must bear the legal consequences of his/her own acts, i.e. there is equality before the law.

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(c) There is an absence in the UK of any special body of courts to try cases where the citizen is in conflict with the government, unlike in France where litigation between citizens and state officials is dealt with by special administrative courts.

It is often said that it is from the principle of the rule of law that all forms of British liberty – personal liberty, liberty of speech and of the press, liberty of meeting and discussion – are derived.

During the 20th century the growth of the welfare state was necessarily accompanied by a huge increase in legislation and a corresponding increase in the state's interference in the lives of individuals. To this extent the rule of law may seem to have been eroded, but it is still valid and of importance.

B. HISTORICAL ORIGINS

Since the development of English law has been a gradual process, we shall give a brief account of its historical origins before discussing the various streams which, together, make up the whole.

Position before the Norman Conquest

In the early days, after the Saxon conquest of England in the 5th to 7th centuries, there was no law in the modern sense. The tribal chiefs, aided by the experienced "elders" of the community, were the depositories and guardians of the ancient customary law or "custom", and enforced the observance of such customs or usages dealing with religion, morality and sanitation by applying sanctions of various kinds. At a later stage, from the 9th century onwards, the Saxon kings began to put many of the old customs into writing. Such compilations are generally referred to collectively as the **laws of the Anglo-Saxons**. Although occasionally such collections refer to changes made by a powerful king (and this gives a hint as to the future of law), they were promulgated as existing laws confined to pre-existing customs. New laws were exceptional, although the conversion to Christianity naturally introduced fresh concepts issuing from divine revelations. Such codifications were not classified: criminal law, civil law, ecclesiastical law, procedure, public law, etc. but were all intermingled.

The Danish invaders brought a second element into English law, and the great legislator, King Cnut, crystallised this Scandinavian importation in the **laws of the Danelaw**, a district north-east of Watling Street where the Danes lived under their old Norse customs.

By the middle of the 11th century, the time of the Norman Conquest, the local customary laws had crystallised into the **laws of Mercia**, the **laws of Wessex** and the **laws of the Danelaw**, all separate districts of England. Note that there was no law common to the whole land. The laws were scattered on all sides: in counties or shires, hundreds (divisions of a shire) and boroughs (towns) there was material ready to be transferred into a single system of law by a centralising agency. This material was largely made up of customs administered by the freemen of the district in the local courts of the county or shire, the hundred and the borough.

The Normans

It was the task of the Norman kings, who seized control of England from 1066, through their judges to weld these customs into a uniform mass, the common law of the realm. In this way the state took over and enforced summary rules of conduct which were originally formulated spontaneously by the people themselves for regulating their actions and behaviour.

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The Norman Conquest was a vital incident in the development of English law. However, William the Conqueror did not violently impose a foreign system of law on the conquered inhabitants. He expressly announced that all men were to enjoy the laws of Edward the Confessor, a previous king. William's statutes, in so far as they were legal enactments, were restorations of the old law of accepted tradition, i.e. the preservation of the *"rights they held on the day when King Edward was alive and dead"*.

Before the Conquest, as we have seen, there was no law common to the whole of England but many local customs, varying from place to place; remember that, under the Anglo-Saxon regime in England, there were local shire and hundred courts. Immediately following the Norman Conquest, these became strengthened. The Anglo-Saxon "shire-reeve" became the Norman sheriff, a royal officer responsible to the King. The hundred court had petty civil and criminal jurisdiction in the villages and townships, while the shire courts had a more extensive jurisdiction, and also heard appeals from the hundred courts. As a result of this extension of their jurisdiction, the courts met more frequently than in Anglo-Saxon times.

William I, a man of high political wisdom, realised that he must unify the English people by a strong government. National unity could be achieved only by the methodical fusion of diverse local customs into a **common law**, running through the whole length of England. This process of unification was largely completed by his great successors, Henry I, Henry II and Edward I; by the middle of the 13th century there had been established a system of royal courts of justice dispensing a common law of the realm.

Curia Regis

The supreme court in England under the Norman kings was **Curia Regis**, or the King's Council. It consisted of the royal household, officers of state, such as the Justiciar and the Chancellor, and the judges. This body exercised judicial, legislative and administrative functions. The Council was originally an advisory body which the kings consulted on matters of state, and through which orders were issued to be executed at local level. However, it was also, a body in which royal justice could be secured. It tried all cases in which the Crown was directly interested, e.g. crimes of a varying nature, breaches of the King's peace and infringements of the King's proprietary rights but, in addition, for ordinary people, it was an emergency court of last resort when all other methods of justice had failed. The courts of the shire, the hundred and the major one remained, with the Norman sheriff as the head of the first two, but there was now an ultimate appeal to the royal court.

Do not confuse Curia Regis with **Magnum Concilium** (the Great Council) which consisted not only of officials and judges but also of all the tenants-in-chief or great barons who held their lands direct from the King.

In time, Curia Regis became the Privy Council and Magnum Concilium turned into Parliament. Gradually, there emerged from Curia Regis three separate courts.

- **The Court of Exchequer**

  This court's principal jurisdiction was that of royal revenue but later it acquired a jurisdiction in cases of debt between citizen and citizen. In early times the judges were badly paid and depended largely on court fees for their remuneration. As a result, judges tried to attract litigants to their court. The Court of Exchequer came in time to take many cases of debt which should have been heard in the Court of Common Pleas (see below). It would sell the writ to commence the action for a sum slightly below the charge demanded by the Court of Common Pleas.

- **The Court of Common Pleas**

  This court's jurisdiction was to hear civil cases between citizen and citizen. At a later time, it tended to interfere with the jurisdiction of the Court of Admiralty to hear cases that were also within Admiralty jurisdiction.

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- **The Court of King's Bench**

  This court's jurisdiction was "pleas of the Crown", i.e. criminal cases. In addition, however, it came to supervise inferior courts by prerogative writs, enjoyed certain jurisdiction for appeals, and took certain cases which were within the jurisdiction of the Court of Common Pleas.

Itinerant Judges

Early in Norman times, the King began to send out bodies of royal officials, known as commissioners, to perform various duties in his name, e.g. the compilation of the Domesday Book, and soon this custom developed into a regular system of itinerant justices, who were royal judges travelling periodically round the kingdom to hear legal and financial disputes in the shires. This system familiarised the justices with the varying local customs, which they would naturally discuss among themselves on their return to Westminster between the circuits, when they would hear cases in the King's central courts.

Centralisation of power naturally led to a desire for uniformity in administration, and this was brought about as these itinerant justices and the sheriffs accumulated and fused local practices and made them applicable to the whole realm, first in the royal courts and then by their gradual application of these merged local customs to the shires. Here we have the origin of the common law of the land. Royal justice superseded all other justice and the surviving customary law was the custom of the King's court put into shape and authoritatively laid down by the judges, but of native origin in its essence.

Court of Admiralty

In about 1341, the King conferred jurisdiction on the Admiral, which the latter exercised through deputies. The Court of Admiralty exercised criminal jurisdiction over offences committed on the high seas and also, a civil jurisdiction of an ill-defined nature. During the 16th and 17th centuries, it took to hearing mercantile cases from the old Courts Merchant and superseded these courts.

The Law Merchant

There existed in England, as abroad, various local courts, which were mercantile (concerned with trade) and administered a body of mercantile law. This 'mercantile law' was recognised in England, as on the Continent, as a definite body of customary law applicable to merchants of all nations attending the great international fairs and markets.

The Courts Merchant existed in the seaport towns and in the fairs and markets where foreign merchants tended to resort. Foreigners in the Middle Ages would be unwilling to submit their disputes to purely national tribunals. Furthermore, what merchants wanted was a system of speedy justice, so that differences could be settled quickly and they could depart.

The law administered in the Courts Merchant was truly of an international nature. The courts in Bristol, say, would enforce the same mercantile rules as the courts in Barcelona or Venice. English law of bills of exchange and negotiable instruments has come to us through the Lombardy merchants attending England's great international fairs.

Courts Merchant flourished in England from the Norman Conquest onwards but they were driven out of existence during the 16th and 17th centuries through the encroachment of the Court of Admiralty. However, the Law Merchant itself was saved since **Lord Mansfield**, who died in 1793, incorporated it into the common law. He declared that the Law Merchant was part of the common law and, in consequence, mercantile cases came to be heard in the common law courts, the latter keeping the Admiralty jurisdiction in check. Mercantile law, which has much foreign custom as its basis, has become a specialised subject and has taken on an especially English character.

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Canon Law

This is the law relating to matters over which the church assumed jurisdiction. It was formulated by ecclesiastical lawyers, mainly on the basis of Roman law and consisted of the decrees of the general councils of the Catholic Church and declarations of the various Popes. It was administered in special ecclesiastical courts which were established in Norman times.

Differences frequently arose between the spiritual courts, as they were called and the royal or lay courts, for the church claimed and exercised jurisdiction not only in obvious church matters, such as the discipline of the clergy and the validity of marriages but also over such civil matters as wills of personal property and the distribution of goods of deceased persons.

By the time of the Reformation and of the Civil War (16th and 17th centuries), the royal courts achieved supremacy over the church courts which, in course of time, lost nearly all the important jurisdiction that they formerly laid claim to. Nevertheless, much of the canon law has become part of the law of the land and may be considered an indirect source of part of English law.

Court of Chancery

The Court of Chancery grew up in the 14th century as a result of the defects in and the rigidity of, the common law, in which there were only a limited number of writs or forms of action. As a result, many cases of hardship and injustice went unremedied and finally, under Edward III, the Chancellor, who was until the time of Henry VIII always an ecclesiastic, began to hold his own court with litigants presenting petitions for special relief. The basis of the law administered by the Chancellor was conscience and this led to principles and conclusions, opposed to common law, since the aim was to secure moral justice, rather than to follow legal rules. This system of law administered by the Court of Chancery became known as **equity**.

C. SOURCES OF LAW

Now that we have given a brief outline of the historical origins of the English courts, we are in a position to discuss the various sources from which English law is derived.

Unwritten Law

- **Common law**

  The common law, as we have seen, was originally based on the merging of the various local customary laws of England as a result of the decisions of the royal judges. In fact, in the law report of Henry IV in the 15th century it is said:

  > *"The common law of the realm is the common custom of the realm".*

  It is, therefore, unwritten, since it depends originally upon a judge's interpretation of the customs of the realm. When we come to discuss the importance of case law in the English judicial system, we shall show that the decisions of judges are, in fact, binding but this does not invalidate the fact that the basis of common law, which has also absorbed mercantile law and some canon law, is essentially unwritten, although cases heard in the courts appear in written law reports. The reports only relate the unwritten law.

  You should note, at this point, that the expression "common law" has come to be used in four distinct senses:

  (i) Historically, as above, to denote the body of law common to all England that arose to supplant the previous local systems of law.

(ii) As opposed to equity (see below).

(iii) As opposed to statute law, also considered below.

Thus, in this sense, it is sometimes said that a certain rule of common law was modified by an Act of Parliament.

(iv) To mean the whole body of English law, including equity and statute law, as distinguished from any foreign system of law. Thus, we frequently speak of "the common law countries", meaning England, the USA and those Commonwealth countries which have adopted English law, especially when we wish to contrast them with European countries, such as France and Germany, the legal systems of which have been strongly influenced by Roman law.

Just as the Romans had their "*jus civile*" as the basis of their law, so English common law lies at the foundation of the English legal system. The law of torts is almost wholly based upon the common law, as is a good deal of English contract law. The common law has played its part in the development of the complicated system of English land law, and has covered departments of public law like constitutional law.

- **Equity**

  Like common law, equity is also based on judicial decision, and not upon written rules. It originally stemmed from the Chancellor's interpretation of what was fair and just according to his conscience and, while in time it became rigid, it was originally flexible. Its basis is, again, unwritten.

Written Law

We have not yet discussed statute law because it was a later development than common law and equity. It is true that, from Norman times onwards, decisions of the King-in-Council had the effect of law, but the promulgation of new laws was very rarely carried out, and **Magna Carta (1215)** is usually regarded as the first published statute.

A statute is a written law passed by the approved legislative process of the state, i.e. nowadays by the Queen-in-Parliament, and it supersedes any other forms of law. Thus, statute law can override both the common law and equity, since it is enacted by the sovereign power and is therefore superior to custom and judicial decision.

Here, an important distinction must be made between "**the** law" and "**a** law". The former is the whole body of law, as defined at the beginning of this study unit, while "**a** law" is a written statute or an order made on the authority of a written statute. Thus, "**a** law" refers only to statute law. You need to understand this distinction clearly, since it sometimes serves as a basis for examination questions.

It is important to appreciate that, since the UK is a member of the European Union (EU), EU legislation overrides English law, and English legislation must not conflict in any way with the **Treaty of Rome** and its implementing legislation in the form of directives and regulations. To that extent, EU law must now be regarded as a source of law in England.

The Pattern of English Law

From what we have already said, we can see that English law is composed of three strands. The bulk of English law is **common law**, which is based on customs and case law. This is modified and supplemented by **equity**, which is based on the principle of moral and abstract justice, rather than upon customary law, and is again chiefly represented by case law. Finally, **statute law**, enacted by the sovereign authority of the state, is increasingly important in the modern state and is superior in status to both the common law and equity. The diagram below illustrates the pattern.

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The Law		
Statute Law	***Common Law***	***Equity***
The supreme law	Custom Case law	An addition to and modification of the common law

The Law of the European Union

The accession of the UK to the European Community, as it was then, on 1 January 1973, introduced a system of supranational law in accordance with the **Treaty of Rome** (which established the EC in 1957) and the UK's **Treaty of Accession**. Since that date legislation has been passed, and continues to be enacted, aimed at fitting European Union law into the English system and the existing framework of parliamentary sovereignty.

EU law is either embodied in the Treaty of Rome – in which case it is often referred to as the **primary legislation** of the EU – or it is derived from the Treaty and termed **secondary legislation**.

The following are the principal forms of EU secondary legislation:

- **Regulations**

  Regulations have direct internal effect in member states. They are mainly "self-executing", although sometimes they may have to be supplemented by national legislation. In general, they relate to detailed, technical aspects of the EU agricultural policy, transport, customs duties, etc.

- **Directives**

  Directives do not have direct internal effect but oblige the governments of member states to ensure that the requirements laid down in them are fully implemented, usually by national legislation. The directives state, in broad terms, what has to be done but leave to the member states the details of implementation. Examples are the various directives on value added tax and company law.

  The European Court of Justice is the EU's supreme judicial authority; there is no appeal against its rulings.

- **Decisions**

  These are usually concerned with specific problems or issues, and they are not necessarily directed to the EU as a whole. They may be addressed to the government of an individual member state, in which case they impose binding obligations but do not have direct internal effect as law in that state. Alternatively, they may be addressed to companies or individuals in one or more member states.

Since the date of UK membership of the EU, the sources of EU law have become sources of English law. The sources of EU law are essentially the Treaty of Rome (primary legislation); secondary legislation (mainly regulations and directives); and precedents established by the European Court of Justice, which constitute developing sources of law.

The European Court of Justice sits in Luxembourg, and consists of 27 judges and eight Advocates-General; one judge and one advocate-general are from the UK. Its main function is to ensure that the law is observed in the interpretation and application of the Treaty, and it is the final arbiter on all legal questions falling within the scope of the Treaty. Apart from its role in interpreting EU law, the Court deals with disputes between member states on EU issues, and between member states and EU organisations. It also hears actions brought by

a member state, by the EU Commission, by the EU Council, or by any individual regarding matters covered by the Treaty. Individuals and companies may challenge in the Court the legality of regulations, directives, etc. only in so far as these are of **direct** concern to them.

One article of the Treaty of Rome, in particular, has an important effect on the administration of justice by UK courts. **Article 234** gives jurisdiction to the European Court of Justice to make preliminary rulings on the interpretation of the Treaty, and the validity of actions taken by the institutions of the EU. Where such a question is raised before any court or tribunal of one of the member states, the court or tribunal may, if it considers that a decision on the question is necessary to enable it to give a judgment, request the Court of Justice to give a ruling on it. If the question of interpretation arises before a court from which no further appeal is possible in the national court system, that court **must** submit a reference to the European Court of Justice.

Remember that all EU law overrides English national law, in the event of conflict or inconsistencies. Furthermore, Parliament has a duty (under international treaty law) to refrain from passing legislation conflicting with EU law. This duty has major implications as regards the judicial interpretation of Acts of Parliament.

Referring to the Treaty of Rome, Lord Denning stated:

> *"In any transaction which contains a European element we must look to the Treaty ..., for the Treaty is part of our law. It is equal in force to any statute. It must be applied by our courts."*

Note, therefore, that EU law, future and present, is automatically binding in the UK, in many cases without local enactments. Judicial notice is taken by English courts of such EU law. Orders in Council and Regulations may be used in the UK to implement EU laws in matters of detail. The whole of existing English law which was inconsistent with EU law was repealed by implication on the UK's accession to the EC, as the EU was then known.

D. THE EUROPEAN UNION AND UK LAW: AN OVERVIEW

Because of the importance of the effect of EU law on UK law we shall look briefly at the composition of the Union and its institutions, as well as some of the significant issues relating to the UK legal system.

Composition of the European Union

When Parliament enacted the **European Communities Act 1972**, which came into effect on 1 January 1973, Britain became a member of the three European Communities:

- European Economic Community (i.e. the Common Market or EC)
- European Coal and Steel Community (ECSC)
- European Atomic Energy Community (Euratom).

As a member state, Britain became subject to Community, now European Union, law. As at November 2007, there are 27 countries in the European Union with a further five countries with applications pending.

The EU is a separate legal entity in international law. As far as the UK is concerned, the country acceded to the Treaty of Rome in 1971 and became a full member of the EU following the European Communities Act 1972. The EU is made up of a number of component parts, having legislative, executive and judicial functions, but the main purpose of the EU is economic and political. The UK has to conform, along with other member states, to EU law, and we will look at the conflict between national and EU law as regards the English legal system later. We will first look at the various bodies making up the EU.

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Institutions of the European Union

- **The Council of Ministers**

  This is the supreme legislative body, although its powers are limited by having to proceed on proposals from the Commission on most matters. The role of the Council of Ministers is to take **executive** and **legislative** decisions and co-ordinate the policies of member states, under the terms of the Treaties.

  The Council comprises government ministers from each member state and the presidency rotates among them every six months. The Council is assisted by a small civil service of permanent officials called the **Committee of Permanent Representatives**, with headquarters in Brussels. The Council works in close co-operation with the Commission, discusses their proposals and ensures that national interests are represented. The heads of government of member states meet to discuss important issues at meetings called **European Councils**.

- **The Commission**

  The Commission is made up of individuals appointed by the member states, with representation depending on the size of the member states. The numbers can be altered as new states are admitted to membership. Individual members are appointed for a period of four years. The President and Vice-President are appointed from amongst the members for a two-year period. The members are chosen for their experience and total independence and are **not** regarded as representatives of their respective governments. The Commission is aided by a substantial civil service working in concert with the Council of Ministers and the Parliament (see below). The Commission has **executive** functions and ensures that the provisions of the Treaty of Rome and other decisions of the EU are carried out. It also helps to draft EU **law**.

  It is misleading to view the Council as the legislature and the Commission as the executive, since the Commission also has legislative powers and the implementation of policy is the responsibility of the institutions of the member states. The Council enacts all important measures but cannot amend Commission proposals except by unanimous agreement. The Commission is the representative body with non-member states and administers EU funds. It answers solely to the Parliament.

- **The European Parliament**

  This is the elected body of the EU, and consists of 785 democratically elected European MPs (or MEPs) from all member states, of which 78 are from the UK. It has **advisory** and **supervisory** functions. It has **no** legislative powers – in fact, the only power it has is to dismiss the Commission by a motion of censure passed by a two-thirds majority.

  The general role of the Parliament is a consultative one, considering proposals from the Commission before they are sent to the Council. A failure by the Council to seek the opinion of the Parliament may leave their actions open to question.

- **The Court of Justice of the European Communities and the Court of First Instance**

  We looked at the composition and functions of the court earlier in the study unit.

- **The Court of Auditors**

  This court monitors all financial transactions in the European Union on behalf of taxpaying citizens.

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Application of Union Law

As we have already noted, EU law is distinct from national law but exists in parallel with it and, where the two conflict EU law prevails.

Some aspects of EU law are directly applicable in the UK (treaties and regulations) and confer rights and duties which must be recognised by the courts of member states. They pass straight into local law without the need for approval of the parliaments of member states.

Directives do not automatically become the law in member states but are instructions to make law within the legislative machinery of each country within the prescribed time limit. Decisions are binding on the member state or corporation within that state to whom they are addressed. Decisions are usually of an administrative nature, e.g. granting authority for some action or providing exceptions to a particular legal rule.

Section 52(1), European Communities Act 1972 states:

> *"All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties and all such remedies and procedures from time to time provided for by or under the Treaties are without further enactment to be given legal effect or used in the United Kingdom, shall be recognised and available in law, and be enforced, allowed and followed accordingly".*

Similarly, as regards secondary legislation, Article 249 of the EC Treaty states:

> *"A ruling shall apply generally. It shall be binding in its entirety and take direct effect in each member state. A directive shall be binding as to the result to be achieved upon each member state to which it is directed, while leaving to national authorities the choice of form and method. A decision shall be binding in its entirety upon those to whom it is directed".*

This concept of direct applicability raises two important constitutional issues. Firstly, whether EU law takes precedence over the law of the individual member states, and secondly, the extent to which parliamentary sovereignty – giving unfettered law-making powers to Parliament – is extinguished by membership of the EU.

The European Union and Interpretation of Law

- **The effect on the courts**

  The law of the EU has had an effect on our domestic courts and case law (precedent). If a superior court from which there is no appeal (e.g. the House of Lords) is dealing with a case concerning interpretation of a European treaty or the validity or interpretation of regulations and directives made by the EU, it must refer the case to the European Court for a ruling on the question unless the correct interpretation is clear.

  Under Article 234, the Court does not interpret national law but merely decides and delivers a general interpretation of EU law as it applies to the case referred. It is then the responsibility of the domestic court of the member state to enforce the ruling. If it cannot because, for example, of national constitutional doctrine then the member state is expected to amend its own laws as soon as possible. Where the member state does not do this it can be brought before the Court by the Commission. However, the Court may only make an unenforceable declaration in judgment against the government of that member. The Court does not have the power to determine that legislation is void for inconsistency with EU laws. In this respect, it is unlike the Supreme Court of the USA.

  The seeking of clarification by the Court of Justice may lead to a consistent interpretation of EU law throughout the Union.

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- **The effect on case law**

  The importance of EU law in relation to existing case law was considered by Lord Denning MR in ***Bulmer v. Bollinger (1974)***. He observed:

  > *"The Treaty does not touch any of the matters which concern solely England and the people in it. They are not affected by the Treaty. But when we come to matters with a European element, the Treaty is like an incoming tide. It flows into the estuaries and up the rivers. It cannot be held back. Parliament has decreed that the Treaty is henceforward to be part of our law. It is equal in force to any statute."*

  It is thus likely that if a particular law of the EU is contrary to a binding precedent of English law, a court lower in the English court hierarchy may ignore it and base its decision on the EU law.

Parliamentary Sovereignty and the European Union

A White Paper published in 1967 on the subject of EU law and parliamentary sovereignty stated that Parliament, in acceding to the Treaty, would be bound to refrain from enacting legislation inconsistent with EU law. However, parliamentary sovereignty is still important, since properly enacted legislation via Queen, Lords and Commons is **binding** and any repeal of the 1972 Act could be effected in this way. The courts have always presumed that Parliament does not intend to derogate from international treaties and conventions, and if any inconsistency arises, the judges would presume that it is Parliament's intention that EU law should prevail. However, Lord Denning had this to say about instances where there is a clear inconsistency:

> *"Thus far I have assumed that our Parliament, whenever it passes legislation, intends to fulfil its obligations under the Treaty. If the time should come when our Parliament deliberately passes an Act with the intention of repudiating the Treaty, or any provision in it, or intentionally of acting inconsistently with it and says so in express terms, then I should have thought that it would be the duty of our courts to follow the statute of our Parliament."*

Academic opinion leans to the view that the 1972 Act is entrenched and fundamental like the **Act of Union 1707** or the **Bill of Rights 1689**, and it has even been suggested that the EU is a new legislative organ additional to the organ of Parliament.

Section 3, European Communities Act 1972, binds the UK to accept the rulings of the European Court which has stated several times (see above) that the Parliament of member states may not legislate inconsistently with EU law. This seems inevitably to involve a rejection of the doctrine of parliamentary sovereignty and curtailment of the legislative powers of Parliament, both antecedent and subsequent. Thus, in addition to existing domestic law being inconsistent, Parliament cannot pass new laws on a matter already dealt with by the EU except to implement its details. In ***Costa v. ENEL (1964)*** the Court said:

> *"The member states, albeit within limited spheres, have restricted their sovereign rights ... no appeal to provisions of internal law of any kind whatever can prevail".*

The European Council agreed at its meeting in Luxembourg in 1985 to adopt five new policy initiatives, which became embodied in the **Single European Act 1986 (SEA)** following its ratification by the national parliaments of all the member states. This ratification was completed by 1 July 1997, the date the Act came into force.

The five new **policy initiatives** were:

- The Internal Market
- Monetary Capacity

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- Social Policy
- Economic and Social Cohesion
- Research and Technological Development.

The internal market

One of the most important of the objectives is the establishment of the Internal Market. What, then, is the Internal Market? Its characteristics are defined under the Act as "*an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty of Rome*".

The member states declared in an annexe to the SEA their firm political will to take the necessary decisions to complete the Internal Market before 1 January 1993. A further declaration annexed to the Act, however, also indicated that member states could derogate from their obligations under the Treaty of Rome in certain policy areas. These policy areas are:

(a) Controlling immigration from third countries

(b) Combating terrorism, crime and trafficking in drugs

(c) Illicit trading in works of art and antiques.

It is the view of some critics of the SEA that the extension of the power of the member states so declared derogates from their obligations beyond those found in the original Treaty.

In specific terms, the aim of the SEA 1986 is to complete the process of economic integration by removing the technical barriers which required goods to be checked at the frontiers between the member states so as to ensure they conform to certain technical and safety standards. Each member state has the responsibility of ensuring that goods produced within its territory and intended for export satisfy the standards agreed for the whole of the European Union, thus avoiding the necessity of further boundary checking when they are conveyed into another member state. It also specifically proposed that private individuals could purchase goods in any European Union country and take them home without paying any customs duties, provided these goods were for their own private use – this aim was realised on the establishment of the Single Market on 1 January 1993.

Some limitations to economic integration still remain, mostly attributable to member states having retained separate excise duties and individual imposition of different rates of VAT, a form of indirect taxation.

Decision-making

The SEA 1986 also heralded two major changes in the EU's decision-making processes, which were designed to accelerate the voting procedure in the Council of Ministers and to give increased powers to the European Parliament.

(a) The Council's voting rules under the Act provide for simple majorities (principally for procedural matters), qualified majorities (for infilling existing policies) and unanimity (for new policies, or if the Council wishes to change a Commission proposition against the wishes of the latter). A qualified majority is comprised of 74% of the votes of the member states, weighted by size. Unanimity can be secured with abstentions, except that in relation to qualified voting, abstentions have the same effect as votes cast against.

(b) The SEA 1986 gave the European Parliament the power to consider proposals brought forward by the Commission and agreed in principle by the Council of Ministers. Proposals in certain policy areas were declared to require the approval of an absolute majority of members of the European Parliament before becoming law – these areas

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include treaties between the EU and "third countries" and the accession of new member states into the EU.

The SEA 1986 devised a "*co-operation procedure*" mainly to facilitate the introduction and implementation of measures aimed at creating the Internal Market. Initiation and promotion of such EU legislation was retained by the European Commission, followed by consideration by the Council of Ministers. The European Parliament was also granted the facility to give an opinion on the Commission's proposals, and the Commission could, but was not obliged to, modify its proposals according to any such opinion expressed.

Other matters

The SEA 1986 also dealt with the following matters:

- Open tendering for public works contracts
- Codification of the mutual recognition of qualifications awarded by member states
- Reduction of state aid to individual industries.

The Treaty on European Union 1992 (The Maastricht Treaty)

At their meeting on 11 December 1991 in Maastricht, the then 12 member states of the European Union agreed and published the text of a **Treaty on European Union**, which was subject to ratification through national referenda. It emphasised the "three pillars" on which European unification is to be based – the European Community in the form it had developed by 1991, the progression towards a common foreign and security policy, and co-operation on justice and interior affairs.

Amongst the specific proposals contained within the Treaty, the following were of special note:

- A common European currency by 1999
- A charter of rights for "European Union citizens"
- Increased powers for the European Parliament
- The introduction of a common foreign and security policy
- New powers for the European Union.

A common european currency by 1999

In the development of the Internal Market, which was set in motion by the Single European Act 1986, businesses operating within the EU were canvassing for an end to uncertain and fluctuating exchange rates, which imposed continuing and increasing problems in relation to the free movement of goods and services within the EU. Payment of commission and losses on the differing selling and buying rates compounded the problems of business.
A potential solution to such problems was a move towards European Monetary Union, with a single currency, the Euro (€), which could be used freely throughout the EU. This finally came into operation on 1 January 1999.

Monetary union as conceived by the Treaty is governed by the European Central Bank (ECB) which, through and in conjunction with a European system of central banks and the national central banks, operates the system. The ECB is completely independent of the views of governments, the Commission or the European Parliament, and six full-time executives direct the affairs of the ECB through the common accord of the heads of state and governments of the member states.

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The primary objective of the system is price stability, and strict discipline is imposed on public finance, prohibiting excessive national government deficits and imposing penalties on member states who offend.

A key question concerns membership of the monetary union, which is divorced from membership of the economic union to which member states already belong. To be eligible for membership of the final stage of monetary union, a member state must have satisfied the **convergence criteria** contained in a protocol to Article 121(1) of the Treaty.

Amongst these criteria are:

(a) The member state's average rate of inflation must not be more than 1.5 points worse than the average of the best three member states

(b) The ratio of government debt to gross domestic product must not be more than 60%

(c) The ratio of its deficit to gross domestic product must not be more than 3%

(d) The national currency must be in the narrow band of allowable deviation of 2.25% and must not have been devalued in the preceding two years.

These stringent conditions of entry were designed to protect the single currency from potential weaknesses in the performance of a participating member state and necessitate strict fiscal policies by national governments.

The United Kingdom did not join the European Monetary Union on 1 January 1999, as it negotiated the option of not participating until it specifically declares it wishes to do so, (as did Denmark). Whether the United Kingdom does eventually participate has yet to be decided, and may well be the result of a national referendum. All the other member states which met the convergence criteria on 1 January 1999 are now obliged to implement monetary union.

Rights of European Union citizens

Article 17, as consolidated by the Citizens' Rights Directive 2006, deals with European Union citizenship, which is mandatory for nationals of member states, since no opting-out is allowed.

As citizens of the EU, nationals of the member states will have the right to move and reside freely within the EU. They will also be granted the right to vote and stand as a candidate in local and European Parliament elections in whichever member state they reside.

The European Parliament is required to appoint an Ombudsman to deal with complaints from any citizen of the EU relating to maladministration in the functioning of the Union institutions, with the exception of the EU courts.

Increased powers for the European Parliament

The co-operation procedure introduced by the Single European Act 1986 was amended by the Maastricht Treaty, which introduced a new procedure called **co-decision**.

The European Parliament is granted the power to prevent legislation being adopted for the first time. The veto can, however, only be exercised after the convening of a Conciliation Committee, comprising members of the Council of Ministers or their representatives and an equal number of representatives of the European Parliament. The Committee must approve a joint-text within six weeks, which is followed by a further period of six weeks during which the Council and the Parliament have to adopt the proposal – if they do not, it fails. The time-scale can be extended by common agreement of the Council and Parliament for a further two-week period.

If the Conciliation Committee fails to agree, the Council is entitled to issue its formal Opinion within six weeks. The European Parliament is then empowered to reject the Opinion by an absolute majority of its Members to prevent the proposal being finally adopted.

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The Treaty also provides the Parliament with the power of veto in relation to the accession of new member states.

A common foreign and security policy (CFSP)

The Maastricht Treaty agreed to establish a CFSP which was not to be part of the EU system *per se* (by itself), not subject to the same decision-making procedures and not subject to judicial review by the European Court of Justice.

The objectives of the policy were to safeguard the common values, interests and independence of the EU, to strengthen security and promote international co-operation so as to reinforce democratic principles. Greater links with NATO were envisaged.

New powers for the European Union

A more proactive role for the European Union was programmed in relation to the following:

(a) Consumer protection, public health and visa policy

(b) The establishment of trans-European transport, telecommunications and energy networks

(c) Co-operation in the areas of justice and home affairs

(d) Treaty provision for development co-operation, industrial policy, education and culture

(e) Environmental protection

(f) An increase in research and development

(g) Further progress on social policy (with the exception of the United Kingdom).

In relation to the development of the last power – social policy – mention should particularly be made of the **Social Chapter**. The articles published by the Treaty relating to the Social Chapter aim to offer rights and advantages to all workers concerning:

- Freedom of movement
- Equal treatment for men and women
- Increased opportunities for vocational training
- Improved working conditions and better health protection in the workplace
- Rights of the elderly and the disabled
- Increased worker consultation and better protection for children and adolescents
- The right of association and collective bargaining.

The Treaty does not impose a minimum wage, which is a feature of national economic policy in France, Germany and the United Kingdom. It leaves the member states the freedom to decide on the best way to ensure that shareholders and workers alike benefit from the increased prosperity which it is envisaged the Internal Market, organised on otherwise strictly capitalist lines, will achieve.

The Social Chapter is to be distinguished from the **Social Charter** which was introduced by the Council of Europe, an organisation which is entirely separate from the European Union. Both the Social Chapter and the Social Charter aim to improve the working conditions and status of workers, but the Social Charter is a completely voluntary code with no provision for countries who have subscribed to it to enforce it. The Social Chapter, on the other hand, was given a legal foundation in the Maastricht Treaty (with only the United Kingdom securing an opt-out allowing it not to enforce the provisions at that time).

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Other features

Two other features of the Treaty on European Union (Maastricht Treaty) 1992 deserve special mention:

- **The European Court of Auditors – An enhanced role**

  The Court of Auditors, whose headquarters is in Luxembourg, has existed since 1977 and is the EU institution whose brief is to monitor the Union's financial probity and regularity.

  It consists of 27 members whose appointments are made by the European Council following consideration by the European Parliament, and is headed by a President.

  The Court's staff audit the accounts of the Union institutions and general and special reports are issued in the name of the Court. The general report is debated in the European Parliament to oversee the Commission's accounting system and special reports examine particular aspects of individual institutional expenditure. The Court of Auditors gave early warning of a developing financial crisis during the early 1980s and in 1989 it identified cases of large-scale fraud in a number of member states and published several searching special reports. More recently, in March 1999 the European Commission's entire 20-member executive resigned after a report accused the Commission itself of widespread fraud, nepotism and mismanagement.

  Article 4 of the **Maastricht Treaty** has upgraded the status of the Court of Auditors, increasing its influence so as to coincide with the completion of the Internal Market. The aim is to exert additional pressure on combating fraud and financial irregularity in the deployment of EU funds.

- **The principle of subsidiarity**

  In the evolution of the European Union since the original Treaty of Rome in 1957, a trend had developed which a number of member states had identified as **federalism**, looking towards a European federal state. Concern had also been expressed relating to the over centralisation of authority in the European Commission in Brussels. These trends were especially repugnant to the United Kingdom, which voiced its concern at the Maastricht meeting.

  The principle of subsidiarity was accordingly platformed at the meeting and the text of Article 3(b) of the Maastricht Treaty was agreed as follows:

  > *"In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the member states and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community".*

  Evidence of the adoption of the principle of subsidiarity by the Treaty is also recorded in its preamble, which defines the objective of the European Union as "*taking decisions as closely as possible to the citizen in accordance with the principle of subsidiarity*".

  Historically, the doctrine of subsidiarity characterised the social philosophy of the Vatican State and states that citizens should be closely involved in the decisions which affect them and that the bodies that take such decisions should be close to them. At the same time, it is not an easy doctrine to apply, because considerable controversy can exist concerning the level of decision making which will secure the best result for such people.

  Article 3(b) and the preamble to the Treaty have taken steps to resolve this controversy to some degree by giving certain power back to the member state and inhibiting the growth of centralised power characteristic of federalism. It would now appear that it is

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for the European Commission to justify its chosen action when contemplating a proposal, i.e. why it is **not** leaving the action to be taken at member state level. Subsidiarity reacts against over centralisation and these parts of the Treaty are an attempt to keep the EU out of matters which a member state can deal with better and more effectively.

Henceforth, the validity of a proposed EU measure may accordingly be successfully challenged on the basis that it contravenes and offends against the principle of subsidiarity. Since Article 230 of the Treaty of Rome 1957 continues to authorise the European Court of Justice to consider actions for annulment, it remains to be seen whether the Court will be called upon to adjudicate upon a potentially repugnant measure in the future.

It also merits noting that according to the Maastricht Treaty notion of the principle of subsidiarity, decentralisation ends at the level of the member state in its inhibiting influence on the growth of central power and does not devolve to regional or local authorities, despite the view that such authorities are "close to the citizen". How the role and authority of the national assemblies set up in Scotland, Wales and Northern Ireland will be reconciled with this scenario is also an issue for the future.

European Communities (Amendment) Act 1998

This Act incorporates the **Treaty of Amsterdam** of 1997 into UK law. The Social Protocol (or Social Chapter) was incorporated into the main body of the Treaty of Amsterdam and this ended the UK's opt-out from the Social Protocol at Maastricht. The 1998 Act gave the UK government the necessary authority to implement the Parental Leave Directive and the Working Time Directive.

Note to students

The word "community" specifically refers to the three bodies:

- The European Coal and Steel Community (ECSC) founded in 1951
- The European Economic Community (EEC) formed in 1957
- The European Atomic Energy Community (EURATOM) formed in 1958.

The EEC later became known as the European Community (EC). The growth in the number of countries in the EC to 12 in 1986 led in due course to the Maastricht Treaty being signed in 1992 where all the countries decided to adopt the new title European Union (EU). This latter term is now used to refer to all European matters.

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Study Unit 2

Common Law, Equity and Statute Law

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A. CUSTOM

We have already referred to custom as a historical source of law. Customary law, which is the foundation of our common law, predominates at the beginning of all social history. Before the Norman Conquest, the various local laws were made up of rules of human conduct, established by usage, and administered in the popular courts by the freemen of the district.

Common law was long identified with customary law, even after the binding decisions of judges (precedents, or case law) had become the true bulk of English common law. Custom, in the legal sense, may be defined as:

> *those rules of human action established by usage which are adopted by the courts because they are followed by the political society as a whole or in part .*

We have seen how **Lord Mansfield** introduced into English law the "*general customs of the merchants*". Thus, the Law Merchant originated from custom and is now followed because this custom is embodied in many precedents, some of which are embodied in enacted law or statutes. In modern law, custom has been practically superseded by legislation, or statute law, which either legalises a custom or annuls it.

General Customs

There is a distinction between customs that are **general** and customs that are **particular** or **local**. The former prevail over the country as a whole and are effective as the common law. Certain requirements are necessary before a custom can become a particular source of law.

- **It must be reasonable** – that is, it must conform to the general view of right and reason prevailing in the community. The courts are not at liberty to override a custom because it falls short of their own ideal of right and justice.
- **It should not be in conflict with statute law**. No custom can take away the force of an Act of Parliament, which cannot be set aside by the development of a custom to the contrary.
- **It must be generally followed and observed as of right** by the members of the community. Should members of a community consider themselves free to depart from the custom and thereby deny their obligation to accept it as binding, the custom has no legal significance.
- In English law, at any rate, a local, though not a trade, **custom must be "immemorial"** – it must have existed for so long a time that the "memory of a man runneth not to the contrary". This refers to the legal memory of man, which has long been supposed to date back to the beginning of the reign of Richard I (1189–1199). So, if a disputant can prove that a custom did not exist at any time after this date, this custom will not receive legal validity. Note that the upholder of a custom need not prove it did exist in 1189: if he/she can prove that it has existed for a substantial period, to rebut it the disputant must prove its non-existence, as above. In other words, the presumption of time immemorial can be raised by proving that it has been observed for a long time; to be void, its beginning must be proved later than the 12th century, e.g. by showing that it originated from legislation of a later date.

Particular Customs

Particular customs need not be in conformity with common law, provided that they do not conflict with any other particular custom in the locality.

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Mercantile customs were a form of particular custom, and have been accepted as a source of law generally. In their case, time immemorial yields to universality of usage. They are still a possible, though not frequent, source of law, and show that the Law Merchant is not dead.

You should note that any custom, general or particular, that fails to satisfy all of the essentials normally required, is not, thereby, debarred from having legal consequences. If the existence of any custom is proved as a fact, it definitely influences decisions on cases dealing with contracts or torts. Trade customs or usage need not be of antiquity. If recognised by the merchants, the courts will uphold it: ***Bechuanaland Exploration Co. v. The London Trading Bank (1898)***.

Conventional Usage

Distinct from the two varieties of custom is a third type, which we may term **conventional usage**. This is not strictly "custom". A usage is an established practice, the effect of which is to incorporate, expressly or impliedly, a term in the contract between the parties concerned. There are usages particular to a special trade, or a special market. The law assumes that, in the absence of any expressed declaration to the contrary, the contracting parties intended to contract in reference to the established usages in the trade, which usages are binding as part of the contract. Therefore, the effect of any established usage is to add a binding term to the contract. Any such usage must be clearly established in the particular trade, and when once judicially recognised – by the courts – it cannot be changed by a later contradictory usage.

Advantages and Disadvantages of Custom

In comparison with statute law, custom has a number of disadvantages:

- It is not quickly made but requires time to evolve
- It is definite and therefore, more difficult to prove
- It is difficult to repeal, unless by statute
- Fresh customs are rare.

On the other hand, as a custom has evolved from a consensus of the people following it, it is more likely to be generally acceptable, and ethically good. Generally speaking – that is, apart from the continued existence of a few purely local customs – the common law of the realm no longer consists of the common custom of the realm. Practically all the general customs have received judicial notice or parliamentary codification and they have, therefore, become either case law or statute law – see ***Magor and St. Mellons RDC v. Newport Corporation (1952) AC 189***.

B. CASE LAW

The old theory was that the common law was simply a type of customary law applicable to the whole kingdom; in fact, the term "law" was considered synonymous with the term "common custom". As we have seen, this identification was rescinded very early, as royal judges began to formulate a body of law built up on their decisions, which sometimes were, and sometimes were not, in accordance with particular or general customs. These duly recorded decisions, called **precedents**, are responsible for the bulk of English common law.

We may regard precedents as a distinguishing feature of English law, and also its real core. The term refers to those decisions of judges which are authoritative and binding. They are sometimes termed judiciary law; judicial precedents; precedents; case law; adjudication; but in all cases the term refers to the rule of conduct enshrined in the decision or judgment of a judge, or judges.

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History of Case Law

In our historical review of the growth of English law, we mentioned how the royal judges, during the first two centuries after the Norman Conquest, gave their judgments either in the royal court at Westminster or on their journeys. We further suggested that their decisions would normally be based on existing or assumed customs. As their aim was to unify the law, they probably circulated to each other "reports" of their decisions, in order that later judgments in similar cases would be framed similarly. There were also the "Rolls" of the courts, to which the judge could refer.

Towards the end of the 13th century, some anonymous reporters began to record the arguments of the pleaders and the judge's ruling, and the members of the legal profession found these notes so interesting for reference and study that **Year Books** (annual volumes), of such records arose. Reports of cases by anonymous reporters continued from Edward I's reign to Henry VIII's, probably written by students or practising lawyers attending the courts. These were succeeded by reports compiled by professional lawyers, and published in printed volumes bearing the author's name. They contained a statement of facts in the issue, a summary of the pleaders' arguments, and the verbatim judgments of the judges.

Naturally these Year Books were not so complete or accurate as modern Law Reports, but they assumed an ever-increasing importance. At first, they possessed persuasive authority only; they were evidence that such was the law, but judges were not bound to accept the decision as binding on them. Still, the mere fact that the judges admitted the principle of uniformity of law led to the playing of an increasingly important role by these reports, and greater weight was attached to the citation of decided cases.

Thus, in time, greater regard came to be paid to former decisions but it was only towards the end of the 18th century that the doctrine of the **binding force of precedent** became accepted by the judges. About this time, Continental countries were codifying their respective legal systems, with a view to making the law more certain and ascertainable. England did not resort to a codification of the law but, in its place, adopted the doctrine of the binding force of precedent, which has the effect of making rules of law of more certain authority, so far as they have come before the courts in litigation.

Present position

The current position is that courts are always bound by decisions of higher courts, and sometimes by those of courts of equal status.

Case law enjoys merit, in the sense that it is usually of finer workmanship than statute law, for the following reasons.

- Judges know more about the law than Members of Parliament
- When a judge is laying down new law in pronouncing his/her decision in an action, the judgment is based upon the concrete facts of the case. Parliament, on the other hand, legislates more for the future.

Note that judicial precedent is a source of law, and not merely evidence of the law.

Operation of the doctrine of precedent

A judge is obliged to decide the case before him or her by reference to a previous decision when the conditions for the operation of the doctrine of precedent are satisfied. These are that the previous decision is, so far as its *ratio decidendi* is concerned, relevant to the determination of an issue of law in the case in question, and that the prior court's decisions are authoritative for his/her court, e.g. it is a court that is superior in the hierarchy.

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Function of the doctrine of precedent

The function of case law is to develop the law, whether common law or statute law. For centuries the prevailing view was that judicial decision was merely a declaration of what the existing law was; a judge is *"not delegated to pronounce a new law, but to maintain and expound the old law"* ***(Blackstone)***. He and his predecessors regarded the judges as the repositories of the entire body of customary principles that had existed from time immemorial, and their decisions as evidence of such customary rules of conduct.

However it is clear, for example, that legal rules referring to radio and television broadcasting can hardly have existed from time immemorial, but have arisen as the need for them developed. In point of fact, all judges have been entrusted with the power to make rules for cases not provided for previously and, in this sense, they make law, but not as a legislative body does.

Their decisions, although evolutionary, are never revolutionary, but are developments of existing rules, and always conform to the general principles of the law of the land as a whole. So-called innovations are simply extensions and modifications, and are natural expressions of the growth of the common law, in consonance with the current ideas and the changing needs of society.

A judge cannot decide, as a legislator does, as he/she pleases. Some standard must be applied, whether it be that of a previous decision, or the opinions of legal writers, or the Roman law, or equity, or some other consideration.

Although in strict legal theory, judges do not make law, it can be argued that they make law in the following limited ways:

(a) Where there is no existing precedent which is directly relevant to the case before them, then they must extend the existing law to cover the new situation by analogy

(b) Where they overrule an existing precedent, frequently because there are other conflicting precedents

(c) Where they distinguish precedents cited before them, and so limit the scope of the previous rule.

Classification of Precedents

Precedents can be conveniently divided into three classes, according to the nature of their binding force.

(a) Authoritative or absolutely binding

In these cases precedents are legal sources of law, and must be followed without question. Absolute authority is accorded to the decisions of the House of Lords, the highest English court.

However, in 1966, by a formal Practice Statement, the House of Lords judges announced that in future they would not regard themselves as necessarily bound by their **own** decisions. The Practice Statement said:

> *"Their Lordships regard the use of precedent as an indispensable foundation upon which to decide what is the law and its application to individual cases. It provides at least some degree of certainty upon which individuals can rely in the conduct of their affairs, as well as a basis for orderly development of legal rules. Their Lordships, nevertheless, recognise that too rigid adherence to precedent may lead to injustice in a particular case and also unduly restrict the proper development of the law. They propose, therefore, to depart from a previous decision when it appears right to do so."*

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In fact, there have not been many occasions since 1966 when the House of Lords has departed from a previous decision. One major example is ***Herrington v. British Railways Board (1972)*** where the court departed from an earlier decision: ***Addie v. Dumbreck (1929)*** concerned with the duty of care owed to a child trespasser.

Every court is absolutely bound by the decision of all courts superior to itself in rank. The Court of Appeal is bound by its own previous decisions, but the High Court and the lower courts are not bound by their own decisions.

At the lower end of the court hierarchy, the Crown Courts, Magistrates' Courts and County Courts **do not** create precedents.

(b) Conditionally binding

While a lower court cannot question the decisions of a court of superior authority, it is not bound to accept the judgment of a court of equal status. Generally speaking, however, conditional precedents will be followed by courts of equal status, unless they are clearly undesirable. Consequently, in course of time, conditional precedents acquire almost absolute authority and, being followed by subsequent decisions, ultimately become binding.

(c) Persuasive

Persuasive precedents are those that do not intrinsically establish the law, but may be followed by courts because they are considered truly to state the law. There is no obligation to follow them. Examples of such precedents are:

- The decisions of inferior courts on superior courts
- The decisions of the Judicial Committee of the Privy Council in appeals from the Commonwealth or any English court
- The decisions of other courts of the Commonwealth
- Foreign judgments
- Statements of law by British judges, which go beyond the case in point – these are called *obiter dicta* (remarks by the way).

The ratio decidendi, or the principle on which the decision of a judge is based, must not be confused with the opinions expressed by him or her either to explain or illustrate the law. Judges express the reasons for the formation of their decisions and this process of reasoning is a vital part of the precedent. Their obiter dicta, however, have no binding force but have persuasive opinion only, the value of which depends upon the reputation of the judge in question. Obiter dicta pronounced by judges in the House of Lords, for example, carry great persuasive authority.

(d) Declaratory and original precedents

A further distinction is often referred to – declaratory precedents, which merely declare the existing law and original precedents, which, by applying a new rule, create or make new law. The old theory was that all precedents are declarations of customary law but, as we have seen, the common law is not, by any means, customary only. Moreover, as regards the principles of equity, these were not to be found in either custom or statute, but had their source entirely in judicial decisions, the various Chancellors making new law in their judgments.

Strictly speaking, there is no fundamental contradiction between the "declaratory" and the "original" theory of precedents. Precedents both declare the law and make it. Every legal decision is a step forward in the development of the law. Even when judges profess openly that they are merely declaring the law by applying an acknowledged rule, since no two sets of facts are precisely the same, the judges by

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their decisions are adding to the existing rule and, therefore, are developing the law as they administer it. Therefore, precedents are declaratory as being evidence of old law, but are original as sources of new law.

(e) Extending and "distinguishing" precedents

We must note another factor which makes for flexibility under the doctrine of precedent (and sometimes, perhaps, for uncertainty and the possibility of confusion). Judges have some latitude to modify the effects of even authoritative or absolutely binding precedents by "extending" the effect of a decision of which they approve, and by restrictively "distinguishing" precedents of which they disapprove.

As an example of the latter we may consider the case of ***Priestley v. Fowler (1837)*** which laid down the rule that a master should not be liable for injuries suffered by his servants in the course of their employment if the injury was caused through the fault of a fellow-servant. This **doctrine of common employment** as it came to be called, was from the outset unpopular with lawyers and it became increasingly disliked. The judges were bound by the decision, but they restricted its effect by confining its application as far as possible. (The doctrine was modified by statute in 1880 and finally abolished by the **Law Reform (Personal Injuries) Act 1948.**)

A precedent is said to be "distinguished" when the court sitting to decide a later case finds that the facts of the case before it are sufficiently different from those of the original precedent to make the precedent inapplicable. Since the facts of no two cases can be exactly alike, you will see that the power given by this device is a considerable one.

Conversely, when a precedent is regarded by lawyers as being desirable and beneficial in its effect, judges may be persuaded to enlarge its application as far as possible by extending the principle concerned to cases where the facts are not strictly similar.

Reversal, Overruling and Disapproval of Precedents

You will appreciate, therefore, that the effect of "distinguishing" is that a precedent may not continue to be binding indefinitely. A precedent can also cease to be binding and a judge can refuse to follow it as a result of:

- **Reversal**: the decision of the case is reversed on appeal because the appeal court disagrees with the principle laid down by the lower court and finds for the other party.
- **Overruling**: where similar facts come before the court in a later case, then the higher court may decide the case on a different legal principle, thus "overruling" the previous precedent. A precedent may also be overruled by a subsequent statutory provision which reverses its effect.
- **Disapproval**: where a higher court in a judgment expresses doubts about the validity of a previous rule but does not expressly overrule it.

Advantages and Disadvantages of Case Law

We can now set out the comparative merits and defects of case law.

The **advantages** are:

- Case law is practical and concrete; this is because it is the product of a set of facts upon which a decision must be reached. It is not the result of academic theorising, but of actual everyday difficulties.
- It is more flexible than legislation. Further, because of its binding nature, people can regulate their conduct with confidence in its certainty.

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- It is more easily and quickly made than legislation, and this is particularly important where adaptation of the law to minute differences of circumstances is required.
- It acts as the best preparation for statute law. Codifications such as the **Sale of Goods Act 1979** and the **Bills of Exchange Act 1882** are the outcome of judicial decisions, and are models of statute law.
- Its detail is much richer than any code of law (but against this must be set its complexity).
- Unlike statute law, there is harmony between new precedents and existing law, which grow concurrently.

The **disadvantages** can be listed as follows:

- It is not made by the community but by the judges. However, Parliament can, and does, overrule judicial decisions, and the judges are strictly impartial and highly expert – probably more so than a body of legislators.
- As case law adds an increasing number of exceptions to unwanted rules, it is notorious for its bulk and complexity. It is a difficult form of law to handle but, as legislators now endeavour to anticipate judicial decisions, the statute law itself tends to become more bulky and involved, too.
- Case law is often criticised as being retrospective in effect or "*ex post facto*". Theoretically, of course, judicial decisions merely give effect to principles that have always existed in the body of the law. This peculiarity does not always operate fairly, for a decision may upset long-standing interests by its retrospective operation.
- Finally, it is difficult to disentangle that part of the judicial decision which is strictly a binding source of law (the *ratio decidendi*) from "things said by the way", i.e. *obiter dicta*.

  Hypothetical opinions are to be carefully distinguished from the material facts of the case on which the decision, via judicial reasoning, was based. Material facts are those that influenced the tribunal in its conclusions; these are the essential parts. Other facts not relevant to the *ratio decidendi* must be disregarded.

  When precedents are quoted against precedents in cases where the facts are similar, the precedent with the greater number of material facts similar to the case in dispute is normally followed. Naturally, this balancing of precedents is a highly difficult and technical process and, even when this complicated process has been completed, a higher tribunal may later reverse the accepted authoritative precedent, which may have been of an inferior court. This makes for uncertainty in the law. To the above must be added the fact that reports differ in accuracy, intelligibility and completeness.

Law Reporting

The system of case law, as you will see, depends on there being available accurate reports of all the important decisions of the superior courts. A full law library runs to some thousands of volumes of reported cases, with all of which the practising lawyer is, in theory, familiar. (In practice, of course, the best that even the best lawyers can achieve is to know how and where to seek the authorities they require.)

The earliest period of reporting is that of the Year Books, from 1283 to 1535. Many were written in "law-French", the language of medieval lawyers. Today, they are of more interest to the legal historian than to the practising lawyer, because it is not often necessary to go so far back for an authority.

From 1535 to 1865 was the period of "private" law reporting. Barristers and judges would report and publish cases considered to be of legal interest, and the law reports of this period

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are "labelled" according to the name of the lawyer reporting them. Like the Year Books, these reports are somewhat uneven in quality: the reports of the famous Sir Edward Coke, covering the years 1572 to 1616, enjoy very high repute.

In 1865, the period of "official" law reporting began, with the creation of the **General Council of Law Reporting**. The Council is responsible for issuing reports of important decisions of the superior courts, and these are labelled according to the year and the court making the decision. The official reports are "authorised", i.e. the barrister making the report must submit his/her notes for examination and amendment by the judge making the decision. However, private, commercially sponsored reports continue to be issued and enjoy considerable popularity among law practitioners and students.

C. NATURE OF EQUITY

Definition

In Study Unit 1, we briefly mentioned the fact that the type of law administered in the Court of Chancery is known as "equity". This word is derived from the classical Latin "*aequitas*", which meant fairness or reasonableness. In its practical application, "*aequitas*" signified the following of the spirit of the law, as opposed to the strict letter, and connoted reasonable modification of the letter of the ordinary law, which was based upon the moral rules of a former age.

As we saw, the common law was administered in the old royal courts and, because its rules were rigid, its strict application led, in many cases, to injustice and oppression. Thus, legal justice could be obtained in the royal courts, but where the rigidity of the common law worked unfairly or provided no remedy, an appeal was made to that higher justice called "equity", which resided in the King, as the "fountain of all justice". Thus, the King's residuary power permitted him to temper the inflexibility of the ordinary law and to do justice according to reason, good faith, good conscience and the current ideas of morality, when he was petitioned so to do.

We may define equity as

> *Those principles of natural justice administered at first by the King-in-Council, and later by the Chancellor, first as a member of that Council and afterwards as an independent judge, to correct and supplement the common law.*

It is, therefore, purely case law and its principles are essentially judicial but they were developed, you should remember, to mitigate the defects of other judiciary law.

History

As you are probably aware, a writ (now called a Claim Form) is the first step in an action arising out of a civil wrong. Very early in the Norman period, the King issued his will in matters of justice by executive orders in writing, the authenticity of which was certified by the Royal Seal. The Chancellor kept the Seal and, with his clerks, wrote out the writs and sealed them. He was, at first, quite a lowly person, being the chief domestic chaplain of the King, and doing the secretarial work. Being an ecclesiastic, he was the "keeper of the King's conscience", and represented the "moral attitude" of the Crown. During the 12th and first part of the 13th centuries, the number of writs grew very rapidly, and they were really an authoritative statement of the common law. In effect, these writs constituted a collection of legal remedies to be obtained from the King by persons applying for them.

The Chancellor, whose duties were at first secretarial, began to frame writs on his own authority. As the issue of a new writ was equivalent to the creation of a new legal right, the judges naturally resented this. The power of the Chancellor was checked first by the judges quashing his new writs, and secondly by the **Provisions of Oxford 1258**, which enacted:

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> *"The Chancellor will seal no writ, excepting writs of course, without the command of the King-in-Council".*

The net result was that the common law became more rigid and the rules operated unjustly. An attempt was made to remedy this by the **Statute of Westminster 1285**, by which the Clerks in Chancery, the secretariat of the royal courts, were authorised and encouraged to extend the range of the law to meet the needs of altered or fresh circumstances, by framing special writs modelled on existing cases. However, the common law courts, which had power to decide whether a writ was good or not, failed to take full advantage of the provisions for extending the law and many further cases of hardship and injustice occurred.

As a consequence, suitors began to address petitions to the King, which were referred to the Chancellor. Finally, petitions were addressed direct to the Chancellor, who took upon himself to remedy the wrong. This judicial activity of the Chancellor commenced at the end of Edward III's reign. In time, the Chancellor sat alone, and disobedience to his decrees and orders was punishable as special contempt of the King's authority. As a result, the Chancellor came to be recognised as a judge, apart from the common law judges, administering justice on equitable principles.

Basis

The basis of the equity administered by the ecclesiastical Chancellors was conscience, and this led in some cases to principles and conclusions opposed to the rules of common law. Abstract justice could be done in individual cases, even though it meant dispensing with the law of the state. The seeds of friction between the Chancellor and the common law judges were sown and differences, in time, became acute.

Superiority of Equity

What was the weapon the Chancellor used when petitioned? If he considered the petitioner had a "*prima facie*" (straightforward) case, he issued a writ of subpoena, which was an order addressed to the defendant, requiring him to appear before the Chancellor and his Council on such a day, in his proper person, under a penalty (subpoena) of so much, to answer on oath what should be objected to him. When he appeared, the defendant was subjected to a searching examination on oath. The Chancellor dispensed with juries, and tried the whole case himself. The procedure was inquisitorial. If he decided in favour of the petitioner, he did not pronounce "guilty" but issued a decree ordering the defendant to perform certain acts, or to refrain from certain acts, such as insisting on his legal rights, under penalty of imprisonment.

This procedure was much more flexible than the limited remedies afforded in the common law courts, with their highly technical system of writs, pleadings, juries to decide questions of fact, and the inflexible rule that a party to an action could not give evidence.

Thus, the Court of Equity was markedly superior in its procedure and remedies, and it is not surprising that it attracted much business with which it could not keep pace, despite the later appointment of a Master of the Rolls, and other staff, and the erection of new courts of equity. There were frequent complaints about the slow procedures and delays.

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D. APPLICATION OF PRINCIPLES OF EQUITY

Uses (Trusts)

One of the earliest subjects falling within the Chancellor's jurisdiction was **uses**, or trusts of land.

Under the feudal system, the King was the supreme and ultimate land-owner – everyone held their land, in the last resort, from him. In return, the land-holder rendered to the King certain services, e.g. the provision of a number of men at arms, agricultural produce, and so on. As society became more developed in the Middle Ages money became more important, and there was a growing tendency to change the service into money. By far the greater proportion of the feudal service became money dues although, strictly speaking, they were neither taxes nor rates.

Although there are records of uses having been created even before the Norman Conquest, the only uses found for some time after the Conquest appear to have been merely temporary uses, e.g. while a man was on a crusade. In about 1225, the Franciscan friars came to England. The rules of their order prevented their owning property, so land was conveyed, for example, to some town to the use of the friars. After this, uses of a permanent nature became more common, and by the middle of the 14th century they were frequent.

The common law refused to recognise the validity of a device of land (a device being a gift of land by will), and it was held that the number of writs in the case of land law could not be increased. The land-owner therefore turned his attention to the use. He conveyed his estate to a trusted friend who was to hold it, not for his own benefit, but to carry out the instructions given by the transferor. In legal terms, the land was formally conveyed to certain trustees, who were called **feoffees**, to the use of the grantor's beneficiary, who was usually called the ***cestui que* use**, (the person for whom the use is). The **feoffees to uses** became the legal owners and were the only tenants recognised by the common law courts. The beneficiary could only rely upon their good faith, and since uses were not incorporated into the common law, he could not make a dishonest feoffee carry out his trust. Redress, therefore, had to be sought elsewhere, in order to secure the enforcement of these obligations.

Petitions for this form of redress were finally, in the 14th century, directed to the Chancellor who, by the early 15th century, decided to protect the interests of the *cestui que* use. Their beneficial interests were, through equity, enforced against the original feoffees to uses, and further, by extension, against the feoffee's heirs and even against a purchaser with notice of the trust, although the purchaser of the legal estate with no such knowledge was not affected. Thus, equitable interests affecting the legal ownership of land were admitted as binding all who came to the land except as *bona fide* purchasers of the legal estate without notice of the equitable interests.

The Statute of Uses

A division of ownership into legal and equitable interests came about because the Chancellor had created interests in equity unknown to the common law. However, in 1535, Henry VIII, finding that the increased frequency of uses deprived him of the revenue arising from the incidents of feudal tenure, forced through Parliament the Statute of Uses, to avoid such losses. This statute attempted to abolish the distinction between legal and equitable ownership. The *cestui que* use was held to be vested with the legal interest in the freehold, the "use" merely operating to transfer to the beneficiaries the legal estate. Hence, the beneficial owner was now **seised** (feudally possessed) of the land as a legal estate and was subject to its common law burdens and incidents.

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Two types of equitable interest remained unaffected:

- Uses of personalty including leaseholds
- "Active" uses, where the trustee needed the legal estate to perform active duties, like collecting rents to pay a cestui que use.

These two exceptions were the basis of the modern trust.

However, in the concept of equitable ownership there followed the new development of a use upon a use. This was not frequent until after 1535. By this procedure, A gave lands to the use of B to the use of C, i.e. B was to hold them for the "use" of C. In ***Jane Tyrell's Case (1557)***, the common law courts decided that there could be *"no use upon a use"*, so that B got the legal estate by virtue of the common law and C took no interest.

After the abolition of the incidents of feudal tenure in 1660, however, the Crown had no further interest in the prohibition of equitable ownership. The courts of equity took the view that it would be unjust to allow B to retain property not belonging to him, and they began to enforce the second use. B, though seised of the legal estate, was deemed to hold to it upon trust for C.

There was thus resurrected the doctrine of equitable ownership, but with a change of name. The new relationship was a **trust**, the legal owner a **trustee** and the old terminology was gradually dropped. In other words, the Statute of Uses became a dead letter and the jurisdiction of Chancery over equitable ownership was completely acquired under the name of trusts, and equitable rights in land again developed and flourished.

Mortgages

A very important body of doctrine was built up by the Chancellor in connection with mortgages. A mortgage of land is only security for the payment of money lent upon it. Such mortgages had been common since the early Middle Ages. It is sufficient here to note that the borrower conveyed his land to the lender (the **mortgagor** to the **mortgagee**) and a day was named in the mortgage deed for the repayment of the mortgage money, generally six months from the date of the conveyance. In the deed, there was a proviso for redemption whereby the mortgagee – who had the legal ownership – agreed to reconvey the land if the money were repaid on the stipulated date. Often, mortgagors were unable to repay on the date named. The result was that the right of redemption was lost for ever. The common law would not and could not help the mortgagor.

Equity interposed and insisted on the **real intention of the parties being adhered to**. In the Chancellor's view, the land was only conveyed as a mere security for the loan. Though the legal right of redemption expired with the date of repayment, an equitable right of redemption arose immediately after such expiry. The mortgagor had a new kind of equitable ownership – he had his **equity of redemption** – and he resembled a beneficiary under a trust. This equitable right he could sell, devise by will, settle, or mortgage again, and he could only lose it after the Court of Chancery had given him ample time to repay. Thus, when application was made to the Court of Chancery to "foreclose", as it is called, the mortgagor was given a last chance by an order "nisi", i.e. unless he paid within a stated time, he lost for ever his right to redeem.

Specific Performance

Another function of Chancery arose in connection with the remedy called **specific performance**. By specific performance we mean compelling a person to carry out a contract he/she has actually entered into. If A agreed to sell a house to B for £45,000 and then had another offer of £45,500, A might sell the house to the higher bidder, breaking the bargain with B. The common law remedy for every such wrong was **damages**. However, suppose B really needs that particular house. In that case, he would prefer a bill in equity

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and the Court of Equity could order A to sell the house to B on pain of imprisonment if A refused.

Injunctions

An **injunction** is an order, granted by the court, preventing an unlawful act. For example, A hears on good grounds that B is about to erect a building near A's own, interfering with A's right to light for his windows. The common law could not prevent B from doing this, but could award damages after the damage was done, i.e. when the light was blocked up. Equity could prevent B from building in such a way, and could compel her to pull down the objectionable wall, or house.

Other Reliefs not Available at Common Law

The Chancellor gave relief against fraud, mistake, accident (especially the accidental loss of a document), breach of confidence, and general inequitable dealing where the inflexibility of the common law worked harshly.

E. EQUITY AND COMMON LAW

Relationship of Equity and Common Law

The origin of the equitable system of granting injunctions can be traced to Henry VI's reign. By the time of Elizabeth I, the now popular Court of Chancery was at variance with the common law courts, and in the early 17th century a quarrel broke out between Chief Justice Coke of the Court of Common Pleas and Lord Ellesmere (the Lord Chancellor), on this subject of injunctions.

In 1616, James I supported the Chancellor, and laid down by statute that, **where the rules of common law and equity conflicted, the latter were to prevail**.

From that time, the rights of the Chancery were rarely disputed and it was a court of equal, and in some subjects, superior authority to the common law courts.

Thus, a more important stage in equity's development was begun. Previously, equity had been a set of principles, based on conscience, or Roman law, or canon law which assisted, supplemented or set aside the law in order to do justice in individual cases. Henceforth it tended to become a more settled system of rules, which supplemented the law in certain defined cases. Thus, the various rules of equity hardened into a definite body of legal doctrine, and by the 18th century the modern English system of equity was finally established.

At length, by the passing of the **Judicature Acts 1873** and **1875**, the Court of Chancery, together with the common law courts, was abolished and the two rival systems of common law and equity as administered on different principles came to an end. The Supreme Court of Judicature was established for the common law and Chancery courts. Every judge has both a common law and an equity "mind". The principle established by the statute of 1616 was retained and where there was any conflict between the rules of equity and those of the common law, the rules of equity should prevail. Notice that though there is still a Chancery Division, the common law courts must administer the law in accordance with the principles of equity, all courts administering common law and equity concurrently and equity prevailing in case of a conflict.

However, always remember that the **Judicature Acts** fused only the **administration** of common law and equity. The two branches of law themselves were **not** fused; they remain and still remain, **distinct and separate**. Maitland, the great historian of equity, wrote:

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"The two streams (of common law and equity) have met, and now run in the same channel, but their waters do not mix".

Contribution of Equity to English Law

Equity has made the following chief additions to the common law:

(a) Trusts and settlements in respect of property

(b) The doctrine of "undue influence" in respect of contracts

(c) Property for the separate use of married women which the common law did not recognise, but which is now statutory

(d) Superior remedies, e.g. specific performance or an injunction, instead of simply "money compensation".

Eventually, equity became almost, but not quite, as rigid as the common law it had replaced and its place, as the vehicle through which newer and better rules were introduced into English law, was taken by legislation.

At one period it appeared that just as the rigidity of the common law had in the first place necessitated the development of equity, so equity itself had reached a state of inflexibility and that legislation would henceforth be the only method of bringing about changes in the law. However, this was never completely true and recent years have seen the emergence of what is sometimes called "new equity", a development that is especially associated with the name of Lord Denning. For example, later in this course we shall see how, in the famous case ***Central London Property Trust Ltd v. High Trees House Ltd (1947)*** he applied equitable principles to modify considerably the effect of the common law doctrine of "consideration" in the law of contract, where the doctrine appeared to be resulting in injustice.

F. CLASSIFICATION OF EQUITY

We can divide equity jurisdiction into three classes.

The Exclusive Jurisdiction

This jurisdiction covers matters of which the old common law took no notice. The great example is the enforcement of trusts, with which we have already dealt.

The Concurrent Jurisdiction

This covered cases which were known to the common law but which the Court of Chancery was inclined, in some instances, to recognise.

Matters of contract would come within this category where the only defence to the claim was one recognised in equity. For instance, if A sued X in the Court of Common Pleas upon a contract, and X's defence was one of misrepresentation, or undue influence, defences which the Court of Chancery had developed, X could apply to the Chancellor for an injunction (called the **common injunction**) prohibiting A from continuing his action at common law, or if A had already obtained judgment in the action, from enforcing the judgment by levying execution upon it. This would force A into the Court of Chancery, if he wished to proceed with his claim against X, when X would be able to raise his equitable defence to it.

It was the concurrent jurisdiction, and the issue of the common injunction by the Court of Chancery, which gave rise to the quarrel during the reign of James I between Lord Ellesmere, the Chancellor, and Chief Justice Coke of the Court of Common Pleas (see earlier).

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Since the Judicature Acts 1873-75, the common injunction has disappeared. Now that all courts administer the common law and equity together, equity prevailing where there is any conflict between the two systems, a defendant can always raise his/her equitable defence to a common law claim in any court. Hence, the need for the common injunction has gone.

It is not often that a conflict arises between the common law and equity because, for the most part, the two systems deal with different matters, but in the concurrent jurisdiction of equity conflicts may be met with. You can find an example of such a conflict after the passing of the Judicature Acts in the case of ***Walsh v. Lonsdale (1882)***. There was a lease of a mill for seven years. At common law the lease should have been in seal; in equity, all that was required was a written lease, though not under seal. The lease in question was in writing, not under seal. Therefore, it was held valid as equity was to prevail in cases of conflict.

The Auxiliary Jurisdiction

Here, equity helped out the common law with new remedies and machinery which was lacking. Instances of this jurisdiction were as follows:

- Injunctions and order of specific performance of contracts
- The subpoena of witnesses
- Rectification and cancellation of documents.

In connection with the administration of the separate systems of common law and equity, prior to the passing of the Judicature Acts 1873-75, great inconvenience was caused to litigants by the fact that the common law was administered in one set of courts, while the system of equity was administered in a totally different tribunal, namely, the old Court of Chancery.

If the action was before the Court of Common Pleas, for instance, in order to obtain a subpoena to summon a witness it was necessary to apply to the Court of Chancery. If one party wanted what was known as "discovery of documents", now known as Disclosure, from his opponent, i.e. an order that he set out on oath a list of the documents in his possession relevant to the case, he had to make application for an order of discovery of documents to the Chancellor.

Now that common law and equity are administered together in all courts, the litigants do not experience the inconvenience which formerly existed when the two systems were administered in different courts.

G. LEGAL AND EQUITABLE RIGHTS

Equitable rights or remedies such as injunction and specific performance are purely **discretionary**; in contrast to remedies at common law or under statute, they are never granted as of right. To that extent, it is not strictly accurate to refer to equitable "rights". They are entirely at the discretion of the court, although in the course of time that discretion has come to be exercised judicially according to precedent. In the ***High Trees House Case***, such discretion was exercised where the rigid observance of the common law doctrine of "consideration" would have resulted in great injustice. In other cases e.g. ***Walsh v. Lonsdale***, equitable rights have been granted where equity and common law were in conflict.

Note that equitable rights or remedies are not self-sufficient and depend on the prior existence of the common law. They developed essentially as devices for rectifying the anomalies and injustices caused by the strict application of legal rights. Without the common law, equitable principles would be unrelated and largely irrelevant.

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H. NATURE OF STATUTE LAW

History

Statute law, often called **legislation**, as we have already seen, is written law enacted by the approved legislative process of the state. A statute is also called an Act of Parliament.

Under the Normans and early Plantagenets, statutes were promulgated by the King, usually at meetings of the Great Council. Its assent to these was only a matter of form, since it was the King who really made the laws.

From the reign of Edward I, representative Parliaments began to develop, for the Model Parliament of 1295 contained not only the royal tenants-in-chief but also representatives of the shires and boroughs, summoned collectively through the sheriffs.

In the early Parliaments, the process of legislation involved the members presenting petitions to the King which were either accepted and promulgated as law or reserved by the King for his further consideration.

Under Edward III, Parliament began to meet in two separate Houses, the Commons and the Lords, and the idea began to grow that statute law should be enacted by the King-in-Parliament. However, Kings still insisted on their right to promulgate legislation without Parliament and it was not until the **Bill of Rights 1689** that the principle of the sole legislative authority of the King-in-Parliament was accepted. Officially, the monarch still has the power to refuse assent to Bills presented by Parliament but this veto was last exercised by Queen Anne in 1707 in regard to a Bill for "*settling militia in Scotland*". The royal veto is unlikely to be exercised these days, except perhaps in some extreme crisis.

Records of Statutes

The early statutes were entered on **Statute Rolls**, which provide the authority for them although, in some cases the original document also survives. The earliest of these Rolls begins with the **Statute of Gloucester 1278**, which limited the jurisdiction of the local courts in civil suits. Between 1278 and 1445 there are six of these Rolls and they are known as the **Great Rolls of the Statutes**.

With the ending of the Statute Rolls we have "enrolments of Acts of Parliament", certified and delivered into the keeping of the Lord Chancellor. There is a continuous series of these running from 1483 until the present day.

From the time of Henry VII, it became the practice for printed copies of statutes to be distributed by the King's Printer and from the 18th century it has been a legal requirement that copies should be distributed throughout the country.

During the 13th and 14th centuries, a statute was cited either by the name of the place where the Council or Parliament sat, e.g. the Statute of Gloucester; by the first words of the statute itself, e.g. Quia Emptores 1290; or according to the object of the statute, e.g. the Statute of Labourers 1349. From the 14th century onwards, when Parliament normally sat at Westminster, statutes were cited by the date of the year of the reign of the sovereign in which the statute was passed, e.g. 24 George 2 stands for the 24th year of the reign of George II.

Most modern Acts of Parliament contain a short title and are usually quoted by their title and the year in which they were passed, e.g. the Criminal Procedure Act 1961.

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The Sovereignty of Parliament

- **Historical importance**

  In view of the disuse of the royal veto Parliament can be said to be the sovereign power in Great Britain and, since by the **Parliament Acts** the Commons can, in most cases, overrule the Lords, the House of Commons in practice exercises this sovereign power. The sovereignty of Parliament means that Parliament possesses unlimited power to legislate upon any topic and to change any existing law or statute.

  Moreover, the validity of the statute so made can never be discussed in a court of law. Thus, the sovereignty of Parliament in English law is unquestionable, the unlimited legislative power of Parliament being the rule of English constitutional law. (However, you should note the effect of the **European Communities Act 1972**, on the doctrine of the sovereignty of Parliament.)

  If there are any practical limitations, they are dictated by the procedure Parliament has developed, in accordance with which it considers Bills presented to it and decides by a process of successive "readings" and "inquiries in committee" in both Houses on the form which should be presented for the royal assent. When the measure has received this assent, it becomes a source of law.

  By Parliament we mean "the Queen-in-Parliament", i.e. the legislature. A Bill passing both Houses and getting the royal assent thus becomes an Act (or statute).

  A Bill may be introduced in either the House of Commons or the House of Lords. In either case it will pass through the formal **first reading** to the House (after which it is printed); **second reading** which involves a debate on the broad principles and purposes of the Bill; **committee stage** consisting of a detailed debate and possible amendments by a special committee of members; **report stage** when the committee reports its findings to the House; and **third reading**, when only verbal alterations may be proposed. It will then **go to the other House** for the same process, after which it **goes to the Queen** for the Royal Assent and becomes an Act of Parliament.

  The effective powers of the House of Lords are now very limited as regards legislation. Once a Bill has passed through the House of Commons and the House of Lords has made amendments, those amendments must be returned to the House of Commons for its approval. The **Parliament Act 1911** provides that any Bill which has been designated a Money Bill (proposing a charge on the public revenue) must be introduced in the House of Commons and having been passed by this House, **must be passed by the House of Lords without amendment within one month** of the time it is received by the Lords. Should the House of Lords fail to pass the Bill, it will nevertheless receive the royal assent and so become law without their consent.

  The **Parliament Act 1949** further diminished the direct power of the House of Lords in relation to **public Bills concerned with matters of public importance**. Once a public Bill has passed through the House of Commons in two successive sessions (i.e. years of sitting) and has been rejected by the House of Lords in each session, it may nevertheless be presented for the royal assent without the agreement of the House of Lords.

- **Significance of the European Communities Act 1972**

  This Act, together with the Treaty of Accession, came into force on 1 January 1973, and makes the necessary alterations to existing English law to enable the UK to comply with the obligations entailed in membership of the European Union. The Act gives the force of law in the UK to existing and future EU law which, under the Community Treaties, is directly enforceable in the member states.

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The effect of this Act and the later **European Communities (Amendment) Act 1986** has been to limit considerably the scope of the doctrine of the sovereignty of Parliament. In 1962, in its judgment in the historic case of ***Van Gend en Loos***, the European Court of Justice declared that: *"The Community constitutes a new legal order ... for the benefit of which the (member) states have limited their sovereign rights"*. The total supremacy of Community law was upheld by the European Court of Justice in another notable case – ***Costa v. ENEL (1964)***. Section 2(1), **European Communities Act 1972**, gives direct legal effect in the United Kingdom to those parts of the EU legal order intended to have direct effect, and the primacy of EU law as a whole is achieved by Section 2(4) of the Act. As a result of UK membership of the EU, the sovereignty of Parliament as a legislative body has been subordinated to EU law, and to the legislative authority of both the EU Commission and the Council of Ministers.

We have already emphasised that EU legislation is now a written source of English law. The **Treaty of Rome** and its implementing statutes now override English law.

An example of this aspect is to be found in Article 85 (now Article 81) of the Treaty of Rome, which states that:

"the following shall be deemed to be incompatible with the Common Market and shall be prohibited; all agreements between enterprises and any concerted practices which are likely to affect trade between member states and which prevent, restrict or distort competition within the Common Market".

The Article is wide enough to affect many normal commercial agreements which fix prices in secure markets. As a result, many such arrangements have been prohibited under the EU law, since they prevent fair competition within the Common Market.

A major effect of UK membership of the European Union has been an increasing move away from case law towards legislation. There has been much emphasis on the interpretation of EU directives and regulations. Interpretation tends to follow the broader Continental techniques, rather than the narrower English approach.

- **Changes to the House of Lords**

  Significant changes were made to the composition of the House of Lords in 1999 by the removal of the voting rights of the majority of hereditary peers.

I. INTERPRETATION OF STATUTES

When a statute is passed in due form, supposedly perfected, it has to be interpreted and applied. Theoretically, this should be easy, for all that has to be done is to apply "the letter of the law". Many statutory measures, however, if so interpreted, would produce interpretations wholly inconsistent with the purpose of the statute; injustice, ambiguities, and unreasonableness never intended by Parliament. Judges, therefore, have a twofold task. They must decide upon the exact meaning of what the legislature has said, and they must consider what the legislature **intended to say**, i.e. the true intention of the law.

The function of interpreting statutes confers upon the judges a considerable amount of power to modify the effect of legislation. We saw earlier that judicial precedents may be extended or restrictively "distinguished", according to whether their effect is liked or disliked. In a similar way, judges, at least in past times, have construed statutes either liberally or restrictively, according to the view they took of the statutes. Thus, it was formerly the rule that **remedial statutes** (those passed to remedy defects in the common law) should be interpreted extensively or liberally, while **penal statutes** (those imposing punishments) and statutes imposing taxation should be interpreted as restrictively or narrowly as possible.

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Rules of Construction

The judiciary interprets statutes by following certain rules of construction.

(a) The literal rule

Application of the literal rule involves interpreting a statute literally, according to its ordinary plain meaning. ***Fisher v Bell (1960)*** could be considered. The literal rule might be said to be the default position. But the judges will commonly use a more purposive approach (the golden or mischief rules), especially where the legislation seeks to implement a social policy such as the outlawing of sex discrimination. ***Pickstone v Freeman (1988)***.

In ***Fisher v Bell (1960)*** a shopkeeper displayed in his window a flick knife with a price ticket and was prosecuted for offering for sale an offensive weapon contrary to the Restriction of Offensive Weapons Act 1959. The Divisional Court said the phrase "offer for sale" was to be taken literally, in accordance with its meaning in contract law and that the defendant's display of the weapon was no more than an invitation to treat.

In ***Re Rowland (1962)*** a man going to the South Pacific made a will leaving everything to his wife, but "if her death precedes or coincides with mine" then to his brother. Shortly afterwards, both him and his wife were lost at sea and the question for the court was whether their deaths should be treated as coinciding.

Lord Denning, dissenting, in the Court of Appeal said that "coincide" should be given the meaning that the dead man must have intended: "on the same occasion", or something like that. The situation that had arisen was clearly the one the testator had in mind when making that provision in his will, because no two deaths are ever exactly simultaneous.

This rule, is applied in the least difficult cases, unless the use of the literal meaning of a statutory provision would lead to an absurdity.

(b) The golden rule

This rule is really to be read in conjunction with the literal rule, and its effect is best explained by Lord Wensleydale in ***Grey v. Pearson (1857)***:

> *"The grammatical and ordinary sense of the words is to be adhered to unless that would lead to an absurdity or repugnancy or inconsistency with the rest of the instrument, in which case the grammatical or ordinary sense of the words may be modified so as to avoid such absurdity, repugnancy or inconsistency and no further."*

The golden rule is applied if the application of the literal rule would result in an absurd interpretation. An absurdity may arise from a literal meaning of the words, as evidenced by Adler v George (1964). Alternatively, it may arise from the policy implications of a literal interpretation: Re Sigsworth (1935). In cases where the literal interpretation of a statute leads to an absurdity modifications are carefully made in order to determine to a less obvious meaning of the words contained in an Act of Parliament.

In ***Adler v George (1964)*** a protester was convicted by magistrates, of obstructing a sentry "in the vicinity of a prohibited place", contrary to Section 3 of the **Official Secrets Act 1920**. He appealed on the grounds that since he was actually inside the prohibited place at the time he could not be in its vicinity. The Divisional Court dismissed his appeal. It would be extraordinary, said Lord Parker CJ, if the statute created a serious offence when obstruction occurred just outside a RAF station but no offence at all when it occurred inside. The words "in the vicinity of" should be construed as meaning "in or in the vicinity of".

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The **Offences Against the Person Act 1861** made it an offence to marry another partner while already married and the defendant was prosecuted under this Act. He claimed that since his second "marriage" was not legally valid, he had not committed the offence defined. The Court said the phrase "to marry" was capable of more than one interpretation: it could mean "to enter lawful matrimony with" or "to go through a form of marriage with". Parliament could not have intended to create an offence that it was logically impossible to commit, so the second interpretation was the one to be preferred: ***R v Allen (1872)***.

(c) The ejusdem generis rule

This literally means "of the same kind". Under this rule, if there is a series of particular words followed by a word of generality, then the category into which the particular words fall will not be extended by the words of generality. For example, if a statute covered *"a house, bungalow, chalet or any other place"* it would not, for example, affect open spaces, because the particular words all relate to covered buildings.

A further example is the case of ***Powell v. Kempton Park Racecourse Co. (1899)***. The **Betting Act 1853** prohibits the keeping of a *"house, office, room or any other place for betting with persons resorting thereon"*. The House of Lords **held** that the words *"any other place"* meant a place similar to a house, office or room and would not, therefore, apply to Tattersall's ring on the racecourse.

(d) The mischief rule

The mischief rule aims to define the problem that a particular Act of Parliament was meant to remedy. In order to determine what was the problem before the Act received Royal Assent, the courts can look at, for example, reports from the Law Commission and also Hansard (the journal of debates in Parliament). Following this process a judge can choose the interpretation which best deals with the problem before him.

The rule originated in ***Heydon's Case (1584)*** and operates as a limited exception to the general principle that judges must ascertain the intention of Parliament solely from the words of the statute. It was **held** in ***Heydon's Case*** that a judge should consider four things:

- The common law before the passing of the Act in question
- The mischief and defect for which the common law did not provide
- The remedy resolved by Parliament
- The true reason for the remedy.

You can see an early application of the rule in ***Gorris v. Scott (1874)*** where legislation provided that any ship transporting sheep or cattle should provide pens on board for the animals. The defendant shipowner failed to provide pens and, during a voyage from Hamburg to Newcastle, some of the claimant's sheep, which were being shipped, were swept overboard and drowned. In an action for breach of duty imposed by legislation, the court **held** that the purpose behind the statute was to prevent the spread of disease and not to guard against the danger of animals being washed overboard. It followed that the claimant's claim must fail as it did not fall within the mischief which the legislation was intended to remedy.

In ***National Real Estate v. Hassan (1939)*** the rule was applied in a case concerning a statute of 1938, which was designed to prevent the exploitation of tenants by landlords who bought the freehold merely with the intention of suing the tenants for breach of the repairing covenants and reaping large-scale damages. The court had to decide whether the Act was retrospective, i.e. prevented landlords suing, even if they bought the freehold before the Act was passed. The court decided that the intention was to

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deal with this mischief and thus, contrary to usual principles, allowed the Act to be retrospective.

In ***Smith v Hughes (1871)*** a number of prostitutes (the defendants) were charged with soliciting "in a street or public place" contrary to Section 1(1) of the **Street Offences Act 1959**. One had been on a balcony above the street and others had been sitting behind open or closed windows at first-floor level. Upholding their convictions, Lord Parker CJ said this was the mischief the Act was intended to prevent – everybody knows this was an Act intended to enable people to walk along the streets without being molested or solicited by prostitutes – and if the defendants could be clearly seen from the street that was sufficient.

Aids to Construction

The judiciary can also use certain aids to construction when interpreting statutes.

(a) Internal aids

These are matters contained within the statute itself, which will help the judge to interpret its meaning and which can be referred to by him or her.

- **The preamble**

  This consists of the introductory paragraphs, setting out in brief the purpose of the statute.

- **The interpretative**

  One or more interpretation sections are often found within a statute. These have the purpose of explaining the meanings of words or phrases within the statute.

  For example, Section 276, Factories Act 1961 explains in great detail the meaning of the term "*factory*".

- **The section headings**

  These may be referred to in order to see if they clear up any difficulties within the section.

  But note that, since any marginal notes are **not inserted by Parliament**, they cannot be referred to by the judiciary.

(b) External aids

These are matters lying outside the statute which can be referred to by the judiciary.

- **Interpretation Act 1889**

  By this Act, Parliament consolidated a series of standard expressions, the interpretation of which is to be applied generally in the interpretation of Acts of Parliament, unless specifically excluded. For example, words having the masculine gender shall include females, and words in the singular shall include the plural and *vice versa*.

- **Dictionaries**

  English dictionaries can be used to explain the ordinary meaning of terms used in statutes.

  Other external sources, such as textbooks and the Hansard Reports of the proceedings in the Houses of Parliament, may only be used in clearly defined circumstances.

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(c) Presumptions of interpretation

These are presumptions which can be relied on by the judiciary when interpreting a statute.

- Unless clearly stated, an Act of Parliament does not alter the common law. Thus, the common law will not be altered unless this is clear

  For example, ***Sweet v. Parsley (1969)*** which dealt with the interpretation of the **Dangerous Drugs Act 1965**, made it clear that there was a presumption that, if a statute was silent as to the need or otherwise of *mens rea* (guilty mind) before an offence was committed, then *mens rea* was to be proved.

- The Crown is outside the effect of the statute
- The Act applies to the whole of the United Kingdom
- The Act is not retrospective.

Interpretation of EU Legislation

EU legislation in the form of directives and regulations and UK statutes implementing such legislation must now be interpreted by English courts in accordance with the principles of interpretation followed by the European Court of Justice. One of the major principles is that of proportionality. Legislative provisions of the Commission or Council must be proportionate to the intended effect and the court will not accept legislative measures if other, less restrictive, measures would achieve the same purpose.

An important aid to interpretation is the **preamble** of the directive or regulation, since it has to state in detail the reasons which form the basis in fact and in law for its determination. The European Court of Justice also makes use of **academic commentaries** by eminent jurists to assist it in its interpretation of EU legislation.

J. CODIFICATION AND CONSOLIDATION

Codification of a Legal System

Many Continental countries have reduced their law to a single code of laws which have been re-enacted as a single statute. This has the advantage of making the whole of the law of the state into statute law but it has not the flexibility of the English system, which brought together **all** the law (whether statute or case law) **on a particular subject** into one comprehensive code.

England has not attempted any general codification of the law. However, certain parts of the law have been codified by, for example, the **Bills of Exchange Act 1882,** the **Sale of Goods Act 1979,** and the **Theft Act 1968**.

It is undesirable that the law should be codified until it is in a fully-developed state.

Once a codification is effected, there is a tendency for the legislature to go to sleep and the law then ceases to be developed with the growing needs of the times. In France, for instance, the law of bills of exchange was codified prematurely, whereas in England the **Bills of Exchange Act** was not introduced until 1882, when the law had become fully mature.

Even when a codification of the whole legal system has been effected, there is still the difficulty of interpreting the code.

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Consolidation

This is the reduction of a number of statutes into one single statute which repeals the former statutes, the contents of which have been so consolidated – an example of this, is the **Rent Act 1977**. Into this enactment were incorporated the provisions (with some amendments) of the previous 40 years, reforming Acts dealing with house tenants and their rents, etc.

Cases which went to interpret sections of statutes that have been consolidated into a later enactment remain as precedents for the constructing of the consolidating statute, so far as those sections have been repeated in the consolidating statute.

K. APPRAISAL OF STATUTE LAW

Advantages

- Statute law can both make new law and abolish obsolete or bad law.
- As it originates from a legislating body, separate as such from the judicature and superior to it, law making in this way provides for an advantageous division of labour.
- The law is known before it is enforced. (This is not entirely true for some statutes were "*ex post facto*", i.e. penalise past acts, or validate past breaches of the law.)
- It is not dependent on the accident of litigation but can come into force at any time to repair a defect in the legal system, without waiting for a case to arise on it.
- Statute law is, theoretically, clear and easily accessible, ready for immediate use, and embodied in an authoritative formula.
- It is less bulky than case law or precedents.
- It can systematise, by intelligible codification, the complex rules of case law.

Disadvantages

- Very often, in an effort to formulate a comprehensive statute, the resulting enactment is diffuse and vague. This means that the judges, in their task of enforcing the law, are compelled to exercise great pains and ingenuity in interpreting the words of the statute.
- The advantages of certainty and definiteness may be outweighed by conservatism or archaism. In other words, a statute is apt to lag behind public opinion in the face of changing circumstances of the age and society. Moreover, many statutes are not always the result of practical difficulties met with, but are the embodiment of academic speculation, and party predilections.
- There is less wealth of detail in a statute but more formality. It may be logically incomplete.
- A statute may do injustice if it applies to a case in a way not foreseen by Parliament.

L. DELEGATED LEGISLATION

Definition

Delegated legislation refers to the exercise of a legislative power, granted ultimately by Parliament, by a subordinate body such as a local authority, a public corporation, the Supreme Court, or a university.

Many modern statutes confer authority upon persons and bodies to issue regulations which are legally binding and which, if disobeyed, may involve those disregarding them in some

penalty. A characteristic of such delegated legislation, however, is that it is only exercised by consent of Parliament, and the powers may be repealed or withdrawn at any time.

Moreover, the exercise of delegated legislation is very strictly interpreted by the courts, which have power to declare regulations so made as "*ultra vires*" (beyond the powers granted) if they do not fall within the statute granting them.

Types

(a) Orders in Council

Although the royal prerogative exercised by the Norman kings of promulgating laws in the Great Council has fallen into disuse, many modern statutes delegate to the Queen-in-Council the power to issue Orders in Council, particularly in times of national emergency.

(b) Ministerial orders and departmental legislation

These consist of the issue of orders and regulations by Ministers or by government departments under powers conferred on them by statute. This type of legislation takes a number of forms of which the following are examples:

- Many statutes merely lay down their purpose in general terms. The details are filled in by orders issued by the Minister.
- In other cases, the Minister is given power to make orders in regard to the subject matter of the statute or to vary or even repeal the expressed provisions of the Act.

A typical example is the **Road Traffic Act 1972** (as amended) which grants the appropriate Secretary of State power to make regulations generally as to the use of motor vehicles on roads, their construction and equipment, and the conditions under which they should be used. In fact, Sections 40 to 50 define the Secretary of State's powers carefully and minutely, specifying the matters on which regulations can be made, provisions for exemption from the rules, testing regulations and so on. The principal regulations made under the Act are the **Motor Vehicles (Construction and Use) Regulations 1978** cited as SI 1978/1017. These contain detailed regulations on brake linings, silencers and construction of petrol tanks, to name but a few elements.

Most of these orders, however, must be laid before Parliament and must either be approved or annulled before coming into operation. Other orders, which are not laid before Parliament, must be published and notice given of where they may be obtained. A considerable number of these statutory powers are governed by the **Statutory Instruments Act 1946**. Statutory Instruments are the most important form of delegated legislation and include all Orders in Council and all those orders which have to be laid before Parliament.

There is often a statutory duty to consult other bodies (e.g. trade unions and trade associations) and civil servants often seek the advice of outside experts regarding the implementation of Statutory Instruments.

(c) Bylaws of local authorities and other public bodies

Local authorities have general power to make bylaws, which affect the activities of people living within their geographical area. Public bodies have similar authority within their spheres of operation.

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Advantages

- Parliament does not have the time to give to minute details of legislation.
- Technical or scientific matters are often better dealt with by experts employed by the government departments than by Members of Parliament.
- Greater flexibility is provided for unseen contingencies and such legislation is of great value in an emergency, such as the outbreak of war.
- It affords an opportunity for experiment; if a Minister issues an order and it is found unsatisfactory, it can be withdrawn at once.

Disadvantages

- The executive tends to get beyond the control of the legislature.
- It intensifies the tendency towards bureaucracy.
- There is a tendency towards undue interference with the liberty of the subject.
- Delegated legislation is attacked as weakening one of the principles of the rule of law. The law-making function is removed from Parliament, which is directly answerable to the electorate, and placed in the hands of unaccountable officials.

Control over Delegated Legislation

The volume and complexity of Statutory Instruments – there are about 2,000 Statutory Instruments made annually – raise complex issues of public awareness and democratic control. Control is exercised through two bodies – Parliament and the courts.

At the beginning of each session, Parliament appoints a joint Select Committee to scrutinise all new Instruments and report on any requiring special attention, perhaps through having retrospective effect or raising wider issues, such as compulsory helmets for motor cyclists.

Most parent Acts stipulate that Statutory Instruments made under them shall be laid before Parliament. They may further stipulate that Parliament may block the Instrument before it comes into operation by one of two procedures. **Affirmative resolution procedure** normally means that unless there is a resolution of both Houses approving the Instrument within a certain time – frequently 28 days – of it being laid before Parliament, it will not come into force. The more common practice is to proceed by way of **negative resolution procedure**. Unless a motion to annul the Instrument is passed within 40 days, the Statutory Instrument will come into force.

All delegated legislation must be published by HMSO under the **Statutory Instruments Act 1946**.

Under the doctrine of parliamentary sovereignty, the validity of an Act of Parliament cannot be challenged in the courts. This restriction does not apply to delegated legislation. The grounds under which the courts can review subordinate legislation are *ultra vires* (i.e. that the scope of the Instrument exceeds the terms of reference laid down in the parent Act) or that procedural requirements laid down in the parent Act have not been complied with.

In some cases the parent Act requires that interested parties shall be consulted before a Statutory Instrument may be issued. Bylaws can be challenged on the ground that they are excessively uncertain, repugnant to the general law or manifestly unreasonable.

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Study Unit 3

The Administration of Justice

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A. ORGANISATION OF THE COURTS

The structure of the court system has been laid down by various Acts of Parliament, the key ones being as follows.

- **Judicature Acts 1873-75**

  These Acts established the basis of the modern judicial system in England. We have already mentioned them in our discussion of equity, and saw then that one of their provisions was the merging of the administration of equity and the common law. However, their main purpose was to rationalise the system of courts which, owing to their historical developments, had a number of separate jurisdictions. The Courts of Exchequer, Common Pleas, Queen's Bench, Chancery, Admiralty, Divorce, Probate, Assizes, etc. were all merged into the High Court, with appeal to the Court of Appeal, and finally to the Lords.

- **Courts Act 1971 (as amended by the Courts Act 2003)**

  This Act ranks in importance with the Judicature Acts of the last century. It altered radically the organisation of the English courts and laid down the structure of a unified national court service, with the object of making justice readily available throughout the country. Under the Act, the High Court and the Crown Court may sit at any place in England and Wales. The Lord Chancellor is empowered to determine and announce from time to time where such sittings shall take place. He is also empowered to set up High Court and Crown Court centres. The largest ones are visited by High Court judges where civil and more serious criminal cases are tried. At the other centres, only criminal cases are heard.

- **Courts and Legal Services Act 1990**

  This Act made changes in the administration of justice which affected Magistrates' Courts, Crown Courts, administrative and employment tribunals and the provision of legal services, as supplemented by the **Access to Justice Act 1999**.

The judicial system comprises, as a result of these Acts, the following courts. They are given in hierarchical order – the highest court first – and we shall then go on to examine each in more detail.

(a) House of Lords

This is the highest court in the land, where civil and criminal appeals are heard.

(b) Court of Appeal (Civil and Criminal Divisions)

Again, this court hears civil and criminal appeals.

(c) Divisional Courts

Two or more High Court judges may convene to hear appeals from inferior courts in cases where points of law are referred from the Magistrates' Court, Crown Court or County Court.

(d) High Court of Justice

This consists of the Queen's Bench Division (including the Admiralty Court and Commercial Court); the Chancery Division; and the Family Division.

The court sits primarily in the Law Courts in London, but may sit anywhere. Civil work, formerly handled at Assizes, is tried by the High Court sitting locally.

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(e) Crown Court

This court, sitting anywhere, has unlimited criminal jurisdiction, taken over from the old Courts of Assize and Quarter Sessions. It also hears appeals from the Magistrates' Courts, by way of a rehearing, and committals for sentence from the magistrates. In addition it acts as a youth appeals court.

(f) County Courts

These courts deal exclusively with civil cases involving smaller claims of less legal complexity.

(g) Magistrates' Courts

These courts have limited first instance criminal jurisdiction and are also where miscellaneous petty civil jurisdiction takes place.

The House of Lords

This is the highest appeal tribunal of both the criminal and civil court systems. The position of the House of Lords as a judicial body is peculiar and shared by no other second chamber. It is a relic of the days when the House of Lords was the King's Great Council and, as such, acted as both an advisory and a judicial body. The **Judicature Act 1873** bestowed the title "Supreme Court of Judicature" on the Court of Appeal and the High Court, and they are still so described, although the title is clearly a misnomer in view of the continuing supremacy of the Lords.

In the rare criminal cases where the legal interpretation of the evidence is open to considerable doubt, an appeal may lie from the Criminal Division of the Court of Appeal to the House of Lords, but before such an appeal can be made, the Court of Appeal or the House of Lords gives "leave to appeal" on the grounds that a point of law of general public importance is involved. In civil cases, appeals to the House of Lords may be made in certain circumstances from the Court of Appeal and also directly from the High Court (**Administration of Justice Act 1969**).

In strict law, all members of the House of Lords are eligible to sit when the Lords acts as a court, but by constitutional convention only the **Appellate Committee** sits as the supreme Court of Appeal. When it acts in this capacity, attendance is restricted to the Lords of Appeal in Ordinary (who are awarded life peerages). Appointments of Lords of Appeal in Ordinary are made on the advice of the Prime Minister, in consultation with the Lord Chancellor, and their number tends to increase with the growing complexity of the law.

In normal circumstances, a court of five Law Lords will sit to hear appeals.

Decisions are by a majority of those in attendance and the Lords are generally bound by their own decisions, unless they have a good reason for wishing to decide contrary to precedent.

The Court of Appeal

(a) Criminal Division

Appeals from convictions and from sentences given by the Crown Court are made to the Criminal Division of the Court of Appeal in London. Appeals are heard by the Lord Chief Justice and several judges of the High Court of Justice (Queen's Bench Division). The grounds of appeal are usually that the sentence is too heavy; that the verdict is contrary to the weight of the evidence; that the judge has not correctly interpreted the law; or that the verdict of the jury is felt to be "unsafe or unsatisfactory". Appeals on questions of fact can only take place with leave.

The Criminal Division sits without a jury and decisions are by a majority. Only the accused (i.e. not the Crown) may appeal to the court, which has power to order a retrial in appropriate cases. Under the **Criminal Appeal Act 1995** the Court of Appeal can

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order investigations to be carried out by the Criminal Cases Review Commission which will report its findings to the court.

(b) Civil Division

Appeals from the High Court of Justice and the County Courts are heard by the Civil Division of the Court of Appeal.

The **Supreme Court Act 1981**, which came into force in January 1982, made a number of changes in the organisation of the Civil Division of the Court of Appeal. There is now a Registrar of Civil Appeals who must have a ten-year "general" qualification (i.e. a right of audience in relation to any class of proceedings in any part of the Supreme Court or all proceedings in County Courts or Magistrates' Courts). The Act enables the making of rules of court to provide for the exercise of jurisdiction in interlocutory matters (i.e. any order which does not finally determine the issues between the parties) by either the Registrar of Civil Appeals or a single judge of the Court of Appeal.

While the Act reaffirms the position that a court (of the Court of Appeal) shall be duly constituted if it consists of an uneven number of judges, not being less than three, it says that a court shall be duly constituted if it consists of two judges for the following purposes:

- Deciding appeals against interlocutory orders
- Deciding appeals against decisions of a single judge
- Deciding appeals where parties have consented to the appeal being heard by two judges
- Continuing an appeal commenced before three judges where one judge is unable to continue, provided the parties consent to the appeal being continued
- Hearing any appeal not covered by the four purposes above of a class prescribed by an order made by the Master of the Rolls.

If an appeal is heard before an even number of judges who are equally divided, any party to the appeal may ask for the case to be re-argued before a court of an uneven number of judges of no fewer than three, before any appeal to the House of Lords.

A single judge, from whose decision there will be no appeal, may hear an application for leave to appeal to the Civil Division of the Court of Appeal. Finally, the Act substituted a new section in the **County Courts Act 1959**, now consolidated in Section 77, **County Courts Act 1984**. The effect of the change is that the Lord Chancellor may by order prescribe classes of proceedings in which there is to be no right of appeal from a County Court to the Court of Appeal without the leave of either the judge in the County Court or of the Court of Appeal. No longer, therefore, is the amount of money at stake in a County Court the sole criterion of whether or on what conditions there is to be a right of appeal.

The High Court of Justice

As we have already noted, the High Court of Justice consists of three Divisions:

(a) Queen's Bench Division (including the Admiralty Court and Commercial Court)

This Division deals with actions for damages arising out of every type of common law civil action. It inherited the jurisdiction of the old (pre-Judicature Acts) common law courts.

The judges of the Queen's Bench Division also deal with criminal cases at Crown Court centres when they go on circuit, at the Central Criminal Court in London, and in the Criminal Division of the Court of Appeal.

In appropriate cases, the judge sits with a jury.

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The **Admiralty Court** deals with maritime cases, and senior Masters of Trinity House sometimes sit as assessors in the court.

The **Commercial Court** has jurisdiction over commercial cases, e.g. insurance matters. Under the **Administration of Justice Act 1970**, a judge of the court is empowered to act as an arbitrator or umpire under an arbitration agreement, if the dispute is of a commercial nature. The Lord Chief Justice must agree before any judge makes him-/herself available to act as an arbitrator. The Commercial Court keeps a list of bodies that offer alternative dispute resolutions (ADR), mediation and conciliation in commercial cases.

The Divisional Court of the Queen's Bench Division also has the power to issue prerogative orders, which are important mainly in the field of administrative law. They are:

- ***Quashing Orders (formerly Mandamus)***

  An order to command a public body or official to carry out some legal duty.

- ***Mandatory Orders (formerly Certiorari)***

  An order to remove proceedings from an inferior court or tribunal to the High Court, where it is alleged that the inferior court has exceeded its authority or acted improperly.

- ***Prohibition Orders (formerly Prohibition)***

  An order to quash a decision of an inferior court.

- ***Habeas Corpus***

  An order to secure the release and/or trial of a person.

The Divisional Court of the Queen's Bench Division hears appeals by way of "case stated" from decisions of the Magistrates' Courts in their summary criminal jurisdiction, or from the decisions of the Crown Court acting as an appeal court from the magistrates. "Case stated" means that the particular point in the dispute, the decision reached and the reasons for so deciding are presented in writing to the Divisional Court as a case for consideration. In the light of the Divisional Court's opinion, the lower court's decision may be affirmed, amended or reversed. If this sort of appeal is adopted directly from the magistrates, the right to appeal in the form of a rehearing before the Crown Court is lost.

(b) Chancery Division

The Court of Chancery was originally the Lord Chancellor's Court. Today, the Chancery Division deals with the law relating to companies; patents; bankruptcy; taxation, partnerships and all matters relating to estates and trusteeships, inheriting the jurisdiction of the former Court of Chancery or Equity. Contentious probate matters, such as proof of relationship and "lost" wills, also fall within its jurisdiction.

This Court has three subdivisions:

- ***Bankruptcy Division***

  This sits in London and deals with all bankruptcy matters in the London area and bankruptcy appeals from County Courts.

- ***Companies Court***

  This also sits in London and deals with company law matters such as liquidation proceedings and company law appeals from County Courts.

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- ***Court of Protection***

  This deals with the legal affairs of persons who lack capacity, such as the appointment and supervision of receivers to hold and manage their property.

(c) Family Division

This Division was created by the **Administration of Justice Act 1970**. It deals not only with matrimonial matters (formerly handled by the old Probate, Divorce and Admiralty Division) but also with all jurisdiction of a family kind, e.g. wardship, adoption and guardianship.

The main jurisdiction of the Family Division includes:

- Defended or complicated divorce and matrimonial cases.
- Applications concerning legitimacy, validity of marriage, presumption of death, adoption, guardianship, wardship, custody of minors and consent to marriage of a minor, and title to property in a dispute between husband and wife.
- Grant of legal title (probate or letters of administration) to authorise executors or administrators to wind up a deceased person's estate.
- All High Court business under the **Child Support Act 1991** (as amended).

Appeals from the civil decisions in domestic proceedings before the magistrates lie to the Divisional Court of the Family Division of the High Court.

Appeals from the High Court

An appeal from the decision of a judge sitting in any one of the three Divisions of the High Court will go to the Court of Appeal (Civil Division). The one **exception** to this rule, introduced by the **Administration of Justice Act 1969**, is that it is possible for an appeal to "leapfrog" the Court of Appeal and go direct to the House of Lords, provided:

- The trial judge is prepared to grant a certificate
- The parties agree to this course
- A point of law of general public importance is involved, which relates wholly or mainly to the construction of a statute or Statutory Instrument; or the judge was bound by a previous decision of the Court of Appeal or the House of Lords
- The House of Lords has granted leave.

In view of these stringent conditions, not many successful applications are made. One example of a leapfrog appeal is ***National Carriers Ltd v. Panalpina (Northern) Ltd (1981)*** which was concerned with the doctrine of frustration applying to a lease of land. The High Court judge found himself bound by a 1943 decision of the Court of Appeal (see above).

The **Supreme Court Act 1981** changed the system of appeals in the Civil Division in order to prevent a backlog of appeal cases and established the office of Registrar of Civil Appeals.

The Crown Court

The importance of the Crown Court is that all proceedings on indictment must be brought in it. An indictment is the written charge giving particulars of the alleged crime which is presented to the jury, and before it is drawn up the accused has normally to appear before a magistrate for a preliminary hearing (called **committal proceedings**) to see whether there is a *prima facie* case for trial.

When the Crown Court sits in the City of London, it is known as the Central Criminal Court, and the privileges of the Lord Mayor and Aldermen of the City to sit as judges are thus preserved.

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The cases which the court can try depend on how it is manned. Professional judges of the Crown Court may be either judges of the High Court or circuit judges or recorders.

The **Courts Act 1971** divided England and Wales into six regions, each region being staffed by High Court judges, circuit judges (formerly County Court judges) and recorders. A **circuit judge** must have a ten-year Crown Court or County Court qualification; or have been a recorder; or have held certain specified offices (e.g. President of employment tribunals) for three years. In addition to their Crown Court duties, circuit judges can preside in County Courts.

Recorders are part-time judges of the Crown Court and must also hold a ten-year right of audience in the Crown Court or in the County Court. They are appointed for a fixed term (subject to extension) and may exercise the same jurisdiction as circuit judges. A recorder is required to serve as a judge for a minimum of 20 days in the year. A solicitor may be appointed a circuit judge after three years' service as a recorder.

In criminal cases the judge **always** sits with a jury.

The **Courts Act 1971** provides that High Court judges shall try the most serious cases, the circuit judges or recorders the least serious, intermediate offences normally being referred to a centre visited by a High Court judge. Pressure of business on particular courts also influences the allocation of cases, and intermediate offences may be tried by a circuit judge, if so directed.

The Crown Court also hears appeals from the Magistrates' Courts exercising summary jurisdiction. Appeals may be against sentence or conviction, where the accused pleaded not guilty; or against sentence, where the accused pleaded guilty.

When the Crown Court is sitting to hear an appeal (or a committal for sentence) from the magistrates, the court shall consist of a High Court judge or circuit judge (or recorder) sitting with no fewer than two and no more than four justices. In addition, any jurisdiction of the Crown Court may be exercised by a court consisting of a professional judge and no more than four justices.

The court may confirm, reverse or vary the decision. It may increase or reduce the punishment within the limits allowed by the Magistrates' Court.

County Courts

County Courts deal exclusively with civil work, mainly small debts and other minor claims. They were established in 1846, when there was an urgent need for the creation of a small claims court.

There are two limitations on the court's jurisdiction. The first is in jurisdiction itself, since matters with which it can deal are limited to those expressly mentioned in statute. The second limitation is geographical.

The general common law and equity jurisdiction of the County Courts is now contained in the **County Courts Act 1984**, as modified by the **Courts and Legal Services Act 1990**. The latter statute has introduced substantial changes in jurisdiction and in procedure. Jurisdiction is also conferred upon the court by other sources, such as the **Rent Act 1977**.

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Original jurisdiction

Under the **County Courts Act 1984** (as amended), a County Court has jurisdiction in the following matters:

(a) Actions in contract and tort. Until 1991 such jurisdiction was limited to actions where the claim did not exceed £5,000. However, this limit has been removed by the **High Court and County Court Jurisdiction Order 1991**, issued under the **1990 Act,** as amended by the Civil Procedure Act 1997.

- Under the Civil Procedure Act 1997 and the accompanying Civil Procedure Rules 1998, defended claims are now allocated to one of three tracks.
- Small Claims Track – for the majority of actions under £5,000, except personal Injuries over £1,000; disrepair over £1,000, landlord harassment and unlawful eviction; dishonesty allegations;
- Fast Track – for the majority of cases between £5,000 and £15,000, estimated to last no longer than a day;
- Multi-Track – for the allocation of cases where the value of the claim is over £15,000, and estimated to last over a day; in personal injuries, for claims up to £50,000.

(b) Actions for the recovery of land, or in which the title to a hereditament comes into question, limited to a value of £30,000.

(c) Equity matters, where the amount involved does not exceed £30,000. These matters include proceedings relating to trusts, the administration of assets of deceased persons, mortgages and liens, and the dissolution of partnerships.

(d) Bankruptcy cases: the County Court has unlimited jurisdiction in cases proceeding in County Courts outside London.

(e) Company winding up, where the registered office of the company is situated within the County Court district, and where the paid-up capital of the company does not exceed £120,000.

(f) Contentious probate matters, in which the County Court can deal with the validity of a will where a Registrar of the Principal Registry of the Family Division of the High Court is satisfied that the value of the deceased's estate is less than £30,000.

(g) Some courts have jurisdiction to hear cases brought by the Equality and Human Rights Commission (formerly the Commission for Racial Equality), alleging discrimination under the **Race Relations Act 1976**.

No jurisdiction

Except by consent of the parties or unless an action is transferred to the County Court by the High Court master, the County Court enjoys no jurisdiction to try the common law actions of defamation, false imprisonment, malicious prosecution or any action involving title to any corporeal or incorporeal hereditament, or the right to any toll, fair, market or franchise.

Exclusive jurisdiction

In some matters the jurisdiction is exclusive to the County Court and proceedings cannot be commenced in the High Court. These include certain proceedings under the **Landlord and Tenant Acts** and regulated consumer credit agreements or hire agreements, where the fixed sum credit does not exceed £15,000 (**Consumer Credit Act 1974**).

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Matrimonial and family proceedings

Where a County Court is designated by the Lord Chancellor as a "Divorce County Court" it has jurisdiction, under the **Matrimonial and Family Proceedings Act 1984** and the **Children Act 1989**, to hear and determine any matrimonial cause (i.e. divorce, nullity or judicial separation), although it may only **try** the cause if it is also designated as a "court of trial". It may also make orders in relation to the financial provision and custody of children associated with such proceedings.

Every matrimonial cause (defended or undefended) must be commenced in a Divorce County Court and is to be heard there unless transferred to the High Court.

Divorce County Courts also have jurisdiction, along with the Magistrates' Courts and the High Court, to deal with adoption and guardianship matters.

Transfer of proceedings between the County Court and the High Court

Under the provisions of the **Courts and Legal Services Act 1990** (as amended), it has become much easier (and less costly) for proceedings to be transferred from the County Court to the High Court and *vice versa*.

Apart from transfers arising from specific legislative provisions, either court may make an order to transfer the proceedings to the other on its own motion or on the application of any party to the proceedings. Proceedings shall be transferred only after taking into account the convenience of the parties and of any other person likely to be affected, and the state of business in the court concerned.

You should note that it may still be advantageous for claimants to commence certain types of action (e.g. debt collecting actions) in the High Court, since early procedures there are generally faster and the enforcement methods more effective. Consequently, a moderate claim of £5,000, where there is no real defence, could be started in the High Court in order to obtain an early decision.

Composition

England and Wales are divided into County Court districts. In all there are some 400 districts.

Circuit judges sit in the County Court as well as the Crown Court. The **Courts Act 1971** makes provision for every judge of the Court of Appeal or of the High Court or a recorder, by virtue of his/her office, to be eligible to sit as a judge for any County Court district.

For the hearing the judge sits alone. There is provision for a jury of eight to be called (e.g. where fraud or defamation is being tried), but in practice this right is seldom used.

The County Court judge is assisted by a **district judge**. District judges (and assistant district judges and deputy district judges) must hold a seven-year general qualification.

The district judge is responsible for the day-to-day administration of the court and also exercises a judicial function. The latter includes interim matters (matters in the course of a legal action) and he can dispose of any action within the jurisdiction of the court. With leave of the County Court judge and the consent of the parties, or where the claim is admitted, he can try any other matter.

The district judge may now grant interim injunctions, where he has jurisdiction to hear and determine the case. He may grant final injunctions where he has trial jurisdiction. He also has power to deal with contempt of court and to assess damages.

Appeal from the district judge lies to the County Court judge.

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Remedies

The County Court now has power to grant remedies without the requirement of an accompanying monetary claim.

The court has the same jurisdiction as the High Court to grant injunctions or declaratory judgments regarding the rights of parties over land or the possession, occupation, use or enjoyment of land, where the capital value of the land or that interest in land is below £30,000.

Appeals

The County Court has little appellate jurisdiction. As we have already seen, this is limited to an appeal from the district judge.

Appeals from the County Court lie, subject to certain conditions, to the Court of Appeal (Civil Division), with the single exception of appeals from orders in bankruptcy matters, which lie, in the first instance, to a Divisional Court of the Chancery Division of the High Court and then to the Court of Appeal if special leave is granted.

Arbitration procedure in the County Court

The arbitration procedure in the County Court has led to the court being described as a **small claims court**. In fact there is no separate small claims court as such. Both of the privately funded small claims courts (one in Manchester, the other in Westminster) were forced to close for financial reasons.

The purpose of the arbitration procedure in the County Court is exactly the same as the original purpose of the County Courts themselves – to provide a quick, cheap and relatively informal means of settling disputes where the amount involved is less than £5,000.

Both the County Court judge and the district judge may act as arbitrators and arbitration is now the normal method of dealing with these small claims. The rules provide for automatic reference to arbitration by the district judge in a default action for £5,000 or less, where the defendant files a defence. (A default action is one where the claimant is claiming a liquidated or unliquidated sum of money.)

Even where the claim exceeds the normal financial limits, the district judge can refer the dispute to a professional arbitrator if the parties consent.

Strict rules of evidence are not followed. If a hearing is necessary, it will be informal and may be held in private. Usually the matter is settled by the arbitrator on the basis of statements and documents submitted. If necessary, she can consult expert witnesses.

The arbitrator may adopt any procedure she considers to be convenient and which offers a fair and equal opportunity to each of the parties to present his/her case. She has a discretion to make an award in the absence of one of the parties and to decide on the costs of the hearing.

So far as costs are concerned, no costs, other than those incurred on the issue of the Statement of Case, will generally be recoverable. This has both advantages and disadvantages. A party may be loath to take advantage of the arbitration procedure if he has no likelihood of recovering costs which he has incurred.

On the other hand, a person may be inclined to carry on arbitration proceedings knowing that he will not incur any liability to pay costs if he loses his claim. To avoid any injustice where a party conducts his case unreasonably, the court may award costs against that party.

There is a limited right of appeal from the district judge to the County Court judge if the district judge has made an error of law or been guilty of misconduct.

There have been increasing moves in recent years to use conciliation and alternative dispute resolution to settle disputes by agreement rather than by referral to the court systems.

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Magistrates' Courts

All criminal cases are first dealt with by the Magistrates' Court, which serves two functions.

- It can deal summarily (i.e. without reference to another court) with many minor offences, e.g. minor theft, assaults, traffic offences, vagrancy and drunkenness. The maximum penalty which may be imposed is a fine of £5,000 and/or six months' imprisonment on any one charge, with a maximum total sentence of one year.
- It acts as a filtering court, sending indictable (i.e. serious) cases to the Crown Court to be dealt with (committal proceedings).

All cases, even those of murder, start in this court.

Cases in the Magistrates' Courts are heard by Justices of the Peace (JPs) – see below. A special panel of justices from each division of every county, or from each borough with its own Bench, must be appointed to conduct youth courts, where special procedures are followed in trying young offenders. At least one member of such a panel must be a woman.

In addition to their criminal jurisdiction, the Magistrates' Courts are engaged for much of their time in civil matters. For example, they have power to make separation orders (but not to grant divorces) and maintenance orders, and also to make affiliation orders where the parentage of a child is disputed. In addition, they deal with Gaming Licences, the enforcement of payment of council tax, and various other matters.

The Criminal Defence Service now operates a Duty Solicitor Scheme in all Magistrates' Courts to provide a solicitor to advise defendants who have no solicitor of their own.

Justices of the Peace

Justices of the Peace, who are normally unpaid, are appointed by the Lord Chancellor on behalf of and in the name of the Queen (**Justice of the Peace Act 1997**). The Lord Chancellor is advised by a local advisory committee. They may be dismissed or called upon to resign by the Lord Chancellor. In many large towns, the more important cases are dealt with by a salaried professional, known as a District Judge (Magistrates' Court) who is a qualified lawyer, with a seven-year general advocacy qualification, appointed by the Lord Chancellor. Two or more – but not more than seven – ordinary justices are required to form a Magistrates' Court. As we have already noted, the justices also have a role in the proceedings of the Crown Court. Each bench of lay magistrates has a salaried clerk, usually a full-time employee, who assists the magistrates on questions of law and procedure.

Other Courts

Judicial Committee of the Privy Council

In the Middle Ages, the Privy Council had extensive judicial powers. These powers were usually exercised through Committees of the Privy Council, such as the Star Chamber and the Court of High Commission. Most of the judicial powers of the Privy Council were destroyed by the Long Parliament in the 17th century, but the Council remained the Supreme Court of Appeal from the law courts of overseas possessions. With the growth of the Empire in the 18th and 19th centuries, these powers became important.

In 1933, the judicial work of the Privy Council was transferred to a special Committee, consisting of the Lord Chancellor and members of the Council who had held high judicial office. At the same time, the Committee was empowered to hear appeals from ecclesiastical courts, i.e. Church of England courts which deal with matters of church discipline. To hear such appeals, the Archbishops also sit as assessors.

The Committee also hears appeals from prize courts (captured shipping) and from certain domestic tribunals in England and Wales, such as decisions of the General Medical Council, where doctors have been disciplined by the tribunal. Latterly, the court has been authorised

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to deal with legal disputes arising from devolved legal powers. This latter jurisdiction is derived from statute.

The composition of the Judicial Committee of the Privy Council is similar to that of the House of Lords when sitting in a judicial capacity, except that it also has as members a number of serving judges from Great Britain and various parts of the Commonwealth. There are, however, great differences in procedure. The decisions of the House of Lords take a semi-legislative form and may be made by a majority; the Lords are bound to a large extent by their own decisions. The decisions of the Judicial Committee of the Privy Council take the form of advice to the Crown, which then gives its decision by Order in Council. The Judicial Committee of the Privy Council is not bound by its own decisions; its decisions have only persuasive authority in English law.

The importance of the work of the Committee is great. Within the British Commonwealth many varieties of law are found – Anglo-Welsh law, French law, Dutch law, Hindu law, etc. The fact that the growth and development of such law is guided into a similar direction is of great importance in strengthening the bond between the various members of the Commonwealth. In recent years, however, the Committee's sphere of influence in this field has declined, as more of the Commonwealth countries have abolished the final right of appeal to the Judicial Committee of the Privy Council.

Coroners' Courts

Coroners' courts are of great antiquity but they are confined, in modern practice, to holding inquests into the possible ownership of treasure trove and to holding inquests into cases of suspicious death.

Under the **Coroners' Act 1988**, their chief function is to inquire into deaths from other than natural causes and for which doctors will not give a certificate. They are also called to sit upon cases arising from deaths in institutions. The procedure is that of **inquest** or inquiry, not that of trial, but the coroner's jury in a case of violent death may find that the evidence points towards a certain person who may then be arrested to be tried by due process of the law. The jury will consist of seven to 11 persons and the coroner may accept the verdict of the majority provided that there are not more than two dissenting jurors.

Under the **Criminal Law Act 1977**, a coroner is no longer required to summon a jury if it appears to him/her that the death was caused by murder, manslaughter or infanticide, or by a motor accident; but he/she may still summon a jury if there appears to be any reason for so doing. The jury need not view the body, unless the coroner so directs or a majority of the jury so require.

In cases of murder, manslaughter or infanticide, it is not for the coroner's jury to bring in a verdict naming a guilty party. Since the Criminal Law Act 1977, this is the task of the police and the Magistrates' Court.

Coroners are barristers, solicitors or medical practitioners, sometimes both medical and legal individuals. They are appointed by county or borough councils to part-time posts, and may be dismissed for inability and/or misbehaviour.

Their other function is jurisdiction in treasure trove – valuables, usually money, hidden somewhere and "found" by someone who does not claim to be the original owner. Treasure trove becomes the property of the Crown which, however, usually restores it to the finder, and it is defined in the **Treasure Act 1996**.

The Restrictive Practices Court

This court was set up by the **Restrictive Trade Practices Act 1956** which we shall consider in the study units on the Law of Contract. The main function of the court is to investigate restrictive trading agreements to see if they are against the public interest. Its jurisdiction also includes resale price maintenance agreements under the **Resale Prices Act 1964**. The court may declare void those restrictive agreements which it considers to be against the

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public interest, and it is empowered to enforce its decisions by injunction. It comprises three High Court judges, one judge of the Court of Session of Scotland, and one judge of the Supreme Court of Northern Ireland. The court is assisted by up to ten expert laymen, appointed by the Crown on the recommendation of the Lord Chancellor.

Ecclesiastical Courts

These courts exercise, at the present time, control over clergymen of the Church of England. In each diocese there is a consistory court, the judge of which is a barrister appointed by the Bishop, and known as the Chancellor. Appeal lies from the consistory court to, depending on the diocese, the Arches Court of Canterbury or the Chancery Court of York, and from either court a further appeal is possible to the Judicial Committee of the Privy Council.

B. ADMINISTRATIVE JUSTICE

The latter part of the 20th century, has seen a great increase in what is termed "**administrative justice**", i.e. the settlement of matters affecting the rights of individuals by some body other than the normal courts – either through the median of alternative dispute resolution, a special tribunal or a Minister of the Crown.

Arbitration

What is generally meant by "arbitration" is a quite different matter from what we have described above. It is the private resolution of disputes outside the framework of the courts, and it must be by agreement between the parties to it.

It is a rule of public policy that people cannot, by agreement or otherwise, oust the jurisdiction of the court. It is the right of all citizens to have their disputes heard and adjudicated upon by the courts of the realm. However, subject to the overriding jurisdiction and control of the court, parties have, for a very long time, been encouraged by the state to settle their differences by private arbitration.

The practice of arbitration was well known in both ancient Greece and Rome. In international affairs in the UK, a treaty between England and France in 1655 provided for arbitration in Hamburg for the calculation of damage suffered as a result of war between the two countries since 1640. Modern international arbitration probably dates from "Jays Treaty" between Britain and the USA in 1794, which provided for the resolution of certain legal issues by a mixed commission.

Domestic arbitration was first provided for in the Arbitration Act 1698 and there has been a succession of Arbitration Acts and provisions since then. Modern law is governed by the Arbitration Act 1950, as amended by the Arbitration Act 1979.

As stated before, arbitration always arises by agreement between the parties. It is usual for such agreement to be contained in a clause of a written contract, which will provide that any dispute arising out of the contract will be referred to arbitration. However, there is no reason why such agreement cannot be reached after a dispute has arisen in respect of a contract that does not specifically provide for arbitration.

Why go to arbitration?

The reasons why people opt for arbitration are twofold:

- The proceedings are private and, thus, no publicity need accompany them. The normal courts are, of course, always open to the public, except in special cases involving the security of the state and juvenile matters.
- The arbitrator appointed to resolve the issue can be a specialist in the subject matter and not a lawyer. Contrary to popular mythology, arbitration is generally neither cheaper nor speedier than court proceedings.

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For these reasons, arbitration is more common in some forms of commercial activity than others. It is almost invariable in engineering and construction disputes, whereas in (say) contracts for the sale of goods it is less common.

Let us, then, first examine the provisions of statute relating to arbitration, and then look at its practical application.

Arbitration Acts 1950 and 1979 (as amended by the 1996 Act)

The principal Act is the 1950 one, which is a consolidation of the Arbitration Acts 1889 and 1934. The 1950 Act is amended in certain particulars by the 1979 Act. References to "the Act" are, therefore, to the 1950 Act. There is a further Arbitration Act 1975, which gives effect to the New York Convention on the recognition of and enforcement of foreign arbitral awards.

The effect of arbitration agreements

Section1 of the Act provides for the authority of an arbitrator, as follows:

"The authority of an arbitrator or umpire appointed by virtue of an arbitration agreement shall, unless a contrary intention is expressed in the agreement, be irrevocable except by leave of the High Court or a judge thereof."

This clearly establishes that, once the parties have agreed to arbitrate, they cannot afterwards back out and litigate in the ordinary courts, unless they are given permission by the judge of the High Court. Such leave is not given lightly, and only for good legal reasons. However, on the principle of not ousting the jurisdiction, the court retains its ultimate control over the proceedings.

Section 4 expands on this by providing that, if any party to an arbitration agreement commences any legal proceedings in court contrary to the agreement, then the other party can apply to the court for a stay of the proceedings. This will be granted, unless there are good and sufficient reasons why the dispute should not be referred to arbitration. A "stay", when granted, effectively puts an end to the court proceedings. The court won't hear the case – so, if the claimant wishes to continue, he/she can do so only by means of the previously agreed arbitration procedure.

The stay will be granted in the following circumstances:

- Where there has been a valid agreement to submit to arbitration
- Where the applicant has taken no step in the proceedings
- Where the applicant was, and is, ready and willing to do everything necessary for the proper conduct of the arbitration
- Where proceedings have been begun by a party to the agreement or by a third party claiming through or under him/her
- Where proceedings are in respect of a matter within the scope of the agreement.

Stay may be refused:

- Where fraud is charged, and the party so charged desires the charge to be heard in open court
- Where the only point in dispute is a question of law
- Where there is good reason to believe the arbitrator is not impartial
- Where time for submission to an arbitrator has expired.

In domestic arbitrations, by virtue of Section 4, the court has discretion whether to grant a stay of proceedings brought in contravention of an agreement to arbitrate. However, by Section 1 of the 1975 Act, it must grant a stay in the case of non-domestic or foreign arbitration proceedings.

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General rules regarding how arbitration is conducted

In general, an arbitrator is free to conduct the proceedings in any manner he/she sees fit. The Act provides, in Section 12, that, subject to any contrary intention in the agreement:

- The parties shall be bound to submit to be examined on oath
- The witnesses may be examined on oath
- The arbitrator has power to administer oaths or take affirmations from parties and witnesses
- The arbitrator has power to sue for a writ of subpoena to compel witnesses to attend – but not that they should produce any documents that they could not be compelled to produce in a High Court action.

Provisions as to awards

An arbitrator does not give a judgment, like a court; instead he/she gives an award. The award is the determination of the issue between the parties, and it usually includes an award of damages.

The Act provides:

- Subject to agreement to the contrary, an arbitrator may make an award at any time, and it may be either an interim or a final award. An interim award is, usually, given in cases where the final determination of the issue is dependent on the outcome of a preliminary matter, whether of law or fact (that is, if the arbitrator decides the preliminary matter in one way, the arbitration will proceed, whereas if he/she decides another way, it will serve to conclude the matter). For example, the preliminary question might be: "Was A in breach of contract?" If the answer is "yes", then the arbitration can proceed to the question of damages; if "no", that concludes things. Plainly, in such circumstances, an interim award on the one question will save time and expense.
- The High Court has power to remove an arbitrator who "fails to use all reasonable despatch" in undertaking the proceedings, or in giving his/her award.
- Subject to contrary agreement, an arbitrator has power to award specific performance of a contract, other than one relating to land. This power is given by Section 15. In principle, there is no reason why the arbitration agreement should not give the arbitrator power to award an injunction to restrain certain conduct. However, speed is the essence of effectiveness in restraining breaches of contract; hence, it is unlikely to be relevant in practice.
- Likewise, subject to contrary intention, every arbitration award is deemed to be final and binding on the parties.

Costs and fees

Section 18 states that, unless a contrary intention is expressed, it is deemed that the arbitrator has power to award costs at his/her discretion. Such costs are taxable by the High Court (i.e. it can examine and assess them). In spite of this discretion, an arbitrator is required to exercise it judicially and in the same way as would the High Court.

An agreement that each party will pay its own costs regardless of the outcome is not correct or enforceable: ***Lewis v. Haverfordwest RDC (1953)***, unless such agreement was reached after the dispute has arisen.

The arbitrator's fees are normally agreed prior to, or at the time of, his/her appointment. If not, however, he/she is entitled to reasonable fees, which may be taxed by the High Court. The usual practice of arbitrators is not to hand down their award until their fees have been paid.

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Appeals, etc.

- The whole object of an arbitration is that the award shall be final and binding on the parties. Hence no appeal, as such, is possible. However, as we have stated before, people cannot (by agreement or otherwise) oust the jurisdiction of the court. Hence, under certain circumstances, a "special case" can be stated for the decision of the High Court.

  The Act lays down the circumstances – but these are amended by the 1979 Act. So, it is first necessary to examine the provisions of the 1950 Act, then see to what extent they are overridden by the 1979 Act.

  Section 21 of the Act provides:

  "(1) An arbitrator or umpire may, and shall if so directed by the High Court state:

  (a) any question of law arising in the course of the reference; or

  (b) an award or any part of an award, in the form of a special case for the decision of the High Court".

  So the arbitrator may always seek the decision of the High Court, or one of the parties may apply to the High Court, requesting it to direct the arbitrator to state a special case. It is only on a point of law, or in connection with the award, that this procedure is available. Issues of fact are solely for the arbitrator.

- Section 1 of the 1979 Act provides that Section 21 of the 1950 Act shall cease to have effect, but it substitutes a right of appeal. It also removes the jurisdiction of the High Court to set aside an award, or remit it for further consideration to the arbitrator, on the grounds of error of fact or law on the fact of the award – that is, an error which is apparent from the award itself.

  However, an appeal now lies to the High Court on any question of law (but not fact) if brought:

  (i) With the consent of all parties to the reference, or

  (ii) By any party with the leave of the court.

  In such an event, the High Court may confirm, vary or set aside the award, or remit it to the arbitrator for reconsideration. The High Court shall not grant leave under (ii), above, unless it considers that the determination of the question of law concerned could substantially affect the rights of the parties.

- Section 2 of the 1979 Act gives any party, with the consent of the arbitrator, or with the consent of all the other parties, a right to apply to the High Court for determination of any preliminary point of law (that is, if the arbitration is likely to depend on some point of law, the court can give a ruling on it before the arbitration gets under way). However, the court must not entertain such an application, unless it would produce substantial savings in costs, or the point of law is one which would be likely to be the subject of an appeal.

- For the first time, the 1979 Act allows the parties to agree to exclude any right of appeal, provided that they do so in writing. An exclusion agreement can take effect to oust the jurisdiction of the court to hear an appeal or to determine a preliminary point of law. In domestic proceedings, an exclusion agreement is valid only if entered into after the commencement of an arbitration, hence it cannot be included in the contractual arbitration clause. In non-domestic arbitration agreements, it is valid if entered into before or after commencement of arbitration.

- A further appeal to the Court of Appeal lies only if either the High Court or the Court of Appeal gives leave, and the High Court certifies that a point of law of general public importance is involved.

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- The effect, therefore, of the provisions of the 1979 Act is to do away with an automatic right of review by the High Court, and make it subject only to the leave of the court, or the consent of all parties.

  In the second place, it gives the parties a limited right to opt out of any appeal.

Miscellaneous

- Where an arbitrator has misconducted himself, he can be removed by the High Court (1950 Act, Section 23), or his award can be set aside.
- If the arbitrator is not impartial or (subject to a valid exclusion agreement under the 1979 Act), if a question of fraud arises, the High Court can give relief by revoking the authority of the arbitrator or by refusing to order a stay of action in the High Court: Section 24.
- Arbitral awards may, by leave of the court, be enforced as if they were judgments of the High Court: Section 26.

Arbitration proceedings

- ***Arbitration agreements***

  There are, basically, two types of agreement to arbitrate. In the first place, there is an agreement to refer an existing dispute to arbitration. These are called "ad hoc" submissions, and they are comparatively rare. In the second place, there is an agreement to refer any future disputes to arbitration.

  There is no special form of agreement necessary, provided the intention is clear – but, usually, agreement is contained in a special arbitration clause in a written contract.

- ***Enforcement of agreement***

  As we have mentioned, agreements to arbitrate are enforced by the very simple expedient of the court staying, or refusing to hear, any action brought in contravention of an arbitration agreement. So, if a party wants redress he/she must, under such an agreement, first arbitrate.

  In fact, the court specifically recognises the validity of clauses in contracts which make it a condition precedent to the enforcement of any claim under the contract that the claimant has first obtained an arbitral award in his/her favour. These are known as "Scott v. Avery" clauses, from the case of that name in 1855.

- ***Appointment of arbitrator***

  As we have already said, the arbitrator is appointed by agreement between the parties, or by some outside and independent person, or by the court.

  An arbitrator is not, by law, required to have any formal qualifications, although the agreement often provides that she shall be qualified in law or in the relevant professional discipline. It is frequently desirable, if any dispute is likely to involve complex technical issues that an arbitrator should be of a profession such that she can fully understand them. The only legal requirement is that she shall be impartial, and not closely associated with the parties.

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Rights and duties of the arbitrator

By virtue of the agreement, the arbitrator (or arbitral tribunal, as the case may be) has a mandate from both parties to conduct the arbitration, and to make an award. The parties bind themselves to accept and be bound by that award, subject only to possible appeal on a point of law.

It is traditionally considered that an arbitrator is in a contractual relationship with the parties to the reference. Therefore, he/she has some obligations towards them, and they have others towards him/her.

Obligations of arbitrator to the parties

(a) ***Duty to take care***

It is a truism to state that all professional men and women owe their clients a duty of care. However, in the case of arbitrators, the law is, unfortunately, unclear. Until recently, it accepted without question that arbitrators were in the same position as members of the judiciary; they were immune from suits for acts committed or omitted in the course of arbitral proceedings.

Two decisions of the House of Lords have cast doubt on this proposition in respect of arbitrators. In ***Sutcliffe v. Thackrah (1974)***, it was held that architects acting in a quasi-arbitral role in certifying payments due from the owner of a building under construction to the contractor were liable for negligent certification. This, in itself, did not radically alter the state of the law.

However, in ***Arenson v. Arenson (1976)***, the problem was examined in more detail, and the rationale of arbitral immunity was considered. The problem was to decide who is an arbitrator (and, so, entitled to immunity) and who is not – in other words, to draw the line between arbitrators proper and quasi-arbitrators. It was held that auditors determining the value of shares in a quasi-arbitral capacity are liable for negligence. However, the House went on to state that it is not necessarily the case that a formally appointed arbitrator is, in every case, immune from an action for negligence.

That is where the situation rests at present. It is plainly for the House of Lords to clarify the situation, and it seems likely that there are three possible solutions at which the House may arrive when opportunity arises, as set out below.

(i) That there is no reason of public policy why arbitrators or valuers should be immune from suit

(ii) That all arbitrators are immune, and so are some valuers, when performing a judicial function

(iii) That it is a question of function, and not title. Persons acting judicially are immune – that is, when they are deciding the merits of a dispute presented to them in an adversarial manner; whereas when they are acting in a purely arithmetical or analytical role (such as valuing), they are not immune.

Whatever is the correct position, parties have a limited right of redress if an arbitrator has been careless or negligent.

(i) The award may be set aside by the court

(ii) The arbitrator may be removed by the court (1950 Act, Section 23)

(iii) It may be that negligence or carelessness could constitute grounds for refusing to pay the arbitrator's fee.

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(b) ***Duty of diligence***

An arbitrator is required to proceed with reasonable diligence and the court may remove him under the 1950 Act, Section 13(3), if he fails to do so.

(c) ***Duty to be impartial***

This duty is fundamental. Breach of it gives grounds for his removal under Section 24. It is not only actual impartiality which gives cause for invoking the Act, but also where it is shown that the arbitrator may not be impartial (e.g. because he is connected with one of the parties).

Thus in ***Re Brien and Brien's Arbitration (1910)***, it was held that the arbitrator had failed to act impartially when he inspected property, the subject of the arbitration, accompanied by only one party. In another case, during an enquiry into the question of liability for a collision between a Portuguese ship and a Norwegian vessel, the English arbitrator remarked that he did not believe the evidence of the Portuguese witnesses, "because the Portuguese, like the Italians, were all liars". It was held that such obvious bias made it imperative that the arbitrator should be removed from office.

Obligations of the parties to the arbitrator

In the same way as an arbitrator owes certain duties to the parties, so the parties owe duties to the arbitrator. The most important of these is a duty to pay his/her fees.

(a) ***Fees for a completed reference***

An arbitrator is, normally, entitled to be paid at the time he/she hands down the award. The amount of the fee may have been agreed in advance, either on the basis of an inclusive fee or at an hourly or daily rate or in any other manner. If it has not been so agreed, he/she is entitled to a reasonable fee.

An arbitrator can enforce payment of the remuneration by bringing an action for it. As either an alternative or an additional course of action, he/she can exercise a lien on the award – that is, withhold the delivery of the award until the fee has been paid.

Where no fee has been agreed, a reasonable fee may be fixed, as follows:

(i) By the arbitrator him/herself under the provisions of the 1950 Act, Section 18(1). If such determination by the arbitrator is excessive, the parties can simply refuse to pay – in which case the arbitrator will be forced to ask the court to tax his/her fee. Or, the aggrieved parties can themselves ask the court to tax the fee, and pay what they consider a reasonable sum into court.

(ii) The arbitrator may, from the outset, apply for his/her fees to be taxed by the court under Section 18(2).

(iii) The parties may pay a reasonable sum into court as a condition of releasing the arbitrator's lien on the award, and then have the actual fee taxed in the normal way.

(b) ***Remuneration for an uncompleted reference***

If the reference is not completed, it may be because the parties themselves resolve their differences and determine the arbitration, or it may be because the arbitrator him/herself terminates it, either with or without fault on his/her part.

In the first case, the arbitrator is entitled to reasonable remuneration for the time spent and trouble taken up to the time of determination. This right can be enforced by normal action in the courts.

In the second instance, the right to remuneration is, obviously, dependent on the circumstances. The arbitrator may die, or become incapable of acting – in which case he/she will, probably, be entitled to a reasonable fee for time and trouble. If, on the

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other hand, the reference is not completed because the arbitrator is removed for fault, or his/her authority revoked, then he/she forfeits all fee.

(c) ***Remuneration where the award is invalid***

Right to remuneration will, here again, depend on the circumstances of the case. The award may be a complete nullity, in which event the fee will depend on the degree of fault by the arbitrator; or the award may be appealed, then remitted by the court to the arbitrator for further consideration. He/she will be entitled to the fee, in this event, for the original award but further work resulting from the remission will depend on the degree of fault of the arbitrator.

Arbitration awards

The award given by an arbitrator may be an "interim" or a final one. As we have seen, interim awards are given in cases where the ultimate finding is dependent on the resolution of an initial point of law or fact – that is, if the initial point is decided in one way, it will automatically mean that the whole dispute is resolved – in which case it would, obviously, be pointless to proceed to a final award. However, if it is decided in another way, the final resolution must be proceeded with.

Unless this "either/or" situation pertains, an arbitrator will, normally, give only one final award.

The substantive requirements for an award are that it must be:

(a) **Cogent**. That is, positive and not merely an expression of hope or opinion.

(b) **Complete**. It must resolve all the points of dispute submitted in the reference.

(c) **Certain**. The award must state precisely what is the arbitrator's finding on each point.

(d) **Final**. All the issues raised in the reference must be disposed of by the arbitrator, and none left over to be decided by some other party.

(e) **Enforceable**. The award must be in such a form that any monetary award can be enforced by action.

The arbitrator is not, normally, required to give reasons for the decision. Whether he/she does or not is at his/her discretion. However, the reference may require reasons to be given and these days generally will.

The 1979 Act, Section 1(5) provides that, in certain circumstances only, an arbitrator can be required by the court to give reasons for his/her decision. This will arise only in the event of an appeal on a point of law and where the award does not contain reasons, or sufficient reasons, for decisions of law to enable the court properly to resolve the matter. However, such an order for reasons can be made by the court only if:

- Before the award, one of the parties to the reference gave notice to the arbitrator that reasons would be required, or
- There is some special reason why such notice was not given.

Enforcement of award

An arbitral award cannot be immediately enforced in the same way as a judgment of the court. It is, first, necessary for the successful party to convert the award into a court judgment. This can be done in two ways:

- By an action on the award It is implied by any agreement to arbitrate that the parties will be bound by a valid award. Hence, if the losing party fails to pay, he/she may be sued for a debt that has arisen by virtue of the award.
- By an application under the 1950 Act, Section 26. This states:

"An award on an arbitration agreement may, by leave of the High Court or a judge thereof, be enforced in the same manner as a judgment or order to the same effect, and where leave is so given judgment may be entered in terms of the award."

In either event, the award is, thus, converted, and it can be enforced thereafter in exactly the same manner as if it had been a judgment of the court.

Types of Tribunal

There are three types of semi-judicial body:

(a) Professional councils

Most professional bodies have a council which possesses power to investigate complaints against members and punish them for misconduct in their professional capacity. The most severe punishment is expulsion from the profession.

A good example is the Law Society, which has power to deal in this way with erring solicitors.

(b) Departmental courts and tribunals

There are many courts or tribunals which have power to investigate certain specified matters and even, in some cases, to punish offenders. The following are some examples:

- ***Rent tribunals***

  This body hears and settles cases of dispute between landlords and tenants.

- ***Social security tribunals***

  This body, set up under the **Social Security Administration Act 1992**, hears and settles disputes about entitlement to benefits under social security legislation.

- ***Income tax commissioners***

  The local Income Tax Commissioners hear appeals by taxpayers against their assessments; they have power to award penalties (fines) against a taxpayer who has evaded tax.

- ***Employment tribunals***

  Employment tribunals (previously called industrial tribunals) were first set up in 1964, and they now deal mainly with disputes arising out of unfair contracts of employment, redundancy, equal pay and sex discrimination.

  A tribunal is made up of a legally qualified chairman, and two lay members, drawn from a panel of people with experience in industry, business, industrial relations, and so on. Wherever possible, the lay members sitting on any case will be representative of both employers and employees.

- ***Employment appeal tribunal***

  This court was formed by the Employment Protection Act 1975, to hear appeals from decisions of employment tribunals on a wide range of matters, such as redundancy, equal pay, unfair dismissal, sex discrimination, and other questions relating to employment legislation.

  The composition of the court for a hearing is one High Court judge, sitting with two or four laymen who have specialised knowledge or experience of industrial relations. The lay members are so appointed as to ensure equal representation to employers and employees. Appeals on points of law go direct to the Court of Appeal. Its procedure is cheap and informal, and the rules of evidence are not strictly observed.

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(c) Ministerial decisions

More common still is the settlement of disputes by the Secretary of State himself. Many minor decisions are entrusted to this source, including the following:

- ***National Insurance***

  The Secretary of State for Social Security settles any disputes about whether a particular employment comes within the Insurance Acts.

- ***Planning permission***

  If planning permission is refused by a local authority, an appeal against the decision lies not to a court but to the Secretary of State for the Environment.

- ***Local government pensions***

  A local government officer who is dissatisfied with his/her employer's decision on a pension matter has a right of appeal to the Secretary of State.

You can see from the examples that not all the decisions which have to be made are of a judicial nature – some involve the interpretation of the law and are clearly judicial but others (e.g. planning appeals) may be based solely on practical considerations. Nevertheless, the decision may affect the rights of citizens very considerably.

Advantages and Disadvantages of the Tribunal System

Administrative justice as we have described it above has many practical advantages:

- The procedure is simple, without any of the complications of a court; most of the tribunals sit informally.
- The arrangement is cheap. If the appeals had to go through the courts (even the County Court) many of the appellants would not bother because of the expense involved. At the tribunals an appellant need not be legally represented, and will incur practically no costs.
- The procedure gets a quick decision. In many of the ordinary courts there are long waiting lists but the tribunals are specialist bodies and can hear cases at short notice.
- Where necessary, the tribunal can visit the places concerned and make notes on the spot. This is important in such matters as planning cases.
- The tribunals deal only with a small range of specialised decisions, often on questions of fact only; consequently, there is no intrusion on judicial work, as such.

The usual criticisms of the semi-judicial tribunals are:

- The tribunals are not courts of law, and are not bound to follow closely legal procedure, e.g. the law of evidence, the right to cross-examine.
- The tribunals are not bound to give their decision according to the weight of the evidence; nor, in many cases, need they state their reasons. Officially, they are not bound by the rule of precedents, although they have established a system of this nature.
- The hearing may not be in public; practice varies.
- The position often arises, when a Minister is concerned, where he/she acts as a judge in his/her own cause. Sometimes a Minister has to hold various local inquiries into disputed decisions of local authorities, about planning permission and compulsory purchase, for example. The local authority has taken action and made an order or refused permission; the persons concerned object, and the Minister hears their objections and the case of the local authority at a public inquiry held on the spot by one

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of his/her inspectors. The decision on whether to confirm the order or decision rests with the Minister.

In many instances, however, the inquiry may have arisen as a result of action which the Minister him-/herself took, e.g. instructing local authorities to refuse permission for some development, etc. Thus the Minister is interested in the decision because of the policy that he/she wishes carried out, either generally or in this particular case. In theory, this is not the ideal frame of mind for acting impartially; in practice, it does not seem to have worked as badly as might have been expected.

Appeals

The right of appeal depends upon the particular wording of the statutes which set up the tribunals. Some give no right of appeal, e.g. the Secretary of State for Social Security has the final decision on the status of insured persons. In other cases, there is a right of appeal on a point of law, usually to the High Court.

In addition, the Queen's Bench Division of the High Court has power to make certain orders where one of these quasi-judicial bodies is acting improperly or beyond its powers, e.g. by dealing with matters outside its jurisdiction. These orders are those of **prohibition,** now renamed **Prohibitive Orders** (which order the court not to deal with the case), and **certiorari**, now renamed Quashing Orders (which order a decision of the tribunal to be brought before the High Court for amendment).

These orders are only given if an aggrieved person makes application to the High Court, and apply only to "judicial" acts of the tribunals, not administrative decisions, such as many of the ministerial decisions.

The **Tribunals and Inquiries Acts 1958** and **1971** now provide for such appeals in every case, **even if the existing statute restricts or forbids such an appeal**. Furthermore, the reasons for the decision of a Minister or a tribunal must be given if requested. Following the recommendations of the Leggatt Report, the structure and ethos of tribunals have now been greatly enhanced, and new provisions come into effect in 2008.

The Parliamentary Commissioner for Administration

The office of Parliamentary Commissioner, or Ombudsman, was established by the **Parliamentary Commissioner Act 1967**, to investigate and report on complaints of injustice suffered by reason of maladministration, i.e. a government department's failure to observe proper standards of administration, not amounting to actual illegality.

The Parliamentary Commissioner is appointed by the Crown, and has the same security of tenure as a judge of the Supreme Court. Complaints are made by citizens through a Member of Parliament. In most of the cases investigated as being within the Commissioner's terms of reference, the administration has, in fact, been exonerated. Commissioners have also been appointed to undertake investigations in relation to local government and the National Health Service.

Most recently, under the provisions of the **Courts and Legal Services Act 1990**, a Legal Services Ombudsman and a Conveyancing Ombudsman Scheme were established, followed by a Banking Ombudsman, an Insurance Ombudsman, a Building Societies Ombudsman and a Pensions Ombudsman.

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C. PUBLIC INTERNATIONAL LAW

Protection of Human Rights

Since January 1966, Great Britain has recognised the competence of the European Commission of Human Rights to receive petitions within the terms of the Convention for the Protection of Human Rights and Fundamental Freedoms, and has declared recognition of the compulsory jurisdiction of the European Court of Human Rights on all matters concerning the interpretation and application of the Convention.

The European Commission of Human Rights and the European Court are both organs of the Council of Europe, which was set up in 1949 to further co-ordination between the countries of Western Europe. The Council's third, or "legislative", organ is the Consultative Assembly. Great Britain's acceptance of the right to petition the Commission and of the Court's compulsory jurisdiction means that a person, whether a national or an alien, who suffers in Great Britain a violation of fundamental human rights, whether by a legislative, executive or judicial act, may seek redress through the Council of Europe. The rights are the following:

- Security of person
- Exemption from all slavery and servitude
- Freedom from all arbitrary arrest, detention, exile and other similar measures
- Freedom from all arbitrary interference in private and family life, home and correspondence
- Freedom of thought, conscience and religion
- Freedom of opinion and expression
- Freedom of assembly
- Freedom of association
- Freedom to unite in trade unions
- The right to marry and found a family
- Freedom of education
- Freedom to own property, either alone or in association with others.

They are, substantially, the same rights that are defined in the Universal Declaration of Human Rights made by the United Nations.

The Convention was incorporated into Anglo-Welsh law by the Human Rights Act 1998, in force 2 October 2000. By Section 2 of this Act, courts or tribunals determining a question relating to a Convention right must take into account judgments, decisions or declarations of the European Court of Human Rights.

European Union Law

For the sake of completeness in this discussion of the administration of justice, you are reminded of the Court of Justice of the European Union. We discussed the composition and jurisdiction of this court and the part it plays in the English national court system in detail in the first study unit of the course.

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D. JUDGES AND JURIES

Most disputes and crimes involve two sets of investigations: deciding what are the true facts and deciding what is the law to apply to them. In some courts, these two processes are entrusted to two bodies – the determination of fact by a jury and of law by a judge – but in all courts the distinction is important because appeals to higher courts lie on points of law; on points of fact, often leave to appeal must first be obtained.

The Status of Judges

All the important judicial offices are held by nominees of the Crown, who are mainly selected from the senior barristers but who, in some cases, are former politicians, e.g. the Attorney-General was often a favoured candidate for the post of Lord Chief Justice, while the Lord Chancellor actually used to combine the functions of judge and politician.

Despite this apparent relationship, it is a principle of the English judicial system that judges must be independent of the Crown. This principle finds expression in several ways:

- Judges hold office for life "during good behaviour". Their salaries are secured on the national revenue and not voted annually by Parliament, and they can be removed only on the petition of both Houses – a procedure which has not been used for over 250 years.
- Judges are immune from personal liability for anything done or said in their public capacity. Consequently, they need not be restrained by fear of legal or other action against them.
- Judges are not under government control and cannot be overridden or instructed by Ministers. They can be overridden only by Act of Parliament.

As a consequence of these arrangements, judges are able to exercise their function without fear or favour and to act quite impartially; their connection with the government is purely nominal.

It is difficult to over-emphasise the importance of the judiciary in the English legal system for, as we saw in an earlier study unit, much of English law is contained in judicial precedents, i.e. is judge-made law. The high status enjoyed by judges in England, as compared with other countries, is partly attributable to the relative smallness of their numbers – a situation that is made possible by the fact that the overwhelming majority of cases, both criminal and civil, are dealt with by lay justices. Since the **Act of Settlement 1701**, all the superior judges have held their offices *"quamdiu se bene gesserint"* (during good behaviour) and their salaries are fixed. They are appointed by the Crown and can only be removed by the Queen upon the presentation of an address by both Houses of Parliament.

The Jury System

A jury consists of 12 persons, men or women, over 18 and not more than 70 years of age, chosen almost at random from lists of registered electors in the county in which they live.

Any person who is currently on bail, has served a lengthy prison sentence or is suffering from a mental disability is disqualified from jury service.

Trial by jury is an essential part of the English legal tradition. It has long been upheld as a bastion against injustice and oppression. In the words of Lord Denning:

> *"Whenever a man is on trial for serious crime, or when in a civil case a man's honour or integrity is at stake, or, when one or other party must be deliberately lying, then trial by jury has no equal".*

Nevertheless, the jury system is surrounded by sentiment and tradition, and there are grounds for questioning whether the above views are supported by reality. In recent years,

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criticism of jury trial has tended to increase. Some of the major points of concern are as follows.

- **Function of the jury**

  In practice, it is difficult to accept that the jury's function is to determine issues of fact alone. Where does law end and fact begin? Admittedly, the jury is not required to decide matters of law, but without receiving a thorough exposition of the legal principles in a case, jurors cannot form a proper appreciation of the facts. For example, in a murder case the jury has to decide whether the facts amount to murder or manslaughter, and they can do this only with the judge's explanation of the relevance of motive. It is for this reason that critics contend that a jury can be greatly influenced by a judge – or, indeed, by clever counsel. It is, therefore, not entirely true that the judge has nothing to do with the facts. In summing up, he/she must collate all the facts brought out in evidence, and evaluate each item for the guidance of the jury.

- **Evidence**

  By their oath, jurors have to try a case on the basis of the evidence presented in court. Unfortunately, this is not a simple matter in practice, because counsel are determined mainly to impress the jury with the strength of their "case". This means that facts may be emphasised in different ways. It may also mean that the jury has to reach a decision on the basis of evidence which is **not** submitted, e.g. by drawing deductions from the fact that the accused does not go into the witness box.

- **Credibility of witnesses**

  The problem of deciding whether a witness is to be believed or not, is another aspect of evidence. Ability to judge people's characters depends to a fair extent upon experience. However, certain occupations or professions are more closely involved in estimating the characters of others, possible examples being schoolteachers and businesspeople. It does not always follow that a particular jury is better or worse than the judge in determining the credibility of a witness.

- **Court procedure**

  Court procedure in England is still very technical and difficult for the layperson to understand. It is also probably true to say that the average juror, on first attendance in court, will not appreciate certain forms of advocacy which are designed deliberately to win over the jury. It has been suggested that the jury's task would be far easier if the opening for the claimant or prosecution were followed by an outline of the case for the defendant, so that there would be a clear picture of what is and is not in dispute.

- **Assessment of damages**

  In a common law action, if the jury find for the claimant, they fix the damages. A frequent criticism is that the amount of damages is not a subject upon which a jury can be expected to have any special ability or experience. Again, in libel cases, there is no way of assessing damage to character and juries' awards are often inconsistent.

- **Complex and technical cases**

  A further criticism of the jury system is that the average juror is not qualified to appreciate the intricacies of complex cases involving wide-scale commercial fraud and similar matters. Such cases often require detailed consideration of financial documents or accounts of which jurors may have little knowledge and experience. It has been suggested that, for such cases, a judge should sit with a small panel of assessors who have commercial and financial experience.

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E. ORGANISATION AND ROLE OF THE LEGAL PROFESSION

Barristers at Law

History

For various purposes the King often required the services of attorneys and by the end of the 15th century there were two official law officers of the Crown – the Attorney-General and the Solicitor-General, who were in fact both attorneys. Thus, to plead a case in court, it was necessary for the King to engage some leading **serjeant** and he was known as the **King's Serjeant**. The serjeants-at-law were the most senior category of advocate at that time, with exclusive right of audience in the Court of Common Pleas. Attorneys, on the other hand, did not appear as advocates in the higher courts. The office of King's Serjeant has now been abolished.

The Tudor monarchs, whose aim was to promote the royal prerogative, found that the serjeants were too closely attached to the Court of Common Pleas to serve their purposes in the way they wished, particularly as they required representation before other courts, e.g. the Court of Star Chamber. They solved the problem by appointing to the offices of Attorney-General and Solicitor-General barristers who were not serjeants. This explains the curious anomaly of the names of these offices, when the holders are invariably barristers.

These two officers were required not only to conduct state prosecution but also to defend the royal interests in Parliament, the Solicitor-General in the Commons and the Attorney-General in the Lords, a practice which lasted until 1660 when both those officers came to sit in the Commons. As a result of this dual function, extra assistance was soon needed, and by the 17th century it became customary to appoint eminent barristers as **King's Counsel** to act for the Crown in court. Unlike the serjeants, who formed a class apart from the ordinary barristers, the King's Counsel remained members of their Inns and during the 17th and 18th centuries their importance grew, and that of the serjeants declined.

The position today

To become a barrister, a candidate must be over 21 and conform to all the rules and regulations of one of the four Inns of Court – the Inner Temple, the Middle Temple, Gray's Inn and Lincoln's Inn.

On passing the requisite examinations, the candidate is "called to the Bar" and is thereafter entitled to appear as an advocate in any court of law in England and Wales.

There are two classifications applied to barristers:

- **Queen's Counsel (King's Counsel)**

  By the 18th century, the title of QC (KC) – sometimes called "silks", because QCs have the right to wear a silk gown – was given to leading barristers by letters patent on the advice of the Lord Chancellor.

  Where a barrister has had considerable practical experience and thinks that he has attained some eminence at the Bar, he may apply to the Appointments Committee to "take silk". If permission is granted, letters patent are issued, he is sworn as a Queen's Counsel and is called within the Bar of the Supreme Court, wearing a silk gown instead of the stuff gown worn by ordinary barristers. Thereafter he takes on less routine work and has the assistance of "junior" barristers in court. It is from the ranks of Queen's Counsel that judges of the Supreme Court are usually appointed.

  A Queen's Counsel is known as a "Leader", presumably because by tradition he is usually accompanied in court by one, and sometimes two, junior counsel.

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- **Juniors**

  A "junior" is any barrister who has not applied to "take silk". Most juniors undertake advocacy as well as the preliminary paperwork, and some successful barristers (on the Chancery side, particularly) remain juniors throughout their working lives. Once a junior takes silk and becomes a QC, he/she cannot return to a junior's practice.

Organisation of the Bar as a profession

There are three key bodies which organise and regulate the profession of barristers.

- **The Inns of Court**

  These have three classes of member:

  (i) **Students** – who join with a view to qualifying by keeping the required dining terms and passing the Bar examinations, so that they may then be "called to the Bar" of their Inn.

  (ii) **Barristers** – who, having been called, will remain members of their Inn until their death or resignation, unless they are disbarred.

  (iii) **Benchers** – who are the more senior members of their Inn and responsible for disciplinary matters. These include the power to disbar a qualified member for breach of any aspect of the etiquette of the Bar, which would then mean that person could no longer practise as a barrister.

- **The Senate of the Inns of Court and the Bar**

  This body was created in 1966. It is the governing body of the Bar. It comprises senior representatives from each of the Inns of Court, together with the Attorney- General and the Solicitor-General. It can make decisions affecting the whole of the Bar on such matters as admission and call, education of student members, and disciplinary rules.

- **The Bar Council**

  This body was created in 1894. It represents the Bar in a general sense, though it has no formal duties or powers. It is concerned with maintaining standards of conduct and propriety, promoting and preserving the services and functions of the Bar, and acting for the profession generally.

Work of a barrister

This may be considered as comprising three areas:

- **Advocacy**

  The barrister speaks in court on behalf of her client, having previously taken instructions from him and/or his solicitor. This is her supreme function but she has others.

- **Drafting documents**

  These are the "Statements of Case", i.e. the preliminary documents required before the case comes on, such as the statement of claim, defence, replies, and Further Questions. Their purpose is to clarify the issue(s) to be brought before the court and to resolve any matters which can be agreed by the parties prior to the hearing.

  Barristers also draft a considerable number of legal documents, such as wills, title deeds, company prospectuses and Memorandum and Articles of Association, partnership agreements and contracts.

- **Counsel's opinion**

  Barristers are often asked by solicitors and their clients to give an opinion on the law relating to a difficult matter, such as the tax consequences of a proposed trust or

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contractual arrangement. The opinion will then form the basis of some policy decision, or it will be used in negotiations.

A barrister's duty

A barrister's duty is to the court, not merely to his/her client, although he/she is not an officer of the court. He/she is liable for contempt and must be properly robed in all courts except the Magistrates' Court. He/she must draw the attention of the court to the authorities (statutes, case decisions, etc.) relevant to the issue(s) before it, not merely to those favouring his/her client.

The barrister and his client

The relationship between a barrister and his/her client is not a contractual one. Thus, he/she cannot sue for his/her fees; but, since 2002, he/she is liable to his/her client for professional negligence.

Only barristers may be appointed to the offices of Lord Chancellor, Attorney-General and Solicitor-General. Although, today, other judicial offices are open to solicitors, in fact the majority of appointments to the High Court, Court of Appeal and the House of Lords are made from the ranks of practising barristers.

Solicitors

History

During the Middle Ages, the two professions of attorney and barrister were not entirely distinct, and attorneys were often members of the Inns of Court. However, a complete separation took place in the 16th and 17th centuries and such membership ceased. The attorneys then established themselves as "go-betweens", and acted as the link between the lay client and the barrister.

In addition, a special type of attorney, called a solicitor, at first of humble status, was attached to the Court of Chancery and specialised in equity work. By the middle of the 17th century solicitors had gained equality of status with other attorneys and at a later date the two types were amalgamated. The name "solicitor" then became generally preferred until, during the 19th century, the term "attorney" virtually disappeared. There were also proctors and doctors attached to the Court of Admiralty and the church courts but their special functions disappeared with the setting up of the divorce and probate courts in 1857.

In 1729, a statute required that attorneys and solicitors should go through an apprenticeship of five years' duration, which was interpreted as a period of "five years' articles" with a practising attorney or solicitor, to learn the profession.

The Law Society

The Law Society was established in 1831, and is now legally compelled to keep a roll of solicitors which is technically in the custody of the Master of the Rolls.

It regulates the education of those wishing to become solicitors, by conducting their requisite examinations, and it has a disciplinary committee which enforces good conduct among members of the profession and which has power to suspend a solicitor from practice or to strike him/her off the Roll.

Training for the would-be solicitor has long been a combination of examinations in law and the understudying of a solicitor in practice. This latter process involves the student in spending a period of time under a Training Contract. When the student has completed this satisfactorily, and passed all the examinations to which he/she is subject, he/she may then apply to the Law Society to be "admitted". This process is effected by the Master of the Rolls formally adding the name of the new solicitor to the roll of officers of the Supreme Court. From the date of admission, the student becomes a solicitor of the Supreme Court of

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Judicature and, as such, an officer of the court, but may not practise until he/she has taken out an annual practising certificate, individually issued by the Law Society.

Present status

Nowadays solicitors are the only members of the legal profession who are not barristers. They have a right of audience and can act as advocates before the Magistrates' Courts, and also before the County Courts. As a result of the **Courts Act 1971**, they may become eligible for appointment as circuit judges and recorders.

Relationship between Barristers and Solicitors

As we have seen, solicitors come under the control of the Law Society and barristers under the control of their respective Inns of Court.

The barrister's brief

A barrister does not normally deal directly with a client but through a solicitor. When a person engages in litigation, his first contact will usually be with a solicitor, who will subsequently advise him on a choice of barristers, particularly if the case involves a court hearing where the solicitor has no right of audience.

The solicitor's main function in litigation is to prepare the case for counsel, i.e. the barrister. He will take instructions from his client and statements from all the witnesses it is proposed to call, and provide all office services for conducting correspondence, copying documents, handling funds and accounting. Finally, he will draw up a brief for the barrister who will conduct the case in court, if the hearing is in the Crown Court or High Court. In addition, if the case is important enough to warrant the expense, he may brief the barrister in a County or Magistrates' Court.

When a QC is employed, a junior may also be briefed and his fee will be a matter for negotiation. The rule that he always received two-thirds of the QC's fee has now been abolished.

Payment of the barrister

A barrister does not discuss her fees with the solicitor employing her. The procedure is for the solicitor to arrange the fees with the barrister's clerk and to mark them on the brief. However, if the solicitor for a client fails to pay the sum marked on the brief, the counsel may report him to the Law Society, which will probably order him to pay the fees on penalty of suspension from practice. A solicitor is supposed to pay counsel's fees, whether he obtains them from a client or not, but usually the barrister will be agreeable to a settlement in the matter where a solicitor has been "let down" by the client.

Retaining fees

Sometimes, when it is desired that a particular counsel – usually the QC – should appear in a case, the solicitor will first pay him a small retaining fee, by the acceptance of which the barrister undertakes not to accept a brief in the case for the other side. However, he does not agree to appear in the case, although the solicitor retaining him is obliged to offer him the brief. Should the solicitor decide later that he prefers another counsel, his only remedy is to offer the brief with a ridiculously small fee which the barrister's clerk will reject.

Solicitors as advocates

A considerable amount of advocacy is done by solicitors in minor cases, particularly of an uninvolved nature.

Solicitors' existing rights of audience are confined to proceedings before the Magistrates' Courts and the County Courts, and to appeals from the magistrates before the Crown Court. The **Courts and Legal Services Act 1990** now makes provision for the Lord Chancellor to direct that solicitors may have rights of audience for all proceedings in the Crown Court.

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Legal work not involving litigation

Although some solicitors become crime or litigation specialists, most do a great deal of work which does not involve litigation, e.g. conveyancing, probate (the administration of deceased persons' estates) and trusts. Sometimes, however, a solicitor will engage counsel to draft conveyancing documents of a complicated nature, e.g. settlement of valuable family property.

Courts and Legal Services Act 1990

Part II of this Act deals with the provision of legal services and lays down a **statutory objective** as follows:

> *"The general objective ... is the development of legal services in England and Wales (and in particular the development of advocacy, litigation, conveyancing and probate services) by making provision for new and better ways of providing such services and a wider choice of persons providing them, while maintaining the proper and efficient administration of justice".*

It goes on to lay down a **general principle** which is to operate in determining whether a person should be granted a right of audience or a right to conduct litigation in relation to court proceedings. Relevant factors to be considered include appropriate qualifications in respect of education and training, membership of suitable professional bodies, etc.

The Act also established the Legal Services Ombudsman. She is appointed by the Minister of Justice and given the responsibility of investigating any allegations about the way in which the appropriate professional body dealt with a complaint made to it with respect to *"an authorised advocate, authorised litigator, licensed conveyancer, registered foreign lawyer, registered body or duly certified notary public and a member of that professional body"*. Her jurisdiction extends to complaints concerning any employees of these specified persons.

Miscellaneous Law Officers

Lord Chancellor

This office has now ceased to function, with many of the judicial functions adopted by the newly appointed Minister for Justice.

Lord Chief Justice

This officer is the head of the Judiciary in England and Wales. The office is held for life, the only ground for removal being an address by both Houses of Parliament to the Crown (**Act of Settlement 1701**). The Lord Chief Justice is a member of the Court of Appeal and is President of the Courts of England and Wales.

Master of the Rolls

The Master of the Rolls is the custodian of the public record and by virtue of his office he is a member of the Court of Appeal. He also has duties concerned with the Roll of Solicitors and, in some cases, appeal lies to him from the decisions of the Disciplinary Council of the Law Society.

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Study Unit 4

The Law Relating to Associations

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A. THE CONCEPT OF CORPORATIONS

Definition

A corporation may be defined as:

> *an artificial unity or entity, normally consisting of a group of individuals, which the law treats as having a common will and, therefore, capable of holding rights and duties.*

In other words, a corporation is a purely artificial entity, treated by the law as a legal person.

One of the root principles of the corporation is **immortality**, for it exists independently of its members, unless it is brought to an end in certain specific ways. This at once distinguishes it from the individual person, whose span of life is restricted and uncertain.

Reasons for Corporate Existence

The primary reason for the creation and recognition of corporations is commercial and economic. Under the protection of the corporation, large-scale enterprises flourish for centuries, having perpetual succession undisturbed by the death of individual members. The continuity of the corporation is not affected, whether old members die, existing members retire or new members are added. The main point to grasp is that the **collective personality of the corporation is entirely distinct from that of its members** operating the corporation.

There are two distinct lives – the juristic life of the corporation and the life of the individual members. Obviously, although a corporation is a "person" in the eyes of the law, it cannot marry or be imprisoned, as an individual can – so it is frequently referred to as a "fictitious person". Because of the artificiality of its personality, the legal capacity of a corporation differs in some respects from that of ordinary individuals.

The distinction between the personality of a corporation and the personality of the individuals making up the corporation was clearly laid down in the case of ***Salomon v. Salomon & Company Ltd (1897)***. Salomon incorporated his business as a limited company, which consisted of seven members of his family and himself. He held all the shares except seven, and also debentures to the value of £10,000, representing a loan which the company borrowed from him. The debentures entitled him to a first charge on the assets of the company. Thus, when the company went into liquidation, Salomon claimed that, as a debenture holder, he was a "secured" creditor. The other creditors claimed that Salomon and the company were the same person and that a man could not owe money to himself. However, The House of Lords **held** that a company, once incorporated, had a legal existence of its own, which was quite independent of the existence of any individual member.

B. CORPORATIONS IN LAW

Creation of a Corporation

Since corporate personality is acquired only by state recognition, it can be conferred only by an authoritative document, having the state's approval. The law, therefore, prescribes that a corporation can be created by one of the following:

- **Royal Charter** whereby the Crown by its prerogative creates one particular corporation, e.g. a borough such as Oxford was incorporated by Royal Charter, and so was the BBC.
- **Special statute** whereby a special Act of Parliament creates corporations to fulfil public functions, e.g. the Post Office Corporation.
- **General Act of Parliament** which grants the privilege of incorporation to all groups complying with certain requirements e.g. the Companies Acts which govern the formation of companies and the Building Societies Act which governs building societies.

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- **Immemorial custom**, whereby a few corporations which never had charters are presumed to have acquired incorporation by immemorial custom in accordance with the fiction that the original charter was lost, e.g. certain very ancient boroughs.

The Acts of a Corporation

Exercise of powers

Since a corporation has no material existence, but has the right to express its will, it has to act through its agents. As it is obviously impossible to allow all the members of a numerous body to act as its representative and to bind it by words or writing, some smaller group within the corporation is selected to administer its affairs. A typical example is that of the Board of Directors of a limited liability company who manage and act for the company as a whole.

There is, however, an important difference in the scope of the actions of corporations created by charter or "lost charter" theory and those created by statute. Corporations formed by charters, also known as **common law corporations**, have all the powers of ordinary persons except those which are specifically withdrawn by the charter which created them. They may, for example, do many things which are not clearly inconsistent with the purposes for which they were created.

On the other hand, statutory corporations may do only those things permitted expressly or impliedly in the statute incorporating them or in the documents of incorporation granted under the statute. Every act done in excess of these powers is *ultra vires*, and is legally void. An act which is *ultra vires* does not bind the corporation in any way. It is treated merely as the act of the agent or official which authorises or performs it.

Since 1989 it has been necessary to distinguish companies which are formed or registered under the **Companies Act 1985** from other forms of corporation as the *ultra vires* rule has been virtually abolished in the case of the former category.

Formal contracts

A company is represented in any matter concerning the law of contract by its agent or agents. Their contracts must, of course, be *intra vires*, i.e. within the company's powers.

The common law required that, when a corporation entered into a contract it used its common seal – the outward sign of authority of the whole body. However, the **Companies Act 1948** made companies incorporated under the Companies Act exempt from the formality of contracting only by means of the common seal, and such corporations are now on the same footing as individuals as regards the form of their contracts.

The same rule now applies to contracts made on behalf of any corporation (**Corporate Bodies' Contracts Act 1960**).

Torts

A corporate body is, in the law of tort, liable for the wrongful act of its servants, provided that the act was done within the scope of the servant's employment and within the powers of the corporation, and it was an act which would have been actionable if done by an individual.

Owing to its nature, a corporate body is not able to sue or to be sued in respect of certain torts. For example, a corporation cannot sue for assault or battery.

However, it has been held that a corporation may sue for defamation, i.e. libel and slander, if it can prove actual damage to its trade or business interest. This does not apply, however, to a municipal corporation, the income of which depends upon the rates it chooses to raise and not upon any trade. A municipal corporation, therefore, cannot sue for defamation, since its reputation is immaterial: ***Mayor of Manchester v. Williams (1891)***.

In ***Cornford v. Carlton Bank (1900)***, it was **held** that a corporate body can be considered to have a malicious mind and therefore, to be liable for the tort of malicious prosecution.

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Cessation of a Corporation

A corporation continues to exist until it is dissolved in one of the following ways:

- By voluntary surrender of its charter to the Sovereign
- By forfeiture of the charter through some default
- By Act of Parliament
- By the method provided for dissolution in the incorporating statute, e.g. under the Insolvency Act 1986 companies are dissolved by means of a "winding-up".

Note that a corporation does not cease to exist merely because all its members are dead. In such a case it is merely in abeyance and it can be revived at any time.

C. COMPANIES

Definition

The major statute governing companies is the **Companies Act 1985** which consolidated all previous statutes relevant to company law.

The 1985 Act has itself been superseded by a **2006 Companies Act**, due to come into full implementation by 2009.

One definition of a company is that it is:

> *an association of members whose shares in the property of the company are transferable.*

Another way of defining it is:

> *an association of individuals for purposes of profit, possessing a common capital contributed by the members composing it, such capital being commonly divided into shares of which each member possesses at least one, and which are transferable by the owner.*

A **limited company** is one in which the liability of its members is limited by the Memorandum of Association (see later) to the amount, if any, unpaid on the shares respectively held by them.

Limited companies are often referred to in the press, on radio and TV and in everyday speech as "firms". You should remember, however, that in the language of the law, **a firm** is a partnership or a one-man business, not a limited company.

Classes of Company

As a result of the **Companies Act 1985**, the following five classes of company now exist:

- Public limited companies (plcs)
- Private companies limited by shares
- Private companies limited by guarantee **without** a share capital
- Private companies limited by guarantee **with** a share capital
- Unlimited companies.

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In practice, these companies fall into three basic legal categories:

(a) Unlimited companies

These are rare, and do not call for a great deal of discussion. Note that the word "limited" is not used as the last word in the name of the company, and that the liability of the members is unlimited. An unlimited company may be reregistered as a limited company.

(b) Companies limited by guarantee

A company limited by guarantee is a private company which has the liability of its members limited by the Memorandum of Association to such amount as the members may respectively thereby guarantee to contribute to the assets of the company in the event of its being wound up. Leading examples are trade associations and organisations formed to promote charity, education, science, etc. They do not normally have a share capital, as they are not formed for profit, but they acquire the benefits of incorporation by registration.

(c) Companies limited by shares

This category is by far the most common, and it represents the ordinary limited company of modern commerce and industry. In a company limited by shares, the shareholders can only be called on at any time to pay the company the amount unpaid on their shares. This liability is stated in the Memorandum and, once the shares are fully paid up, it ceases.

Under the Act, companies limited by shares are classified as either **public** or **private**. A public limited company (plc) is defined by the Act as a limited company (whether by shares or by guarantee with a share capital) whose Memorandum states that it is a public company and which has registered as a public company. Such a company must have a minimum nominal allotted share capital of £50,000, and must identify itself on business stationery, etc. as "Public Limited Company". A private company is then defined in the Act as any company that is not a public company. The minimum number of persons who may form a public company is two. For private companies there is now no restriction on the number of members or shareholders, or on their right to transfer shares.

Note that companies limited by shares are often known generally as **joint stock companies**.

Advantages and Disadvantages of Creating a Company

The choice between using a limited company as a trading vehicle and remaining unincorporated as a sole trader or a partnership is one which has significant implications for businesses.

Once incorporated, the members of a limited company enjoy limited liability. So long as they have paid for their shares in full they cannot be required to contribute to the debts of the company. However, you will find examples later where the "veil of incorporation" can be lifted to remove the benefits of limited liability.

The company can sue and be sued in its own name. This is an advantage to shareholders in that they do not become immediately responsible for the debts of the company. However, in the event of a liquidation, ordinary shareholders rank last in the list of creditors of a company and rarely recover the full value of their investment. This reinforces the basis on which a company owns property, which is that its assets belong to the company itself, not to its members.

Ownership and **management** are fundamentally separate in a company. Although in many small companies the reality is that the directors are also the company's shareholders, this does not change the fundamental point under English company law; and it is unusual for large public companies which have a Stock Exchange listing to have a similar situation. While

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directors of a public limited company will usually have a shareholding, it is rare for them to have a controlling interest.

Once incorporated a company is subject to all the rules of company law as laid down in the **Companies Acts**. These are often complex rules but companies and their directors are deemed to be aware of them and to understand that non-compliance may often lead to personal criminal liability.

In comparison with other trading entities, such as sole traders or partnerships, the company enjoys greater flexibility in the raising of capital. For example, it may raise capital by means of a floating charge over the whole company or a specific part of the company's assets. Until the charge crystallises the directors are free to deal with or sell those assets subject to the charge. Companies can also raise capital, subject to compliance with Stock Exchange regulations, from the various securities markets such as the Alternative Investment Market and the Unlisted Securities Market. In due course this can lead to a full Stock Exchange listing where the company's shares are fully traded, with its activities being subject to full public scrutiny.

While many business operators elect to trade as a limited company to reduce their personal risks, banks and other lending institutions will not necessarily provide finance to the company itself. In the absence of a good trading record and substantial fixed assets which can be charged in the event of default, banks will frequently only lend to companies where the directors provide their own personal guarantees.

In order to incorporate a company the subscribers must register a range of documents with the Registrar of Companies together with a fee. There are usually fees payable to professional advisers who form the company, although it is increasingly the case for new companies to be purchased "off the shelf" from a company formation agent in order to minimise costs. During the life of the company there are annual compliance requirements such as submission of annual accounts to the Registrar of Companies, completion of an annual return and notification of all other relevant statutory issues such as appointment or resignation of directors and the company secretary, registration of mortgages and charges and any changes in the location of the registered office. Although the preparation and submission of annual accounts will involve a cost to the company, the audit requirements have been considerably relaxed for companies with annual turnovers under the thresholds of £90,000 and £350,000.

In recent years there has been an increasing number of companies formed as trading vehicles by individuals offering personal services, particularly in the information technology field. This has enabled the owners of the company, usually a single shareholder, to maximise their personal earnings by taking dividends from the company instead of salaries as employees.

However, this practice has come under the scrutiny of the Inland Revenue and its advantages may be restricted where the personal service company contracts with a single client company.

Distinction between Directors and Shareholders

A company is an artificial legal person recognised in law as having an existence distinct from that of its members. Once incorporated the members (shareholders) of a limited company enjoy limited liability. As long as they have paid for their shares in full they cannot be required to contribute to the debts of the company.

It is important to recognise that ownership and management of a company can be separate even though the individuals concerned are physically the same. **Shareholders** as owners of the equity or share capital of the company have the right to freely transfer their shares unless there is some restriction in the company's constitution. Shareholders, however, have no authority to "manage" the business of the company. Directors exercise day-to-day management of the company subject to the Companies Act, the Memorandum and Articles of

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the company (see later) and the directions given by the members of the company by special resolution at a general meeting.

Shareholders have the following rights by virtue of owning shares in a company:

- To receive dividends
- To receive a return of capital in a winding-up
- To participate in surplus assets on a winding-up
- To attend and vote at general meetings.

Shareholders have no right to see the minutes of directors' meetings, only of shareholder meetings. Their decisions at general meetings may in some instances require a 75% majority.

Directors are appointed by the company in accordance with its Articles of Association. Their activities are controlled by the Articles, which deal with appointment, qualification, rotation and remuneration and by the Companies Act 1985, Company Directors' Disqualification Act 1986 and Insolvency Act 1986 and latterly the Companies Act 2006.

Directors have a **fiduciary duty** (duty of good faith) towards the members of the company. Every director must give notice to his/her company of any interest which he/she has in the shares and debentures of the company. Directors can be removed from the board of a company without their consent under the provisions of Table A (the model set of Articles of Association). Directors cannot vote or participate in a board meeting discussion to consider a matter in which they have an interest unless they have given prior notification of this interest. Generally directors may consider whatever matters they consider necessary to be discussed at a board meeting and they reach decisions by a simple majority vote.

In many small companies, e.g. husband/wife/partner or family companies, the directors and shareholders are the same. In this case it is important to realise that the above provisions of the Companies Act apply. This is particularly critical in the event of liquidations where directors of companies ensure that their own assets are kept separately from those of the company in which they are the only shareholders. Provided directors have not contravened the provisions of the Companies Act or Insolvency Act then the creditors of a company are unable to seek redress from them personally in the event of the liquidation of their company.

The Veil of Incorporation

The fundamental principle of English company law was laid down in the case of ***Salomon v. Salomon & Co (1897)***, namely that a company duly incorporated is a separate legal entity with its own rights and liabilities distinct from those of its shareholders. This is the case whether the company is a single member private company, a subsidiary company in a group of companies, or a public limited company with a Stock Exchange listing and many thousands of shareholders.

In ***Salomon's*** case, Mr Salomon had carried on a shoe manufacturing business for over 30 years and decided to form the business into a limited company. The company was registered with him and six others holding the shares. He then sold his business to the new limited company for a figure of just under £40,000. This sum was paid for by the company issuing shares valued at £20,000 to Mr Salomon and his family. A secured debenture, which was a floating charge on the company's assets, was created in favour of Mr Salomon for £10,000. The balance was then paid in cash.

However, some time later the new company found itself in financial difficulties and was put into liquidation. When the financial position of the company was assessed, its assets were worth only about £6,000 and the amount owing to trade creditors was about £7,000. When a judgment had to be made by the court it had to decide whether the trade creditors or the debenture holder (Mr Salomon) was entitled to the £6,000 assets. The trade creditors argued

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that since an individual could not owe money to himself, so too a company could not owe money to its major shareholder. However, the court decided that the company was a separate legal entity, which could owe money even to a major shareholder. Therefore, the debenture which had been created in favour of Mr Salomon was valid and as holder he was entitled to such assets as remained within the limited company prior to liquidation.

This principle, that upon incorporation a company becomes a separate legal entity, is fundamental to the organisation and management of English limited companies and as stated above, the case of ***Salomon v. Salomon & Co. Ltd. (1897)*** established the legal principle of 'separate corporate personality' i.e. from the date stated on a company's certificate of incorporation the company acquires its own rights and liabilities, separate from those of its members and it has perpetual succession, which means that members can come and go and the company remains – a company has a dual nature as both an association of its members & a person separate from its members.

Moreover, following incorporation, an incorporated company has, inter alia, the following attributes:

- It can hold property in its corporate name
- It can sue and be sued in its corporate name
- It can be a debtor and creditor in its own name, and even of its own members
- Insolvency of the company need not bring about the bankruptcy of its members (limited is one of the main advantages of incorporation)
- It has perpetual succession, so that the membership may change, without affecting the legal personality of the company
- It can make contracts in its corporate name
- It can commit crimes, which do not involve mens rea (i.e. a guilty mind) such as road traffic offences (crimes involving mens rea can also be committed if the person who was instrumental in causing the crime to be committed was inn a senior management position within the company, such that he can be considered to be the alter ego (other self) of the company)
- It can commit torts, either through the instrumentality of its officers or its employees. The company can be vicariously liable for acts of employees committed in the course of employment.

The case of ***Salomon v. Salomon & Co. Ltd. (1897)*** led to the coining of the phrase 'lifting the corporate veil'.

The principle that a company is a person, separate from its members, can produce unsatisfactory results in certain circumstances. Company law, therefore, recognises a number of exceptions to the principle of 'separate corporate personality'. In these exceptional circumstances, described collectively as **'lifting the corporate veil'**, the company is treated as the same person as its members & managers i.e. they lose the shield of the veil of incorporation and become 'jointly and severally' liable with the company for all debts and liabilities as in the case of partners in a traditional partnership, as defined by the Partnership Act 1890.

Although there is no one consistent principle running through these various exceptions, those provided by statute tend to penalise breaches of the companies legislation and those provided by the case law tend to involve situations where *'special circumstances exist indicating that it (the corporate veil) is a mere façade concealing the true facts'* per Lord Keith in ***Woolfson v. Strathclyde Regional Council (1978)***.

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Common law examples of lifting the corporate veil include:

- Trading with the enemy

  The leading case on this is ***Daimler Co. Ltd. v. Continental Tyre & Rubber Co. (Great Britain) Ltd. (1916)***. If, as in this case, the persons in actual control of the company are enemy aliens, the company can also be so regarded (as an enemy) for the purposes of the law relating to trading with the enemy.

- Cases involving groups of companies where the corporate veil may be lifted either on public policy grounds or in the interests of justice

  There has been a lot of controversy over the years in relation to groups of companies, where each company within the group, according to the doctrine of incorporation, is a separate legal entity i.e. there is a 'veil of incorporation between a holding company and its subsidiary(ies). Similarly, there is a 'veil of incorporation' between co-subsidiaries. However, there have been a number of cases where the courts have lifted the veil (or veils) of incorporation between a holding company and its various subsidiaries, with two main aims:

  (i) Firstly, to benefit the group of companies concerned by obtaining higher compensation payments in the event of compulsory purchase of premises. Case illustrations of this scenario include Smith, Stone & Knight Ltd. v. Birmingham Corporation (1939) and DHN Food Distributors v. London Borough of Tower Hamlets (1976).

  (ii) Secondly, to benefit the creditors of the group of companies concerned (including the Inland Revenue) of an insolvent company by making other companies within the group liable for its debts. This doctrine has been implemented frequently to determine the extent of tax liability.

  A case illustration of the corporate veil being lifted for this reason is ***Firestone Tyre & Rubber Co. Ltd. v. Lewellin (1957)*** where the veil was lifted because it is clearly contrary to public policy to evade tax, and lifting the veil shows that in a group, which is one financial entity and potentially has the resources to pay the creditor his outstanding debt, all members and directors of the company become jointly and severally liable for paying the tax bill just like in a traditional partnership.

- Where working relationships have broken down within a quasi-partnership company

  The leading case on lifting the veil on this ground is ***Ebrahimi v. Westbourne Galleries Ltd (1972)***. A breakdown in the management of a company or the complete exclusion of a member director from participation in management, have been redressed (remedied) by winding-up the company concerned on the just & equitable ground in accordance with Section 122(1)(g) of the Insolvency Act 1986. The courts regarding the company, in such cases, in fact, if not in form, as a partnership. This scenario normally arises in companies with few members, which because of this and their management structure are termed quasi-partnerships.

- Where a company is a sham and is seeking to evade the enforcement of existing rights

  The House of Lords in ***Woolfson v. Strathclyde (1978)*** stated that it is appropriate for the courts to lift the veil of incorporation only where special circumstances exist indicating that it is a 'mere façade' concealing the true facts. The "façade" or "sham" concept seems to apply where the company concerned has been formed primarily to evade existing liabilities or defeat the law. Here, the courts have been prepared to investigate sharp practice by individuals who are trying to hide behind a company's "façade". The leading case on lifting the veil under this ground is ***Gilford Motor Co v. Horne (1933)*** – seeking to evade the operation of a restrictive covenant in his contract of employment with his previous employer, the Gilford Motor Co.

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In ***Creasey v. Breachwood Motors Ltd (1993)***, where a company transferred its assets to another company to avoid liabilities arising from a wrongful dismissal claim brought against the first company, the court allowed the claimant to pursue the assets of the first company into the second company. See also ***Gencor v. Dalby (2000)***.

Statutory examples of lifting the corporate veil include:

- The fall in minimum membership of a plc to below the statutory minimum of two members in contravention of Section 24 of the Companies Act 1985

  This states that if a plc carries on business without having at least two members and does so for more than 6 months, a person who, for the whole or any part of the period that it carries after 6 months, (a) is a member of the company, and (b) knows that it is carrying on business with only one member, is liable jointly & severally with the company for the payment of the company's debts contracted during the period, i.e. after the 1st 6 months, or, as the case may be, that part of it. It should be noted that this provision has not been carried over to the Companies Act 2006.

- Incorrectly stating a company's name in correspondence etc.

  Section 349(4), Companies Act 1985 states that if an officer, for example, a director or secretary, signs a bill of exchange (e.g. a cheque) on which the correct name of the company is not stated, he will be required to pay the amount of it, on the basis of personal liability, if the company refuses to honour (pay) it. Again, it should be noted that this provision has not been carried over to the Companies Act 2006.

- Where a plc does business or exercises any borrowing powers, before it has been issued with a 'trading certificate' from the Registrar of Companies

  This can lead to the directors of the company which is in default being held personally liable for any loss or damage suffered by a third party to any transaction entered into be the company in contravention of this section.

  It should be stressed that the failure of a plc to obtain a Section 117 'trading certificate' (Section 761 certificate under the Companies Act 2006), before it does business or exercises its borrowing powers, does not affect the validity of a transaction entered into be the company, but where a company operates in contravention of Section 117 and fails to comply with its obligations in connection with the transaction within 21 days from being called upon to do so, the directors of the company are jointly and severally liable to indemnify any other party to the transaction in respect of any loss or damage suffered by him by reason of the company's failure to comply with its obligations (the directors who are liable are those persons who held the office of director at the time when the transaction was made). Directors have joint and several liability with their company just like partners have joint & several liability with their firm.

- Where there is a holding and subsidiary relationship between companies, the holding company is required, subject to certain exceptions, not only to prepare its own individual accounts *but also* group balance sheets and profit and loss accounts of it, the parent and its subsidiary undertakings: Section 229, Companies Act 1985. This suggests that for financial purposes at least, that the companies within a group are as one. The veil of incorporation can then be lifted between the individual entities (subsidiaries) within the group so that the companies' investors (and others e.g. the Inland Revenue) can judge the financial position of the group as a whole.

- In the event of fraudulent trading

  Under Section 213, Insolvency Act 1986, if the court finds that the business of a company has been carried on with intent to 'defraud', i.e. has engaged in fraudulent trading, it can hold any person (e.g. directors, accountants and/or employees) who were 'knowingly parties' to the fraud personally liable to make such contribution to the

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company's assets as the court thinks fit, under the circumstances. Examples of "fraudulent trading" include paying creditors out of order on the preferential list of creditors – especially a party "knowingly" paying one party of creditors off in the knowledge that this will result in creditors higher up the preferential list losing out financially. Liability is no longer limited because the persons who have engaged in fraudulent trading are required to pay a fine set by the court. In a traditional partnership there is no limitation of liability in the event of the firm failing. Partnerships are permitted to have limited partners but such partners are not permitted to participate in the management of the firm, otherwise they will lose their shield of limited liability.

- In the event of wrongful trading

  Under Section 214, Insolvency Act 1986, if on the winding-up of an insolvent company a past or present director (or shadow director) knew or ought to have known, before the commencement of the winding-up, that there was no reasonable prospect that the company could avoid insolvent liquidation and failed to take every step to minimise the loss to the company's creditors, then the court may declare, on the application of the liquidator, that the person(s) is/are liable to make such contribution as the court thinks fit – ***unless*** they can establish that they took ***every step*** they ought to have taken with a view to minimising the potential loss to the company's creditors. The judgement standards under this section are based on objective criteria rather than 'personal morality and honesty'; a person is to be judged on the basis of his/her own knowledge, skill and experience that could reasonably be expected of someone carrying out his/her "function" in relation to the company [Section 214(4)]. Liability is no longer limited because the director who has engaged in wrongful trading is required to pay a fine set by the court.

Cases which affect directors and shareholders:

- ***Williams v. Natural Life Health Foods (1998)***

  Here the House of Lords stated that a director of a limited company was only personally liable for loss suffered as a result of negligent advice given by him on behalf of the company if he had assumed personal responsibility for that advice.

  In this case such an assumption of responsibility had to be determined objectively and the absence of personal dealings would indicate very strongly that the director would have no responsibility.

- ***Re Continental Assurance Co. of London plc (1996)***

  Here the court decided that a non-executive director of a company had failed to appreciate what the responsibilities of a director were in relation to the understanding of a company's financial affairs. The director was required to exercise the competence required by the Companies Act in relation to the affairs of the company. His conduct as a director of the company made him unfit to be concerned in the management of a company and he was disqualified for three years from holding office as a director.

- ***Hood Sailmakers Ltd v. Axford (1997)***

  Here the company's Articles stated that a quorum for a meeting was two directors. As the company only had two directors and one of them was abroad, it was not possible to hold a valid meeting. The director remaining in the UK attempted to use the written solution procedure to enable decisions to be made effectively by himself, who remained in the UK. The court decided that this written resolution procedure was invalid as one director was attempting to override the quorum requirements to his advantage.

- ***Ross v. Telford (1997)***

  Here the court examined a case of corporate deadlock where equal shareholdings held by two parties in a company were preventing decisions being made by the company. In

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this case and in others, where deadlock arises either from non-attendance rendering meetings inquorate or from equality of voting power, companies find it impossible to function. However, the decision in this case makes it clear that courts will not attempt to solve a dilemma for parties which they have caused by the way in which they have divided the share capital or organised the quorum requirements. The solution is most likely to rest with the parties themselves, who can resolve the deadlock by agreeing to wind up the company.

- ***Re Park House Properties Ltd (1997)***

  Here the court held that where directors had never played any active role in a company and had never been paid as directors, they still had obligations to fulfil. In this case three directors were disqualified from holding office since the law imposes statutory and financial duties on all directors. Their complete lack of involvement in the running of the company, its financial problems and the preparation and filing of accounts led the court to conclude that they were unfit to hold office as directors.

D. COMPANIES IN LAW

Formation

Incorporation

A company is formed by the requisite number of persons lodging with the Registrar of Companies a signed Memorandum of Association and Articles of Association. Once these documents are approved by the Registrar, the Registrar issues a Certificate of Incorporation which brings into being a new legal entity.

A private company may begin business on the issue of the Certificate of Incorporation but in the case of a public company, certain other formalities must be observed before the Registrar issues a certificate to commence business.

Memorandum of Association

The Memorandum of Association states that its signatories wish to be incorporated as a company; the proposed company's name, objects (no longer required under the 2006 Act), powers, capital and the situation of its registered office. It must also contain a clause stating that the liability of members is limited. It is expected that, as this document expresses the powers of the company, all persons having dealings with the company shall be acquainted with its provisions, particularly as no act beyond its scope is binding upon the company, even should every member acquiesce. This is the *ultra vires* doctrine we referred to earlier.

In ***Ashbury Carriage Co. Ltd v. Riche (1875)*** a company was formed with the objects of making, selling and mending railway carriages and as mechanical engineers, to purchase, lease and work mines, minerals, land and buildings. It purported to enter a contract to purchase a concession to build a railway in Belgium. The members of the company, in general meeting, ratified the contract, but it was nevertheless **held** to be *ultra vires* and void, for it was beyond the objects clause in the Memorandum.

However, the **1985 Act** consolidated significant amendments to the *ultra vires* doctrine as a result of the harmonisation of British company law with EC (now EU) law. Section 35 modified the doctrine by providing that a person dealing in good faith with a company need no longer inquire into the limitations on the capacity of the company or powers of the directors. This has the effect of preventing the company from avoiding its responsibility under an *ultra vires* contract, but left the *bona fide* third party the option of either enforcing such a contract against the company or of backing out on the grounds that the contract was *ultra vires*.

In 1989 further legislation reached the statute book on this particular issue. Section 108, **Companies Act 1989** substituted new Sections 35, 35A and 35B into the 1985 Act. These

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new provisions, to all intents and purposes, abolished the *ultra vires* rule altogether, in so far as it affects companies formed or registered under the 1985 Act. The provisions are as follows:

(a) By Section 35, "*the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's Memorandum*".

A shareholder may, however, still obtain an injunction to restrain an intended *ultra vires* act, providing he/she does so before any binding legal obligation has been entered into by the company. Furthermore, directors will remain liable for any acts which are *ultra vires* the Memorandum, unless those acts are ratified by a special resolution and a further special resolution is passed to relieve them of liability.

(b) Section 35A brings within the section the power of directors to bind the company to acts within the power of the company.

Neither Section 35 nor Section 35A applies to charities.

(c) Section 35B relieves a party to a transaction with a company from the need to inquire into the terms of a company's Memorandum or any limitation in the directors' powers.

Similar provisions are enacted for companies not formed under the Act but which are registered under it, and for unregistered companies.

Section 110 of the 1989 Act also substitutes a new Section 3A and Section 4 into the 1985 Act. These provisions enable a company to state that its object is to *"carry on business as a general commercial company"*, which is explained as enabling the company to *"carry on any trade or business whatsoever ... (and to do) ... all such things as are conducive to carrying on any trade or business by it"*. The sections also enable the company to alter its objects **for any purpose whatsoever**. Formerly the opportunities for such alterations were restricted to a few specific situations.

For companies which choose to adopt such a broadly worded objects clause and to avail themselves of the modified procedures, the *ultra vires* doctrine would appear to be dead.

Articles of Association

The Articles of Association are the rules for the internal management of the company. The First Schedule of the Companies Act is known as "Table A" and it constitutes a model set of Articles which are applicable to every company, unless the company's own Articles expressly exclude or modify the provisions of Table A. From 2009 and the full introduction of the Companies Act 2006 provisions, there will be separate sets of model articles for private companies and plcs.

Matters regulated by the so-called model set of articles include:

- Share Capital
- Transfer of Shares
- Votes of Members
- Appointment of Directors
- Dividends
- Winding-up
- Alteration of Share Capital
- Proceedings of General Meetings
- Powers of Directors
- Removal of Directors
- Accounts

Can the Articles of Association be amended following incorporation?

Yes, by following the procedure laid down in Section 21(1) of the Companies Act 2006 [Section 9(1) in the Companies Act 1985], which states that ' a company may amend its articles by special resolution'.

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However, it should be noted that, amongst other things, the statutory power of a company to amend its articles must be exercised subject to the common law requirement that the shareholders voting in favour of the resolution must be exercising their power to vote *'bona fides for the benefit of the company as a whole':* ***Allen v. Gold Reefs of West Africa Ltd (1900)***.

The exact meaning of the phrase 'bona fide for the benefit of the interest of the company as a whole' is thus of paramount importance. It can be seen from the decided case law in this field that the determination of whether or not an alteration is 'bona fide for the benefit of the interest of the company as a whole', involves a subjective element, in that those deciding on the alteration must ***genuinely believe*** that they are acting in the interests of their company as a whole.

However, there is also an objective element. In ***Greenhalgh v. Arderne Cinemas Ltd. (1951)*** it was stated by Evershed MR that any alteration had to be in the interest of the 'individual hypothetical member'.

Moreover, in ***Brown v. British Abrasive Wheel Co. (1919)*** where an alteration to the articles of the company was proposed to give the majority shareholders [98%] the right to purchase the shares of the minority [2%]. It was held that the alteration was invalid as it would benefit the majority shareholders rather than the company as a whole and was in any case to wide a power.

Conversely, in **Sidebottom *v. Kershaw Leese & Co (1920*)**, an alteration to the articles gave the directors the power to require any shareholder, who entered into competition with the company, to transfer the shares to nominees of the directors at a fair price. It was held that under those circumstances the alteration was valid as it would benefit the company as a whole. Moreover, the courts have held that it may be in the interests of the company to purchase, compulsorily, a member's shares or to alter the whole structure of the company. Of course, if it can be shown that the majority are acting dishonestly or oppressively, in making such an alteration, then the resolution will be declared invalid: ***Clemens v. Clemens Bros Ltd (1976)***.

Furthermore, the articles cannot be altered in such a way as to conflict with the memorandum (as it is the superior constitutional document) or any provision of the Companies Acts. In particular, no member can be bound by any alteration to subscribe for more shares or increase their liability to contribute to the capital of company in any way: Section 25 of the Companies Act 2006 (Section 16 in the Companies Act 1985). Any alteration to the articles after the date on which the member became a member which requires the member to take or subscribe for more shares than the member holds, or which increases a member's liability to pay money to the company, will not be enforceable against the member in a court of law **unless** they have agreed in writing to subscribe for more shares etc.

Is a company member entitled to object to a proposed amendment of the Articles of Association?

Yes, any member, irrespective of the size of his shareholding, has two possible courses of action open to him:

(a) Under the common law, he can seek to get the amendment set aside on the grounds that it is not 'bona fide for the benefit of the company as a whole'. The phrase 'bona fide for the benefit of the company as a whole' originates from the words of Lindley MR in the case of ***Allen v. Gold Reefs of West Africa (1900)***:

".the power conferred must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole…".

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It seems therefore, that the test, which should be applied, is whether the proposal is, in the honest opinion of those voting for it, "bona fide for the benefit of the company as a whole" (i.e. for the benefit of all the company's members).

(b) Under Section 459 of the Companies Act 1985 [Section 994(1) in the Companies Act 2006], he can bring a petition on the grounds that the proposed amendment of the articles is unfairly prejudicial to him in his capacity as a company member. The usual remedy awarded by the courts in such cases is the purchase of the members shares under Section 461(2)(d) of the Companies Act 1985 [Section 996(2)(e) in the Companies Act 2006].

So what sort of conduct by a company is likely to be regarded by the court as unfairly prejudicial?

Case law has established a number of situations which prima facie amount to unfairly prejudicial conduct and it should be emphasised that conduct may be perfectly lawful but still unfairly prejudicial. Thus the following types of conduct have been deemed to be unfairly prejudicial by the English courts.

- ***Exclusion and removal from the board*** where the company was one in which the director had a legitimate expectation of being involved in management i.e. a quasi-partnership company. In ***Re Bird Precision Bellows Ltd (1986)*** a minority shareholder with 26% of the shares suspected that the managing director of 'this quasi-partnership' company was concealing bribes that he had received in order to secure contracts. When the Department of Trade & Industry refused to investigate the minority shareholder was removed from the board. The minority shareholder claimed that this amounted to unfairly prejudicial conduct. His claim was upheld.
- ***A policy of making low dividend payments***. In ***Re Sam Weller & Sons Ltd. (1990)*** the petitioners, who between them held 42.5% of the shares in their family business, complained that the company had not increased its dividend for 37 years, despite its profitability. In 1985 its net profit had been £36,000 yet only £2,520 was paid out in dividends. The company was controlled by the petitioners' uncle, Sam Weller, who along with his sons continued to receive directors' fees and remuneration. Peter Gibson J. commented on the petitioners' position: *"As their only income from the company is by way of dividend, their interests may not only be prejudiced by the policy of low dividend payments, but unfairly prejudiced."*

Restrictions on a company's power to amend its Articles of Association

(a) Any alteration of the articles must be 'bona fide for the benefit of the company as a whole':

That is, any amendments which cannot be so regarded will be deemed invalid irrespective of whether a special resolution has been passed in favour of the alteration concerned in general meeting. As indicated above, the exact meaning of the phrase 'bona fide for the benefit of the company as a whole' is best understood by making reference to decided caselaw in this area.

- In ***Sidebottom v. Kershaw, Leese & Co. (1920)*** an alteration of the articles, enabling the directors who were also the majority shareholders, to request the compulsory purchase of the shares, at a fair value, of any member competing with the company's business, was approved by the court. The court found this to be a valid alteration of the articles because in the words of Lord Sterndale MR "*it is for the benefit of the company that they should not be obliged to have amongst them as members, persons who are competing with them in business and who may get knowledge from their membership which would enable them to compete better".*
- In ***Brown v. British Abrasive Wheel (1919)*** the company, British Abrasive Wheel, needed to raise additional capital. 98% of the shareholders were willing to

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contribute the required capital but only on the condition that they could buy-out the 2% minority shareholding in the company. Having failed to affect this by agreement, the 98% majority then proposed to alter the company's articles of association in order to give them the power to compulsorily purchase the shares of the 2% minority. The minority shareholders objected to this alteration and brought an action against the company on the ground that the alteration was not 'bona fide for the benefit of the company as a whole'. The court agreed with the minority shareholders, irrespective of the fact that the majority shareholders were prepared to insert any provision as to price, which the court deemed fair.

- The rationale for the court's decision to disallow the alteration of that articles was that the proposed alteration could not be truly regarded as 'bona fide for the benefit of the company as a whole' but rather for the benefit of the majority shareholders and was, in any case, too wide a power. Moreover, there was no direct link between the company's need to raise additional capital and the alteration of the articles. Although the whole scheme of events had been geared towards the provision of extra capital, following the removal of the objecting minority shareholders, it would in fact have been possible after the minority had been expelled from the company, for the majority shareholders to then refuse to provide the additional capital.

(b) The amendment must not contravene Companies legislation

The statutory restrictions on a company's power to alter its articles are the same as the restrictions in relation to its power alter its Memorandum.

- A member cannot be required to take more shares. Section 16 of the Companies Act 1985 (Section 25 in the Companies Act 2006) provides that the articles cannot be altered so as to require a member to take up more shares, or in any way to increase his liability to contribute to the share capital or otherwise pay money to the company, unless he consents in writing.
- The right of a member to object to a variation of his class rights cannot be taken away. Under Section127 of the Companies Act 1985 (Section 633 in the Companies Act 2006) shareholders have a statutory right to object to a variation of their class rights. The object of this section is to protect shareholders from being prejudiced by the voting of other shareholders who hold shares of another class in addition to those of the class affected by the variation. In accordance with Section 127 of the 1985 Act, 15% of the class not voting for the variation may apply to the court to have it cancelled within 21 days of the consent of the class being given, whether in writing or by resolution. Once such an application under Section127 has been made, usually by one or more dissentients on behalf of the others, the variation will not take effect unless and until the court confirms it. For example, if a variation reduces the dividend on preference shares from 7% to 6% per annum, and 80% of the preference shareholders are also ordinary shareholders, the requisite consent of the preference shareholders is likely to be obtained, since the variation will leave more profits for a dividend on the ordinary shares – this would be unfair to the 20% of the preference shareholders whom are not ordinary shareholders and they could petition under Section 633 to have the variation cancelled.
- The right of a member to bring a petition on the grounds of unfair prejudice cannot be taken away. Section 994, Companies Act 2006. A member might bring a petition on the grounds of unfair prejudice in the following cases:

  (i) Where the majority shareholder and director is using the assets of the company for his own personal benefit. In Re Elgindata (No.1) (1991) the majority shareholder and director used the assets of the company for his

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own personal benefit. The petitioner complained that this was unfairly prejudicial to him and the court, subsequently, ordered the respondents to purchase the shares held by the petitioner.

(ii) Where the majority shareholder is, in effect, transferring sources of profit into another company owned by them. In Re London School of Electronics Ltd (1986) a petition was presented by a minority shareholder where the majority shareholder was, in effect, transferring sources of profit into another company owned by him. The court held that this was unfairly prejudicial conduct and made an order for the majority shareholder to purchase the petitioner's shares.

(c) The proposed alteration of the articles must not conflict with a court order

For example, in accordance with Section 461 of the Companies Act 1985 (Section 996 in the Companies Act 2006) following a Section 459 petition on the grounds of unfair prejudice, a court may order that a company does make any, or any specified, alterations to its articles without obtaining the leave of the court.

Name of a Company

Registration

The Memorandum must state the name of the company. The general rule is that any name may be selected. However, a company cannot be registered by a name which, in the opinion of the Department of Trade, is undesirable. Also, the last word of the name of a limited company must be the word "Limited" or "plc", as appropriate, unless permission is given to dispense with the word "Limited". In selecting a name, it is not necessary to use the word "company" and the modern tendency is to omit it.

The Department of Trade's policy regarding undesirable names is explained in an official Guidance Note but the list of rules contained in it is not exhaustive and does not restrict the Department's discretion. In general, a name will not be allowed if it is misleading, e.g. if the name of a company with small resources suggests that it is trading on a great scale. A name will be refused if it is too like the name of an existing company. Only in very exceptional cases and for valid reasons will names be allowed which include "British", "Royal", "Imperial", "National", "International"" "Commonwealth", "Co-operative", "Bank", "Trust", "Crown", etc.

Change of name

A company may change its name by special resolution, with the approval of the Department of Trade. A small fee is payable to the Registrar for filing the new name and the issue of a new Certificate of Incorporation. The change does not affect any rights or obligations.

Business Names Act 1985

This Act applies to companies, partnerships, or individuals who carry on business under a name **other than** the corporate name of the company, the forenames and surnames of the partners, or individual.

Businesses controlled by the Act must state on all letters, written orders for goods and services, invoices and receipts, and written demands for payment of debts:

- In the case of companies, their corporate name
- In the case of a partnership, the name of each partner
- In the case of individuals, their own names and
- In each case, an address within Great Britain for the service of legal and statutory documents.

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They must also display on any premises, to which customers or suppliers have access, a prominent notice containing such names and addresses.

Capital of a Company

Types of capital

The term "capital" may be used in various senses. It may mean the nominal or authorised share capital; the issued share capital, the paid-up share capital or the reserve share capital of the company. The capital is issued in the form of different classes of shares or stock, which are subscribed by the members. Stock has been defined as *"simply a set of shares put together in a bundle"*: ***Morrice v. Aylmer (1875)***.

Paid-up shares may be converted into stock. For example, a company which has 10,000 paid-up £1 shares may convert them into £10,000 worth of stock. If shares are converted into stock, the value of the holder's stake in the company remains the same, although it is expressed in different terms, e.g. a person who formerly held 100 shares of a nominal amount of £1 each will now hold a nominal amount of £100 worth of stock.

The different types of share capital noted above are, in more detail, as follows:

(a) ***Nominal or authorised capital***

The Memorandum of Association sets out the maximum amount of capital which the company is **authorised** to issue, although a company need not issue capital to the full amount authorised unless, or until, it wishes to do so. The company's nominal or authorised capital depends on its business requirements.

(b) ***Issued capital***

This is that part of the company's nominal capital which has been issued to the shareholders.

(c) ***Paid-up capital***

This is the proportion of the issued capital which has been paid up by the shareholders. The company may, for example, have a nominal capital of £500,000 divided into 500,000 shares of a nominal amount of £1 each, of which £400,000 is issued (i.e. 400,000 of the shares have been issued) and only £100,000 is paid up because the company has, so far, required only 25p to be paid up on each share.

(d) ***Uncalled capital***

Uncalled capital is the balance of the issued capital and it can be called up at any time by the company from the shareholders.

(e) ***Reserve Capital***

This is that part of the uncalled capital which a company has, by special resolution, determined shall not be called up, except in the event and for the purposes of the company being wound up.

Shares

A share may be of any chosen denomination, e.g. £5, £1, 50p. This is known as the **nominal** value and should not be confused with the **actual price paid**. A share originally issued for £1 may increase in value, so that the market price becomes £3 or more, or it may decrease in value, so that the market price is only a few pence. The nominal value always remains the same and has little significance, whereas the market price depends on whether investors consider that the future prospects of the company are good or bad.

When shares are issued, they need not necessarily be paid for in full. Sometimes the company does not need to use the whole amount represented by the share capital at the time

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of issuing the shares and consequently, £1 shares may be paid in part (e.g. 50p) the balance remaining payable on "call" from the company when it requires the funds.

The liability of the shareholder is limited to paying the market or issue price (or any unpaid amount of "call") of her shares. She cannot be required to contribute further to the company's debts, even though it is hopelessly insolvent.

This is the meaning of the term "limited liability", which is a basic principle of company law.

In other words, once the shareholder has purchased fully paid shares, he is under no liability whatsoever for the debts of the company. If he has purchased partly paid shares, his liability is limited to the unpaid portion of the nominal value; if the shares are nominally £1 each and 75p was paid on issue, he is liable to pay no more than 25p per share when requested to do so by the company. Note that we are talking about the nominal value of partly paid shares; the market price varies according to demand and supply and the shareholder may have paid 60p, or even £1.25, each to purchase the shares, but this does not affect his liability for 25p each.

The shares which make up the capital of the company are usually of two main types; either **preference shares**, which entitle the holder to be paid a dividend at a fixed rate per cent before any other dividend is payable, or **ordinary shares**, which are entitled to distribution of a dividend out of the remaining profit, the rate of dividend being decided each year according to what the company can afford. In the event of a winding-up, the company's preference shareholders usually carry the right to the return of capital before the ordinary shareholders, who are dependent upon the assets available.

Rights of shareholders when a company is a going concern

(a) ***Voting rights***

Ordinary shareholders have superior voting rights to those enjoyed by preference shareholders. The right to vote at general meetings equals the right to influence the way the company's affairs are conducted, by voting at meetings of members. The model articles for plcs and private companies only govern the voting rights of ordinary shareholders. Each member has one vote on a 'show of hands' or on a 'poll' – "one vote for every share of which he is the holder". Preference shareholders can normally only vote in certain specified circumstances as identified either by their company's constitution or the terms of share issue. Normally preference shareholders of a company are only given the right to vote in certain specified circumstances, e.g. where the rights attached to their preference shares are being varied, in which case they will have no right to vote in any other circumstances.

(b) ***Dividend rights***

Ordinary shareholders **always** have the right to participate in the distribution of profit. As long as the company continues to operate as a going concern, ordinary shareholders are entitled to a dividend of **profit**, which may be of any size as recommended by the directors and approved by the company's members. The amount of dividend distributed to an ordinary shareholder is proportional to the nominal value of the shares, which he holds. Preference shareholders only have the right to participate in the distribution of profit if it is expressly given by the company's constitution and/or terms of issue. Ordinary shareholders don't have a right to a dividend of a fixed rate. The size of an ordinary shareholders dividend is dependant on the size of the company's profit. No profit ***equals*** no dividend. The dividend of preference shareholders is paid at a fixed rate e.g. 6% of the nominal value of each share, and is payable in priority to the payment of a dividend to any other class of shareholder. Ordinary shareholders don't have a right to a cumulative dividend. Dividends on ordinary shares are never cumulative. No profit ***equals*** no dividend. Preference share dividends in the absence of an express provision to the contrary are assumed to be cumulative

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(c) ***Statutory pre-emption rights***

Companies legislation provides that no company can allot securities without first offering them pro rata to existing ordinary shareholders on the same or more favourable terms than it is proposing to offer them to other people – this is commonly termed a 'rights issue'. The shareholders must be given 21 days in which to decide whether to accept or reject the offer. Section 89 of the Companies Act 1985 (Section 561 in the Companies Act 2006) provides valuable protection for existing shareholders by requiring that new shares be first offered to existing members so that their proportionate holding in the company can be maintained, hence the term rights issue.

Preference shareholders do not have statutory pre-emption rights, although they could obtain pre-emption rights if they were expressly given to them by their company's articles of association.

(d) ***Freely transferable subject to articles of association***

This right applies to both ordinary and preference shares.

Rights of shareholders on winding-up

(a) ***The payment of arrears of cumulative dividend which have been declared***

Ordinary shares are never cumulative; therefore, no such rights exist. Preference shareholders do have this right and it is normal for the articles of a company to provide for the payment of such arrears.

(b) ***Limitation of liability***

This means that In the event of corporate failure a member's liability is limited to any amount outstanding on their shareholding. plus the whole of any share premium. This right applies to both ordinary and preference shareholders.

(c) ***The right to have their capital contribution returned***

Ordinary shareholders always have the right to have their capital contribution returned to them on winding-up. If preference shares are given participating rights by their company's constitution, ordinary shareholders will rank behind the holders of that class.

(d) ***The right to participate in the distribution of surplus assets***

Ordinary shareholders always have this right. The rights of preference shareholders are exhaustive. They are not entitled to participate in the distribution of any surplus assets unless they are expressly given this right by their company's articles of association.

Alteration of capital

A limited company with a share capital, if so authorised by its Articles, may alter the conditions of its Memorandum by:

- Increasing its share capital by new shares or
- Consolidating and dividing all or any of its share capital into shares of larger amount than its existing shares or
- Converting all or any of its paid-up shares into stock, or reconverting stock into paid-up shares of any denomination or
- Subdividing all or any of its shares into shares of smaller amount than is fixed by the Memorandum or
- Cancelling shares which have not been taken or agreed to be taken by any person.

All these powers require a resolution of the company, in general meeting, to be exercised.

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Meetings

Classification

There are three kinds of General (shareholders') meetings of companies:

(a) ***Annual General Meetings (AGM)***

Every company must hold its first AGM within 18 months of incorporation and thereafter no more than 15 months apart and at least once in every calendar year, in accordance with Section 366 of the Companies Act 1985. This means that, if a company holds its AGM on 1 January 2008, then it must hold its next AGM by 31 March 2009 at the latest.

If a company fails to hold an AGM then any member may apply to the Secretary of State to call a meeting in default.

The business conducted at AGMs tends to be routine, such as the re-election of directors; appointment of auditors, consideration of accounts and approval of dividends. In line with the recognised distinction between public and private companies, the Companies Act of 1989 introduced a new provision, which permits private companies, subject to approval by a unanimous vote, to dispense with the need to hold an annual general meeting. Under Section 381A of the Companies Act 1985 it is no longer necessary for a private company to convene a general meeting where the members have unanimously signed a written resolution setting out a particular course of action.

(b) ***Extraordinary General Meetings (EGM)***

An extraordinary general meeting is any meeting other than an AGM. EGMs are usually called by the directors, although members holding 10% of the voting shares may requisition such a meeting by virtue of Section 368 (Companies Act 1985).

The directors of a company must call an EGM within 28 days of becoming aware of this situation if the net assets of a public company have been reduced to less than half in value of the company's called-up share capital. The main purpose of such a meeting is to consider what, if any, remedial measures should be taken by the company to deal with the situation.

(c) ***Class Meetings***

This refers to the meeting of a particular class of shareholder i.e. those who hold a type of share providing particular rights, such as preference shares. Where a proposal is put forward to vary the class rights attached to particular shares then it is necessary to obtain the approval of the holders of the particular class concerned. In order to achieve this approval, a meeting of those holding such shares has to be called to seek their approval of any proposed variation. The statutory procedures governing the variation of class rights are contained in Sections 125-127 of the Companies Act 1985.

Statutory provisions

There are detailed statutory provisions concerning a number of matters in connection with the calling and conduct of meetings, including the following:

- A specified minimum notice of meetings must be given to all the members.
- The notice must state whether it is proposed to transact any "special business" at the meeting and, if so, it must state the nature of such special business. (This is to protect members from the danger of allowing important changes in the company's structure or policy to be made in their absence.)
- No business can be transacted unless a quorum is present.
- Provisions are made with regard to the duties and powers of the chairman of the meeting (usually the chairman of the Board of Directors).

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- There are rules governing voting. Voting may be by show of hands or (on the demand of any person present and entitled to vote) by poll. In the latter case, members may vote by proxy. (A **proxy** is a written instrument entitling another to vote in a member's place, and the Act makes detailed provisions concerning voting by proxy.)
- Special provisions are made with regard to the three kinds of resolutions that may be passed at meetings – ordinary, extraordinary and special. These are outside the scope of your course.

By the rule in ***Foss v. Harbottle (1843)***, the court will not interfere at the suit of a member or a minority of members where there is a wrong done to a company itself or an irregularity in its internal management, if such action is capable of confirmation by a majority of the members. However, there are certain exceptions to this rule, e.g. a minority may sue to prevent the company from acting illegally or *ultra vires*, or from perpetrating a fraud on the minority of members.

Directors

Nature of directorship

All registered companies must have directors, and normally there must be at least two, although one suffices for a private company or one registered before 1929.

The position of directors is similar to that of trustees, e.g. in their fiduciary relationship to the company, in issuing shares, and approving transfers of shares. However, they are trustees for the company and not for the individual shareholders, nor for third parties who have made contracts with the company. Directors are also sole agents for the company when they make contracts for the company and, as such, are in a fiduciary position to the company and cannot make secret profits at the company's expense.

A company may act only through its agents – and such agents, if they direct and control the company's affairs, are deemed to be directors. Under the Act, *"director"* includes any person occupying the position of director, by **whatever name** called.

Powers of directors

The powers of directors are usually set out in the Articles, authorising them to carry on the business of the company, and there is generally an additional clause giving them powers of management and all the powers of the company which are not otherwise specifically mentioned in the Articles.

If the Articles are silent on this point, the law implies that all the ordinary powers connected with a business of the same kind as that carried on by the company are being conferred upon the directors.

The powers of directors may be enlarged, or in certain circumstances restricted by the shareholders, and if the directors act beyond their powers the shareholders may ratify their act, provided it is not *ultra vires* the company.

As we have already said, a director is in a fiduciary position to the company in her capacity as agent, and she cannot, therefore, place herself in a position where her own interests conflict with her duties. Directors must on no account make any secret profits. Any such benefit is regarded as a bribe, and the directors are accountable to the company for such. Where a director accepted a gift of 200 fully paid shares from the promoter of the company, he was compelled to make good to the company the advantage gained: ***Eden v. Ridsdale Lamp Co. (1889)***.

A director is bound to exercise faithfully the trust he has accepted, and is bound to exercise fair and reasonable diligence in discharging his duties and to act honestly; but he is not bound to do more: ***Re Forest of Dean Company (1878)***.

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Liabilities of directors

The directors are liable for negligence or breach of trust in relation to the company's affairs. The Act makes ample provision for the liability of directors guilty of fraud or gross negligence in respect of the company or third persons. During the course of a winding-up, the Act provides that a director who has misapplied or retained or become liable or accountable for any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company, may be compelled to repay or restore the money or property or to pay such sum to the company as the court thinks fit.

Directors are personally responsible for fraud; although, where the company has taken advantage of fraudulent misrepresentations, the company may be held bound as well as the directors.

A director owes a duty to the company to devote to her duties such care, prudence, and diligence as could **reasonably** be expected of a **reasonably responsible person** in those kind of circumstances. She must exercise such skill as may reasonably be expected of a person of **her** knowledge and experience. For care and diligence, the director's conduct is measured objectively against the standards of the reasonably prudent and responsible person. For skill, or "professionalism", the executive director with a service contract will be required to display higher standards. Like any other responsible employee, she will be required to show both care and skill of a kind to be expected of an employee receiving that kind of salary and charged with those kind of responsibilities.

Borrowing by a Company

Borrowing powers

Trading companies have implied power to borrow for trading purposes and to give security for loans, unless expressly prohibited from doing so by the Memorandum of Association. Other companies need express power to raise loans. If a loan (or any portion of a loan) is *ultra vires* the company, it is void, even if it is ratified by the members in general meeting.

However, in such circumstances the lender may have the following remedies:

- If the money has not been spent, he can obtain an injunction restraining the company from parting with it and he can recover it
- He can bring an action against the directors for breach of warranty of authority
- If money has been used to pay creditors, the lender may stand in the place of such creditors (this is known as **subrogation**) but he will not get any priority which may have attached to such creditors' interest.

Debentures

A company may borrow money by the issue of debentures which are, in reality, promises to repay the sum borrowed and are executed under the seal of the company.

A debenture can be a document issued to such lender and it is then a self-contained security, entitling the holder to take action in his/her own name. An alternative method of raising funds is to execute one debenture in the form of a trust deed, appointing trustees. Lenders do not receive an actual debenture, but only a debenture stock certificate. **Debenture stock** is the whole amalgamated borrowing of the company and holders of stock certificates are not, generally, entitled to take proceedings individually but have to do so through the trustees, who are the beneficiaries of the promises in this case.

A debenture is merely a promise to repay the money borrowed and it does not, of itself, constitute an actual charge on the assets of the company. It is usual to give security to the debenture holders by effecting a mortgage or charge on the assets of the company, so that, in the event of the company's being wound up, the debenture holders have a first claim to

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receive payment. This security may be given in the form of a **fixed charge**, a mortgage on some specific part of the company's assets, e.g. the factory premises at X town, or by means of a **floating charge**, which may be described generally as relating to the whole of the assets of the company. The advantage of a floating charge, from the company's point of view, is that it remains entitled to deal freely with the assets so charged.

Distinction between debentures and shares

Debentures must be carefully distinguished from shares in a company. In modern times they are often regarded by investors as being merely different species of the same thing; each enables members of the public to invest in a company and to participate in its profits. However, in law, they are quite distinct. A **shareholder** is a member of the company, with certain rights and liabilities. A **debenture holder** is **not** a member of the company – but a person outside the company who happens to be its creditor; legally, his/her position vis-à-vis the company is similar to that of ordinary trading creditors. Secondly, a **shareholder's dividends** are his/her share of the company's **profits**; **debenture holders** merely receive **interest** on the loan. In modern times, the distinction has tended to become blurred by reason of the increase in popularity of issues of shares that do not carry voting rights and preference shares which are entitled to a fixed dividend – the position of such shareholders is very similar in practice to that of debenture holders – but the legal position, largely for historical reasons, is that they are completely different and distinct.

Common Seal

The common seal of a company is the signature of the company and the sealing of a document is witnessed by the officers of the company specified in the Articles of Association. The seal must be kept at the registered office of the company under some form of control which will adequately prevent its unauthorised use.

However, as mentioned above, the company may act in a number of ways through its agents, and it is no longer necessary for documents in normal business use to be impressed with the seal of the company. The Companies Act 1989 provides for documents to be signed as a deed and for companies to dispense with the use of a seal in commercial transactions.

Minority Protection

Protection of members interests against unfair prejudice

Case law has established a number of situations which prima facie amount to unfairly prejudicial conduct and it should be emphasised that conduct may be perfectly lawful but still unfairly prejudicial. Thus the following have all been found to be unfairly prejudicial:

- Exclusion and removal from the board, where the company was one in which the director had a legitimate expectation of being involved in management i.e. a quasi-partnership company: In ***Re Bird Precision Bellows Ltd (1986)*** a minority shareholder with 26% of the shares suspected that the managing director of 'this quasi-partnership' company was concealing bribes that he had received in order to secure contracts. When the Department of Trade & Industry refused to investigate the minority shareholder was removed from the board. The minority shareholder claimed that this amounted to unfairly prejudicial conduct. His claim was upheld.
- The majority shareholder and director using the assets of the company for his own personal benefit. In ***Re Elgindata (No.1) (1991)*** the majority shareholder and director used the assets of the company for his own personal benefit. The petitioner complained that this was unfairly prejudicial to him and the court granted an order under Section 461 of the Companies Act 1985 in accordance with which the respondents were ordered to purchase the shares held by the petitioner.

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- A policy of making low dividend payments. In ***Re Sam Weller & Sons Ltd. (1990)*** the petitioners, who between them held 42.5% of the shares in their family business, complained that the company had not increased its dividend for 37 years, despite its profitability. In 1985 its net profit had been £36,000 yet only £2,520 was paid out in dividends. The company was controlled by the petitioners' uncle, Sam Weller, who along with his sons continued to receive directors' fees and remuneration. Peter Gibson J. commented on the petitioners' position: *"As their only income from the company is by way of dividend, their interests may not only be prejudiced by the policy of low dividend payments, but unfairly prejudiced."*

It should be noted that the courts may also take the petitioner's conduct into account when deciding whether certain actions are unfairly prejudicial as demonstrated by the case of ***Re R A Noble & Sons Ltd (1983)*** the minority shareholder had provided the capital but had left the management of the company in the hands of the other director, on the understanding that he would be consulted in relation to major policy matters. However, he was not so consulted by the other director and confined himself to enquiries of the activities other director on social occasions and accepted assurances that all was well. His petition, under Section 459 of the Companies Act 1985 followed on from a breakdown in the relationship between the two directors. It was held that the minority shareholder's exclusion from the company's management was largely the result of his own lack of interest. Consequently, his petition was dismissed.

In the event that a Section 459 petition is successful, the court may in accordance with Section 461 of the Companies Act 1985, make such order that it deems fit for giving relief in respect of the matters complained of, including:

- Regulating the future conduct of the company's affairs e.g. that a controlling shareholder should conform with all the decisions that are taking during the course of board meetings
- Requiring the company to do an act that it has omitted to do or to refrain from doing an act so complained of
- Providing for the purchase of the shares of the minority shareholder at a fair value by other members o by the company itself – the usual remedy
- Requiring the company not to make any specified alteration/amendment to its articles of association without leave of the court.

Applications by minority shareholders to have a company wound-up on just and equitable grounds

The court has enormous discretion when considering whether it would be 'just and equitable' to compulsorily wind-up a company under Section 122(1)(g) of the Insolvency Act 1986. Court orders on this ground have been granted, amongst other things:

- Where breakdown of mutual trust & confidence has occurred, especially in the case of a quasi-partnership: **Ebrahimi v. Westbourne Galleries Ltd (1972)** where Mr Ebrahimi and Mr Nazar had carried on business in partnership dealing in Persian and other carpets. They shared equally in management & profits. In 1958 they formed a private company carrying on the same business and were appointed, as its first directors.

  Shortly after the company's incorporation, Mr Nazar's son, George, became a director. Mr Nazar and his son between them held the majority of the votes exercisable at General Meetings. The company made good profits, which were all, distributed as director's remuneration; no dividends were ever paid. In 1969, Mr Ebrahimi was removed from his office as a director by a resolution at a General Meeting under what is now known as Section 303 of the Companies Act 1985 and a provision of the company's articles. Following on from this Mr Ebrahimi asked the court to find that it was "just and "equitable" to compulsorily wind-up the company. It was held by the House of Lords that

the company should be compulsorily wound-up on 'just and equitable' grounds because of Mr Ebrahimi's inability, after his dismissal, to participate in the company's management and because profits were paid as director's remuneration.

- Where there is a complete deadlock in the management of the company's affairs: **Re Yenidje Tobacco Co Ltd (1916)** where two sole traders had merged their businesses into a company of which they were the only directors and shareholders. They quarrelled bitterly, refused to speak to each other and conducted board meetings by passing notes through the hands of the secretary. One sued the other for fraud and he in turn petitioned to have the company wound-up on just and equitable grounds. The court stated that: 'in substance these two people are really partners' and by analogy with the law of partnership [which permits the dissolution if the partners are really unable to work together] it was just and equitable in this case to wind the company up.
- Where the managing director, who also represented the majority shareholding interest in the management of the company, refused to hold general meetings, submit accounts or pay dividends: **Loch v. John Blackwood Ltd. (1924)**.

Administration

What is an administration order?

An administration order is an alternative procedure for dealing with the affairs of an insolvent company, established by the Insolvency Act 1986. It is an order directing that, during the period in which it is in force, the affairs, business and property of the company shall be managed by a person appointed for that purpose by the court and known as 'the administrator' in accordance with Schedule B1 of the Insolvency Act 1986.

A licensed insolvency practitioner is appointed as an administrator by the court under an administration order. The order is usually sought through a petition by a company that is, or is likely to become insolvent. Administration orders were introduced by the Insolvency Act 1986 as a constructive way of trying to save a company's business.

Who may apply for an administration order?

In accordance with Schedule B1 of the Insolvency Act 1986 applications can be made by:

- The company itself
- The directors of the company
- A creditor or group of creditors of the company [including floating charge holders over the whole or substantially the whole of a company's property
- The supervisor of a company voluntary arrangement – notice of the petition must immediately be given to prescribed persons and cannot be withdrawn except with the leave of the court.

Under what circumstances is an application for an administration order likely to be successful? – Can one or more of the objectives of the three-part test in Schedule B of the Insolvency Act 1986 be met?

The **primary objective** will be to rescue the company in whole or in part as a going concern. Where a company can be rescued, then the rescue plan will be put into action. Inter alia, if the company involved is a holding company with subsidiaries this could involve them selling off one of the subsidiary companies within their group to ensure the group's long-term financial survival. In other words, 'downsizing'.

The administrator may pursue the **secondary objective** of maximising returns for the company's creditors as a whole, over and above what would be likely if the company were wound-up without first going into administration, if the administrator considers the primary objective is not reasonably practicable. This could involve the company concerned continuing

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to trade until such time as it has satisfied outstanding customer orders and sold its remaining stock-in-trade, in the interests of a more beneficial winding-up; maximising returns for the company's creditors over and above what would be likely if the company were wound-up immediately without first going into administration.

The **third objective**, which will only apply if neither of the other two objectives is possible, will be to realise property, to make a distribution to one or more of the secured or preferential creditors but without "unnecessarily harming" the interests of the creditors as a whole Where there are no funds available for the unsecured creditors, the administrator will realise the company's assets and make payments to preferential creditors and fixed and floating charge holders and will arrange for the company to be placed into creditors' voluntary liquidation.

An application for an administration order is likely to be successful in those cases where one or more of the objectives of the above three-part test can be satisfied e.g. the second and third objective.

It follows that an administration order will not be made where a company has already gone into liquidation: Schedule B1, Insolvency Act 1986.

Advantages of the administration order as an insolvency procedure

The two main advantages are that:

- Once an administration order has been issued, it is no longer possible to commence winding-up proceedings against the company or enforce charges on the company's assets. This major advantage is in no way undermined by the fact that an administration order cannot be made until after a company has begun the liquidation process. It is open to a secured creditor to enforce their rights and to forestall the administration procedure.
- An administration order can be put in place very quickly, in response to the urgent needs of a company and its business. The company then has the benefit of a stay on all creditors' actions and the administrator has wide powers to deal with not only the company's assets but also those of third parties subject, in some case, to the court granting leave for the proposed action. Administration is a collective procedure that, almost always in the long-term, offers better returns to unsecured creditors than an immediate liquidation.

The effect of an administration order being granted

In the event that the court makes an administration order:

- A qualified Insolvency Practitioner is appointed to administer the affairs of the company
- The rights of creditors to enforce debts remain suspended
- All company documents must state that the company is in administration and the name of the Administrator
- Any petition for winding-up is dismissed
- An administration order in effect creates a 'breathing space' for the company – it freezes civil actions against the company and repossessions of goods from the date of the presentation of the petition. Once an administration order has been issued it is no longer possible to commence winding-up proceedings against the company or enforce charges on the company's assets – this is one of the major advantages of an administration order.

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Winding-up (Liquidation)

Definition

Winding-up or liquidation is the legal term for the termination or dissolution of a company. It is comparable, in some ways, with the death of an individual or with the bankruptcy of an insolvent person.

(Note: A limited company cannot be made bankrupt – a bankruptcy applies only to individuals and persons trading as partners.)

There are three types of liquidation under the Insolvency Act 1986:

- Members' voluntary liquidation
- Creditors' voluntary liquidation
- Compulsory liquidation

Circumstances in which a company may be wound-up voluntarily

In accordance with Section 84(1) of the Insolvency Act 1986 a company may be wound-up voluntarily:

(a) When the period (if any) fixed for the duration of the company by the articles expires, or the event (if any) occurs, on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting has passed a resolution requiring it to be wound-up voluntarily

(b) If the company resolves by special resolution that it be wound-up voluntarily

(c) If the company resolves by special resolution to the effect that it cannot by reason of its liabilities continue its business, and that it is advisable to wind-up

(d) The decision to have a voluntary liquidation may be made because the company may be no longer required to exist for one (or more) of a number of reasons, including:

- It may have been formed for the purpose of undertaking a particular project which has now been completed e.g. the Millennium Dome
- The owner-manager may be retiring
- Its original purpose [object] may have become redundant following a group restructuring.

The distinguishing features of a members' voluntary liquidation

In accordance with Section 90 of the Insolvency Act 1986 this is where the directors are able to make a formal declaration (known as a *'statutory declaration of solvency'*) stating that after full inquiry into the company's affairs they are of the opinion that the company will be able to pay its debts (including statutory interest) within 12 months of the commencement of the winding-up.

Moreover, a company **must be solvent** in order to use this method of liquidation and in the event that the amount realised from the company's assets being insufficient to pay its creditors in full, the liquidation will be converted into a **creditors' voluntary liquidation**: Section 96, Insolvency Act 1986.

A company is placed into a members' voluntary liquidation on the passing of a special resolution by the shareholders who at the same time appoint a Liquidator. On his appointment all directors' powers will cease.

Distinguishing features of a creditors' voluntary liquidation

In accordance with Section 90 of the Insolvency Act 1986 this is where the directors are **unable** to make a formal declaration that the company can pay all its liabilities in full within 12

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months (including the addition of statutory interest) i.e. they are cannot make a Section 89 statutory declaration of solvency prior to the commencement of the liquidation procedure. A company uses this method of liquidation when it is insolvent – in a creditors' voluntary winding-up a formal declaration of solvency is not possible owing to the circumstances leading to the winding-up: Section 90, Insolvency Act 1986.

In this type of winding-up, the special resolution is followed by a creditors' meeting, where it is possible for a liquidation committee to be appointed: Section 98, Insolvency Act 1986. During the course of this meeting the company's directors must place before a meeting of creditors a full statement of the company's affairs: Section 99, Insolvency Act 1986. Such meetings form no part of a members' voluntary winding up.

As with a members' voluntary liquidation, the company is placed in liquidation on the passing of a special resolution by the shareholders who at the same time appoint a Liquidator. In a creditors' voluntary liquidation, in direct contrast, to a members' voluntary liquidation, both members and creditors have the right to nominate a liquidator and in the event of dispute, subject to right of appeal to the courts, the creditors' nominee prevails. In this context the liquidator is primarily accountable to the creditors.

It is the Liquidator's duty to realise the assets, investigate the company's affairs, report on the directors' conduct and distribute funds available in accordance with the Insolvency Act 1986.

Compulsory liquidation

A compulsory liquidation is a liquidation imposed by a court order, usually as a direct consequence of a creditor's petition on the ground that the company is unable to pay its debts: Section 122(1)(f). In accordance with Section 123 of the Insolvency Act 1986, a company is regarded as unable to pay its debts if, amongst other things:

- A creditor is owed more than £750 **and**
- Presents a written demand in the prescribed form (known as Statutory Demand Form 4.1) to the company **and**
- The company fails to pay, secure or agree a settlement of the debt to the creditor's reasonable satisfaction.

A compulsory winding-up petition may also be presented by any of the following parties in accordance with Section 124(1) of the Insolvency Act 1986:

- The company or its directors
- The official receiver
- The Department for Business Enterprise and Regulatory Reform (formerly the Department of Trade and Industry)
- Any contributory (a 'contributory' is any person who is liable to contribute to the assets of the company in the event of it being wound-up).

In compulsory liquidations the official receiver is automatically appointed as Liquidator for the company concerned.

Distinguishing features of a compulsory liquidation

As with a voluntary liquidation, it is possible for a company to be placed in liquidation on the passing of a special resolution by the shareholders who at the same time appoint a Liquidator.

In accordance with Section 122(1) of the Insolvency Act 1986 both solvent and insolvent compulsory liquidations are possible. A company must be solvent in order to be wound up on just and equitable grounds – see ***Ebrahimi v. Westbourne Galleries (1972)***.

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This method of liquidation is appropriate where

- A public limited company has been registered for a year and has failed to obtain a trading certificate under what is now Section 761 of the Companies Act 2006: Section 122(1)(b), Insolvency Act 1986
- A company does not commence business within a year of it being incorporated or suspends business for a whole year: Section 122(1)(d), Insolvency Act 1986
- A company is unable to pay its debts: Section 122(1)(f), Insolvency Act 1986
- The court is of the opinion that it is just and equitable that the company should be wound-up: Section 122(1)(g) e.g. ***Ebrahimi v. Westbourne Galleries (1972)***.

The main **effects** of the making of a compulsory winding-up order against a company are

- As soon as the order is made, all actions for the recovery of debt against the company are stopped
- The company will cease to carry on business except where it is necessary for its beneficial winding-up (i.e. in the interests of a more favourable asset realisation)
- The powers of the directors will cease and are assumed by the liquidator
- The employees of the company are automatically made redundant
- The Official Receiver becomes the liquidator until an Insolvency Practitioner is appointed.

Role of the Liquidator following appointment

On appointment, the Liquidator takes over all the powers of the directors and he owes a fiduciary duty to the company. He must exercise reasonable care and skill when performing his functions. The Liquidator's powers, which enable him to carry out the winding-up are wholly set out in the Insolvency Act 1986. Amongst other things, a Liquidator's powers include the power to:

- Sell any of the company's assets
- Raise any money for the purposes of the liquidation by using the company's assets as security
- Appoint an agent to do any business which the Liquidator cannot do himself
- Do all acts or execute all documents in the name of and on behalf of the company
- Do all other things which may be necessary for the winding-up of the company and distributing its assets.

The liquidator of a company can increase the assets available for distribution to creditors by bringing an action for fraudulent trading and/or wrongful trading.

Directors' liability for "wrongful trading"

On the application of the Liquidator, the courts can deem a director personally liable to the company's creditors for their losses incurred through the company's wrongful trading.

This applies to directors or former directors of insolvent companies who, prior to the commencement of the winding-up of their company knew, or ought to have known, that there was no reasonable prospect of their company avoiding insolvent liquidation and who have failed to take all reasonable steps to prevent it from happening: Section 214, Insolvency Act 1986.

The effect of this statutory provision is that a director may be made personally liable for the debts and liabilities of the insolvent company if he knew that it could not avoid insolvent liquidation and did not take all reasonable steps open to him to prevent its creditors from

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suffering greater loss than they would have suffered by an immediate cessation of the company's activities or if a reasonable director with the knowledge available to him would have concluded that the company could not have avoided insolvency and would have taken more effective steps to minimise the losses to creditors. Conversely, directors may escape liability where they can show that, after the time when they knew, or ought to have known, that there was no reasonable chance of their company avoiding insolvent liquidation, that they took every step with a view to minimising the potential loss to the company's creditors.

In deciding what a director ought to have done, the courts adopt a partly objective standard by considering what would have been done by a reasonably diligent person having the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in question. There is an additional subjective test, which may serve to increase the individual's liability depending on the actual knowledge, skill and experience that the director involved has.

The extent of a director's personal liability to contribute to the assets of the company is determined by the reference to the losses incurred by the company **from** the date when the defendant **ought** to have realised that the company could not avoid going into insolvent liquidation: ***Re Produce Marketing Consortium Ltd. (1989)***.

Under the 1986 Act, the courts, on application by the Secretary of State or the Official Receiver, must disqualify a director if the company became insolvent while he was a director and his conduct as a director of that company makes him unfit to be involved in the management of another company.

In order to ensure that directors do not have the constant threat of possible disqualification, the order itself must be applied for within two years of the liquidation, although this time limit may be extended at the court's discretion.

Substantial case law has developed in recent years as a result of the provisions for fraudulent trading and wrongful trading contained in Companies legislation.

Fraudulent trading

Fraudulent trading occurs where the business of the company is carried on with intent to defraud creditors or for any other fraudulent purpose. It is, therefore, necessary to establish dishonest intent in order to obtain a successful conviction. This will be inferred where a company carries on business and continues to incur liabilities where there is no reasonable prospect of those liabilities being met*:* ***Re William C Leitch Bros.(1932).*** Other examples of "fraudulent" trading under Section 213 of the Insolvency Act 1986 include, paying creditors out of order on the preferential list of creditors, especially where a party "knowingly" pays one party of creditors off in the knowledge that this will result in creditors higher up the preferential list losing out financially.

To this end, a creditor who, knowing of the circumstances, accepts money fraudulently obtained by the company may be liable to repay it even if he took no part in the fraudulent trading itself: ***Re Gerald Cooper Chemicals Ltd. (1978)****.*

In general, it may be properly inferred that there is an intent to defraud creditors if a company carries on business and incurs debts when, to the knowledge of the directors, there is no reasonable prospect of the company being able to pay them. It is not necessary to show that there was no prospect of the creditors ever being paid. It is enough that there is no reason for thinking that they will be paid as the debts fall due or shortly thereafter: In the case of **R v. Grantham (1984)** two of the company's directors who ordered a consignment of potatoes on one month's credit, at a time when they knew payment would not be forthcoming, were found guilty of fraudulent trading.

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E. UNINCORPORATED ASSOCIATIONS

We must now consider the rather unusual position of groups of persons who are associated in some common interest but have not become incorporated and therefore, have no corporate entity or legal personality. Within this general category are numerous examples of associations ranging from small social and bridge clubs; cultural societies, sports clubs and religious bodies (other than the Church of England) to large, powerful trade unions. Also included in this category are partnerships.

Legal Position

Since the law does not treat such associations as separate entities, with a legal personality of their own, it is necessary to clarify their position in certain respects, among which the following deserve particular notice:

- If property is held by a large number of persons who form an unincorporated association, it is usual to vest the property in trustees and to set out the rules and regulations of the association in a trust deed.
- An unincorporated association cannot enter into a contract. A contract made on its behalf is regarded by the law as the contract of the individual members who actually made, or gave, authority for the particular contract – such as the managing committee.
- Any torts committed in connection with any of the activities of the association are treated as the torts of the individual members responsible. For example, the committee of a football club which commissioned the repair of a stand was held responsible when a member of the public was injured, on the collapse of the stand, owing to bad workmanship.
- The members as a whole are liable for the debts of the association if the contract was made by an authorised agent.
- The members may delegate certain powers to a committee, sometimes including the powers of expulsion. If a court considers that the exercise of such power is contrary to public policy, it may overrule the committee's decision.

We must now consider the particular case of partnerships. These are associations of persons which, because of certain characteristics, are given some of the attributes of a legal personality, although they are not incorporated.

F. PARTNERSHIPS

Definition

A partnership is defined in Section 1(1) of the Partnership Act 1890 as:

> *'the relation which subsists between persons carrying on business in common with a view to a profit'*

Under the 1890 Act 'business' includes every trade, occupation or profession. Although 'business is a broad term it does imply the carrying on of some form of commercial activity. It is for the court, looking at the facts, to resolve any doubts about whether a 'business' is being conducted.

A partnership is, thus, based on a contract between its members and since it can be created informally and dissolved informally, it differs completely from a corporation.

You will remember that a corporation must be created either by charter or by statute and once formed, it has a continuous legal personality. Partnership, on the other hand, can be formed

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by means of a deed, i.e. an agreement under seal signed by the persons who agree to become partners, or by means of a simple agreement in writing, or even by an agreement made orally or simply implied from the actions of the persons concerned.

What constitutes a 'partnership' under the Partnership Act 1890?

Guidance on this is provided by Section 2 which states that where a person receives a share in the profits of a 'business', this will serve as prima facie evidence that he/she is a partner of a firm, although the presumption can of course be shifted by other conflicting evidence.

A partnership requires the participation of at least two persons; they can be either natural or legal persons.

There also must be a 'profit motive' underlying the 'business'. It will be a question of fact whether the partners aim to make a profit. The parties must intend to make a profit as a consequence of their dealings.

- Sharing Gross Returns: Section 2(2): The sharing of gross returns does not of itself create a partnership, whether or not the persons sharing gross returns also have a common interest in any property from which the returns are derived – see: ***Cox v Coulson (1916)***.
- Sharing Net Profits: Section 2(3): If a person receives a share of the net profits of a business, this is prima facie evidence that he is a partner in the business, but it does not of itself make him a partner in the business. In particular:
  - (i) A person will not be a partner just because he receives repayment of a debt in instalments which vary according to the profits of the business
  - (ii) An employee will not be regarded as a partner because he is paid, or partly paid by a share of the profits of the business
  - (iii) A deceased partner's widow and/or child will not be regarded as a partner just because they receive, as an annuity, a share of the profits of the business in which the deceased was a partner
  - (iv) A person who has loaned money to a business under an agreement, which provides that the interest rate will vary according to the profits or repayments will be made as a percentage of the profits, will not be regarded as a partner provided the loan agreement is in writing and signed by all the parties
  - (v) A person who has sold the goodwill of a business will not be regarded as a partner just because he receives as payment a share of the profits of the business – see: ***Pratt v Strick (1932)***.

In deciding whether an arrangement is a partnership, the courts look at the substance of the agreement and not what the parties have called it. If the arrangement appears objectively to be a partnership, the law will treat it as a partnership.

Differences between a Registered Company and a Partnership

The following important differences exist between a registered company and a partnership.

(a) The method of formation

All companies must be registered in accordance with the procedure laid down in the Companies Act 1985 (from 2009 the 2006 Act).

'Any two or more persons associated for a lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability'.

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In relation to the formation of an ordinary partnership there are no formal registration requirements which must be followed under the Partnership Act 1890. Although no formalities are required for a partnership to be formed in direct contrast to registered companies, a **partnership deed** is often drawn up to cover the rights and responsibilities of the partners during the term of the partnership and also on its dissolution. If there is no deed of partnership, the Partnership Act 1890 governs the legal relations between the partners.

(b) The need for a written constitution

In accordance with the Companies Act 1985 (from 2009 the 2006 Act) a company must have a written constitution i.e. a memorandum of association and articles of association.

A partnership agreement need not be in writing although in the vast majority of cases it will be evidenced in writing.

(c) Separate corporate personality & its legal implications

Following incorporation, a company is a body corporate with a separate corporate personality and amongst other things can be sued in its own name as a separate legal party from its members, in the event of a breach of contract by it. This legal principle was established by the case of ***Salomon v. Salomon & Co. Ltd. (1897)***. On the registration of a company's memorandum of association, the Registrar of Companies issues a company with a certificate of incorporation, identifying clearly to outsiders that the company is a corporate body and that the liability of its members is limited. From the date on the certificate of incorporation the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, [link to perpetual succession] become a body corporate by the name contained in the memorandum.

A partnership is not a corporate body and does not have a separate corporate personality i.e. the members and the firm are for legal purposes the same person and can be sued directly e.g. in the event of a breach of contract; this is one of the major differences between a firm and a company. In the event of a partnership business failing and the assets of the firm being insufficient to pay creditor's debts, the personal assets of the firm's partners can be seized, which could lead to a partner being declared bankrupt.

(d) Agency

The concept of agency is central to the understanding of company commercial transactions. In a company, mere membership does not of itself invest the shareholder with the power to act as an agent for and on behalf of the company. In companies directors act as agents, deriving their authority to do so from the company's articles of association; the principal in the agency relationship being the company's constitution. Agency powers are contained in the company's articles of association and these powers are the principal agency relationship source i.e. they state whose acts will be regarded as those of the company. The articles will normally grant full agency powers to the board of directors who are required to exercise this power bona fide in the interests of the company, a fiduciary obligation. They are also under a duty to exercise care and skill when entering into contracts on behalf of the company. The standard of care and skill they are required to demonstrate is the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company.

In ordinary partnerships all partners are agents of the firm in the absence of an agreement to the contrary. The Partnership Act 1890 s.5 defines the scope of an agent's apparent authority, in relation to the power of a partner to bind his firm.

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'Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom he is dealing either knows that he has no authority, or does not know or believe him to be a partner'

The scope of a partner's authority to bind his firm in contractual agreements is a matter which is usually regulated by a partnership agreement i.e. not all partners may have apparent authority to act as agents of their firm.

(e) Limitation of liability of members

In a company limited by shares the financial liabilities of the business, such as trading debts, end when members have fully paid for their shares together with any share premium. Essentially, all the shareholders of a company will have limited liability in the absence of grounds justifying the drawing aside of the corporate veil by the courts or the judiciary.

The liability of partners for the debts of the firm on dissolution is unlimited, in the absence of an agreement to the contrary. If the assets of the firm are insufficient to meet the liability, the creditor can look to the personal property of the individual partners. To this end, all the partners are said to be 'jointly and severally liable' with the firm (Section 9, Partnership Act 1890) which means that each partner is responsible for the whole of the firm's debts; a situation which may result in bankruptcy proceedings being brought against the firm's partners.

(f) Management structure

In a company there is a separation of equity ownership and control. A company is managed by those empowered to do so under its articles of association, its board of directors. The means available to company members, to require directors to account for their actions are, therefore, of critical importance and company law in the interests of democracy provides that certain decisions, such as alterations to the articles or memorandum, can only legitimately be carried out in general meeting of the company.

In a partnership there is no separation of ownership of control, in the absence of an agreement to the contrary. Under Section 24 of the Partnership Act 1890 all partners have the right to participate in the management of their firm and this statutory provision will operate in the absence of an agreement to the contrary.

Denial of this right of a partner to participate in the management of the firm would be grounds for dissolution on 'just and equitable' grounds in accordance with Section 35 of the Partnership Act 1890. The relationship between partners of a firm is *uberrimae fidei* and such denial amounts to a breach of mutual trust and confidence.

(g) Membership

A company continues to exist even when its members change or die, because of perpetual succession. Company members can enter and leave a company fairly easily, just by buying and selling their shares. One advantage of this is that the deeds to company property do not need to be altered when the membership of the company changes, unlike the situation, which exists in partnerships. The shares in a company are normally freely transferable in accordance with a company's articles of association.

In the absence of a partnership agreement to the contrary the firm will be dissolved when one of its partners leaves or dies i.e. a partnership does not have perpetual succession. Moreover, a new partner cannot join the partnership without the consent of all the existing partners. This highlights the nature of a partnership as a joint venture

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based on utmost trust; a partnership relationship is *uberrimae fidei.* In the absence of an agreement to the contrary the shares in a partnership are **not** freely transferable.

(h) Borrowing

A company can raise loan capital by issuing debentures (debt secured by means of a floating or fixed charge on the company's assets).

A partnership cannot issue debentures secured on the firms' assets.

(i) Formalities and public inspection

A company must file with the Registrar of Companies a wealth of detail about itself on a regular basis. Moreover, on the payment of a nominal fee all of this information is open for public inspection. Thus its membership, its annual accounts and details of the property it has charged, are amongst the long list of details, with which the Registrar must be provided; all documents on receipt becoming public documents. Thus there is a considerable internal administrative burden associated with the preparation of such documentation in line with the requirements of Companies legislation. Furthermore, financial penalties can be exacted against companies in default – persistent default can lead to directors incurring criminal liability – the consequences of which are imprisonment and/or disqualification of a company director in accordance with the Company Directors Disqualification Act 1986.

A firm by direct contrast to a company can maintain complete secrecy over its affairs (other than providing details of its proprietors where the Business Names Act 1985 applies) – one of the main advantages. A partnership must register under the Business Names Act 1985 any name it uses to trade under which does not consist of the surnames of all the partners, this name e.g. Smith & Co.

(j) Termination

A company cannot be wound-up without statutory intervention. Since a company has been created by statutory intervention, namely by the Companies Act 1985 (from 2009, the 2006 Act) its termination is also regulated by statutory intervention, namely by the Insolvency Act 1986. A company will not normally be required to be wound-up on the grounds that one of its members has died or been declared bankrupt.

A partnership may be dissolved without statutory intervention. For example, in the absence of an agreement to the contrary, a partnership will be dissolved on the death or bankruptcy of a partner.

(k) The Articles of Partnership

As a general rule, the partnership comes into being by means of an agreement in writing, the document being known as the **Articles of Partnership**. This will be signed by all the partners and contain all the conditions, etc. under which the partners intend to carry out their business.

The Articles of Partnership usually include clauses dealing with the nature of the business; its capital and property and the respective capitals of each partner, the method of sharing profits and losses and the rules as to interest on capital and drawings.

Provision is also often made for the method of determining the value of goodwill on retirement or death, and of computing the amount payable to an outgoing or deceased partner. The partners are bound by the Articles and if any point is not addressed within them, the **Partnership Act** applies.

The facts in ***Greenaway v. Greenaway (1939)*** were that under the Articles of Partnership a partner was liable to be expelled if he acted in a manner contrary to the good faith required of partners and prejudicial to the firm's general interest. For a long

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time there was considerable acrimony between two of the partners, which eventually came to a head when one assaulted the other. It was **held** that his expulsion was justified, since his assault was an act of disloyalty and constituted conduct which was clearly contrary to the good faith required of partners.

(l) Registration – the firm name

A partnership is not subject to registration, unless it is a limited partnership.

Legally, the firm's name is merely a convenient way of alluding to existing partners. An authority to lend to a firm does not authorise a loan to that firm when the partners have changed, but copyright can be registered in a firm's name. The firm's name will be protected. Partners can sue and be sued in a firm's name, although they must appear in person.

The Duties of Partnership

The fiduciary nature of a partnership means that each partner has a duty to act in good faith, in the best interests of the firm.

In addition to this general fiduciary duty. the Partnership Act 1890 lays down certain specific duties:

(a) The duty to disclose

'Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives': Section 28

This statutory duty is strict and applies to 'all things affecting the partnership': **Law v. Law (1905)**. In this case the two Laws, William and James, were partners in a woollen manufacturers' business in Halifax, West Yorkshire. William lived in London and took little part in the running of the business. James bought William's share of the firm for £21,000. Later William discovered the business was worth considerably more and that various assets unknown to him had not been disclosed. The Court of Appeal held that, in principle, this would allow William to set the contract aside. Cozens-Hardy LJ explained this decision in the following terms:

'Now it is clear law that, in a transaction between co-partners for the sale by one to the other of a share in the partnership business, there is a duty resting on the purchaser who knows, and is aware that he knows, more about the partnership accounts than the vendor, to put the vendor in possession of all the material facts with reference to the partnership assets, and not to conceal what he knows'.

(b) The duty to account

'Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property name or business connection': Section 29.

This duty of partners to account for private profits to the firm is very wide – 'any use by him of the partnership property name or business connection', for example, can extend beyond the use of the partnership assets or exploitation of a partnership transaction.

To this end, the clearest example of liability under Section 29 is the receipt of secret profit i.e. where one partner makes a personal profit out of acting on behalf of the partnership: **Bentley v. Craven (1853)**. In this case Bentley, Craven and two others were partners in a sugar refinery at Southampton. Craven was the firm's buyer and as such he was able to buy sugar at a discount on the market price. Having bought the sugar at the discounted price he than sold it to the firm at full market price. The other partners only later discovered that he had been buying and selling the sugar to them on his own behalf. The firm successfully claimed his profits from these dealings. It would

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have made no difference if the other partners could not have obtained a discount so that they in fact suffered no loss since they would have had to pay the full market price in any case.

(c) The duty not to compete

'If a partner, without the consent of the other partners, carries on any business of the same nature as and competing with that of the firm, he must account for and pay over to firm all profits made by him in that business': Section 30.

The central issue in relation to Section 30 of the partnership Act 1890 is whether the business is in competition with that of the firm. If it is, then the liability to account is established and there is no need to show any use of partnership assets etc. in that business, as with Section 29 (regarding accountability of partners for private profits). Whether or not there is a competitive business is a question of fact. By analogy with the Law of Trusts, it may depend upon how specialist the business is e.g. a Yacht or Classic Car Company may require more protection than a firm of newsagents. If a partner sets up or becomes involved in any competing business without the consent of the other partners, he must pay to the firm any profits he has made in the competing business: **Pillans Brothers v Pillans (1908)**.

The Rights of Partnership

Subject to an express provision to the contrary in the partnership agreement, Section 24 of the Partnership Act 1890 sets out the following statutory rights for the partners of a firm:

(a) To share equally in the capital, profits and losses of the business: Section 24(1)

The profits belong to the partners but so do the debts/losses. All the partners, in the absence of an agreement to the contrary, are 'jointly and severally liable' with the firm by Section 9 of the Partnership Act 1890, which means that each partner is responsible for the whole of the firm's debts. The personal property of partners can be seized by creditors to pay for the partnership debts if the business fails. A creditor could sue the firm and all the partners together, or sue them in turn until the debt is paid. The estate of a deceased partner can be made liable for a debt incurred while the deceased was a partner: ***Bagel v Miller (1903)***. Dormant partners are also liable equally with active ones.

(b) To be indemnified by the firm for any liabilities incurred or payments made in the ordinary course of business: Section 24(2)

If one partner does settle a partnership debt either willingly or unwillingly because he is the one who has been sued [remember all the partners of a firm are jointly and severally liable for the debts of the firm in the absence of an express agreement to the contrary by virtue of Section 24(1), he has a right to claim an indemnity from his fellow partners under Section 24(2) of the 1890 Act.

(c) To be paid interest on any additional capital contribution at the rate of 5% per annum: Section 24(3)

The 1890 Act by virtue of Section 24(3) makes a distinction between a contribution of capital by a partner on formation of the partnership and any additional contribution which he may agree to make. On this additional contribution he is entitled to 5% interest per annum from the date on which he made the additional contribution.

(d) To participate in the management of the business: Section 24(5)

The continuation of a partnership depends on it not only being a joint venture but on the existence of mutual trust and confidence amongst the partners inter se. A right to management participation is a necessary consequence of unlimited liability for the debts of the firm. Denying a partner the right to participate in the management of the firm in

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the absence of an agreement to the contrary is a ground for partnership dissolution on 'just and equitable' grounds in accordance with Section 35(f) of the Partnership Act 1890.

It should be noted that a limited partner has no rights of management and that if he interferes in the running of the business he will lose his shield of limited liability.

(e) To prevent the admission of a new partner or prevent any change in the nature of the partnership business: Sections 24(7) and (8) respectively

The successful operation of partnerships as business organisations depends on the sustainment of mutual trust between the partners inter se. It is not surprising, therefore, that the 1890 Act does not regard this as a matter for the majority to decide, Section 24(7) stating that: 'No person may be introduced as a partner without the consent of all existing partners' (subject to an agreement to the contrary in the firm's partnership agreement).

In connection with changes in the nature of the firm's business Section 24(8) states that: 'Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners'.

Based on the wording of Section 24(8), there is clearly a distinction being made between day-to-day business decisions and the fundamental nature of the business itself. Unlike a company, therefore, a partnership cannot alter its object(s) except by unanimous consent (only 75% compliance required in companies) subject, as ever to any contrary intention in the partnership agreement of the firm. The fact that any decision about changing the nature of the business must be unanimous illustrates that a partnership relationship is uberrimae fidei ('of utmost good faith').

(f) To have access to the firm's books: Section 24(9)

This unfettered right of a partner to inspect the books of the firm is a valuable one and again flows from the nature of a partnership i.e. as a joint venture based on mutual trust and confidence.

Partners as agents

In the absence of a provision to the contrary in a firm's partnership agreement, all partners have apparent authority to act as agents for the firm and to bind it by their acts: Section 5, Partnership Act 1890:

> *'Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom he is dealing either knows that he has no authority, or does not know or believe him to be a partner'*

The reference in Section 5 to carrying on business 'in the usual way' raises such questions as does one partner have the implied authority to borrow money; insure the premises; convey land, give guarantees, sack employees etc. in the course of the firm's business.

The agency relationship in partnerships:

- The firm (partners collectively) = the principal
- Partners (individually) = agents
- Implied authority = entering into transactions usual for the kind of business.

So long as partner is acting within the authority implied by Section 5, he will bind the firm, whatever the partners have privately agreed, unless the third party:

- Knows of the restriction on the partner's authority or
- Does not know that the person he is dealing with is a partner i.e. believes he is dealing with an individual.

Relationship of Partners to Third Parties

As third parties are not permitted to inspect the Articles of Partnership, the court does not presume that third parties know the contents of the Articles. No matter what the Articles of Partnership may state with regard to the relation of partners to one another, an act performed by a partner in the ordinary course of business will bind the firm and all the other partners. This is known as **joint and several liability**.

A distinction is sometimes drawn between the **express** (or actual) and **implied** (or ostensible) **authority** of a partner. Express or actual authority is that conferred upon a partner by the terms of the Articles of Partnership. Implied or ostensible authority is vested in a partner by virtue of his/her status as a partner, and is determined entirely by what is necessary for the usual scope of the firm's business. Whether the act of a partner is necessary for the usual scope of the business is a question of fact to be determined by the nature of the firm's business and by the practice of the persons engaged in it.

It is usual for partnership articles to contain a clause imposing some agreed limitations on the authority of certain or all partners, e.g. forbidding junior partners to negotiate loans on behalf of the firm, but remember that such express restrictions have no effect on outsiders dealing with the firm, unless the outsider knows, or should know, of the restriction.

Thus, in ***Mercantile Credit Co. Ltd v. Garrod (1962)*** P and G were partners in a car repair business and garage. The Articles forbade any buying and selling of cars by way of trade. The business was run by P, and G was a "sleeping" partner with no share in management. P sold a car to M by way of trade, in defiance of the Articles and without G's knowledge. M later found that the firm did not own the car, and claimed compensation from G. It was **held** that G was liable, since M was unaware of the restriction in the Articles and P had appeared to be acting within the usual scope of a garage business.

A partner has no implied authority to bind the firm by deed (***Steiglitz v. Egginton (1815)***) or to give a guarantee in the name of the firm (***Brettel v. Williams (1849)***). If a partner, without special authority, gives a guarantee or signs a bill of exchange, makes or endorses a promissory note, borrows money, or pledges goods in the name of the firm, then the firm will not be bound, as these acts are not in the usual course of the business of the firm. With a trading firm, however, any partner may bind the firm on bills of exchange, promissory notes, or on a contract to borrow money on behalf of the firm.

(Remember that this applies to trading firms only, i.e. firms the business of which is the buying and selling of goods.)

In ***Higgins v. Beauchamp (1914)*** Beauchamp and X carried on a partnership business as owners and managers of cinemas. The Articles of Partnership forbade the partners to borrow money on the firm's behalf. X borrowed money from Higgins on the firm's behalf. The firm was **held** not to be liable, as it was not a trading firm; X had, therefore, no implied authority to borrow on the firm's behalf.

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Termination of Partnership

A partnership can be dissolved ***without*** a court order in the following circumstances:

(a) On the expiry of a fixed term / on the completion of a specific venture: Section 32(a) and (b)

Subject to any agreement to the contrary between the partners, a partnership is dissolved in accordance with Section 35(a) *'if entered into for a fixed term, by the expiration of that term'*. It is important to note here that a partnership for a fixed term includes any partnership with a time limit, however vague or uncertain and that a partnership for an *'undefined time'* in Section 35(c) must be read in the light of the wording of Section 35(a) as including only totally open ended agreements. Moreover, subject to any agreement to the contrary between the partners, a partnership is dissolved in accordance with Section 35(b) *'if entered into for a single adventure or undertaking, by the termination of the adventure or undertaking'*.

(b) On the giving of notice: Section 32(c)

Subject to any agreement to the contrary between the partners, a partnership is dissolved 'if entered into for an undefined time, by any party giving notice to the other or others of his intention to dissolve the partnership'. A partnership for *an 'undefined time'* in Section 35(c) must be read in the light of the wording of Section 35(a) as including only totally open-ended agreements.

(c) On the death or bankruptcy of any of the partners: Section 33

Subject to any agreement to the contrary between the partners, a partnership will dissolve upon the death or bankruptcy of any of the partners. (Contrast with the situation in registered companies i.e. perpetual succession: Section13, Companies Act 1985 re the effect of registration.)

(d) On the occurrence of events making the object of the partnership illegal: Section34

In accordance with Section 34 of the 1890 Act 'a partnership is in every case dissolved by the happening of any event which makes it unlawful for the business of a firm to be carried on or for the members of the firm to carry it on in partnership'. For example, if prohibition were introduced in the U.K. all partnerships whose object was to sell alcohol would be operating illegal and would be dissolved in accordance with Section 34. A partnership is always dissolved by any event which makes it unlawful either for the business of the firm to be carried on or for the members of the firm to carry on in business together: **R v Kupfer (1915)**.

Even if there is nothing (either express or implied) in a firm's partnership agreement, one partner may apply to the court for a dissolution order under one of six heads set out in Section 35 of the Partnership Act 1890:

(a) If a partner is suffering from a mental disorder: Section 35(a)

The procedure now is that if a partner becomes a patient under the Mental Health Act 1983 his receiver or the other partners may apply to the court for a dissolution which can be given if the person is incapable of managing his property and affairs.

(b) If a partner suffers some other permanent incapacity and is permanently incapable of carrying out the partnership agreement: Section 35(b)

For example, if he becomes permanently disabled as a result of an accident. Section 35(b) refers to a partner becoming *'in any way permanently incapable of performing his part of the partnership contract'*. Thus the analogy is with 'insanity'. It is of course a question of fact in each case as to whether this situation has arisen. It will also depend on the partner concerned's duties and it could hardly apply to a sleeping or limited

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partner of the firm. Moreover for this section to operate successfully the incapacity must be permanent.

(c) If a partner has been found guilty of misconduct in his business or private life which in the opinion of the court is likely to prejudicially affect the carrying on of the business: Section 35(c)

For example, if he is convicted of theft. However, in order to operate successfully Section 35(c) requires proof of conduct by one partner, which the court, having regard to the nature of the business, regards as 'calculated to prejudicially affect the carrying on of the business'. This heading includes conduct not directly connected with the business and there is no need to prove actual loss or public knowledge; the test is objective i.e. would a client knowing of this conduct have moved away from dealing with the business.

(d) If a partner persistently breaches the partnership agreement or makes it impractical for the other partners to carry on business with him: Section 35(d)

However, in order to operate successfully Section 35(d) requires evidence that the offending partner wilfully or persistently commits a breach of the partnership agreement, or otherwise conducts himself in matters relating to the partnership business in such as a way that it is not reasonably practicable for the other partner or partners to carry on the business in partnership with him. The problem for the courts in such cases is to avoid this draconian solution for petty internal squabbles whilst at the same time seeking to end matters if the other partners in the firm genuinely cannot continue in partnership with the partner concerned as demonstrated by the case of ***Cheeseman v. Price (1865)***. In this case the offending partner had failed to enter small sums of money received the firm's customers into the accounts in accordance with the firm's partnership agreement. This had happened 17 times and was held to be sufficient to tip the scales in favour of dissolution.

(e) If the business is being carried on at a loss: Section 35(e)

Straightforward court order for dissolution will be granted*: 'when the business can only be carried on at a loss'*.

(f) If it is just and equitable to do so: Section 35(f)

This has been the subject of many successful cases in company law because it has a direct counterpart in the form of Section 122(1)(g) of the Insolvency Act 1986 and has been applied by analogy to justify the winding-up of a small limited company or 'quasi-partnership' – see ***Ebrahimi v. Westbourne Galleries Ltd. (1973)***]. Examples of circumstances where it would deemed just and equitable to dissolve a partnership include the following:

- Refusal to meet on matters of business
- Continued internal quarrelling
- The existence of a state of internal animosity that precludes all reasonable hope of a reconciliation and friendly co-operation i.e. a breakdown in trust and confidence
- Where one of the partners has been wrongfully excluded from participating in the management of the business in contravention of Section 24(5) of the 1890 Act.

Bankruptcy of Partnership

Since the liability of a general partner extends to the whole of the debts of the partnership, or he is liable jointly with the other partners, a creditor in the bankruptcy of a partnership can pursue one of two courses:

- Proceed against the partners jointly, i.e. in the name of the firm. If he obtains judgment against the firm, the debt must be satisfied out of the assets of the firm. However, if the

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assets of the firm are insufficient, then the creditor can look to the private assets of the partners in order to satisfy his debt.

- Proceed against any individual partner. If he obtains judgment against a certain partner and this judgment cannot be satisfied out of the private property of that partner, then the creditor cannot proceed against the remaining partners.

The creditor must pursue one course or the other. If he pursues the second course described above, the partner against whom the judgment is obtained will be liable to pay the full amount. However, he has a right to call upon the other partners to contribute the shares that they should bear.

Liability of New and Retiring Partners

Pay particular attention to the following points dealing with the liability of partners.

(a) Incoming partner

Unless a new partner makes a special agreement to the effect that she will take over the liability in respect of the firm's debts at the time of her joining the firm, she cannot be held liable on such debts. In the absence of such an agreement, the new partner can be held liable only in respect of debts incurred **after** she became a partner in the firm.

(b) Retiring partner

A retiring partner can be held liable only in respect of debts incurred before his retirement, provided due notice of retirement is given. This notice takes the form of an advertisement in the *London Gazette*, which is sufficient notice to those persons who have had no dealings with the firm, and a letter or circular to those persons who have previously dealt with the firm. In other words, if this notice is not given, a partner is liable for any debts incurred by the firm after his retirement. An exception to this occurs where, by a special agreement, a partner arranges to be liable for debts incurred by the firm after his retirement.

Note also that an agreement may be made between existing creditors and the firm, whereby the former agree to discharge a retiring partner from all liability. However, there must be valuable consideration to support such an agreement. The mere agreement of the remaining partners to be held liable for all debts is not sufficient for this purpose, as they are already liable.

In ***Tower Cabinet Co. Ltd v. Ingram (1949)*** C and I dissolved their partnership but no notice was given or advertisement published in the *Gazette*. After this dissolution, C ordered goods from T, using the firm's old notepaper which showed I as a partner. T did not know I was a partner before the dissolution. It was **held** that I was not liable to T.

Rights of Partners on Dissolution

The rights of partners on dissolution are usually contained in the Articles of Partnership. Where they are not provided for in this way, the following are the more important provisions which apply:

- The assets or property of the firm must be applied in paying off the creditors of the firm
- The assets remaining are to be applied in paying to the partners the amounts which are due to them as partners
- The assets of the partnership, together with any amounts contributed by partners to make up a deficiency, are to be distributed as follows:

  (i) In paying off all creditors of the firm who are not partners

(ii) In paying off rateably any loans made by partners to the firm, such loans being distinguished from capital and carrying 5% interest per annum

(iii) In paying rateably to the partners the amounts due to them in respect of capital

(iv) If any surplus remains, it is to be shared among the partners in the proportions in which they share profits.

Where the assets are sufficient to pay the creditors and any loans made to the firm by the partners, but insufficient to repay each partner his/her full capital, the rule in ***Garner v. Murray (1904)*** provides that the deficiency in capital is to be borne by the partners in the ratio in which the profits are divisible. In this case, G, M and W were partners on the terms that profits should be divided equally. The capital was contributed unequally, G contributing more than M. On dissolution, the assets, though sufficient to pay the creditors, were insufficient to repay the capital in full. It was **held** that the true principle of division was for each partner to be treated as liable to contribute a third of the deficiency, and then to apply the assets in paying to each partner rateably his share of capital.

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Study Unit 5

Contract Law 1: Fundamentals of Contracts and their Creation

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A. WHAT IS A CONTRACT?

The whole essence of business life is the making of contracts – contracts to perform work; contracts to buy and sell; contracts to make something; or to employ someone; or to use something. We must, therefore, know what a contract **is**, and **when we have one**.

A contract is an **agreement** between **two or more people**. Every contract is an agreement – but not every agreement is a contract. Two people agree about something to be done. They are called "the parties". First, the subject of their agreement may be such that neither of them has the remotest intention that any legal consequences should flow from it. For example, you invite someone to dinner and she says "Yes, I would love to come". You have an agreement. However, if she just does not turn up, neither of you would expect to hurry round to court and sue for the cost of the wasted food! So, the first essential of a contract is that the parties should intend their agreement to have **legal consequences**.

In the second place, the agreement reached may have certain aspects about it which make it such that the law will not enforce it. In other words, although it is a contract, it is not a **valid** contract.

Per Treitel: *" A contract may be defined as an agreement which is either enforced by law or recognised by law as affecting the legal rights or duties of the parties. The law of contract is, therefore, primarily concerned with three questions: Is there an agreement? Is it one which should be legally recognised or enforced? Or, in other words, what remedies are available to the injured party when a contract has been broken?"*

There are **seven** essential elements of a legally enforceable contract.

(1) Agreement – i.e. offer and acceptance

(2) Intention – to create legal relations

(3) Consideration – As a general rule the law will not enforce gratuitous promises, i.e. those, which are not supported by consideration, e.g. putting down a deposit on a car.

(4) Contractual capacity – Each party must have the power to legally bind himself contractually by the agreement – minors [people under the age of 18] and people who are either drunk (i.e. results in the contract been flawed on the grounds of undue influence) or insane have limitations placed on their power to contract.

(5) Form – The general rule is that a contract may be in any form whatsoever. Thus, most contracts are valid irrespective of whether they have been made orally, in writing or even implied by conduct, as in ***Carlill v. Carbolic Smoke Ball Co. (1893)***. Certain contracts must be in writing by virtue of an Act of Parliament, including:

- Bills of exchange (e.g. cheques) and promissory notes (e.g. bank notes)
- Regulated consumer agreements (e.g. a hire purchase agreement)
- Legal assignments of debts (i.e. the signing over of a creditor's right to payment)
- Contracts for the sale or other dispositions of land
- Certain contracts must be evidenced by writing (although the contract itself may be oral). The main example here is a contract of guarantee – such a contract cannot be enforced unless the person giving the guarantee has given some written evidence of his agreement.

(6) Legality i.e. the contract must not be illegal. An example of an illegal contract would be one for the supply of illegal drugs such as cocaine or heroin.

(7) True consent – i.e. there must be no vitiating factors such as duress or undue influence.

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Form of Contract

Most contracts are equally valid and effective, whether they are oral or written. The only difficulty with oral contracts is that the parties may not properly remember what they actually agreed and it is more difficult – should need arise – to prove the details of the agreement. However, certain contracts must be in writing, and others are unenforceable unless evidenced by writing.

Contracts which, by statute, must be in writing

- A bill of exchange or promissory note must be made in writing (Bills of Exchange Act 1882).
- Contracts of marine insurance are void unless made in writing in the form of a policy (Marine Insurance Act 1906).
- A consumer credit agreement, such as a hire purchase or loan agreement, must be in writing and signed by both parties (Consumer Credit Act 1974).
- A bill of sale must not only be in writing but also in a certain form; otherwise, it is void (Bills of Sale Act 1878).
- Contracts for the sale of land – but not contracts to grant a leasehold – must be in writing and must be signed by or on behalf of both parties: **Law of Property (Miscellaneous Provisions) Act 1989**.

  In ***Commission for the New Towns v. Cooper (GB) Ltd (1995)***, the prospective vendor and purchaser of a leasehold property met and orally agreed the terms for its sale, agreeing to place on record the terms of their agreement in an exchange of letters which, in fact, amounted to an offer and acceptance (see later) when prepared.

  The court was required to decide whether a valid agreement had been concluded for the purpose of Section 2(1) of the Law of Property (Miscellaneous Provisions) Act 1989, which states:

  > *"A contract for the sale or other disposition of an interest in land can only be made in writing and only by incorporating all the terms which the parties have expressly agreed in one document or, where contracts are exchanged, in each."*

  HELD: A valid agreement had not been made, the court stating that:

  > *"when there has been a prior oral agreement, there is only an 'exchange of contracts' within S.2(1) of the Act when documents are exchanged which set out or incorporate all of the terms which have been agreed and when, crucially, those documents are intended, by virtue of their exchange, to bring about a contract to which S.2(1) applies .... The letters exchanged ... were not documents of the kind described as contracts in S.2(1) of the 1989 Act, and therefore no contract meaning a legally enforceable agreement was made …."*

  In ***Firstpost Homes Ltd v. Johnson (1995)***, the prospective vendor and purchaser met and concluded an oral agreement for the sale and purchase of 15 acres of land. Thereafter, the prospective purchaser typed out a letter, addressed to him, containing the terms of the agreement for the other party to sign. The vendor's name and address was stated in the letter and it also referred to an "enclosed plan" which identified the land, the plan being attached to the letter with a paper-clip.

  The prospective vendor signed the letter and the plan; the prospective purchaser signed the plan but did not sign the letter. Section 2(3) of the Law of Property (Miscellaneous Provisions) Act 1989 states:

"The document incorporating the terms or, where contracts are exchanged, one of the documents incorporating them (but not necessarily the same one) must be signed by or on behalf of each party to the contract."

The prospective purchaser claimed specific performance (see later) of the contract.

HELD: His claim would be rejected. Section 2(3) of the 1989 Act required the letter as the contractual document to be signed by both parties. The purchaser's signing of the plan only did not satisfy this requirement.

Contracts which, by statute, must be either in writing or evidenced by writing

- The **Statute of Frauds 1677** decreed that some contracts would be unenforceable if their existence was not "evidenced" by writing. Some note or memorandum in writing was necessary, signed by the party to be charged with the contract. The object was to prevent certain fraudulent practices which were then common. The Statute of Frauds has been repealed but some of its provisions have been exempted from repeal, and re-enacted.
- **Contracts of guarantee** must, by the **Law Reform (Enforcement of Contracts) Act 1954**, still be either in writing or evidenced by it. A contract of guarantee is one whereby one person agrees to "*answer for the debt, default or miscarriage of another person*" – e.g. A promises that if B does not pay the debt, he will. These must be distinguished from contracts of "indemnity", where a party promises to prevent loss falling on another from the results of a transaction into which he has entered at the request of the person who promises the indemnity. A contract of indemnity does not have to be evidenced by writing.

Classification of Contracts

There are *two* classes of contract – contracts under seal (or specialty contracts) and simple contracts.

(a) Contracts under seal

These form an overriding exception to the rule that, unless a contract is required by statute to be in writing or evidenced by it, it is equally valid if merely oral. Contracts under seal were, originally, those of a more important nature, and the formalities required of "signing, sealing, and delivering" were designed to impress on people the solemnity of the transaction. Nowadays, these formalities have largely disappeared, but such a contract should still contain the words "*signed, sealed and delivered* ", and it is usual (but not necessary) to impress on it a red adhesive wafer in place of the seal.

Contracts under seal, usually called "deeds" – technically "specialties" – can be used for any contracts but they **must** be used for:

- Contracts where there is no "consideration" – e.g. a gift is legally enforceable only if it is given under seal
- Conveyances of land
- Leases of over three years.

The limitation period for taking action in respect of contracts under seal is 12 years: Limitation Act 1939 – that is, the law will not enforce a contract unless an aggrieved party takes action within a certain time after any cause of action arises. This is called "the limitation period".

(b) Simple contracts

These are all other contracts, whether in writing or parol (i.e. verbal). The limitation period for simple contracts is six years.

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Contracts "Uberrimae Fidei"

Contracts "*uberrimae fidei*" (of the utmost good faith) are those in which it is essential that there is a complete and honest exchange of information of all material facts between the parties. The best examples of such contracts are those relating to insurance. Here, the insurer must be supplied with all the material facts by the insured party before he/she accepts the risk.

Other examples of such contracts are those relating to title in contracts for the sale of land (as regards title only), contracts to subscribe for shares in companies, contracts of family arrangement, and contracts made between persons who have previously entered into contracts of suretyship and partnership.

If full disclosure of the facts is not made, the other party has the right to rescind the contract, and damages may be claimed for any negligent misstatements.

The case of ***Woolcott v. Sun Alliance & London Insurance Ltd (1978)*** illustrates the principle of *uberrimae fidei* in insurance contracts.

The claimant, Mr Woolcott, who had a conviction for robbery, was in September 1972 granted an advance of £12,000 by the Bristol and West Building Society, to whom the defendant insurers had issued a block policy of fire insurance. No question was asked by the building society about Mr Woolcott's moral character.

The advance having been granted, the names of the society and claimant as mortgagee and mortgagor, respectively, were noted in separate record sheets which, as between the building society and the insurers, were declared to be incorporated in, and to form part of, the policy. A fire occurred on 16 August 1974, as a result of which the property was destroyed. The defendant insurers satisfied the building society's claim of £12,000, the amount of their interest as mortgagees, but refused to meet Mr Woolcott's claim on the ground that he had not disclosed either to the insurers or to the society material facts known to him, namely his previous convictions.

The court accepted the evidence of the underwriters called to give evidence, that the *"criminal record of an assured can affect the moral hazard which insurers have to assess"*.

On the duty to disclose, the court relied strongly on the judgment of J MacKenna in ***Lambert v. Co-operative Insurance Society Ltd (1976)***, where the learned judge said:

> *"Everyone agrees that the assured is under a duty of disclosure and that the duty is the same when he is applying for a renewal as it is when he is applying for the original policy .... There are, at least in theory, four possible rules or tests which I shall state. One, the duty is to disclose such facts only as the particular assured believes to be material. Two, it is to disclose such facts as a reasonable man would believe to be material. Three, it is to disclose such facts as the particular insurer believe to be material. Four, it is to disclose such facts as a reasonable or prudent insurer would have treated as material."*

The court **held** that the proper test in the case was the fourth test: the claimant had a duty to disclose his criminal record, and that duty was not affected by the absence of a proposal form.

In ***St Paul Fire and Marine Insurance Co. (UK) Ltd v. McConnell Dowell Constructors Ltd (1996)***, the defendant company were building contractors and had entered into a contract for the construction of new Parliament buildings for the Marshall Islands, a group of islands in the Pacific Ocean. The claimants were their underwriters who were providing construction works insurance for the project. The insurance risk had been accepted by the underwriters on the defendant's assurance that the buildings would have piled foundations: in the event, and without notifying the claimants, the defendant used spread foundations,

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which were shallower and less expensive than piled foundations. The buildings accordingly sustained subsidence damage in the course of their construction.

The claimants sought a declaration from the court that they were entitled to avoid the insurance policy because of material misrepresentation and non-disclosure.

HELD: The declaration sought by the claimants would be granted. The type of foundation constituted a material consideration by any prudent insurer in estimating risk, and on the evidence the claimants would not have effected insurance cover on the same terms if they had been notified of the change in the type of foundation. The court stated:

> *"... there is no general obligation upon a contracting party to disclose even material facts to the other party (provided the non-disclosure does not make any positive representations misleading) whereas contracts of insurance, being of the utmost good faith, ... do give rise to such duty ...."*

B. THE AGREEMENT

Offer and acceptance are the two elements of a binding agreement. To this end, the courts are concerned with the objective appearance of an agreement rather than the fact of agreement i.e. the parties to a contract are judged on what they said and did rather than on what they intended. The standard is that of the reasonable man.

As you can imagine, a number of rules have been developed to regulate and assist in the determination of whether a valid offer and/or acceptance has been made.

What is an Offer?

In the words of Treital an offer is:

> *"an expression of willingness to contract on certain terms, made with the intention that it shall become binding as soon as it is accepted by the person to whom it is addressed".*

The usual definition of an offer is a promise, capable of acceptance, to be bound on particular terms. The first consequence to note from this definition is that the promise to be accepted must not be too vague. The classic case on this point is ***Scammel v. Ouston (1941)*** where the courts refused to enforce a sale stated to be made 'on hire purchase terms', because, neither the rate of interest, nor the period of repayment, nor the number of instalments were stated.

The fundamental feature of an offer is that it expresses a definite willingness to be bound by a contract on the part of the person making the offer. The offer sets out the terms upon which the offeror is willing to enter into contractual relations with the offeree.

As soon as it has been accepted by the offeree, a legally binding contract has been entered into, and failure to perform what has been promised will result in breach of contract.

An offer may be made to a particular person or to a group of people or even the world at large following the decision in ***Carlill v. Carbolic Smoke Ball Co. (1893)***. If the offer is restricted then only the people to whom it is addressed may accept it; but if the offer is made to the public at large, it can be accepted by anyone as evidenced by ***Carlill***. In this case the company manufactured a patent "smoke ball" which, it claimed, prevented influenza. It advertised in the press that it would pay £100 to anyone who contracted influenza after taking one of its smoke balls. Mrs Carlill read the advertisement, bought a smoke ball from the chemist, and used it as directed. However, she promptly got influenza, and she sued the company for the promised sum of £100. The company claimed that it was a "mere puff", and not meant to be taken seriously.

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HELD: The promise to pay £100 was a valid offer to the world at large. Mrs Carlill had accepted by complying with the conditions, and was entitled to the money.

Pre-requisites of a valid offer

There are **five** pre-requisites of a valid offer. To be valid, an 'offer' **must be**:

(1) Clear, definite and unequivocal. The 'offer' must represent a definite and unequivocal statement of willingness to be bound in contract i.e. it must not be flawed by vitiating factors such as duress or undue influence. Moreover it cannot be vague or uncertain in its interpretation. An 'offer' to sell someone a particular car for £5,000 will be an 'offer'. But a statement that a person may sell one of his cars for about £5,000' will not constitute an 'offer' for it is uncertain and vague. It is for the parties to make their intentions clear.

Consequently, the courts will not enforce

- Vague agreements: Scammel v. Ouston (1941) or
- Incomplete agreements: Walford v. Miles (1992). In this case the courts refused to enforce an 'agreement to negotiate in good faith', 'an agreement to make an agreement' will always be void.

(2) One that the offeror intends to be bound by. There must be a clear intention of willingness at the time the contract is made to be bound by the 'offer'. All the offeree has to do is accept the terms as laid down by the offeror and the contract will be complete. The offeror must not be merely negotiating: ***Gibson v. Manchester City Council (1979)***. In this case the Council had sent a letter to Gibson stating 'The corporation may be prepared to sell the house to you at a purchase price of £2,725.' This was held not to be an 'offer', capable of acceptance by Gibson [the letter merely constituted an 'invitation to treat' i.e. it was inviting Gibson to make an offer to buy the property from the Council.

(3) Made to a person, a group of persons or the whole world at large. An example of an offer being made to the whole world is provided by the leading contract case of ***Carlill v. Carbolic Smoke Ball Co. (1893)***.

(4) Communicated by the offeror, so that the offeree may either accept or reject it i.e. a person cannot accept an offer of which he has no knowledge. In order to be valid the offer must actually reach the person to whom it was made to be capable of acceptance i.e. the offeree must know of its existence as evidenced by the case of ***R v. Clarke (1927)***. In this case the Government of Western Australia offered a free pardon to the accomplices of certain murderers if they gave evidence that would lead to their arrest and convictions. Clarke provided the information but admitted that he was not aware of the reward at the time he gave the information to the authorities. The court held that he could not claim the reward of a free pardon because he was not aware of the 'offer' at the time he gave the information.

(5) Open when it is accepted i.e. still in force. That is it must still be in force at the time when the offeree accepts it. It is important to note that when an offer has terminated it is no longer capable of acceptance by the offeree.

Until such time as **all** of the above conditions are present the 'offer' will not be valid and as such is incapable of acceptance by the offeree.

Distinction from request for information or invitation to treat

An offer must be distinguished both from a request for information or an invitation to treat. The importance of this distinction lies in the fact that only offers can be accepted and lead to a legally binding contract.

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(a) An example of a request for information occurred in ***Harvey v. Facey (1893)***. P sent a telegram to D, saying: "*Will you sell us Bumper Hall Pen? Telegraph lowest cash price*". D replied by wire: "*Lowest cash price Bumper Hall Pen for £900*". P promptly sent another telegraph: "*We agree to buy Bumper Hall Pen for £900*". The sale never went ahead, and P sued.

HELD: The first telegram was a mere request for information. The second was information supplied as requested. The third was the only one with any contractual meaning, as it constituted an offer to buy for £900. This offer was never accepted, so no contract came into being.

(b) An invitation to treat is not the same thing as an offer. An invitation to treat is merely an invitation to others to make offers. It follows that an invitation to treat cannot be accepted in such a way as to form a contract and equally the person extending the invitation is not bound to accept any offers made to them.

There are many instances of "invitations to treat".

- A shopkeeper (or supermarket) displaying goods marked at a certain price is inviting the public to make an offer. The price tag is merely an indication of the price that is likely to be accepted. "He does not bind himself to sell at that price, or at all": ***Timothy v. Simpson (1834); Pharmaceutical Society of Great Britain v. Boots Cash Chemists (Southern) Ltd (1952)***

  What happens is that, in a shop or supermarket, the act of taking goods off the shelf contractually means nothing. However, putting them down in front of the shopkeeper or cashier constitutes an offer to buy (at the named price, unless otherwise stated in the offer). Ringing up the price on the till, for example, constitutes acceptance.

- In ***Partridge v. Crittenden (1968)*** the plaintiff had advertised live birds for sale in a periodical. The plaintiff was charged with unlawfully offering for sale a wild live bird contrary to Section 6(1) and Schedule 4 of the Protection of Birds Act 1954. It was held that the plaintiff could not be guilty of the offence and charged because the advertisement was an invitation to treat and not an offer for sale.

- A request for a tender of an estimate. 'Tenders' arise where one party wishes particular work to be done and issues a statement requesting interested parties to submit the terms of which they are willing to carry out the work. In the case of 'tenders', the person who invites the tender is simply making 'an invitation to treat' – the person who submits a tender is the offeror and the other party is at liberty to accept or reject the offer made by him. It is only when a 'tender' is actually made that it is regarded as an 'offer', which the party inviting the 'tenders is free to 'accept' or reject.

  In **Spencer v. Harding (1870)**, it was **held** that "an invitation to tender is not, normally, an offer, unless accompanied by words indicating that the highest or lowest tender will be accepted". However, in **Blackpool & Fylde Aero Club Ltd v. Blackpool Borough Council (1990)** it was **held** that an invitation to tender could constitute an offer to consider the merits of the tender – along with any other tenders. This was accepted by anyone who submitted a tender on time. Thus the council could be sued for refusing to consider a tender even though it had been submitted by the specified date.

- At an auction, a bid constitutes an offer. As with other offers, this can be withdrawn at any time before the fall of the hammer, which constitutes acceptance: **Sale of Goods Act 1979, Section 57(2)**.

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- An offe**r of shares to the public**. Contrary to common understanding, a share prospectus is not an offer; it is merely an 'invitation to treat' inviting people to make offers to subscribe for shares in the company, which is the subject of the prospectus.

Despite the phenomenal growth in trade over the Internet and other modes of commercial dealing, it is a sad reflection on the current law that it appears to be unable to keep abreast of these developments. The area of e-commerce continues to be beset with the usual problem of deciding upon which elements of the transaction made on a website constitutes the "offer" (possibly a unilateral one) and which the "invitation to treat".

Despite the intervention of statute **(The Electronic Communication Act 2000)** and European Directives on the issue **(Electronic Commerce [EC Directive] Regulations 2002)**, it still remains a contentious issue, although the received wisdom is that such a website display constitutes merely an invitation to treat. Such a view is supported by the problems recently experienced by Argos Stores who, by mistake, displayed on their websites TV sets worth £300 on sale for just £3. However, the issue was settled by reference to the principles of mistake (see Unit 6), which were brought to bear to decide the issue in Argos's favour.

Termination of an Offer

An offer, once made, does not remain open for acceptance indefinitely. It can terminate for a number of reasons and once terminated, it is no longer capable of being accepted. An offer terminates in **five** different ways:

(1) **By death**

An offer will terminate on the death of the:

- Offeror where the offer was of a personal nature or
- Offeree: ***Reynolds v. Atherton (1921)***. In this case Warrington LJ was of the opinion that an offer ceases, by operation of law, on the death of the offeree. The better view is, probably, that it is terminated only if the offeree is aware of the fact, unless the personality of the offeror is an essential ingredient of the matter.

(2) **By the occurrence of a condition**

The condition may be express or implied: ***Financings Ltd v. Stimson (1962)***. In this case the defendant, on 16 March, saw at the premises of X, a dealer, a motor car advertised for £350. He wished to obtain it on hire purchase and signed a form provided by X. The form was that of the plaintiffs, Financings Ltd, a finance company, and stated: *"This 'agreement' shall be binding on [the plaintiffs] only upon signature on behalf of the plaintiffs"*. On 18 March the defendant paid the first instalment of £70 and took away the car. On 20 March dissatisfied with it, the defendant returned it to X, saying that he was ready to forfeit his £70. On 24 March the car was stolen from X's premises, but was recovered badly damaged. On 25 March, in ignorance of these facts, the plaintiff signed the 'agreement'. When the plaintiffs subsequently discovered what had happened, they sold the car for £240 and sued the defendant for breach of the hire purchase contract. The Court of Appeal gave judgement for the defendant. The so-called 'agreement' was in truth an offer by the defendant to make a contract with the plaintiff. But it was subject to the implied condition that the car remained, until the moment of acceptance, in substantially the same state as at the moment of the offer. As Donovan LJ asked in the present case: *"Who would offer to purchase a car on terms that, if it were severely damaged before the offer was accepted, he, the offeror, would pay the bill?"*

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(3) **By rejection**

Rejection can either be outright (express or implied) or in the form of a 'counter-offer: if acceptance is not a mirror image of the offer then it will amount to a counter-offer, and will terminate the original offer: ***Hyde v. Wrench (1840)***. In this case the defendant offered to sell a farm for £1,000. The plaintiff said he would only give him £950 for it. It was held that this constituted a counter-offer, which terminated the original offer, which was therefore no longer open for acceptance.

(4) **By lapse of time**

If the offer is stated to be open only for a specified time period it will expire (lapse) after this time – where there is no specific time period mentioned by the offeror the offer will lapse after a reasonable length of time. In the event of a dispute about the duration of an offer the court will determine what is reasonable – what is reasonable is a question of fact to be decided in each case on its merits. An offer may lapse and thus be incapable of being accepted because of passage of time:

- At the end of a stipulated time (if any) or
- If no time is stipulated, after a reasonable time: ***Ramsgate Victoria Hotel Co. v. Montefiore (1866)***. In this case an attempt to accept an offer to buy shares after 5 months failed, as the offer had clearly lapsed.

(5) **By revocation** (or cancellation)

The offeror may revoke the offer at any time prior to acceptance: ***Routledge v. Grant (1828)***. Grant offered to buy Routledge's house and gave him 6 weeks to accept the offer. However, within that period, he withdrew the offer. It was held that Grant was entitled to withdraw the offer at any time before acceptance and upon withdrawal, Routledge could no longer create a contract purporting to accept it.

It should be noted that, unless an offer specifically states that it is irrevocable, or that it will remain open for a definite stated time, it can be withdrawn at any time before it has been accepted – provided, that is, that the revocation has been communicated to the offeree: ***Byrne v. Van Tienhoven (1880)***.

That is the general rule. However, difficulties can arise. For instance, if the acceptance of an offer involves the doing of some act (acceptance by conduct), can the offer be withdrawn when the act has been partially completed? According to the strict rule, the answer should be "yes" – but, fortunately common sense has prevailed. The classic example is in ***Rogers v. Snow (1573)***: if one man offers another £100 if he will go to York, can the offer be withdrawn when the traveller is halfway there? Much judicial ink has been used to explain this but the generally accepted solution is that the acceptance is complete once the offeree has commenced the performance, but the offeror is not bound to pay until it has been completed. In ***Errington v. Errington (1952)***, a father promised his son and daughter-in-law that a house in which they lived should be theirs as soon as they had paid off the mortgage. To his knowledge, they started paying the instalments. He then purported to revoke the offer.

Lord Denning had this to say:

> *"The father's promise was a unilateral contract, a promise of the house in return for their act of paying the instalments. It could not be revoked by him once the couple entered on performance of the act, but it would cease to bind him if they left it incomplete and 'unperformed'."*

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Acceptance in the law of contract

Acceptance is the unconditional assent to all the terms of the offer. There are a couple of points to be borne in mind at this stage

- The offeror can require any form of acceptance, whether it be oral, written or inferred from the conduct of the parties e.g. in ***Carlill v. Carbolic Smoke Ball Co.(1893)*** where Mrs Carlill was held to have accepted the company's offer by using the smoke ball in the prescribed manner.
- Acceptance is not effective unless it is communicated to the offeror. ***Felthouse v. Bindley (1862)***. *In this case the* plaintiff, Paul Felthouse, wrote to his nephew, John, on 2 February, offering to buy his horse for £30 15s, and added, *"If I hear no more about him, I consider the horse mine at that price."* The nephew made no reply to this letter, but intimated to the defendant, an auctioneer, who was going to sell his stock, that the horse was to be kept out of the sale. The defendant inadvertently sold the horse to a 3rd party at an auction on 25 February and the plaintiff sued him. The court held that the plaintiff's action must fail as there had been no acceptance of his offer to buy the horse before 25 February.

Pre-requisites of a valid acceptance

There are **four** pre-requisites of a valid acceptance. It must be:

(1) Made while the offer is still in force: ***Routledge v. Grant (1828)***

(2) Made by the offeree or his authorised agent: ***Powell v. Lee (1908)***

(3) Clear, absolute and unqualified i.e. exactly match the terms of the offer: If any alteration is made or anything added, then this will be a counter offer: ***Hyde v. Wrench (1840)***

(4) Communicated to the offeror either orally, in writing or by conduct; **unless** acceptance by conduct (as in ***Carlill***) is appropriate or the postal rule applies. The postal rule states that the communication of acceptance will be complete and effective at the point when the letter of acceptance is posted or placed into the hands of the relevant postal authorities **not** when it is received: ***Adams v. Lindsell (1818)***. It is possible for the offeror to expressly or impliedly reject 'The Postal Rule'.

In ***Adams v. Lindsell (1818)***, on 2 September, D sent a letter offering to sell P some wool, and he requested an answer by post. The letter was misdirected, and it did not reach P until 5 September. He accepted the same day. Had the offer been properly directed, an answer should have been received by 7 September – so, on 8 September, D sold the wool to someone else. P's acceptance arrived on 9 September.

HELD: The contract was formed on 5 September, when P's acceptance was posted. D was, therefore, in breach of contract.

However, the so-called "parol rule" is not absolute and, in circumstances where a contrary intention is indicated, it will be ignored.

Communication of acceptance

The main rules regarding communication of acceptance are as follows.

(1) It must be carried out by the offeror or his authorised agent: ***Powell v. Lee (1908)*.**

(2) Acceptance is not effective unless and until it is communicated to the offeror: ***Entores Ltd v. Miles Far East Corporation (1955)*** following the reasoning of ***Entores*** where an acceptance message is left on an answer machine acceptance is not communicated unless and until it is heard by the offeror. Also, linking in with other modern communication methods when a person sends an e-mail to indicate their

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acceptance, of an offer, acceptance does not take place unless and until the e-mail concerned has been read by the recipient.

(3) An offeror may not state that silence shall amount to acceptance: ***Felthouse v. Bindley (1862)***.

(4) Communication of acceptance by post is subject to the postal rule: ***Adams v. Lindsell (1818)***. The postal rule states that the communication of acceptance will be complete and effective at the point when the letter of acceptance is posted or placed into the hands of the relevant postal authorities (hence the need in such cases to sent documentation by registered post). In accordance with the postal rule, acceptance occurs when a letter is posted, not when it is received, in direct contrast to revocation of an offer. Moreover, it is irrelevant that the letter is lost in the post – this will not prevent the application of the postal rule by the courts: ***Household Fire Insurance Co v. Grant (1876)***.

In ***Brogden v. Metropolitan Railway Co. (1877)***, Mr Brogden had supplied coal to the company without any formal agreement. It was then suggested that the parties should have a written contract. So, the company's agent drew up a draft which he sent to Mr Brogden with a request to fill in certain blanks. Mr Brogden duly did this, and signed and returned the draft – but after having made certain alterations. The agent put the agreement in a drawer and forgot about it. Coal was supplied on the stated terms – then a dispute arose.

HELD: The return of the draft as altered was a counter-offer. The acceptance of this counter-offer was never communicated to Mr Brogden – so *prima facie*, no contract was formed. However, acceptance could, on the facts, be inferred, as the subsequent supply of coal on the terms of the document amounted to acceptance by conduct.

If an acceptance is given verbally or by telephone, or a written document is handed to the offeror, no problem of when the acceptance is communicated can arise. However, if acceptance is made by post, what then? Is it valid when posted, or when received? There has to be a rule, and for no particular reason English law says that a postal acceptance is complete and the contract binding, when the letter is posted or handed to the postal authorities. This means that, should the letter of acceptance be lost or delayed in the post, this does not affect the validity of the contract.

(5) Acceptance may be in the form of express words or implied by conduct: ***Carlill v. Carbolic Smoke Ball Co (1893)***.

(6) Acceptance must be communicated in the precise way stipulated by the offeror unless an equally quick, efficient or reliable method is chosen e.g. via e-mail instead of facsimile. If the offeror suggests a particular form of acceptance, but does not insist upon this, then another equally effective method of acceptance will suffice: ***Manchester Diocesan Council for Education v. Commercial and Central Investments Ltd (1969)***. Conversely, if no particular method of acceptance is prescribed, the form of communication will depend on the nature of the offer and the circumstances in which it is made. If the offeree requires his offer to be accepted in a particular manner, then acceptance must accord with these requirements.

When is acceptance by post legally effective?

Acceptance by post will only be effective where acceptance by post is either the chosen, obvious or reasonable method of acceptance.

- Chosen method of acceptance. The post will be a chosen method of acceptance where the offeree has stipulated that posting the acceptance is the only acceptable method.

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- Obvious method of acceptance. The post will be an obvious method of acceptance in a standard business situation or where the parties are communicating at a distance and the offeror requires a record of the reply.
- Reasonable method of acceptance. The use of the postal service is reasonable in the circumstances, for example, where an offer has been made be post (i.e. by a letter of offer) and the offeror has indicated the use of the post for the purpose of making the acceptance (i.e. by a letter of acceptance). It will be the reasonable method of acceptance if an ordinary person, looking at all the circumstances would assume that to reply by post was the proper way to accept. Clearly, acceptance by post will not be reasonable where there is a postal strike.

The logic underlying the postal rule is that the main risks associated with its use lie with the offeror should the letter of acceptance be delayed or lost in the post.

Tenders

This topic has to be specially considered regarding acceptance of an offer. Suppose a local authority invites tenders for the supply of specified goods to be delivered over a given period. A trader puts in a tender showing that he/she is prepared to supply at a given price; this is clearly an offer. But there may be difficulty in deciding whether subsequent action by the corporation is an acceptance. There are two possibilities, depending on the wording of the corporation's original invitation.

- If the corporation states that it requires a specified quantity of the goods during a particular period, then, on "acceptance" of the tender, the trader is bound to deliver.
- If the corporation advertises that it may require specified goods up to a maximum amount, deliveries to be made if and when required, the effect of acceptance is quite different. The trader has made a standing offer. There is no acceptance by the corporation in the legal sense: this will only take place when a requisition for a definite quantity of goods is made. Each requisition by the offeree, i.e. the corporation, is a separate act of acceptance which creates a separate contract: ***Percival Ltd v. LCC (1918)***.

Incomplete Agreement

It sometimes happens that the parties to a contract will agree in principle only, leaving many details unresolved, or they will agree only certain things, or omit other necessary matters. These are called "incomplete agreements".

In extreme cases, the court will hold the whole contract void for uncertainty. However, it is reluctant to do this, and it will uphold a contract if at all possible. For example, in ***Perry v. Suffields Ltd (1916)***, the only detail agreed in a contract for the sale of a public house was the price of £7,000. Such vital matters as the date for completion and the deposit were omitted. The court upheld the sale, as it was the manifest intention of the parties that the sale should go ahead.

Such incomplete agreements tend (though this is by no means invariable) to fall into a number of categories. The **three** common ones are:

(a) Stipulations for the execution of a formal document

Agreement may be reached, often verbally, and the parties then state that a formal contract will be drawn up. It is a question of construction of the agreement as a whole as to whether the initial agreement constituted the actual contract, and the formal document was intended to be merely spelling it out, or whether the execution of the formal document was intended to be a condition precedent to the validity of the contract (***Von Hatzfeldt-Wildenburg v. Alexander (1912)***, ***Bianca v. Cobarro (1947)*** and ***Chillingworth v. Esche (1924)***).

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The words on the document "*subject to contract*" always imply that the paper in question is not intended to be a contractual document.

(b) Letters of intent

Again, it is a question of construction as to whether a "letter of intent" is the contractual agreement or whether it is merely an expression of pious hope, with no contractual force.

(c) Terms "to be agreed"

It is an important principle of law that you cannot "make a contract to make a contract". Sometimes, the parties are unwilling to agree all the terms beforehand, and at other times it is actually impossible so to do. So, terms are left open "to be agreed later". That is one instance of a "contract to make a contract".

The problem, of course, is what happens if, when the time comes, you don't agree! If a mechanism for resolving such a dispute is included, all is well – e.g. by arbitration, or a price equated to the Retail Price Index, or whatever; but if there is no such mechanism agreed, the court will have difficulty. It will be reluctant, as we have seen, to declare the whole contract void for uncertainty. If, however, the term left open for "future agreement" is fundamental to the whole contract, it will have no option. If it is an ancillary term, only the particular provision may be struck out, and the rest of the contract will be upheld; or the court may imply a customary trade or reasonable solution. We can look at **three** examples.

- ***Smith v. Morgan (1971)*** – A contract for sale of land gave the purchasers a first option to purchase adjacent land at a price to be agreed.

  HELD: The vendor was bound to offer the land at the price at which he was prepared to sell.

- ***Foley v. Classique Coaches Ltd (1934)*** – P owned a petrol filling station and also the adjoining land. He sold the land to D, who owned and ran coaches, on the condition that they would buy petrol exclusively from him. The agreement stated that the price of the petrol would be "*agreed from time to time*". D broke the agreement.

  HELD: That, in default of agreement, a reasonable price must be paid.

- ***Hillas & Co. Ltd v. Arcos Ltd (1932)*** – P agreed to buy timber from D, at a price equated to the "*official price list*". The agreement contained an option for P to buy further timber next year – but no price was mentioned.

  HELD: Because of the previous dealings between the parties, and the original reference to the "*official price list*", the option was not void for uncertainty, and the price should be ascertained in the light of the normal practice in the timber trade.

Certainty of Terms

The terms of a contract must be reasonably certain. If they are too vague, the whole contract may, again, be void for uncertainty. For instance, in ***G Scammell & Nephew Ltd v. Ouston (1941)***, an agreement to buy goods "*on hire purchase*" was **held** to be void, as there were so many different kinds of hire purchase agreement that it was impossible to ascertain the true intention of the parties.

However, as in ***Hillas & Co. Ltd v. Arcos Ltd (1932)***, the court will always do its best to ascertain the intention and uphold the contract.

Meaningless phrases can sometimes be ignored, or disregarded as "*mere surplusage*": ***Nicolene Ltd v. Simmonds (1953)***.

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C. CLASSIFICATION OF STATEMENTS AND TERMS

All but the very simplest of contracts can be broken down into a number of constituent parts – promises to do something, or to abstain from doing something else; statements of fact or of opinion; assurances of quality, quantity or performance. These are the usual points; there may be others.

However, it is rare for all the terms of a contract to be actually written down or agreed between the parties. Certain things are too obvious to need mentioning; some are simply forgotten; others are matters to which the parties never gave a thought.

Hence, the first classification is into "express terms" and "implied terms".

Express Terms

These are the terms of the contract which have been specifically agreed between the parties, whether in writing or verbally. Of these, some are, plainly, of greater importance than others.

- **Fundamental terms** are those on which the whole basis of the contract rests, or the "core" of the agreement. What is, or is not, fundamental can be specifically agreed but, if it is not, it is a question of fact for the court to determine.

  In ***Barber v. NWS Bank plc (1996)***, the claimant, Mr Barber, was interested in purchasing a car apparently owned by a garage in October 1989. He did not have the ready finance to do so: accordingly, the garage sold the car to the defendant bank for cash and Mr Barber entered into a conditional sale agreement with the bank whereby the car was to remain vested in the bank until he had paid all the instalments due under the agreement.

  Having continued to remit all the instalment payments until May 1991, Mr Barber decided to sell the car, only to discover that it was the subject of a prior finance agreement, which existed at the date of the agreement with the bank and upon which moneys were outstanding.

  HELD: Because of the provision in the conditional sale agreement that the car was to remain vested in the defendant bank until all payments under the agreement had been made, it was an express term and condition that the defendant bank was, at the date of the agreement, the owner of the car. Since this was not in fact so, Mr Barber was entitled to rescind the agreement and recover all the moneys he had paid under it, comprising the deposit and all instalments remitted.

- **Collateral or ancillary terms** are those which support the fundamental terms – or, perhaps, "add flesh to the bones". They are not, in themselves, vital to the validity of the contract.

Implied Terms

Terms which, for one reason or another, have been omitted from the specific agreement often need to be put into the contract in order that it may make sense. The necessity for this was brought out in the leading case on the subject – ***"The Moorcock" (1889)***. D owned a wharf on the Thames. P owned a ship, "The Moorcock", and he agreed that she should moor at D's wharf, and be unloaded by him. While this was being done, the tide ebbed, and the ship grounded on a hidden rock, and was damaged. The contract contained no reference to such an event.

HELD: The parties must have intended that it should be a term of the contract that the berth should be safe from hazard to the ship while unloading.

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Lord Justice Bowen said:

> *"Now an implied warranty, or as it is called, a covenant in law, as distinguished from an express contract or express warranty, really is in all cases founded on the presumed intention of the parties, and upon reason. The implication which the law draws from what must obviously have been the intention of the parties, the law draws with the object of giving efficacy to the transaction and preventing such a failure of consideration as cannot have been within the contemplation of either side; and I believe that if one were to take all the cases, and there are many, of implied warranties or covenants in law, it will be found that in all of them the law is raising an implication from the presumed intention of the parties with the object of giving to the transaction such efficacy as both parties must have intended that at all such events it should have."*

That is, perhaps, a rather long-winded way of saying that terms will be implied only if it is necessary to give business efficacy to the contract.

Note that although the courts usually imply terms which are positive (i.e. the party concerned has to do something), negative terms can be implied. Thus, in ***Fraser v. Thames Television (1983)***, the members of a group called "Rock Bottom" sued Thames Television for alleged breach of contract concerning a TV series, an implied term of which was that Thames would not use the idea for the series, which was based on the history of the group, unless the members of the group were employed as actors in the series. The court implied this negative term on the grounds that it was necessary to give business efficacy to the agreement between the parties.

Terms will also be implied by custom, by statute, or by course of previous dealing.

- **By custom**

  If a certain thing is customary in the particular trade, it will readily be implied into contracts in respect of that trade. The same applies if a thing is the custom in a particular **district** or **place**.

  In order to be implied, the custom must be "*notorious, certain and reasonable*" and "*not offend against the intention of any legislative enactment*".

  However, trade usage may create an implied term: ***Sabi v. Jetspeed (1977)***.

- **By statute**

  Certain statutes provide that, in the absence of specific agreement, terms will automatically be implied into contracts dealing with the subject matter of the statute. The principal ones (see later in the course) are the Sale of Goods Act 1979, the Supply of Goods (Implied Terms) Act 1973 and the Supply of Goods and Services Act 1982.

- **By a course of previous dealing**

  It may be clear (or a matter of dispute!) whether a term can be implied from the same parties having agreed on a previous occasion.

Representations

These are statements of **fact** made by one or more parties to the agreement. Statements of law or of opinion are not, strictly speaking, "representations".

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Conditions

"Conditions" are terms of the agreement which are of **primary importance**.

Fundamental terms will, invariably, be conditions – although not all conditions are necessarily fundamental. It can be, and often is, stated in a written contract that certain terms are "conditions". Indeed, in most leases of property, it is stated that all terms are "conditions".

The reason for so stating is that the remedies available in the event of a breach of a condition are more extensive than for breach of a less important term. This will be covered in more detail later in the course.

If the contract does not specifically state which terms are conditions, that is then a question of fact for the court to determine

The breach of a condition, usually, allows the injured party to rescind the contract (rescission), as well as to seek damages for loss he/she has suffered as a result of the breach. Rescission is, in effect, declaring the contract cancelled, and refusing either to carry on with its performance or to be bound by its stipulations.

Warranties

A warranty is a less important term of the contract, the breach of which, normally, allows the injured party to seek only damages. However, in the case of breach of either a condition or a warranty, the "equitable" remedies of "specific performance" or "injunction" (i.e. a court order decreeing "do this" or "do not do that", respectively) may also be available to the party not in breach. These will be dealt with in a later study unit, when we discuss remedies for breach of contract.

Once again, if the parties do not state whether a term is a condition or a warranty, the court's job is to decide for them. In ***Bettini v. Gye (1876)***, B contracted with G (who was a director of an opera company) for B's exclusive services as a singer. One of the terms was that B should be available for rehearsals for at least six days before the beginning of the opera season. B turned up in London only two days beforehand and, therefore, G rescinded the contract.

HELD: That, in view of the length of the engagement, and all other circumstances, it could not reasonably be inferred that it was the intention of the parties that six days for rehearsals was a vital ingredient of the agreement. It was, therefore, only a **warranty**, and G was not entitled to rescind the contract.

Finally, a word of warning: the terms "condition" and "warranty" are not universally applied. For instance, in insurance contracts, the word "warranty" has, from time immemorial, been applied to essential terms. Breach of an insurance warranty usually gives the insurance company grounds for rescission. The House of Lords has railed against this anomaly but to no avail. It is too entrenched for even such an august body to change!

D. CONSIDERATION

We have seen that "consideration" is an essential element of a valid contract in English law. In certain other jurisdictions, this is not the case; however, historically, the common law of England has always viewed a contract as a bargain. **Both sides** must give something. The only exception to this rule is in the case of contracts under seal – "specialty" contracts. These do not require to be supported by consideration in order that they may be enforced by the courts.

A number of rules have grown up in the doctrine of consideration and in practice, in commercial contracts consideration is invariably present. The subject is a favourite

examination one. There have been repeated proposals for abolishing consideration as a requirement in all or at least in written contracts.

Definitions

There are various types of consideration – "good", "valuable", "nominal", and "bad". In order to be valid, consideration must be both "good" and "valuable". **Valuable consideration** is where some benefit is given or some detriment suffered. It is only consideration which is valuable in the eyes of the law which is sufficient to support a valid contract – although it must also be good, in the sense that it is not forbidden, or "bad".

A definition given in ***Currie v. Misa (1875)*** was as follows:

> *"A valuable consideration, in the sense of the law, may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered, or undertaken by the other."*

A shorter but less precise definition given by Sir Frederick Pollock, which has been approved by the House of Lords, is:

> *"The price for which the promise is bought".*

So, the essential feature is that there must be either some benefit accruing to the "promisor" (that is, the person who **makes** a promise) or some detriment accruing to the "promisee" (the person who **receives** a promise). Usually, the benefit and the detriment are the same thing, looked at from the different viewpoints of the parties. If I buy a book from you for £1, then £1 is a benefit to you and a detriment to me. On the other hand, the book is a detriment to you (because you no longer have it) and a benefit to me.

Types of consideration

There are **three** types of consideration.

(a) Executory consideration

This occurs where the parties exchange promises. For example, *"I promise to pay you £100 provided you promise to service my car".* The contract comes into existence from the moment the promises are exchanged, but its performance remains in the future. To this end, executory literally means *'yet to be done'*.

(b) Executed consideration

This type of consideration arises when one party to a contract has performed his side of the deal and the other party has yet to perform his or her side of the deal. For example, acceptance of a unilateral offer to the world at large as in ***Carlill v. Carbolic Smoke Ball Co. (1893)***.

(c) Past consideration

Past consideration is not good consideration as demonstrated by ***Re McArdle (1951)***. In this case a number of children were entitled to a house on the death of their mother. Whilst the mother was still alive the son and his wife had lived with her, and the wife had made various improvements to the house. The children later promised that they would pay the wife £488 for the work she had done.

It was held that as the work had been completed at the time when the promise was given, it was past consideration. Consequently, the later promise to pay her £488 for the work she had done on their mother's house could not be enforced.

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Principles governing consideration

Consideration is governed by **three** main principles:

(a) Consideration need not be adequate but must have some value.

The courts do not, in general, ask whether 'adequate value' has been given in return for the promise or whether the agreement is harsh or one-sided. This is what is meant by saying that 'consideration need not be adequate'.

In ***Chappell & Co. Ltd v. Nestlé Co. Ltd (1960)***, Nestlé manufactured chocolate. As a promotional gimmick, the company offered to sell a gramophone record to anyone who applied, for the sum of 1s 6d (7½p) **plus** three of the wrappers from its bars of chocolate. The wrappers themselves were of insignificant value and on receipt they were, in fact, thrown away by Nestlé.

HELD: The wrappers formed part of the consideration for the sale of the records.

Where the consideration, although of some value, is insignificant in relation to the transaction, it is called "nominal consideration".

In ***Pitt v. PHH Asset Management Ltd (1994)***, a property known as The Cottage was advertised for sale at £205,000. There were two persons interested in purchasing it, Mr Pitt, the claimant and a Miss Buckle. They entered into a "contract race" for the property. Mr Pitt made an offer of £200,000, subject to contract, which was refused upon receipt of an improved offer of £210,000 from Miss Buckle. The following day Mr Pitt telephoned the handling estate agent and advised him that he would seek an injunction to prevent the sale to Miss Buckle and that he was able to exchange contracts as soon as the agent wanted.

The agent referred the matter to his principal, the defendant company, who owned the property and thereafter told Mr Pitt that the sale to him at £200,000 could proceed, subject to contract and that no other offer would be considered provided contracts were exchanged within 14 days. Despite this "lock-out" agreement, the property was sold to Miss Buckle thereafter at £210,000.

HELD: The claimant, Mr Pitt, was entitled to damages for breach of the "lock-out" agreement, even though the sale was subject to contract. The agreement was a contract not to negotiate with anyone except Mr Pitt for 14 days, the consideration being the withdrawal of his threat to seek an injunction and the commitment by Mr Pitt to an exchange of contracts within 14 days to bind the sale.

However, it should be noted that, although consideration need not be adequate, it must be real. It must be **capable of being quantified** and having its value estimated by the law.

Two examples of consideration, which is **not** real and therefore, not good are:

- "In consideration of natural love and affection": **Bret v. J S (1600)**
- A promise by a son that, if his father would release him from a debt, the son would cease to bore his father with his complaints: **White v. Bluett (1853)**.

Consideration that is **impossible to give or perform** is also not good; likewise, consideration that is discretionary. If the promisee can perform his side of the bargain "if he likes", or "unless he changes his mind ", consideration is not good.

On the other hand, an undertaking by a manufacturer to sell his entire output to one buyer was **held** to be binding, notwithstanding the fact that the manufacturer did not bind himself to have any output: ***Donnell v. Bennett (1883)***.

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The distinctions can be fine. It is, really, a question of whether the court can find some **quantifiable value** in terms of money, benefit or detriment in the transaction to justify the desire to give effect to the intentions of the parties, and uphold the contract. Consideration is much easier to imply in commercial contracts than in domestic ones.

However, one type of consideration does not have any value in the eyes of the law, and that is if it is **illegal**. In point of fact, a contract that is illegal is void. However, whether this is because the consideration is bad or because the enforcement of illegal contracts is "contrary to public policy" is an arguable point.

(b) Consideration must not be past

This category does not usually count as valid consideration i.e. it is insufficient to make any agreement which is based on it a legally binding contract. Normally consideration is provided either at the time of the creation of the contract or at a later date. However, in the case of past consideration the action is performed before the promise that it is supposed to be the consideration for. Such action is not sufficient to support a promise, as consideration cannot consist of any action already wholly performed before the promise was made. A party to a contract cannot use a past act as a basis for consideration. Therefore, if one party performs an act for another and only receives a promise of payment after the act is completed, the past act would be past consideration.

The classic situation involving past consideration is illustrated by the case of ***Re McArdle (1951)***. The buyer of an article cannot sue on a guarantee given by the seller after the contract of sale has been made. The consideration for the promise of guarantee is past.

In ***Roscorla v. Thomas (1842)*** it was **held** that the seller's guarantee that the horse sold to the buyer was "*sound and free from vice*" could not be enforced against him since it had been given **after** the sale had been concluded. In other words, the guarantee did not form part of the consideration for the sale of the horse.

A similar principle applies where a person agrees to perform some service for another and **after** the work has been completed the second person agrees to pay for the service. The courts would have little hesitation in saying that since the service had been performed **before** there had been any mention of payment the consideration was past and the promise unenforceable.

On the other hand, an act performed before the giving of a promise can be consideration, if the act was done at the request of the promisor. The request implies a promise of benefit to follow. In ***Lampleigh v. Braithwait (1615)***, Braithwait was languishing in gaol. He requested Lampleigh to try to obtain for him a pardon from the King. In his efforts to achieve this, Lampleigh incurred expense. Braithwait subsequently promised to pay £100 for his trouble. He then refused to pay.

HELD: Although the consideration for the promise to pay was past, nevertheless it was good. A promise of payment could be implied from the **request for services**.

The determination of whether the consideration is past is a question of fact for the court. It does not have to follow the strict chronological events. Provided the making of the promise and the consideration for it are substantially one transaction, this will suffice. Nor is the wording of the promise decisive. A promise "*in consideration of your having today advanced £750*" was binding on proof that the advance had, in reality, been made at the time of the promise: ***Goldshade v. Swan (1847)***.

However, there are a number of exceptions to the rule that past consideration will not support a valid contract. For example under Section 27 of the **Bills of Exchange Act 1882** past consideration can create liability on a bill of exchange; and under Section 29

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of the Limitation Act 1980 a time-barred debt becomes enforceable again if it is acknowledge in writing. Also, where the plaintiff performed the action at the request of the defendant and payment was expected, then any subsequent promise to pay will be enforceable. Thus in ***Re Casey's Patents (1892)*** the joint owners of patent rights asked Casey to find licenses to work the patents. After he had done as requested they promised to reward him. When one of the patent holders died his executors denied the enforceability of the promise made to Casey on the basis of past consideration. It was held that the promise made to Casey was enforceable. There had been an implied promise to reward him before he had performed his action and the later promise simply fixed the extent of that reward.

(c) Consideration must be sufficient

The rule is consideration need not be adequate but it must be 'sufficient' i.e. it must have some value in the eyes of the law. It is up to the parties themselves to decide the terms of their contract as the court's will not intervene to require equality in the value exchanged, as long as the agreement concerned has been freely entered into as evidenced by the case of ***Thomas v. Thomas (1842)***. In this case the executors of a man's will promised to let his widow live in his house, in return for rent of £1 per year. It was held that £1 per year was 'sufficient consideration' to validate the contract, although it did not represent adequate rent in economic terms.

Consideration Must "Move" from the Promisee

This rule means that a person can enforce a promise only if she can show that **she herself** gave the consideration for it. However, the consideration in the sense that it is a detriment to the promisee does not have to benefit the promisor. The detriment by itself is sufficient.

(Note: Do **not** confuse this with the doctrine of privity, which we shall meet later.)

In ***Tweddle v. Atkinson (1861)***, two young people got married. Afterwards, their respective fathers entered into an agreement whereby they both would pay a sum of money to the husband, who should have the right to sue for the sums. Both fathers subsequently died. The husband then sued the executors of one of them for the sum due.

HELD: No consideration had **moved from the husband** – so, the promise to pay was, as far as he was concerned, gratuitous.

Conversely, if the consideration is a benefit to the promisor, this does not mean that the promisee need necessarily suffer a detriment. However, because of the rule that it must move from the promisee, if the benefit to the promisor was, in fact, provided by some third party, then the promisee cannot sue upon it.

Forbearance to Sue as Consideration

A promise to refrain from suing either a debtor or a third person may be sufficient consideration to support a promise of some act or thing by the debtor or the third person, as the case may be. This need not involve a waiver or a compromise of the ultimate right of action against them. A temporary forbearance may suffice.

In ***Alliance Bank v. Broom (1864)***, Broom was asked to give security for money advanced to him by the bank. He promised to assign some documents of title to goods but failed to do so. The bank sued for specific performance – i.e. an order compelling Broom to assign the securities.

HELD: The bank was entitled to the order. Although it had not promised that it would not sue for the debt, the act of **requesting security** did, in effect, give Broom the benefit of some measure of forbearance, which he would not otherwise have had. This forbearance, albeit unquantifiable in time, was sufficient consideration for the promise to assign the documents.

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However, for forbearance to sue to be consideration, some **liability** must exist – or, at least, be thought to exist. If the party forbearing to sue knows that his claim is, in fact, invalid, his forbearance to attempt what it is impossible to achieve is not valid consideration: ***Callisher v. Bischoffsheim (1870)***.

Furthermore, the forbearance to sue must be connected with the debtor's promise for it to constitute good consideration. If the creditor refrains from taking legal action in respect of a debt, which is already in existence – an **antecedent debt** – this is not sufficient to support a further promise.

In ***Wigan v. English & Scottish Law Life Assurance Society (1909)***, a debtor mortgaged an insurance policy to his creditor to secure a debt. However, he left the executed document with his solicitors. The solicitors managed to get extra time for payment without disclosing to the creditor the existence of the mortgage. Only after the debtor's death did the creditor hear about it.

HELD: The creditor had not given consideration for the **interest he acquired** (by virtue of the mortgage) in the insurance policy. Thus, he could not reimburse himself out of the proceeds of the policy.

The reasoning for the decision was that, as the existence of the security was unknown to the creditor, it could not be claimed that his forbearance to sue was given in response to the promise of executing the mortgage.

Forbearance to sue can, thus, be good consideration. However, it will not be so if the forbearance itself is forbidden by law, either as being contrary to public policy or to statute. For example, under the **Matrimonial Causes Act 1973**, a wife cannot bind herself by contract not to apply to the court for maintenance in matrimonial proceedings (that would be ousting the jurisdiction of the court). So, any promise to forbear could not be enforced.

Is the Performance of an Existing Statutory Duty Sufficient Consideration?

In certain circumstances only, the performance of an existing duty can be good consideration to support a further promise. In general, if a person has a legal obligation to do a certain thing, the doing of that very thing can neither be a detriment to him/her nor a benefit to a promisor. The case of ***Collins v. Godefroy (1831)*** establishes that the performance of an existing statutory duty is not sufficient consideration to establish a contract. In this case the plaintiff had attended on subpoena to give evidence on the defendant's behalf in a case in which the defendant was a litigant and he alleged that the defendant had promised to pay him six guineas for his trouble. Lord Tenterden held that there was no consideration for this promise, stating the following: *"If it be the duty imposed by law upon a party subpoenaed, to attend from time to time to give his evidence, then a promise to give him any remuneration for loss of time incurred in such attendance is a promise without consideration."*

Is the Performance of an Existing Public Duty Sufficient Consideration?

In this situation, performance beyond that already legally required is capable of amounting to sufficient consideration: ***Harris v. Sheffield United Football Club (1987)*****.** In this case the defendants argued that they were not obliged to pay for a large number of policemen who attended their ground at home matches because a major police presence at the ground was necessary to preserve law and order.

The Court of Appeal thought that as the defendants had voluntarily chosen to put their matches on at times, typically Saturday afternoons, when large attendances and therefore larger possibilities of disorder were likely and when a substantial police presence could only be achieved by calling policemen off rest days and paying large sums of overtime. It was therefore held that the police authority was entitled to be paid.

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In ***Glasbrook Brothers Ltd v. Glamorgan County Council (1925)***, the police were under a public duty to protect a coal-mine during a strike. At the request of the manager, they provided a stronger guard than they considered necessary – but for an agreed price.

HELD: The extra protection was good consideration for the promise to pay the price.

"The House of Lords, while agreeing that it was the duty of the police 'to give protection to the person and the property of all ... subjects', nevertheless, felt that, if a person gets special police protection as a result of a promise to pay for it, there is consideration and the promise is thus enforceable."

Is the Performance of an Existing Contractual Duty Sufficient Consideration?

Generally speaking, no. The reason for this is that consideration cannot be present if the promisee merely performs an obligation that he/she is already bound by contract to perform.

- ***Stilk v. Myrick (1809)***

  Two seamen deserted from a ship. The captain was unable to replace them so he promised the remaining crew that he would share out with them the wages of the deserters, if they would work the ship back to London. However, when the ship eventually reached London, the owners refused to make the promised payment.

  HELD: That the captain's promise could not be legally enforced as the sailors had only done what they were already obliged to do by their contracts of employment.

  However, on similar facts, the decision was otherwise where the crew did more than they were contractually bound to do, or in a different manner.

- ***Hartley v. Ponsonby (1857)***

  A ship became so shorthanded that it was unsafe to continue with the voyage. The captain, therefore, discharged all the remaining crew from their contracts, and offered them new contracts at higher wages if they would continue with the voyage.

  HELD: The consideration for the promise of higher wages was good.

  Despite the clear difference between these two cases, the law may not be entirely clear on the point.

- ***Williams v. Roffey Bros & Nicholls (1990)***

  Roffey Bros had entered into a contract to refurbish a block of flats and subcontracted with Williams to carry out carpentry work for a fixed price of £20,000. It soon became apparent that Williams was in such financial difficulties that he might not be able to complete the work on time with the consequence that Roffey Bros would be subject to a penalty clause in the main contract. Consequently, Roffey Bros offered to pay Williams an additional £575 for each flat he completed. On that basis Williams carried on working, but when it seemed that Roffey Bros were not going to pay him, he stopped work and sued for the additional payment in relation to the eight flats he had completed after the promise of additional payment.

  The Court of Appeal held that Roffey Bros had enjoyed practical benefits as a consequence of their promise to increase Williams' payment: the work would be completed on time; they would not have to pay any penalty; and they would not suffer the bother and expense of getting someone else to complete the work at short notice. These benefits were sufficient, in the circumstances, to provide consideration for the promise of extra money and Williams was held to be entitled to recover the extra money owed to him. Although the Court of Appeal did not overrule ***Stilk v. Myrick***, it

is clear that its sphere of relevance will be curtailed by the application of ***Williams v. Roffey Bros (1990)***.

As a result of the Court of Appeal's decision in ***Williams v. Roffey Bros (1990)*** it now appears that the performance of an existing contractual duty can amount to consideration for a new promise in circumstances where there is no question of fraud or duress, and where practical benefits accrue to the promisor. Moreover, another possible result of the court's decision in ***Roffey Bros*** is that the performance of a contractual duty may, indeed, be good consideration, particularly if the other party has a special need to have the contract performed in a particular manner or by a specified date.

Contrast ***Atlas Express Ltd v. Kafco (Importers and Distributors) Ltd (1989)***. Here a small company entered into an agreement with a national firm of carriers. The carriers subsequently purported to impose higher charges than previously agreed. Because the company was unable to find an alternative carrier and was heavily dependent on the contract, it reluctantly agreed to the new terms but later refused to pay.

HELD: The facts constituted economic duress (see later) but the courts also refused to enforce the new agreement for the higher charges as it lacked any fresh consideration from the purchasers, Atlas. The carriers' claim for additional payment was, therefore, dismissed.

Discharge or Variation of Existing Duties

The problem here is whether an agreement to accept some different performance of the contract from that originally agreed, or a full release from the contract, constitutes consideration.

If the discharge or variation involves a **mutual** alteration of rights or obligations, there is no difficulty. The consideration is the giving-up of rights by one party in exchange for the relinquishment of other rights by the second party.

However, if one of the parties has fully performed his obligations, there is, on the face of it, no consideration for his agreeing to release the other party from his outstanding obligations. Where the contract is varied, there are three likely situations – as follows.

- The parties may agree to terminate their contract and enter into a fresh one, imposing different rights and duties. As we have seen from ***Hartley v. Ponsonby (1857)***, above, this course provides good consideration.
- The parties may vary their contract in such a manner that the variation may affect the rights or obligations of either of them, according to how things turn out in practice. In this case, the possible benefit or detriment is the respective consideration for the promises of each of them.
- The agreement to vary the contract may confer benefit on one party only. Here, the strict rule must apply, and no consideration be deemed to be present.

There is, however, a possible let-out to this strict application, which has been developed by equity. The principle here is this: if one party has led the other to believe that she will not enforce her strict rights, and the other party has incurred expense or loss in **reliance** on that promise, then it would be inequitable to permit the first to go back on her promise.

In ***Hughes v. Metropolitan Railway (1877)***, a landlord gave notice requiring his tenant to do repairs within six months. During this period, he negotiated with the tenant for the purchase by the tenant of the lease. The negotiations broke down, whereupon the landlord sought to forfeit the lease, because the repairs had not been done.

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HELD: He could not do this, as the tenant had relied on the negotiations and, so, neglected to safeguard his legal position by executing the repairs. The landlord was bound to give a further six months' notice to repair before forfeiting the lease.

Breaking this case down, the variation of the contract was the implied promise by the landlord not to enforce his strict contractual rights to insist on repairs. This benefited **one** party only – the tenant. There was, therefore, no consideration for the promise. However, the tenant, having relied upon it, did not start doing the necessary repairs until it was too late. The equitable principle of "fair dealing" overrode the strict legal requirement for consideration. Therefore, the landlord was not permitted to break his promise by relying on the technical legal requirement.

The landlord was not permanently prevented from insisting on his rights; he merely had to give the necessary notice again after the equitable disability had disappeared.

Part-payment of a Debt

If a creditor promises to accept part-payment of a debt in settlement of the whole, there is no consideration for the promise. He is, therefore, not bound by it, and can sue for the balance.

This was established as early as 1602, in ***Pinnel's Case***, where it was **held** that "*payment of a lesser sum on the day in satisfaction of a greater sum cannot be any satisfaction for the whole*".

The rule in ***Pinnel's Case*** was approved by the House of Lords in ***Foakes v. Beer (1884)***. Mrs Beer got judgment for a debt from Dr Foakes of about £2,000. Some months later, Dr Foakes asked for time to pay, and Mrs Beer agreed in writing not to enforce the judgment, provided Dr Foakes paid by certain instalments. This, he duly did. After the £2,000 had been repaid, Mrs Beer claimed interest on the judgment debt.

HELD: She was entitled to it. The rule in ***Pinnel's Case*** ensured that payment of the lesser sum (i.e. without the interest which a judgment debt always allows) was not a discharge of the whole.

There was no consideration for her promise to accept payment by instalments – so, she was not bound by the fact that the promise did not include the interest.

The apparent harshness of this rule, which can not only cause hardship but also produce absurd results, has been much criticised. In 1881, the then Master of the Rolls had the following to say about the rule in ***Pinnel's Case***.

> *"According to English Common Law, a creditor might accept anything in satisfaction of his debt except a less amount of money. He might take a horse, or a canary, or a tomtit if he chose, and that was accord and satisfaction; but by a most extraordinary peculiarity of the English Common Law, he could not take 19s 6d [97½p] in the pound."*

However, there are **four** exceptions to the rule in ***Pinnel's case (1602)***:

(a) Early payment of a reduced amount, if agreed by the creditor

Where there is a promise by the debtor to pay the reduced sum earlier than the date on which the full debt falls due, then provided the creditor agrees to it, this will be legally binding. If payment of a smaller sum is made at an earlier date than that required and it is accepted, then that can be satisfaction for the whole debt as demonstrated by the facts of ***Pinnel's case (1602)***. In this case the plaintiff, Pinnel, sued Cole in debt for £8 10s due on a bond on 11 November 1600. Cole's defence was that, at Pinnel's request, he had paid him £5 2s 6d on 1 October, and that Pinnel had accepted this payment in full satisfaction of the original debt. The court in this case found in favour of Pinnel but made it clear that 'but for' a technical flaw they would have found in favour of the defendant Cole.

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(b) Substituted performance

This arises where the creditor accepts some other form of consideration instead of money, such as the delivery of goods. Alternatively payment of a lesser sum together with an additional element, such as a promise to repair the creditor's car, would suffice.

(c) Payment of a lesser sum where the debtor is disputing the value of the work that has been performed, and the creditor accepts the reduced amount

The reason why the creditor is bound by such an arrangement is that if the dispute were to be resolved by court action, the court might determine the value of the work performed as worth even less than the debtor offered to pay. Accepting the reduced sum may be seen as a new bargain.

(d) Where the equitable doctrine of promissory estoppel applies

Central London Property Trust Ltd. v. High Trees House Ltd. (1947): The equitable doctrine of promissory estoppel was explained and applied by Denning in the case of the High Trees case and operates as an exception to the principle that part payment of a debt cannot be satisfaction of the whole of the debt and that, accordingly, a debtor is not obliged to pay the balance of the contractual debt to the creditor.

In the ***High Trees*** case the plaintiffs had granted a 99-year lease of a block of flats from 1937 at a rent of £2,500 per year. Because of wartime conditions the defendants were unable to let all of the flats during the war and, consequently, the plaintiffs agreed to reduce the rent by half. By the end of the war the flats were fully let again. In an important obiter dictum in his judgement, Denning J. considered that the wartime agreement between the two parties was binding – in other words, that the plaintiffs would not be able to recover the full rental for the wartime period. He said that the plaintiffs were estopped (i.e. prevented) from claiming the rent on the basis that a promise, which was intended to be binding and intended to be acted upon, which was acted upon, is binding in the sense that the courts will not allow the promisor to act inconsistently with that promise.

The essence of this decision is that the principle of ***High Trees*** applies where it is equitable to apply it. Estoppel is a concept known both to law and equity; estoppel at common law is commonly concerned with preventing a person from denying the existence of facts which he himself previously asserted; as a rule of evidence it debars him from leading evidence to rebut his own earlier assertion, where another, in consequence thereof, has acted to his detriment on the faith of the assertion.

Promisory estoppel is not concerned with **facts** but with **promises and intentions**.

E. THE INTENTION TO CREATE LEGAL RELATIONS

The courts will not enforce any contract unless it is clear that the parties intended to be legally bound by their agreement. It is presumed that this is the intention in normal commercial contracts and that it is not the intention in respect of domestic and social agreements. However, each of these presumptions is rebuttable.

Commercial Agreements

In all commercial agreements, the presumption is that the parties **intend** to create legal relations.

With these agreements there is a strong presumption that the parties intend to enter into a legally binding agreement in consequence of their dealings. However, In commercial situations the presumption is so strong that it will usually take express words to the contrary to avoid its operation as demonstrated by the case of ***Frank Co v. Crompton Bros (1925)***.

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In this case it was held that an express clause stating that no legal relations were to be created by a business transaction was effective in rebutting the presumption that it was a commercial agreement, which the parties intended to be legally enforceable in the event of breach.

Another example is agreements, such as football pools coupons, which are stated to be *'binding in honour'* only: ***Jones v. Vernon's Pools Ltd (1938)***. In this case the conditions of entry of a football pool competition stated that the sending in of the coupon should not give rise to any legal relationship and that the arrangements of the pool were 'binding in honour only'. The plaintiff claimed to have sent in an entry but the defendants denied having received it; it was conceded that had it been received it would have won a prize. The judge, Atkinson J, said the agreed conditions (i.e. that the arrangement was *'binding in honour only'*) prevented the plaintiff from succeeding in his claim; there was clearly no intention to create legal relations, and it was consequently unnecessary to decide the issue of fact.

However, whether the particular words used have the effect of so negativing contractual intent is a question of legal construction of the contract. In ***Edwards v. Skyways Ltd (1964)***, the company told an employee whom it was going to dismiss that he would receive an "*ex gratia*" payment.

HELD: The words did not mean that contractual intent was negatived. They were only a denial by the company that it previously had any legal liability to pay the amount.

Domestic and Social Agreements

In all domestic & social agreements, the presumption is that the parties **do not intend** to create legal relations.

With these agreements the presumption is that the parties do not intend to create legal relations when they exchange promises. From the outset it is essential to realise that the intention **not** to create legal relations in such relationships is only a presumption and that, as with all presumptions, it may be rebutted by the actual facts and circumstances of a particular case.

Rarely, if ever, do social agreements give rise to the implication that legal consequences were intended. The winner of a golf competition had no legal right to the prize, because no one connected with the competition intended such results to flow from the entry of competitors: ***Lens v. Devonshire Club (1914)***.

In the case of agreements between members of a family, some are and others are not intended to have legal consequences. There is no reason why a husband cannot contract with his wife, or a father with his son. However, on the other hand, such pacts are frequently not meant to have this effect. It is, obviously, much easier to imply contractual intent in an agreement between two commercial organisations operating at "arm's length" than it is between immediate members of a family. As always, if the situation is not expressly stated, the court has to construe the agreement, and all the circumstances surrounding it.

In ***Balfour v. Balfour (1919)***, the wife of a man working in Ceylon had to remain in England for medical reasons. Her husband promised to pay her an allowance of £30 a month.

HELD: The agreement was not intended to have legal force (also, the wife had not provided any consideration for the promise).

However, a case which is in direct contrast to the above case is ***Merritt v. Merritt (1970)*** where the husband left the matrimonial home, which was in joint names of husband and wife and subject to a building society mortgage, to live with another woman. The husband and wife met and had a discussion in the husband's car during which the husband agreed to pay the wife £40 a month out of which she must pay the outstanding mortgage payments on the house. The wife refused to leave the car until the husband recorded the agreement in writing and the husband wrote and signed a piece of paper which stated 'in consideration of

the fact that you will pay all charges in connection with the house…until such time as the mortgage repayment has been completed I will agree to transfer the property to your sole ownership'. After the wife had paid off the mortgage the husband refused to transfer the house to her. It was held by the Court of Appeal that the parties had intended to affect their legal relations and that an action for breach of contract could be sustained.

A different situation may arise in the "pools syndicate" type of agreement. It is quite a widespread practice for members of a household, a group of friends, or employees in a business to participate on a regular basis in a football pools scheme or some other form of prize competition. A leading case is ***Simpkins v. Pays (1955)***. The defendant owned a house in which she lived with X, her grand-daughter, and the claimant, a paying boarder. The three took part together, each week, in a competition organised by a Sunday newspaper. The entries were made in the defendant's name but there was no regular rule as to the payment of postage and other expenses. One week, the entry was successful and the defendant obtained a prize of £750. The claimant claimed a third of this sum but the defendant refused to pay, on the ground that there was no intention to create legal relations but only a friendly adventure.

Judgment was given for the claimant. The court **held** that there was an intention to create legal relations, and it was "*a joint enterprise to which each contributed in the expectation of sharing any prize that was won*".

In contracts or agreements between more distant family members than husband and wife, contractual intent is easier to imply. For instance, a lady added an extra room to her son-in-law's house at a cost of £600. There was an understanding between them that she should live there for the rest of her life. However, after about a year, she left of her own accord. It was **held** that, although there was a contract to permit her to reside for her lifetime, there was no intention that the cost of £600 should amount to a contract of loan: ***Hussey v. Palmer (1972)***.

Other Cases

The issuing of "free travel" passes by transport undertakings may or may not be intended to be contractually binding. Such a pass issued to an employee "*as a matter of course*" and as one of the "perks" of the job will, probably, not have contractual force: ***Wilkie v. LPTB (1947)***, whereas one issued to an old-age pensioner and written in legal language will, probably, be binding: ***Gore v. Van der Lann (1967)***.

If a statement is made in anger or as a jest, this fact may well negative contractual intent. So, as always, it is a question of the proper construction of the contract to ascertain the intention of the parties.

F. CAPACITY TO CONTRACT

In general, anybody over the age of 18, who, at the time, is sober and mentally unimpaired, is capable of contracting.

This also applies to corporations which can contract in exactly the same way as living persons – but, of course, they must do it through the agency of a human being. A corporation can contract under its corporate seal or by parol.

However, certain categories of person have no capacity (or only limited capacity) to contract.

Minors

By the **Family Law Reform Act 1969**, a minor is a person under the age of 18 years. She becomes adult at the beginning of her 18th birthday – i.e. at one minute past midnight.

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There are two circumstances in which contracts with a minor may be unenforceable:

- Most contracts with a minor are "voidable" at her option. That is to say, she **but not the other party**, has the right not to be bound by the contract. To be voidable, she must repudiate the contract during her minority, or within a reasonable time after reaching her majority. If not, the contract will become binding.

  This category covers the majority of contracts into which a minor enters, except those mentioned below. So, it is at the minor's option whether she wishes to be bound by her contract or not.

  In ***Smith v. King (1892)***, a minor became liable to a firm of brokers for £547. After he reached his majority (then 21) the firm sued, and he compromised by giving two bills of exchange for £50. One of the bills was endorsed to Mr Smith, who took it in ignorance of the circumstances.

  HELD: The debt was contracted during minority and, so, it was voidable.

- Some contracts are, by statute, unenforceable against a minor. For example, under the **Consumer Credit Act 1974** it is an offence to send literature to a minor inviting him/her to borrow money or obtain goods or services on credit. An exception to this general rule exists where the money borrowed has been used for the purchase of necessaries (see below). In this case the lender can recover such part of the loan as was actually spent on necessaries.

  Where an adult guarantees a loan to a minor then, prior to 1987, that guarantee would be treated as unenforceable. Now, however, Section 2 of the **Minors' Contracts Act 1987** provides that such a guarantee shall no longer be treated as unenforceable merely because the contract with the minor cannot be enforced.

  Section 3 deals with the situation where a minor acquires goods under an unenforceable or repudiated contract. The courts are empowered to order restitution of the property "*if it is just and equitable to do so*". The important difference between this provision and the former power contained in the **Infants Relief Act 1874** is that the court is no longer restricted to cases where the minor has acted fraudulently, e.g. giving a false age in order to obtain a loan.

However, contracts for "necessaries" **are** binding on a minor. Necessaries are those things a person immediately needs, such as food; drink; clothing; accommodation; medicines. Necessaries are not confined to those things which are absolutely required to keep him alive but they extend to all such things as are reasonably necessary for him in the station in life to which he belongs. They exclude luxuries, and also a surplus of necessary items (e.g. a contract to buy two shirts would, probably, be binding but one for a dozen would not be.)

In ***Nash v. Inman (1908)*** the claimant was a West End tailor and the defendant was a minor undergraduate at Trinity College, Cambridge. The claimant sued the minor for the price of various items of clothing, including eleven fancy waistcoats. It was proved that the defendant was well supplied with such clothes when the claimant delivered the clothing in question. Accordingly, the claimant's action failed because he had not established that the clothes supplied were necessaries.

Other contracts binding on a minor are those which are beneficial for him/her, such as contracts of apprenticeship or service, or education.

Mentally-disordered and Drunken Persons

Except for contracts for necessaries, contracts are not binding on such persons, unless they specifically ratify them during a lucid period (in the case of a mentally disordered person) or when sober.

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Study Unit 6

Contract Law 2: Contract Regulations

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A. PRIVITY OF CONTRACT

It is a fundamental principle of law that two people cannot by a contract impose liabilities on, or bind, a third party; nor can anybody have rights or obligations imposed upon him/her by a contract, unless he/she is a party to it. This principle is called **privity of contract**. Sometimes, this rule can cause absurdities or injustice, and in appropriate cases the law has found ways around it. However, the general principle is of great importance. Let us state it in another way. Only the **parties to a contract** can enjoy rights or acquire obligations under that contract. Again, there have been repeated suggestions that a named third party would be able to take the benefit of the contract. However, in ***Midland Silicones v. Scruttons (1962)*** a sub-contractor had to pay the full loss to the owner of goods. A limitation in both his and the main contract did not help him against someone **he** had no contract with.

The application of the rule takes two forms:

Attempts to Confer Rights on Third Parties

The problem usually arises when third parties attempt to sue to enforce rights they think they have acquired under a contract to which they are not a party. The law will not permit them to sue.

In ***Price v. Easton (1833)***, a man owed Price a sum of money. He agreed with Easton that he would work for him, if Easton would pay off his debt to Price. The work was duly done but Easton failed to pay Price. Consequently, Price sued Easton.

HELD: Price could not recover the money, because he was not a party to the contract for work.

At this early stage of the development of the doctrine, it could be – and, indeed, was – argued that the reason why Price could not sue was because he had provided no consideration. However, the case of ***Tweddle v. Atkinson (1861)*** established that the question of consideration was immaterial. The rule of privity of contract stood on its own two feet. In that case, as we saw earlier, the respective fathers of a husband and wife made a contract between themselves to each pay the husband a sum of money. They further agreed that the husband should have the right to sue if one of them defaulted. The father of the wife died without having paid, and the husband sued his executor. It was **held** that he could not do so. The judge said:

> *"It is now established that no stranger to the consideration can take advantage of a contract, although made for his benefit".*

In ***Dunlop Pneumatic Tyre Co. Ltd v. Selfridge & Co. Ltd (1915)***, Lord Haldane restated the rule as follows:

> *"In the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it".*

The leading authority in more recent years is ***Beswick v. Beswick (1968)***. A coal merchant made over his business to his nephew. As part of the deal, the nephew promised that he would pay an annuity to the uncle's widow after his death. The uncle died, and the nephew failed to pay the annuity. The widow then sued in two capacities – in the first place, in her own right and, second, as administratrix of the uncle's estate. It was **held** by Lord Denning that she could not sue in the first capacity, as she was no party to the contract. She could, however, sue as administratrix of the estate, and get an order for specific performance of the contract.

The next problem is whether a party to a contract can recover damages in respect of a third party's loss; and, if so, can the third party compel the money to be handed over to him/her? The answer is "yes" in both cases. In ***Lloyd's v. Harper (1880)***, it was said:

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> *"Where a contract is made with A for the benefit of B, A can sue on the contract for the benefit of B, and recover all that B could have recovered if the contract had been made with B himself".*

The second question was answered in ***Jackson v. Horizon Holidays Ltd (1975)***. Mr Jackson contracted with Horizon for the company to provide holiday accommodation of a certain standard for the whole Jackson family. The accommodation turned out to be woefully inadequate, and Mr Jackson sued.

HELD: He could recover for distress to himself, as a party to the contract, and also on behalf of his wife and child, who were not parties.

Any money recovered on behalf of third parties was in trust for them, and had to be accounted for to them.

In ***Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd (1994)***, the parties entered into a standard form of building contract, one of the terms of which precluded a party from assigning the benefit of the contract. The contract related to the development of a large estate and both parties were aware that the properties, when built, would be occupied by or purchased by third parties. It became necessary for the building owner, one of the parties to the contract, to institute proceedings against the builders and to claim substantial damages after he had parted with the ownership of the land to third-party property owners.

HELD: A prohibition of the assignment of a contract can be rendered ineffective if both parties agree to its release. In the absence of such mutual agreement, however, and where on the facts the parties are to be treated as having entered into the contract on the basis that the original landowner is entitled to enforce the contract for the benefit of those who actually sustain loss through defective performance, the original landowner is entitled to an award of substantial damages.

The court stated:

> *"The present case falls within the rationale of the exceptions to the general rule that a complainant can only recover damages for his own loss. The contract was for a large development of property which, to the knowledge of both parties, was going to be occupied, and possibly purchased, by third parties .... Therefore, it could be foreseen that damage caused by a breach would cause loss to a later owner and not merely to the original contracting party .... In such a case, it seems proper ... to treat the parties as having entered into the contract on the footing that the building owner would be entitled to enforce contractual rights for the benefit of those who suffered from defective performance but who, under the terms of the contract, could not acquire any right to hold the builders liable for breach."*

Attempts to Impose Liabilities on Third Parties

A person cannot be bound by the terms of a contract unless he/she is a party to it. However, contracts between two people can affect the rights of third parties. Conversely, a person may commit a tort by interfering with the parties in the performance of their contract.

In ***Lumley v. Gye (1853)***, Johanna Wagner was employed by Lumley as an opera singer. For his own purposes, Gye maliciously induced Miss Wagner not to perform.

HELD: Gye was liable to Lumley for the tort of wrongful interference with contractual rights.

Instances of attempts to impose liabilities on strangers fall into **three** main categories:

(a) Contracts for sale of goods

These often revolve around attempts to impose conditions on the resale of goods. If a manufacturer sells to a retailer with certain conditions attached, he may want those conditions to attach to the goods when they are resold to the public. However, on account of the doctrine of privity, he cannot enforce those conditions against a third

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party who buys from the retailer. All he can do is to insist that the retailer himself attaches the desired conditions on his contract with the public (or other third parties).

In ***McGruther v. Pitcher (1904)***, P manufactured "*revolving heel pads*" as licensee of the patent's owner. Inside the lid of each box, a notice was stuck stating that it was a condition of sale that the pads would not be resold at less than a certain price, and that "*acceptance of the goods by any purchaser will be deemed to be an acknowledgement that they are sold to him on those conditions and that he agrees with the vendors to be bound by the same*". A purchaser then resold the goods to the public at less than the specified price. P tried to sue the retailer to prevent this.

HELD: P failed. There was no privity between him and the retailer. Further, he could not rely on the printed notice, even though the ultimate purchaser might be aware of it, because "*you cannot in that way make conditions run with the goods*".

Thus, the common law rule is clear – two parties to a contract cannot impose liabilities in the form of restrictions on third parties who subsequently acquire the goods. In respect of price only, this rule can be overridden by statute. Under the **Resale Prices Act 1976**, agreements on resale price maintenance may, provided they are not those which are void under the Act, be enforced against third parties who buy the goods with notice of the price restrictions.

(b) Contracts affecting land

There have always been substantial differences between the law relating to land and that relating to other forms of property. Land is called "real property"; other forms are "personal property".

In land law, restrictive covenants can always be made to "run with the land", irrespective of privity of contract between the original vendor and subsequent purchasers: ***Tulk v. Moxhay (1848)***.

(c) Chartering of ships

Attempts have been made to extend the principles of "real" property to contracts for the charter of ships. Ships are, of course, "personal property" or "chattels".

In ***Lord Strathcona Steamship Co. Ltd v. Dominion Coal Co. Ltd (1926)***, Dominion Coal had a time-charter of a ship. The original owners sold the ship to Strathcona, which was aware of the charter, and agreed to be bound by its terms. The company failed to honour the agreement, and claimed that it was not bound by the charter, as it was not a party to it.

HELD: An injunction would be granted to restrain Strathcona from breaching the charter.

Now, at first sight, the decision appears to be wrong. Under the rules of privity, Strathcona was not a party to the charter, so could not legally be bound by its terms (whatever the moral rights might be). It has been contended, however, that notwithstanding that a ship is a chattel, the equitable rule in ***Tulk v. Moxhay*** ensured that equity would not permit an act to be done which was inconsistent with a covenant with notice of which the chattel was acquired. This argument is not very convincing, if you refer back to the "revolving heel pads" case: ***McGruther v. Pitcher (1904)***.

A better explanation is that a contract can be **implied** between Strathcona and Dominion, transferring the obligations of the original charter to Strathcona. This is called a "novation".

However, whatever the true explanation of this case is, its limits were defined in 1958, in the ***Port Line*** case.

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In ***Port Line Ltd v. Ben Line Steamers Ltd (1958)***, Silver Line Ltd chartered a ship to Port Line for 30 months from March 1955. In February 1956, Silver Line sold the ship to Ben Line – but on condition that she be immediately chartered back to Silver Line, to enable the company to carry out its contract with Port Line. This second charter agreement contained a provision that "*if the ship be requisitioned, the charter would forthwith terminate*". No such clause appeared in the original charter, and Ben Line was unaware of this anomaly.

In August 1956, the ship was requisitioned by the Crown – and, so, Port Line lost the use of her. Port Line brought an action against Ben Line to recover the compensation received by Ben Line from the Crown.

HELD: Port Line could not sue Ben Line, because there was no privity of contract between them, and Ben Line was unaware at the time it purchased the ship of Port Line's rights under the original charter. However, even if Ben Line had had notice, the company would not have been in breach of any duty to Port Line as it was by no act of theirs that Port Line was unable to use the ship during the period of requisition.

It, thus, appears from this case that the exception to a privity rule permitting a liability to be imposed on a third party will only apply:

- If the third party has **actual notice** of the liability and
- If the third party's conduct has been either **inequitable** or in breach of a **separate agreement** with the other party to the contract. In ***Midland Silicones v. Scruttons (1962)***, Midland Silicones did not know that United States Lines stevedoring had been sub-contracted to Scruttons.

Exceptions to and Avoidance of the Privity Rule

(a) Collateral contracts

In an effort to avoid the privity rule causing either an absurdity or injustice, the courts will, sometimes, imply a "collateral" contract between a third party and one of the parties to the main contract. A collateral contract is one that is separate from, but substantially in respect of the same subject-matter as, the main contract.

In ***Shanklin Pier v. Detel Products Ltd (1951)***, P employed contractors to paint a pier. Detel approached P and represented to him that the company's paint would last for seven years. On the strength of this representation, P instructed the contractors to buy Detel's paint for the job. In practice, it lasted only three months.

HELD: Although the contract for the supply of paint was between the contractor and Detel, a collateral contract would be implied between Detel and P that the paint would last for seven years.

As will be apparent to you, had the privity rule been strictly applied, P would have no right of action against Detel. Also, as the contract for painting the pier did not contain a warranty that it would last any particular time, P would have no rights against the contractor. Even if P did have such a right, Detel's misrepresentation was made to P. So, the contractor would have no rights against Detel in respect of it.

The device of implied collateral contract ensured that justice was done. A problem can, however, arise over consideration in such collateral contracts. In the Detel case, the consideration for Detel's promise that the paint would last seven years was P's instruction to the contractor to buy Detel's paint.

However, in ***Channock v. Liverpool Corporation (1968)***, the facts were that P's car was damaged and repaired by a garage in pursuance of a contract between it and an insurance company. Repairs were inordinately delayed.

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HELD: There was a collateral contract between P and the garage that it would do the repairs in a reasonable time. The consideration for this was the leaving of the car with the garage for repair. Although not necessarily a detriment to P, it was a benefit to the garage, in the sense that it enabled it to contract with the insurance company to do the repairs.

(b) Statute

As we have already seen, statute can override the privity rule. The best example is that of the **Resale Prices Act 1976**. Other instances are given below.

- **Law of Property Act 1925**, Section 56(1): A person may take an immediate interest in land or other property or rights, although he/she may not be named as a party to the conveyance or other instrument.
- **Married Women's Property Act 1882**: People may insure their lives for the **benefit** of their spouses or children, and these then can enforce the contract on the death of that person, although they are not parties to the contract.
- **Road Traffic Act 1972**: A person driving a car with the consent of the owner can enforce any provision of the owner's insurance policy that is in his/her favour.

(c) Trusts

A beneficiary of a trust may enforce the terms of a contract made for his benefit between his trustee and a third party.

The trust does not have to be a formal one. The rule applies to any situation where the law will deem a person to be in the position of a trustee, or where he constitutes himself a trustee for another. In such a case, if the "constructive" trustee makes a contract for the benefit of his "*cestui que trust*" (i.e. beneficiary), that person can enforce the contract. However, it is necessary that the trustee be joined as a party to any such action to avoid the danger of the third party, or promisor, being sued a second time in respect of the same action by the trustee.

In ***Midland Silicones v. Scruttons (1962)***, the arguments of agency and trust were both unsuccessfully employed in the Court of Appeal and the House of Lords.

Note: The rule in privity of contract ensures that a person not a party to the contract cannot be sued in contract. This does not preclude such a person being sued on any other pretext for a breach of their obligations such as in Negligence, which we deal with later.

Recent Developments

The law relating to privity of contract has undergone important reforms by the passing of the **Contracts (Rights of Third Parties) Act 1999** (in force on 11 May 2000). Section 1(1) states that a third party may enforce a term in a contract if:

- The contract expressly provides that he/she may do so, or
- The contract attempts to confer a benefit upon him/her.

Section 1(2) states that the third party will be denied such rights if the parties make it clear that a third party should have no such rights.

The third party must be expressly identified in the contract:

- By name – e.g. John Jones
- As a member of a class of persons – e.g. "all employees"
- As answering to a particular description – e.g. "subsequent purchasers".

It does not matter that the third party does not exist when the contract is made – e.g. a subsidiary company yet to be formed; a child not yet born.

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B. JOINT OBLIGATIONS

Definitions

- "**Several**" liability is present where two or more people make separate promises to another person. These separate promises can be made by the same instrument or by different instruments. The promises are, thus, **different** – and, if one is discharged or breached, this has no effect on the others.
- "**Joint**" liability arises where two or more people together promise to do the same thing. In this event, there is only **one** obligation, and the discharge of it discharges all the joint promisors. The rules regarding joint obligations are outlined below.
- "**Joint and several**" liability occurs where two or more persons **in the same instrument** make a joint promise to do a certain thing and, at the same time, each of them makes a separate promise with the promisee to do the same thing. So, **one joint obligation** arises, and also as many several obligations as to the same thing as there are promisors.

How Joint Liability Arises

If two (or in each case more) people make the same promise to a third, it is presumed by the law that the intention was that their liability should be **joint**. **Express words** are necessary to make the one obligation a joint and several liability.

Examples of joint liability being presumed are outlined below.

- **Partnerships**

  The liability of partners for the **debts** of the partnership is joint.

- **In Respect of Bills of Exchange and Cheques**

  If two people draw, accept, or endorse a bill of exchange or a cheque, their liability in respect of it is joint. In the case of a promissory note, the liability may be either joint or joint and several, depending on the words used.

Effects of Joint Liability

(a) Joining all parties

As we have mentioned, if the obligation which is the subject of joint liability is discharged, then all the joint promisors are discharged. However, if the promisee wishes to take action in respect of the obligation, he/she should "join" all the promisors who are still alive in the one action. If this is not done, any of the defendants (i.e. promisors) can apply to have the action stayed until all of them have been properly joined.

There are certain exceptions to this rule, and there is no requirement to join a joint promisor who is:

- A discharged bankrupt
- Outside the jurisdiction of the court
- Protected by the **Limitation Act 1980**
- A member of a firm of "common carriers"
- An undisclosed "sleeping partner".

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(b) Death

The death of one joint promisor serves to transfer the obligation to the other joint promisors. His/her estate is not, thereafter, liable. An exception to this is in the case of partnerships. As we have seen, the liability of partners is joint but the estate of a deceased partner is liable for partnership debts to the extent only that the remaining partners cannot satisfy them. However, when the last surviving joint promisor dies, the obligation does then pass to his/her personal representative.

(c) Judgment against one joint debtor

If judgment is obtained against one of the promisors to a joint obligation, this serves to bar any further action against the others, even if it is not satisfied. The reason is that the debt is deemed to merge in the judgment. Hence, the practical as well as legal advisability of suing all the joint debtors.

In the event of joint and several liability, a judgment against one of them does not bar action against the others. The creditor can sue them all together, or one at a time, as he/she pleases. As you will appreciate, the fact that not only have the promisors jointly agreed to be liable but that each has also made a separate promise ensures that this flexibility is allowed to the creditor.

(d) Contribution between themselves

If one joint or joint and several promisor pays the debt, or pays more than his/her share, he/she can recover the excess from the others in equal shares – subject, however, to any agreement between themselves to the contrary: ***Deering v. Earl of Winchelsea (1787)***.

C. ASSIGNMENT

Background and Definition

Assignment is the act of transferring obligations or rights under a contract to another person, not a party to the original contract.

Now, it is not only the law but also common sense that a person cannot transfer his/her liabilities under a contract unless the other party agrees to accept performance by the transferee. Nor can a person be compelled to accept liability for the contract from anybody other than the person with whom he/she contracted. This principle was established in the old case of ***Robson and Sharpe***.

In ***Robson and Sharpe v. Drummond (1831)***, Sharpe undertook to paint annually and keep repaired a carriage, which he hired to Drummond for five years. After three years, Sharpe retired, and he informed Drummond that, henceforward, his partner Robson would be responsible for the painting and repair. Robson was not a party to the original contract and Drummond, therefore, refused to accept this and returned the carriage.

HELD: He was entitled to do so.

The reasoning here is that a person is entitled to insist that the work is carried out by the person whom he, obviously, trusts to do it properly and in accordance with his wishes. That person has been selected on the basis of skill, competence, or other characteristics – so, it is right and proper that no one else should do the job.

However, in cases where the contract is such that it is quite immaterial who actually does the work, provided it is done adequately, it may be performed **vicariously** by someone else: that is to say, the performance is transferred to a third person without the necessary consent of the employer. However, normally the **liability**, as opposed to the actual performance, is not transferred.

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In ***British Waggon Co. v. Lea & Co. (1880)***, the Parkgate Company hired a number of railway wagons to Lea, and agreed to keep them in repair. Parkgate then went into liquidation and assigned both the repair work and the benefit of the contract to British Waggon. Lea refused to accept this and rescinded the contract.

HELD: He could not do so.

Robson and Sharpe v. Drummond was distinguished on the grounds that, here, any ordinary workman could carry out the necessary work and it was of no importance who actually did it.

Of course, with the agreement of both parties, either the benefit of or the liabilities under a contract can be assigned to a third party. What one is, in reality, doing in such a case is cancelling the old contract, and substituting a new one, with the third party. This, as we have seen, is called a "novation".

Originally, the common law forbade the assignment of rights or obligations under contracts, whereas equity would permit them. So, statute stepped in to regulate the apparent absurdity. Now, therefore, there are **two** types of assignment.

Statutory Assignments

By the **Law of Property Act 1925**, Section 136, *"any absolute assignment by writing under the hand of the assignor of any debt or other legal thing in action, of which express notice in writing has been given to the debtor, is effectual in law to pass and transfer from the date of such notice:*

(a) the legal right to such debt or thing in action;

(b) all legal and other remedies for the same; and

(c) the power to give a good discharge for the same without the concurrence of the assignor".

Section 136, therefore, permits any rights arising under a contract to be legally assigned to a third party, without the consent of the other party, provided that the assignor gives prior written notice to the other party. However, note that it is **only** rights under the contract that may be so assigned – the right to receive payment of a debt, the right to receive payments due on the contract, and so on. A person still cannot assign the liabilities – that is, the duties he/she has to perform, or the obligation to make payment, etc., by virtue of this statutory provision.

Equitable Assignments

Equity does not insist on the formality of written notice before the assignment of a debt or other "thing in action" is valid. Plainly, it is sensible to do so but not essential.

In equity, an assignor can assign a right arising under the contract in two ways:

- By transferring the right to receive something, be it payment or the performance of the contract, to his/her assignee
- By instructing the other party to the contract (the debtor) to discharge his/her debt to, or give performance to, the assignee.

Provisions Applicable to both Statutory and Equitable Assignments

(a) The assigning of rights under a contract is not necessarily a separate or collateral contract between assignor and assignee, although it can be. It is a **right**, and consideration for it is not necessary: ***Holt v. Heathfield Trust Ltd (1942)***.

(b) A contract can specifically declare that rights under it shall be incapable of assignment – in which event, any purported assignment will be **invalid**.

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(c) The assignment of certain rights is **prohibited** by statute, or made **void** by reason of "public policy" – e.g. benefits under Social Security legislation; the salary of a public officer; the right of a wife to receive maintenance.

(d) Rights arising under commercial contracts are, normally, readily assignable. However, it may appear from the contract that the requirements of one party are a material consideration in ascertaining the obligations of the other. In such event, the benefit of the contract may not be able to be assigned. Two examples may serve to illustrate the difference.

In ***Tolhurst v. Associated Portland Cement Manufacturers Ltd (1902)***, Tolhurst contracted to supply a small company with "*750 tons of chalk per week for 50 years, and so much more as the company shall require for the manufacture of Portland cement upon their piece of land* ". The small company sold its business to Portland Cement, which was a large concern.

HELD: Portland Cement could maintain an action against Tolhurst in its own name. Portland Cement was entitled to the benefits of the contract, and the assignment of them was valid.

The reasons given were:

- That the assignment did not increase the burden of the contract on Tolhurst, as the small company might have increased its capital and worked "*its piece of land*" more intensively, and
- With a contract of such long duration, the possibility of assignment must have been contemplated.

On the other hand, consider ***Kemp v. Baerselman (1906)***. Here, D contracted to supply a cake manufacturer with all the eggs that he would require for one year, and the manufacturer agreed not to purchase eggs from elsewhere. The cake manufacturer transferred his business to another company.

HELD: The contract for eggs was not assignable. The obligation to supply eggs was not limited to the capacity of a piece of land, or anything else. Its assignment would, therefore, increase the burden of the contract on D. In the second place, the agreement of the manufacturer not to purchase elsewhere was personal, and the obligation would not have been binding on the assignee company.

D. MISTAKE

The subject of "mistakes" in contracts, and how they affect the validity or otherwise of the bargain, is one of the most illogical areas of contract law. Many of the cases turn on fine distinctions. As a generalisation, if you make a mistake in entering into a contract, that is your bad luck – you must suffer the consequences. However, there are certain types of mistake which the law recognises as affecting the agreement. In some instances, common law will declare that a mistake has served to nullify the consent, and so made the contract void "*ab initio*", or as if it had never been made. In others, equity will step in to allow the contract to be rectified or rescinded, or to act as a defence to a request for an order of "specific performance" of the contract (you will remember that specific performance is a court order compelling the guilty party to execute the contract according to its terms).

At common law, there are two basic types of mistake which may serve to render the contract void: **common mistake** (where both parties have made the error) and **unilateral mistake** (where only one of them has).

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Common Mistake

Where the mistake is shared by both parties, it may mean that there is no true agreement or "*consensus ad idem*". There is agreement of a sort but it is based on a false assumption, hence common law may declare the contract void on the grounds that the agreement is not a true consensus.

There are only a few circumstances where this will apply.

(a) Mistake as to some Fact which Lies at the Basis of the Contract

If both parties assume some fact to be true, and that fact is a root condition of the contract, and it is either false or non-existent, then the contract is nullified.

The leading example of this is ***Bell v. Lever Bros Ltd (1932)***.

Lever Bros had a subsidiary in Africa, called the Niger Company Ltd. Mr Bell and another man were directors of the Niger Company, and they had service agreements with the parent, Lever Bros. These agreements, as well as providing for large salaries, also contained a provision that the directors were prohibited from carrying on business on their own account. Unbeknown to Lever Bros, the two directors did carry on private business and made substantial profits from it.

For quite unconnected reasons, Lever Bros terminated the two service contracts before their expiry, and paid a substantial "golden handshake" to each of the two directors. They later learned about the private business profits. Had they discovered this beforehand, they would have been entitled to terminate the service agreements summarily without payment of any compensation. They sought to recover the payments they had made.

It was found as a fact by the jury (they had juries in civil actions in those days) that the two directors had not given a thought to their previous breaches of contract when entering into the contract for compensation with Lever Bros. It was, therefore, a case of common mistake – Lever Bros did not, at the time, know about their right summarily to dismiss, and it never occurred to Mr Bell. Hence, they both contracted for the compensation payment on the basis of ignorance of a vital fact.

Both the High Court and the Court of Appeal **held** that there had been a common mistake as to some fact at the root of the contract. Hence, as there was no true agreement, the contract was void ab initio and Lever Bros were entitled to recover the payments. By a majority of three to two, the House of Lords **overturned** this decision, mainly on the ground that the mistake was not sufficiently fundamental to avoid the contract.

(b) Mistake as to the Existence of the Subject-matter of the Contract

This, usually, occurs in contracts for the sale of goods. If both parties think they are contracting for a certain thing, and unknown to both it does not actually exist, then the contract is void. There are a number of important cases to illustrate this principle.

In ***Couturier v. Hastie (1856)***, the parties contracted for a cargo of corn which was believed to be in a ship bound from Greece to England. In fact, before the date of the sale, the corn had rapidly deteriorated, and the ship had put in to Tunis and sold the cargo for what it would fetch.

HELD: The contract was void because of mistake as to the existence of the subject matter.

In ***Barrow, Lane & Ballard Ltd v. Phillip Phillips & Co. (1929)***, there was a contract to buy specific bags of nuts, stored in a warehouse. Unknown to both parties, at the time of the sale, those particular bags of nuts had been stolen.

HELD: The contract was void.

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There is an alternative argument as to the reason why a contract should be void if there has been a mistake as to the existence of the subject-matter. This is that:

> *"cases where goods have perished at the time of sale ... are really contracts which are not void for mistake, but are void by reason of an implied condition precedent because the contract proceeded on the basic assumption that it was possible of performance"*: Lord Denning in ***Solle v. Butcher (1950)***.

The result is, usually, the same: the contract is void. However, on occasions, the court will refuse to imply such a condition precedent.

In ***McRae v. Commonwealth Disposals Commission (1951)***, the Commission sold a salvage firm, McRae, an oil tanker lying stranded on a Jourmand reef, 100 miles off the coast of New Guinea. When the salvage firm arrived on the scene, it found that not only was there no oil tanker but also no reef anywhere in the vicinity!

HELD: McRae succeeded. The contract was not void for mistake, and no condition would be implied that the contract would be void if the tanker was not in existence.

This is, perhaps, an example of the court trying to ensure that justice was done. The Commission was reckless in asserting the existence of the vessel. Had the contract been declared void for mistake, the purchase price would have been repaid but not the very substantial expense of fitting out the salvage expedition and searching the area.

(c) Mistake as to Title

This is an uncommon type of mistake but it does occur – not least in examination questions! The principle is that, if someone makes a contract in the belief that the subject-matter belongs to the other party whereas in reality it is his/her own property, the contract will be void **(*Cooper v. Phibbs*)**.

In ***Cooper v. Phibbs (1867)***, A contracted to lease a fishery in Ireland from B. Unknown to both of them at the time, A was, in fact, "tenant in tail" (i.e. beneficial owner) of the fishery.

HELD: The lease would be set aside.

In a contract which involves sale of goods, the seller warrants his/her title to the goods. So, if there is a common mistake, the contract is not avoided, and the seller may be liable for damages for breach of warranty. It is only where there is no such warranty that the contract will be void if the buyer purchases his/her own property.

(d) Mistake as to the Quality of the Subject-matter

This category of mistake probably raises the greatest number of problems for the courts. An ordinary error as to quality will not avoid the contract, although it may well give rise to an action for damages. In order to qualify as a mistake, which will serve to avoid the contract:

- It must be common to both parties **and**
- It must be such that the quality makes the thing contracted for an essentially **different thing** from that which it was thought to be.

In ***Kennedy v. Panama, New Zealand and Australian Royal Mail Co. (1867)***, the company issued a prospectus offering shares, and it stated that the extra capital was needed to fulfil a profitable mail contract with the Postmaster in New Zealand. It later transpired that the contract was beyond the Postmaster's authority to make. Mr Kennedy, who had purchased shares in reliance on the statement in the prospectus, attempted to repudiate the share purchase contract on the grounds that the shares issued were totally different in substance from those for which he had contracted.

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HELD: He failed on these grounds. The shares purchased under an admitted mistake were not sufficiently different in substance or quality to avoid the contract.

A mistake as to quality which was not sufficient to make the thing contracted for a totally different thing occurred in ***Frederick E Rose (London) Ltd v. H Pim Junior & Co. Ltd (1953)***. The parties contracted for the sale of "horse beans" which both believed to be the same as "*féveroles*". They were not the same thing.

HELD: The contract was valid. The difference was not sufficiently fundamental.

However, the common mistake was sufficiently fundamental to avoid the contract in ***Scriven Brothers v. Hindley (1913)***. Here, Hindley bid at auction for what he believed was hemp. The auctioneer thought he was offering tow.

HELD: Hemp and tow are totally different commodities, and the contract was, therefore, void.

(e) False and Fundamental Assumption

This is the last category of common mistake. As was said in ***Bell v. Lever Bros***:

> "*Whenever it is to be inferred from the terms of the contract or its surrounding circumstances that the consensus has been reached upon the basis of a particular contractual assumption, and that assumption is not true, the contract is avoided* ".

There are two important cases which illustrate how a false and fundamental assumption by both parties will serve to avoid a contract.

- ***Magee v. Pennine Insurance Co. Ltd (1969)***

  Mr Magee claimed on his insurance company for damage to his car. The damage was caused by a risk which was covered under the policy. The insurance company agreed to pay. It later transpired that, unbeknown to both parties, at the time of the accident the policy was, in fact, voidable by the insurance company.

  HELD: The contract was avoided by reason of the false and fundamental assumption of both parties that the policy was valid.

- ***Sheikh Brothers Ltd v. Ochsner (1957)***

  The company granted Ochsner a licence to cut sisal on its estate in Kenya, on condition that he delivered to the company for processing 50 tons per month of the sisal cut. Unknown to both, the estate was incapable of producing this quantity of sisal.

  HELD: The contract was avoided. It was based on a false and fundamental assumption.

Unilateral Mistake

As we mentioned earlier, this occurs when only **one** party is mistaken. It is fundamental that no contract can validly be formed if offer and acceptance do not correspond. So, if one party makes an offer which is accepted in a radically different sense by the other, there is no valid agreement.

However, contracts are construed **objectively** – so, the test is not what the intention of the one mistaken party was but, rather, what would a hypothetical reasonable person have understood from the words used? Cases can occur when there is so much ambiguity, whether actual or latent, that no reasonable agreement could be reached. Once again, these fall into various categories.

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Mutual Mistake

If, even after applying the objective test, the parties are genuinely at cross-purposes as to the subject-matter, or as to the terms of offer or acceptance, the contract will be void.

In ***Raffles v. Wichelhaus (1864)***, the parties contracted to buy a cargo of cotton to arrive "*ex Peerless from Bombay*". Two ships, both named "Peerless" sailed from Bombay – one arriving in October and the other in December. The parties each intended that the contract should be in respect of the different ships.

HELD: The contract was avoided.

The case of ***Scriven v. Hindley*** referred to under (d) Mistake as to the Quality of the Subject-matter (above) could also be considered to fall into this category. One party thought the contract was for hemp, the other thought it was for tow.

(a) Mistake as to the terms of the contract

A mistake as to the terms of a contract will serve to avoid the contract only if the mistake is **known** to the other party. In this case there is, probably, an element of bad faith, if not of actual fraud. The normal "objective" test can, therefore, be replaced by subjective intention. It must, however, be an error as to the **terms**, not as to the quality or substance. These latter constitute **motive**, and an error in motive will not avoid a contract.

In ***Hartog v. Colin and Shields (1939)***, Argentine hare skins were offered for sale. By mistake, they were offered at a price per pound instead of a price per piece. The custom of the trade and previous negotiations had been based on a price per piece. The offer was accepted.

HELD: The purchasers must have known that the offer did not reflect the true intentions of the seller, so the contract was void.

In ***Smith v. Hughes (1871)***, oats were purchased in the belief that they were old oats. They were, in fact, new oats which were quite unsuitable for the purpose. The decision hinged on whether the purchaser made a mistake in thinking they **were** old oats, or whether he was mistaken in thinking he was being **offered** old oats. In the former event, the mistake would be one of motive – thus, not avoiding the contract. In the latter event, it would be a mistake as to terms, which, if known to the seller, would avoid the contract. The actual decision was, therefore, one of fact for the jury.

It was decided that the contract was binding since the mistake related to the quality or substance of the oats (i.e. motive) which the seller had done nothing to induce.

(b) Mistake as to person

The next category of mistake is where one party is mistaken as to the person with whom he/she has contracted. It is in this area where most confusion arises, and in which the courts have drawn fine distinctions.

When solving examination questions on this subject, there are two vital questions which you must ask yourself:

- "Does the identity of the person with whom the contract is being made matter?" In other words, is it the intention to contract with that particular person, and no other? And, if the answer is "yes", then:
- "Is the mistake as to his/her identity, not as to his/her attributes" (e.g. solvency; character; social standing; etc.)?

If the answer to both these questions is "yes", then, in all probability, the contract will be avoided if a mistake has been made.

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Let us explain the reason for asking these questions. In the first place, in many contracts it is of no significance with whom a person is contracting. A shopkeeper is not concerned whether he sells a packet of cigarettes to me, or you, or the man in the moon. Hence, if we have falsely stated who we are, it does not affect the validity of the contract.

Whereas, if it is intended to contract with a particular person, and no other, then a mistake as to his/her identity is one which the law recognises as grounds for avoiding the contract. For instance, if you want a solicitor to defend you on a drink/driving charge, and you have heard that Mr A L Cohol is the best man in town, then you want him, and no one else. It is the essence of the contract that **he** is employed to defend, and not his brother or his clerk.

The second point is that the mistake must be as to the **identity** of the other person. An error as to his/her attributes does not affect the validity. It is no good thinking that you wish to contract with Lord Gooseberry because he is rich, of high standing, and known to be a good guy. If it turns out that the contract goes sour because his lordship is, in fact, bankrupt, and a thoroughly nasty character, then you have no redress by trying to avoid the contract.

Most of the cases involve fraud in one form or another. They often arise because a fraudulent person has purchased goods and sold them to an innocent third party. The problem then is that, if the contract is void for mistake, the third party has no title to the goods, and must return them. If, on the other hand, the contract is merely voidable for fraud, and is not validly avoided in time, then the third party gets a good title.

A case which illustrates the first question as to whether the identity of the other party is material is ***Upton-on-Severn RDC v. Powell (1942)***, which we mentioned in the previous study unit.

To recap: Mr Powell's farm was on fire, so he called the police, which called Upton fire brigade. The Upton brigade promptly arrived and put out the fire. However, unbeknown to Mr Powell, his farm was actually in the Pershore fire brigade area. The Upton brigade sent in a bill for an "*out of area*" call. Had the Pershore brigade been called, it would have come for free.

HELD: It was of no significance to Mr Powell which brigade came, so, if he made a mistake, the contract was not avoided, and he must pay.

The other side of the coin is shown by ***Boulton v. Jones (1957)***. Mr Jones had, for a long time, had business dealings with a certain Mr Brocklehurst. One day, he sent a written order for goods, addressed to Mr Brocklehurst. By chance, on that very day, Mr Brocklehurst, without telling Jones, had transferred his entire business to his foreman, Mr Boulton. The latter, on receipt of the letter, dispatched the goods. Jones refused to pay.

HELD: He was not liable to. The identity of the other party was a material consideration and, therefore, the contract was void for mistake.

The question of identity, rather than attributes, is answered by the following illustrations.

In ***Cundy v. Lindsay (1878)***, a fraudulent person, called Blenkarn, wrote to Cundy, offering to buy some goods. He forged the signature of Blenkiron & Co. which was a reputable firm, trading in the same street.

Cundy sent the goods under the impression that he was dealing with Blenkiron & Co. The innocent Mr Lindsay purchased them from Blenkarn.

HELD: The contract between Cundy and Blenkarn must be void for mistake. The identity of the contracting party was of material importance.

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The opposite result occurred in ***Kings Norton Metal Co. v. Edridge, Merrett & Co. (1897)***. One Wallis ordered goods from Kings Norton Metal on the letter heading of a fictitious firm, called Hallam & Co. They were delivered, and Wallis sold them to Edridge Merrett.

HELD: The first contract was good. Kings Norton Metal intended to contract with the writer of the letter. That the company made a mistake as to his attributes did not affect the validity of the contract.

If people contract face to face, this problem of the identity of the other person often presents difficulties. However, the principles, and the questions to be asked, are the same.

In ***Lake v. Simmons (1927)***, a woman, called Ellison, posing as the wife of a wealthy customer called Van der Borgh, went into a jeweller's shop. She purchased a few trivial items, to inspire confidence. As a result, she was allowed by the jeweller to take away two valuable necklaces "*on approval*", for her purported husband. That was the last that was seen of her!

HELD: The jeweller thought he was dealing with Mrs Van der Borgh, and it was for that reason alone that he allowed her to take away the necklaces. The contract was void for mistake.

However, you must always consider the basic rules of contract as to when the contract was actually formed.

In ***Phillips v. Brooks Ltd (1919)***, a certain Mr North went into a jeweller's shop. He selected some jewellery and bought it. As he was writing out a cheque for £3,000, he said: "*I am Sir George Bullough*", and gave an address. The jeweller checked with a directory and found that Sir George did, indeed, live at that address. He allowed North to take away the jewellery. The cheque bounced.

HELD: The contract was made **before** the identity of the person had been disclosed. However, even if it hadn't been, the jeweller intended to contract with the man who came into his shop. The contract was, therefore, valid.

It might have been voidable (i.e. avoidable) but it had not in any case been avoided before title passed. ***Lewis v. Averay (1972)*** expressly prefers the voidable: ***Phillips v. Brooks Ltd (1919)*** approach to the void: ***Cundy v. Lindsay (1878)***.

Non Est Factum

The doctrine of "*non est factum*" (that is not my deed) is a form of unilateral mistake. The principle is that a person is, normally, bound by his signature to a document. If he has not bothered to read it, or he does not understand it, then that is his problem. However, if he has been misled or deceived into signing a document which is **essentially different** from that which he intended to sign, then he can claim "*non est factum*", and the document and signature are void. The defence is not lightly available – a mistake as to the contents is not sufficient: it must be one as to the **character** or **effect** of the document.

In ***Lewis v. Clay (1898)***, Clay was persuaded by a friend of long standing to "*witness the friend's signature*". A document was placed before Clay, covered up except for four openings for his signature. He duly signed in the spaces provided. In reality, however, what he had signed were two promissory notes and two authorisations to Lewis, to pay the proceeds to someone else.

HELD: The promissory notes were void.

In ***Saunders v. Anglia Building Society (1971)***, Mrs Saunders was an elderly widow. She gave the title deeds of her house to her nephew, with the intention that the house should be a gift and enable him to borrow money on the security of it. It was a condition that she should

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be able to live there for the rest of her life. Later, she was persuaded by a friend of the nephew, who she knew was helping him get a loan, to sign a document. The friend said it was "*to do with the gift*". The old lady, who had broken her spectacles, signed without reading the document. The document was, in fact, a conveyance of the house to the friend.

HELD: The plea of *non est factum* failed. The whole series of events had to do with the title of the house; so, the document Mrs Saunders signed was not essentially different from what she thought it was.

E. MISREPRESENTATION

A **representation** is a statement made by one party to the other, before or at the time of contracting, with regard to some existing fact or to some past event, which is one of the causes inducing the contract. If a person is misled into entering a contract by an untrue statement or representation, made by the other party before or at the time of making the contract, then the party who has been deceived may have a right of redress. Such an untrue statement is called a **misrepresentation**.

Note that a person's actions or behaviour may amount to a misrepresentation. In ***Walters v. Morgan (1861)*** the court stated that "*a single word or ... a nod or a wink, or a shake of the head, or a smile*" intended to induce a person "*to believe in the existence of a non-existing fact, which might influence the price of the subject to be sold*" will constitute misrepresentation.

Rules

There are four rules which decide whether a particular statement is a misrepresentation such as to allow of redress and, if it is, what that redress may be.

In the first place, in order to constitute a misrepresentation, the statement must be one of **fact**, either past or present. Statements of law or of opinion cannot be misrepresentations, nor can statements of intention which are not carried out. Second, the representation must **induce** the contract. In the third place, it must be **addressed** to the party misled. Lastly, it must be **false** or **untrue**.

Let us examine these requirements in more detail.

(a) Statement of fact

In negotiating a contract, all sorts of statements are made. Some are "mere puffs" not intended to be taken seriously. A good example of this is "*probably the best lager in the world* ".

Others are expressions of opinion.

In ***Anderson v. Pacific Fire Marine Insurance Co. Ltd (1872)***, a shipping company effecting an insurance policy wrote to the company and stated that in the ship's master's opinion a certain anchorage was good. The vessel was later lost at that anchorage.

HELD: The letter was not a representation of fact, but merely of opinion.

Expressions of intent do not constitute misrepresentations, unless they are false statements of the intentions of the party making them. If a person says "I intend to do something" and at the time of making the statement she genuinely does so intend, then even if she breaks her promise, it will not constitute a misrepresentation of fact. But if she says it, with the intention at the time of breaking the promise, then she is misrepresenting a fact, and legal consequences flow from it. The fact she has falsely stated is the state of her mind. As Lord Justice Bowen remarked in ***Edgington v. Fitzmaurice (1885)***:

"The state of a man's mind is as much a fact as the state of his digestion .... A misrepresentation as to the state of a man's mind is, therefore, a misstatement of fact".

Lastly, the untrue statements must be of fact, not law. This must, however, be taken with reservations. A misstatement of the general law is not a fact, but a false statement of a person's private legal rights may well be a misrepresentation of fact. A person is deemed to know the general law, so should not be deceived, but he/she cannot necessarily know or check on private legal rights. The matters are therefore considered to be facts.

(b) The statement must induce the contract

If a false statement is made to which the other party pays no attention, or which does not in any way influence him, then this does not affect the validity of the contract. The degree of inducement does not have to be total but the party deceived must, to some material extent, have been influenced by the statement into making the contract.

In ***Horsfall v. Thomas (1862)***, Horsfall manufactured a gun for Thomas, which had a defect making it worthless. Horsfall tried to conceal this by inserting a metal plug in the defective part.

Thomas never inspected the weapon and, when he used it, it blew up.

HELD: As Thomas never inspected the gun, the attempted concealment of the defect did not affect his mind and did not induce him to accept the weapon.

(c) The statement must be addressed to the party misled

Unless the untrue statement was either made to the other party or it was made to another person in the knowledge and with the intent that that person should pass it on to the other party, it does not affect the validity of the contract.

In ***Peek v. Gurney (1873)***, a company issued a false prospectus inviting applications for shares. Mr Peek purchased shares, not direct from the company but from a person to whom they had been allotted.

HELD: The prospectus was not addressed to Mr Peek; therefore, he could not repudiate the contract on grounds of misrepresentation.

(d) The statement must be untrue

This is not quite as obvious as it sounds. In English law, there is no general duty for one party to acquaint the other of all the relevant facts. Unless the contract is one of those which are "*uberrimae fidei*" (of utmost good faith) the principle of "*caveat emptor*" (let the buyer beware) applies to contracts generally – not merely to those for sale of goods. Hence, mere silence does not constitute a misrepresentation. A positive untrue statement must have been made.

In ***Keates v. Cadogan (1851)***, Lord Cadogan let a house to Keates. He knew that the house was required for immediate occupation. The house was in a ruinous condition.

HELD: There had been no false statement made, and no warranty, express or implied, that the house was fit for occupation.

Types of Misrepresentation

There are **three** different types of misrepresentation that can be made, and their effects on the contract are different. Damages can always be recovered and, in certain circumstances, the contract can also be avoided by the innocent party. The question is partly decided by common law, and partly by virtue of the **Misrepresentation Act 1967**.

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(a) Fraudulent misrepresentation

This occurs where an untrue statement is made knowingly or without belief in its truth.

In ***Derry v. Peek (1889)*****,** a company was empowered to run trams by horsepower or (with the consent of the Board of Trade) by steam. The directors believed that the Board of Trade's consent would be forthcoming, and they issued a prospectus, stating the company had the right to use steam-trams. The Board of Trade refused consent.

HELD: The misrepresentation was not made fraudulently.

The effect of a fraudulent misrepresentation is to allow the party deceived to rescind, as of right, the contract, and seek damages for loss sustained. Of course, she does not have to rescind it. She can always affirm it, and merely seek damages. However, it is important to remember that rescission is always available to her.

(b) Negligent misrepresentation

A false statement is made "negligently" when it is made carelessly, or without reasonable grounds for believing it to be true. As you will appreciate, the distinction between fraud and negligence can be a fine one. However, broadly speaking, a misstatement is negligent if it was merely carelessly made, but it is fraudulent if it is made with evil intent or recklessly.

The distinction is, however, important, for, although the innocent party has a right to claim damages under the **Misrepresentation Act 1967**, Section 2(1), his/her additional remedy of rescission is by virtue of Section 2(2) of the Act, subject to the discretion of the court. The court's discretion will be exercised only if it would be "*equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as the loss that rescission would cause to the other party*".

At the time of ***Derry v. Peek*** "fraud" was deemed to include recklessness. See also ***Spice Girls Ltd v. Aprilla World Service BV (2000)***.

(c) Innocent misrepresentation

This type of false statement is one which was made neither fraudulently nor negligently. By virtue of Sections 2(1) and 2(2) of the **1967 Act**, the remedies for an innocent misrepresentation are either rescission or damages – but not both. Further, neither of these remedies can be claimed as of right. The court has the unfettered power to make whichever order would be just and equitable in the circumstances.

F. UNDUE INFLUENCE

A contract is voidable at the option of the innocent party if it was entered into as a result of undue influence.

Duress

If a person is coerced into making a contract by fear for his own physical wellbeing or that of his immediate family, or for the safety of the goods, or – on rare occasions – for his economic profits, this is called "duress". The coercion may be either actual or threatened. The so-called contract is void.

(a) Duress to the person

This consists of actual or threatened violence to the person, or imprisonment. It can be either in respect of a party to the contract or in respect of her immediate family. The degree of threat necessary varies with the physical or mental state of the person threatened. In other words, the test is a **subjective** one. If the person was in a state of

fear, whether reasonably so or not, then this will suffice to permit her to avoid a contract she was coerced into making as a result of the threats of or actual physical violence or imprisonment. Imprisonment, in this sense, does not necessarily mean being thrown into gaol. It also means loss of liberty, e.g. by being locked in a room.

In ***Mutual Finance Co. Ltd v. John Wetton & Sons Ltd (1937)***, a family company was induced to give a guarantee for a debt by threats to prosecute a member of the family for the forgery of a previous guarantee. At the time, the coercers knew that the father of the alleged forger was in a delicate state of health.

HELD: The guarantee would be set aside.

(b) Duress of goods

This is actual or threatened unlawful detention of goods. This type of duress does not, at common law, entitle a party to avoid a contract entered into as a result of the duress but, in equity, it entitles him/her to recover any money paid in order to secure the release of the goods.

In ***Maskell v. Homer (1915)***, tolls were paid on goods as a result of the threat of seizure. The tolls were unlawfully demanded.

HELD: The money could be recovered.

(c) Economic duress

The threat of loss of profits if a contract is not made is called "economic duress". It has only fairly recently been recognised by the law as a possible cause for avoiding a contract, and the law on economic duress is not yet fully developed.

The proposition is that if a person is induced to enter into a contract by fear of loss if he/she does not agree to the contract, this may constitute actionable duress. However, the degree of coercion must be substantial. In ***Pao On v. Lau Yiu (1979),*** the Privy Council said:

> *"There is nothing contrary to principle in recognising economic duress as a factor which may render a contract voidable, provided the basis of such recognition is that the duress must amount to coercion of will which vitiates consent. It must be shown that the payment made or the contract entered into was not a voluntary act."*

This case was an unusually complicated one from Hong Kong, and it hinges on factors other than duress. However, a good example is ***North Ocean Shipping Co. Ltd v. Hyundai Construction Co. Ltd – "the Atlantic Baron" (1978)*.**

An oil-tanker, the Atlantic Baron, was being built in Korea. As is usual, the price was contractually payable in stages, in US dollars. The owners had made a long-term charter contract for the ship with Shell to commence on the date she was due to be delivered by the builders. Part-way through the building contract, the US dollar was devalued by 10%, and the builders demanded an extra payment on subsequent stages of payments to correct this. They threatened to withhold delivery if these extra sums were not paid.

In the meantime, the bottom had dropped out of the tanker charter market, so had the vessel not been delivered in time, the owners would have been compelled to renegotiate the charter contract with Shell at a far lower market rate. The loss over a long-term charter would have been enormous. Thus, to avoid this, they paid up.

HELD: The action of the builders was potentially economic duress such as to allow the owner to recover the money paid under duress. However, in the circumstances, they had failed adequately to protest, and had been deemed to have affirmed the contract as altered.

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Contrast ***Atlas Express Ltd v. Kafco (Importers and Distributors) Ltd (1989)***, which we mentioned in the last study unit. Here a small company entered into an agreement with a national firm of carriers. The carriers subsequently purported to impose higher charges than previously agreed. Because the company was unable to find an alternative carrier and was heavily dependent on the contract, it reluctantly agreed to the new terms but later refused to pay.

HELD: The facts constituted economic duress and the carriers' claim for additional payment was dismissed.

In ***CTN Cash and Carry Ltd v. Gallaher Ltd (1994)***, the claimants owned six wholesale warehouses and the defendants were manufacturers and distributors of certain popular cigarette brands. Separate supply contracts were entered into periodically between each of the warehouses individually and the defendants. The defendants granted the claimants credit facilities, though these could be withdrawn at any time.

The manager of one of the claimants' warehouses submitted an order to the defendants, but through mistake the cigarettes were delivered to one of the other warehouses. The defendants arranged to collect the cigarettes and deliver them to the right one, but before they could do so, they were stolen. The defendants, under the mistaken impression that the cigarettes were at the time of the burglary at the claimants' risk, invoiced the claimants for their payment.

The claimants rejected the invoice, whereupon the defendants notified the claimants that their credit facilities would be withdrawn. The claimants, faced with this threat, paid the invoice and thereafter took proceedings against the defendants, contending that the money had been paid under duress.

HELD: The defendants' conduct had not amounted to duress, and accordingly the claimants' claim failed. Common law does not recognise inequality of bargaining power in commercial dealings: the defendants had merely exerted commercial pressure not amounting to legal duress with a view to recovering a sum of money which they believed in good faith at the time to be due to them.

The lesson to be learnt from these cases is:

- That the duress must be such as to **vitiate consent** and
- That any contract entered into or money paid must be done under formal protest, and rescinded as soon as the duress has lifted.

Undue Influence

Undue influence is said to exist where one person has a special relationship with another and, as a result of this relationship, that other is induced to enter into a contract to his/her disadvantage.

Where there is a confidential or fiduciary relationship, the stronger party must show that undue influence was **not** exerted.

Lord Chelmesford said in ***Tate v. Williamson (1866)***:

> *"Wherever two persons stand in such a relationship that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed."*

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Examples of where such a confidential relationship is likely to exist are:

- Parent and child
- Guardian and ward
- Solicitor and client
- Doctor and patient
- Religious adviser and the person to whom advice is given
- Trustee and beneficiary.

A confidential relationship is, strangely enough, not automatically presumed between husband and wife, although it can be shown to exist. Nor is the above list exhaustive. Any situation where trust and confidence are imposed by reason of the relationship can be one where undue influence can apply.

In ***Tufton v. Sperni (1952)***, P and D were both members of a committee to establish a Moslem cultural centre in London. P was going to provide funds, and D induced him to buy D's house for the centre at a grossly high price.

HELD: The contract would be set aside by reason of undue influence.

There is no necessity for there to have been actual **fraud** for a contract to be set aside for undue influence. However, undue influence must be proved, except in cases of confidential relationships.

In ***Credit Lyonnais Bank Nederland NV v. Burch (1996)***, the defendant was employed by a company which was experiencing financial problems. One of the company's directors, who was known to the defendant and her family, asked the defendant to put her flat up as collateral security for the company's overdraft in favour of the claimant bank, the company's bankers. He did not, however, explain the company's detailed financial position to her, but intimated that if she failed to provide the collateral security requested, the company would collapse and she would be out of work.

The claimant bank took steps to advise the defendant to take independent legal advice before entering into a formal mortgage of her flat to them, but she did not do so and entered into the mortgage, guaranteeing repayment of the company's borrowing from them without limit. It became necessary to enforce the mortgage by her, due to the further deterioration in the company's trading position.

HELD: The mortgage could not be enforced against the defendant and would be set aside because the transaction was so patently disadvantageous to the defendant as to raise a strong presumption of undue influence. This presumption had not been rebutted, because the claimant bank had failed to take reasonable steps to avoid being fixed with constructive notice of the employer's undue influence over the defendant, when neither the potential extent of her financial obligations had been explained to her nor had she received independent advice in fact. It was necessary that she should have at least received independent advice in the circumstances before she entered into the mortgage.

Contracts made under undue influence are voidable. Rescission is, however, an equitable remedy, and, therefore, discretionary. Existing rights are not affected but the contract comes to an early end.

The party seeking to set aside a transaction on the grounds of undue influence cannot do so in the following circumstances:

- If third parties have acquired rights under it, bona fide and for value
- If there has been unreasonable delay. "Delay defeats equity." The facts of each case must determine what constitutes reasonable delay.

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In ***Allcard v. Skinner (1887)***, a young lady, on entering a convent, made over her property to the convent. After a year she left the convent but delayed for five years before applying to the court to rescind her gift.

HELD: She was defeated because of the unreasonable delay. Once she had left the convent, any undue influence had ceased and she should have taken prompt action in the matter.

G. VOID AND ILLEGAL CONTRACTS

For one reason or another, the state may either refuse to assist a person in enforcing certain contractual rights or it will declare a contract to be null and void. Contracts falling into these categories are, in some way, tainted. However, the reasons why they are tainted, and why the state takes or denies the actions it does, cover a very wide range of situations.

A contract to commit murder may have all the ingredients of a perfectly valid contract. However, quite obviously, the state is not going to enforce it. Can you imagine the furore there would be if a judge made an order of "specific performance", compelling a man to carry out his contract to strangle someone's mother-in-law, according to its terms?

At the other end of the scale, a contract may either be only mildly naughty or it may have no moral taint whatsoever but merely be contrary to some state regulation. A contract to fiddle your income tax might fall into the former category, and one to sell goods without having obtained a statutory licence into the latter.

However, all these wide varieties of contracts are contrary to public policy. They are all illegal contracts, which may be ***void ab initio***, or they may be merely **unenforceable**.

Objects Illegal by Statute

Statute may declare certain types of contract *void ab initio* – that is, the contract itself is illegal and incapable of creating any rights. Certain gaming and wagering contracts fall into this category.

The **Gaming Act 1845** (as amended by the **Gambling Act 2005**), Section 18, states as follows:

> "*All contracts or agreements ... by way of gaming or wagering shall be null and void ... no suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager*."

On the other hand, a contract may be void without being itself illegal, and all that happens is that no rights are created which can be enforced by the courts. There is no other penalty.

An example of this occurred in ***Re Makmoud and Ishahani (1921)***. A wartime statutory order forbade the sale or purchase of linseed oil without a licence from the appropriate government department. A contract was made between P and D to sell linseed oil. Before making it, D falsely assured P that he possessed a licence. However, he later refused to take delivery, because he had no licence.

HELD: The court would not entertain the action, as the statute clearly said that that kind of contract must not, in the public interest, be entered into.

Yet again, a contract may in itself be perfectly lawful but its performance may be illegal, or the particular method of performance may be forbidden.

In ***St John Shipping Corporation v. Joseph Rank Ltd (1957)***, shipping company so overloaded its vessel that she was submerged below her statutory load line. The cargo owners refused to pay the freight.

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HELD: The legality of the contract was not affected but it amounted to a statutory offence. So, the cargo owners had to pay.

On the other hand, in ***Ashmore, Benson, Pease & Co. Ltd v. A V Dawson Ltd (1973)***, D, a haulage company, was engaged by P to carry two 25-ton loads. These loads were loaded on to two 20-ton lorries under the eyes of P's manager. One of the lorries had an accident, and the load was damaged.

HELD: P's claim for the loss suffered failed, as the manager must have realised that the lorries were overladen, and, hence, he participated in an illegal performance.

The distinction between these two results is that, in the first case, the illegal performance was unknown to the cargo owners at the time, and, hence, there could be no justification for their refusing to pay the agreed freight. The statute merely provided a penalty for contravention, without making the contract itself void or illegal. In the second case, both parties knew of the illegal performance – and, so, damage directly resulting from the method of performance was irrecoverable.

The important thing to remember about statutory illegality is that, because of the wide variety of reasons for which the legislature may interfere in private contracts or transactions, it is essential to read and construe the words of the statute properly. Some may merely provide a penalty for transgression, leaving the contract unaffected; others may make the contract itself void or unenforceable, while some provide for both a penalty and unenforceability.

Gaming and Wagering

The subject of gaming and wagering is extremely complex. However, a short summary is called for. A wagering contract is one where there must be two parties or sides who both stand to win or lose on an uncertain event. Buying a sweepstake ticket, entering a coupon for the pools, or betting on the "tote" at a racecourse, are not wagering contracts. In all of these, only **one** of the parties stands to win or lose. Another essential of a wagering contract is that the parties have no interest in the contract, other than that created by the bet. This lets out of the category such transactions as insurance contracts and Stock Exchange bargains, both of which bear a superficial resemblance to wagering.

The common law long discouraged betting, until the **Gaming Act 1845** made such contracts null and void. It not only did this but it also affected collateral contracts in the same way.

In ***Hill v. William Hill (Park Lane) Ltd (1949)***, a racehorse owner failed to honour debts with a bookmaker. The bookmaker reported the matter to Tattersalls (a form of "court of honour" for horse-racing bets), which ordered the debt to be paid by instalments. The owner failed to comply.

Tattersalls, therefore, threatened to report this non-compliance to the Jockey Club, which would have warned the owner off the turf. He bowed to the threat and gave the bookmaker a post-dated cheque, which bounced.

HELD: The debt was irrecoverable. The House of Lords would not countenance the argument that the debt was not a gaming debt at all but, instead, an action on a dishonoured cheque. The cheque was collateral to the main contract of wager, and would not be enforced.

The 1845 Act was further strengthened by the **Gaming Act 1892**, which extended the provisions to contracts of principal and agent, whereby one man employed another as his agent to make a bet.

Finally, the **Gaming Act 1968**, while restricting the provision of credit for gaming, did liberalise the law in many respects. Games such as hazard and roulette, as well as games of chance played in a place habitually kept for gaming, were for a long time illegal by statute. The 1968 Act provided that certain games of chance could lawfully be played in such places under strict conditions.

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Objects Illegal at Common Law

Public policy decrees that the courts will not assist parties who have made certain types of contract. The contract is not illegal to make but its object is illegal. Public policy is an imprecise concept, and it changes as time goes by. There are, however, broad categories.

(a) Agreements to commit a crime, a tort, or to perpetrate a fraud

Plainly, a contract the object of which is to commit a criminal offence cannot be enforced. However, if an illegal act is committed during the performance of an otherwise perfectly lawful contract, it will not necessarily render the whole contract unlawful.

In ***Archbolds (Freightage) Ltd v. S Spanglett Ltd (1961)***, statute forbade the carrying of goods belonging to another for reward unless an "A" licence was held. D agreed with P to carry 200 crates of whisky belonging to a third party from Leeds to London. P was unaware that D did not hold an "A" licence. The whisky was stolen during the transit.

HELD: The contract was perfectly valid, and it was only the method of performance that was illegal. Hence, the claim by P for the loss of the whisky was enforceable.

In the same way, the courts will not enforce a contract the object of which is a tort – although, if a tort is committed in the course of a contract for other purposes, the contract will not, normally, be invalidated.

In ***W H Smith & Son v. Clinton (1908)***, Clinton agreed to indemnify Smith, a firm of publishers, against the consequences of libel which might appear in a certain journal. Smith knowingly published a libel in that journal, and had to pay damages. The firm sought to recover from Clinton under the indemnity.

HELD: The indemnity was unenforceable.

The perpetration of fraud can take many forms but all contracts having fraud as their object are unenforceable. One of the commonest forms is fraud against the Revenue.

In ***Alexander v. Rayson (1936)***, Rayson agreed to lease Alexander's flat in Piccadilly for £1,200 a year. In order to reduce the rates payable, the transaction was effected by two documents: in the first place a lease for £450 pa, covering certain landlord's services – and, in the second place, an agreement by the landlord to render substantially the same services for an additional £750 pa.

HELD: The lease and the agreement were both documents intended for a fraudulent purpose; so, neither could be enforced.

(b) Agreements Injuring the state in relation to other states

These can either be contracts with an enemy in time of war, or they can be contracts which are hostile to a friendly state.

In the first place, any contracts with an alien enemy in wartime are illegal at common law. They are also illegal by statute, by virtue of the **Trading with the Enemy Act 1939**. It is forbidden to enter into or perform a contract with an alien enemy during a war, and even to perform such a one which was made before war broke out. Apart from any criminal penalties that may be provided by statute, such contracts are unenforceable.

In the second place, agreements which contemplate a hostile act against a friendly country, or even an act to be performed in a friendly state which is illegal by the laws of that state, are contrary to public policy, and unenforceable in England. A partial exception to this is acts which contravene the revenue laws of another country. It is a principle of international law that no country will enforce the revenue laws of another. It used to be thought that this also extended so far that an agreement contravening

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foreign revenue laws would not be contrary to public policy in England. However, it has now been held that this proposition goes too far. The courts will not enforce foreign revenue laws, but, equally, they will not assist anybody unlawfully to circumvent them.

An early case of acts hostile to a friendly state is ***De Wütz v. Hendricks (1824)*****.** Here de Wütz was attempting to raise a loan to support Greek rebels against the Turkish government. He deposited some papers in connection with the matter with Hendricks. The loan fell through, and de Wütz tried to recover the papers.

HELD: The object was the overthrow of a friendly foreign state. Hence, the court would not assist in the recovery of the papers.

Acts to be performed in a foreign country which are illegal by the laws of that country will, equally, not be enforced.

In ***Regazzoni v. K C Sethia (1944) Ltd (1958)***, a contract was made to sell and deliver to Genoa, in Italy, jute sacks from India. Both parties knew that the ultimate destination of the sacks was South Africa. By the laws of India, the export of jute to South Africa was illegal.

HELD: The contract would not be enforced in England.

(c) Agreements which tend to harm the public service

Any agreement which tends to harm the public service is contrary to public policy. Examples are:

- Contracts for the sale of public offices
- The assignment of salaries from public offices
- Contracts for a person to use his/her influence to secure for another a title, a public or government office, or similar.

In ***Parkinson v. College of Ambulance Ltd (1925)***, the secretary of the College of Ambulance promised Colonel Parkinson that, if he made a large donation to the college, which was a charitable institution, he would receive a knighthood. The Colonel made a large donation, and, not receiving his knighthood, he sued for the return of his money.

HELD: The action failed, because the contract was against public policy and illegal.

(d) Agreements to pervert the course of justice

Contracts under this heading usually comprise agreements not to disclose crimes, or not to prosecute for criminal offences. They are unenforceable but, in addition, by virtue of the **Criminal Law Act 1967**, concealing an offence is itself a criminal offence. "Concealing" is committed if a person accepts a price, other than merely making good loss caused by the offence, for not disclosing the offence.

(e) Agreements tending to abuse the legal process

These largely comprise the acts of "maintenance" and "champerty".

- **Maintenance** is the supporting (usually financially) of litigation in which the person maintaining has no legitimate interest.
- **Champerty** is where a person assists in litigation in exchange for a share in any proceeds gained from it e.g. a solicitor representing a client for a percentage of the damages awarded to his/her client. English law has always frowned on champerty but it is the common practice in many foreign jurisdictions.

  This must be contrasted with a Conditional Fee Agreement, which is a perfectly legitimate arrangement between a potential litigant and his/her legal adviser.

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Both maintenance and champerty were, at common law, both torts and crimes. The Criminal Law Act 1967 abolished these but contracts in respect of both are still contrary to public policy.

Another type of abuse of the legal process is collusion in divorce. Nowadays, however, this is more honoured in the breach!

(f) Agreements contrary to good morals

Contracts which are for immoral purposes will not be enforced.

In ***Pearce v. Brooks (1866)***, a firm of coach builders hired to a prostitute a coach with an interesting design. It was known to the firm that it would be used by her in plying her trade. She failed to pay the hire.

HELD: The contract would not be enforced.

(g) Contracts in restraint of marriage which affect the due discharge of parental duty

It is against public policy to restrain the freedom of marriage or to promote for a fee a marriage between one person and another.

Likewise, agreements for a fee to promote a separation or divorce are unenforceable, or those to transfer rights and duties in respect of a child from its parents.

(h) Agreements which oust the jurisdiction of the courts

From a commercial point of view, this category is important. It is the right of every subject of the Queen to have his/her rights determined by the ordinary courts. Hence, any agreement to oust the courts is void.

Arbitration agreements to refer any dispute arising under a contract to arbitration have long been acceptable, provided that the agreement did not preclude the parties from referring any point of **law** to the courts. In ***Scott v. Avery (1855)*****,** it was **held** that a clause in a contract providing that it should be a condition precedent to any course of action accruing that an arbitrator should have made an award was not contrary to public policy. Even nowadays, such provisions are called "Scott v. Avery clauses."

The principle that parties to arbitration could refer a point of law to the court was enshrined in the **Arbitration Act 1934**. The principle has been eroded, but not done away with by the **Arbitration Act 1979** (as amended), which provides that the parties may agree to exclude the right of appeal to the court. If they do not so agree, then the right remains.

(i) Agreements in undue restraint of trade

These also form a most important category of contracts, which are contrary to public policy, containing fine distinctions. The problem is that, *prima facie*, any agreement is void if the purpose of it is to restrict the liberty of a person in the future to carry on trade with persons who are not parties to the contract – that is to say, to restrain trade. But, at the same time, a person has every right to protect his interests and his business from unfair competition. There is an obvious clash between these two propositions. So, the principle is that a person may restrict the right of another to trade, only so far and to the extent that is necessary and reasonable to protect his legitimate interests.

Each case must be considered separately, and the general rule is that every contract in restraint of trade is *prima facie* void unless the restraint(s) can be shown to be reasonable as between the parties, and not injurious to the public interest.

Contracts in restraint fall into a number of categories.

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- **Employer and employee**

  This occurs where an employer inserts in a contract of employment clauses restricting her employee from engaging in a competing business after he has left the employment concerned. For example, a company may legitimately wish to prevent a salesperson from trying to take away all the customers on whom he calls, and transferring their custom to a rival company, if it later employs him. On the other hand, the salesperson has a right, which the law will respect, to earn a living in the manner of his choice.

  So, a covenant will be enforced which seeks to prevent an employee from competing after leaving that employment, provided it is no wider in geographical area and in time than is reasonably necessary to protect the employer's legitimate interests. What is "reasonable" in a given case will depend on the status of the employee, and on the rights which need protecting.

  In ***Sir W C Leng & Co. Ltd v. Andrews (1909)***, a junior reporter on a provincial newspaper was required not to be connected with any other newspaper within 20 miles of Sheffield.

  HELD: The constraint was unreasonably wide.

  In ***Foster & Sons Ltd v. Suggett (1918)***, a works manager was not permitted to engage in glass-making anywhere in the UK.

  HELD: It was reasonable, as the employee was trained in trade secrets which were applicable throughout the country.

  In ***Littlewoods Organisation Ltd v. Harris (1978)***, Harris was a director of the mail-order side of Littlewoods' business. His contract precluded him from working for any other mail-order company for 12 months after leaving Littlewoods' employment. He wished to join GUS Ltd., a rival mail-order business.

  HELD: The restraint was reasonable, in the sense that mail-order business is highly skilled and very competitive. Harris was a director, and in a position to know and supply many trade secrets.

  In determining what constitutes reasonableness the courts occasionally adopt a common sense approach. In ***Clarke v. Newland (1991)*** a doctor in general practice was prevented by his contract from "practising" locally for three years after leaving the practice. He claimed that this restraint was unreasonable since it could prevent him from working in a hospital since that could constitute "practising".

  HELD: The restraint was intended to apply to general practice only and would be valid to that extent. He could therefore be restrained from starting in a rival general practice.

  If the employer is himself in breach of contract he will not be allowed to enforce it even though the restraint in itself is reasonable and the employee is in breach of the restraint.

  In ***Briggs v. Oates (1990)*** the employee had been wrongfully dismissed by his employer. His contract forbade him practising as a solicitor within a specified area. It was **held** that since the employer had broken the contract by dismissing the employee he could not be allowed to enforce it.

  If the courts decide that the employer is simply trying to prevent reasonable competition then they will declare the restriction invalid. So, in ***Faccenda Chicken Ltd v. Fowler (1986)*** Fowler, an ex-employee, used information about prices and products sold by the company to set up in competition. The company tried to argue that he was misusing confidential information. The court **held** that

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the employer was simply trying to prevent competition. The information which the employee was using could not be described as confidential since most of it, e.g. prices and products, was already public knowledge.

The decision shows that the courts will not automatically take the employer's view of any situation. It is for the employer to prove that he/she is genuinely trying to protect against unfair competition by the ex-employee.

- **Sale of goodwill of a business**

  If the restraint is merely to stop competition without protecting the business sold, it will be unenforceable.

  In ***Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co. Ltd (1894)***, Nordenfelt was an inventor and maker of guns. He sold his business to Maxim, and agreed that he would not, for 25 years, engage in the manufacture of guns. He was, however, permitted to deal in explosives, etc. After some years, he wanted to join a rival gunmaker.

  HELD: Although unrestricted as to geographical area, and lengthy as to time, the covenant was not unreasonably wide in the circumstances. This was especially so as Nordenfelt had received a very large sum of money for the sale of goodwill.

- **Supply of goods – vertical agreements**

  This type of contract is where suppliers of goods have restricted agreements with the buyers – e.g. a wholesaler agreeing to purchase all his/her requirements for particular goods from a single manufacturer. A common form of this, nowadays, is the "solus" petrol agreement between oil companies and garages.

  In ***Esso Petroleum Co. Ltd v. Harper's Garage (Stourport) Ltd (1968)***, Mr Harper owned two garages. In respect of the first, he agreed with Esso to purchase only its petrol for 4½ years. In respect of the second, he mortgaged it to Esso for 21 years, in return for a loan of £7,000. He agreed that he would not redeem the mortgage during this period, and that he would, for the whole 21 years, buy only its petrol.

  HELD: The first agreement, lasting 4½ years, was reasonable. As regards the second, 21 years was far too long for the petrol tie, and unnecessary to protect Esso's interests, which were adequately secured by the mortgage. It was, therefore, unenforceable.

- **Supply of goods – horizontal agreements or cartels**

  In cartels, manufacturers or dealers in similar goods band together to control the price or other conditions for sale, etc. These are, clearly, in restraint of trade – and, so, they are void at common law. It is only if they can positively be shown to be in the public interest that they will be enforced.

  In ***Re Motor Vehicle Distribution Scheme Agreement (1961)***, UK motor manufacturers agreed among themselves to sell their cars only through specially appointed dealers, who would be required to keep adequate stocks and spares, to purchase a fixed number of vehicles a year, and to purchase at the manufacturer's retail price less a fixed discount. The manufacturers claimed that the agreement was in the public interest, because it kept in existence an efficient distribution network.

  HELD: The court ruled that the agreement was in restraint of trade.

  In addition, cartels and similar agreements are controlled by statute. We shall outline the law on this subject later in the course.

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- **Exclusive service agreements**

  Under these agreements the employee is, in effect, agreeing to work only for the employer. Here the courts are sometimes conscious of the inequality of the bargaining power of the respective parties. Simply put, if the courts feel that the employee is in a weak position and stands to gain less from the contract than the employer then they will not enforce it.

  In ***Schroeder Music Publishing Ltd v. Macaulay (1984)***, an unknown songwriter entered into an agreement giving the publishers the full world copyright in all of his songs. The agreement also gave the publishers the right to terminate the contract or assign the benefit of it at any time. There was no corresponding duty to publish or promote any of the songwriter's compositions.

  HELD: This was an unreasonable restraint of trade. The court was apparently influenced by the inequality of bargaining power of the parties. However, later cases seem to suggest that the granting of relief on the ground of inequality of bargaining power may be in decline.

You should note that if the court decides that a party is genuinely trying to protect against unfair competition, but the wording of the restraint is too restrictive, it may consider using **severance**. For severance to be applied, the court must be satisfied on several issues:

- That the contract can be split into separate components
- That those components are capable of standing alone and being enforceable as separate contracts
- That no rewording of the contract is required
- That the unenforceable part is a relatively minor part of the contract as a whole.

You can see an example in ***Goldsoll v. Goldman (1915)***. The claimant bought the business of the defendant who traded in imitation jewellery in the United Kingdom. One of the terms of the contract was that the defendant would not trade in imitation or real jewellery either in the United Kingdom or in certain foreign countries. It was **held** that the restraints concerning real jewellery and foreign countries could be severed, and that the contract could be enforced in respect of the sale of imitation jewellery in the United Kingdom only.

In ***Marshall v. N M Financial Management Ltd (1995)***, the defendant company, which was operating in the financial services sector, had engaged the claimant as a self-employed agent selling life assurance and other financial services. He received commission from them for business introduced by him and his contract of engagement stated that entitlement to commission would cease on termination of the contract. It also stated that commission arising prior to, but not paid at, termination would be remitted within one year of termination, provided that the claimant was not employed by a competitor during that year.

The claimant terminated his contract of engagement with the defendant company and immediately joined a competitor. He claimed for prior commission due to him on termination, but this was refused by the defendant company.

HELD: The commission claimed was legally due to the claimant. The contractual provision was in restraint of trade, because it could not be justified as reasonably necessary to protect the lawful interest of the defendant company in conserving its existing customer base.

The unlawful restriction could also be severed from the rest of the contract, because the real consideration for the payment of prior commission derived from the claimant's service under his contract, not an agreement not to compete.

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H. EXCLUSION CLAUSES

What is an Exclusion Clause?

An exclusion clause is a clause, which purports to exclude liability for the happening of certain events e.g. liability personal injury or death due to negligence.

To be valid, exclusion clauses must satisfy the requirements of:

- The common law
- The Unfair Contract Terms Act 1977
- The Unfair Terms in Consumer Contracts Regulations 1999.

Common Law

The following requirements at common law need to be met for an exclusion clause to be valid:

- The exclusion clause must have been incorporated into the contract by signature, by notice or by a previous course of dealings **and**
- The clause must cover what actually happened: Parties seeking to rely on exclusion clauses must use very clear words to exempt themselves from liability. When interpreting exclusion clauses the *contra proferentem rule* is used.

Especially clear language must be used to exclude liability for negligence. For example, through the use of the word *'negligence'* in the clause: ***White v John Warwick & Co Ltd (1953)*** and ***Hollier v Rambler Motors (AMC) Ltd (1972)***. If clear language is not used, liability for negligence may still be excluded if the language of the clause is sufficiently wide to cover negligence. For example, clauses often provide that liability for harm or danger is to be excluded *"howsoever caused"*:

In ***White v Warwick (1953)*** the plaintiff hired a bicycle from the defendants under a written agreement, which included a provision that "nothing in this agreement shall render the owners liable for any personal injuries". The plaintiff was injured when the saddle tilted forward and the Court of Appeal found the defendants liable in negligence. The exclusion clause was construed so as to exclude only the concurrent liability that would otherwise have arisen under the contract.

In ***Hollier v Rambler Motors (1972)*** the plaintiff made an oral agreement with the defendants that they would repair his car. He had used the same garage three or four times over the previous five years and on at least two occasions had been asked to sign an "invoice" excluding liability for damage by fire. A fire broke out in the garage through the defendant's negligence and the car was damaged. Salmon LJ said that the clause could and should be interpreted as covering only damage caused by fire resulting from causes other than negligence.

Under the common law an exclusion clause can be incorporated into a contract in ***three*** ways.

(a) **By signature**

If you sign a written contract then you are bound by its terms, whether you have read and understood them or not in the absence of any misrepresentation: ***L' Estrange v. F. Graucob Ltd (1934)***: In this case the plaintiff ordered a slot machine from the defendants and signed a standard printed order form including (in very small print) a clause excluding any kind of warranty. The machine did not work and the plaintiff claimed not to be bound by the exclusion clause, which she had not read. The court found against her: in the absence of misrepresentation, a party who signs a document is normally bound by its contents whether or not he has read them.

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If your signature on a written contract has been obtained by the other party misrepresenting the true meaning of an exclusion clause, you will not be bound by its terms, irrespective of whether you have read and understood them: ***Curtis v. Chemical Cleaning and Dyeing Co. (1951)***: In this case the plaintiff took a satin wedding dress to the defendants to be cleaned. She was asked to sign a document containing a clause excluding the defendants' liability for damage of any kind; before signing, she asked what the document was and was told that it excluded liability for damage to beads or sequins. The plaintiff signed without reading the document; the dress was stained during cleaning and the plaintiff sued. The Court of Appeal found in her favour: the assistant's innocent misrepresentation of the effects of the document had the effect of excluding the clause from the contract.

(b) **By notice**

If notice of an exclusion clause's existence has been given to the other party before or at the time the contract was made the details of the clause itself need not be communicated: ***Olley v Marlborough Court Hotel (1949)*** and ***Thompson v. London Midland and Scottish Railway Co. (1930)***. In the latter case the plaintiff went on a railway excursion and was given a ticket with the words *"Excursion: for conditions see back"*. On the back was a notice referring customers to the conditions printed in the company's timetables (which cost 6d each); these conditions excluded liability for any injury. The plaintiff was injured on the journey but lost her claim. The Court of Appeal said the ticket was a contractual document and the fact that the plaintiff could not read did not alter the legal position. She should have realised that the special excursion price might imply special conditions.

In cases where a notice board is used, it must be sufficiently large and be placed in a prominent position: ***Thornton v. Shoe Lane Parking Ltd (1971)***. In this case the plaintiff parked his car in the defendant's car park, paying his money and taking a ticket from the automatic machine at the entrance. On the ticket, in small print, was a notice referring to conditions displayed in the car park; these were not visible from outside and were quite lengthy, including one excluding liability for any injury to a customer. When the plaintiff returned later to collect his car, there was an accident in which he was seriously injured and he sued. The Court of Appeal struck out this exclusion clause, holding that so wide ranging and unusual an exclusion called for exceptionally clear and explicit notice.

Where some form of document is used to incorporate an exclusion clause by notice, the exclusion clause will only be valid if a reasonable person would expect contractual terms to be present in or on the document: ***Chapelton v. Barry UDC (1940)***: In this case the plaintiff hired a deckchair belonging to the defendants, paid the hire fee and took a ticket without reading it. The chair collapsed and the plaintiff was injured; the defendants relied on a clause printed on the ticket excluding liability for any injury. The Court of Appeal said the ticket was not a contractual document – no reasonable person in the circumstances would have thought it anything more than a receipt – so the clause had not been incorporated in the contract.

(c) **By a previous course of dealings**

Terms which have previously been included following a previous course of dealings (or following trade custom) may be incorporated into the contract without being specifically referred to: *British* ***Crane Hire Corporation Ltd v Ipswich Plant Hire Ltd (1974)***. In this case the defendants hired a dragline crane from the plaintiffs on the strength of an agreement made by telephone, with the documentation to be sent on later. The conditions of trade in these documents included an undertaking that the defendants would indemnify the plaintiffs for any damage. Before the documents had been signed, the crane (without fault by anyone) sank in marshy ground and the plaintiffs claimed on the indemnity. The Court of Appeal allowed the clause to stand as part of the contract.

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Although it had not expressly been drawn to the defendant's attention at the time of the verbal contract and there was no common course of dealing between the parties, both were members of a trade association and commonly used their standard conditions (including a term such as this) and both would have assumed that some conditions were to be applied.

Transactions must be frequent and regular enough to constitute a course of dealings: ***Hollier v Rambler Motors (1972)***. In this case the plaintiff made an oral agreement with the defendants that they would repair his car. He had used the same garage three or four times over the previous five years and on at least two occasions had been asked to sign an "invoice" excluding liability for damage by fire. A fire broke out in the garage through the defendant's negligence, and the car was damaged. When the case was being heard by the Court of Appeal Salmon LJ said that three or four transactions over five years could hardly be regarded as a *"course of dealing"* giving sufficient notice of the term.

Unfair Contract Terms Act 1977

In accordance with the Unfair Contract Terms Act 1977, two main requirements need to be satisfied in order for an exclusion clause to be **valid**.

(a) If it does not purport to exclude or restrict liability for death or personal injury resulting from **negligence**: Section 2(1), Unfair Contract Terms Act 1977. Section 1 of the UCTA 1977 defines 'negligence' as not taking reasonable care or exercising reasonable skill in the performance of the contract and of any common law duty to take reasonable care or exercise reasonable skill.

(b) If it passes the test of **reasonableness**. In the case of loss or damage (other than death or personal injury) a person cannot exclude or restrict his liability for negligence except insofar as the term satisfies the requirements of reasonableness in Section 11(2) of the 1977 Act: Section 2(2), Unfair Contract Terms Act 1977.

Section of the 1977 Act defines a 'reasonable' term in this context to be a term which is "a fair and reasonable one to be included (in the contract) having regard to the circumstances which were, or ought reasonably to have been known to or in the contemplation of the parties when the contract was made."

Guidance on what would be considered a **reasonable** exclusion clause is provided by ***Phillips Products Ltd v Hyland (1987)***. In this case the plaintiffs hired an excavator and driver from the defendant under a contract providing that the hirer was to be responsible for all damage arising from the driver's work. The driver caused damage and the plaintiffs sued. Kenneth Jones J said he was not satisfied that the term was fair and reasonable. The Court of Appeal upheld this decision on the basis that the trial judge's decision was not clearly wrong and added that, in deciding whether a clause was reasonable, the courts would look at its effect rather than its form.

Guidance on what would be considered an **unreasonable** exclusion clause is provided by ***George Mitchell (Chesterhall) Ltd v. Finney Lock Seeds Ltd (1983)***. In this case the appellants, a firm of seed merchants, contracted to sell to the respondents, 30lb of Dutch winter cabbage seed for £201.60. The respondents planted 63 acres with the seeds. However, the resultant crop was worthless, partly because of the fact that the seed delivered was autumn seed and partly because, even as autumn seed, it was of inferior quality. The respondents sued for damages for loss of the crop and the appellants argued in their defence that they were protected by a clause in their standard conditions of sale limiting their liability to the replacement cost of the seed or refunding payment. The relevant wording of the clause that they were seeking to rely on was that:

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"..all liability for any loss or damage arising from the use of any seeds or plants supplied by us and for any consequential loss or damage arising out of such use….or for any loss or damage whatsoever"

The House of Lords held that this clause was sufficiently clear and unambiguous to be effective at common law but that it did not pass the reasonableness test in Section 11 of the Unfair Contract Terms Act 1977.

Moreover, in concluding that the aforementioned clause was unreasonable, the House of Lords attached considerable weight to evidence, ironically, given by the sellers that they commonly made ex gratia payments in the case of complaints from customers, which they regarded as 'justified'. This was treated as evidence that the sellers, prima facie, did not themselves regard their terms of sale as reasonable.

Other factors which contributed to this finding of unreasonableness were the fact that the seller's breach was the result of gross negligence. To this end, this last factor is often regarded as an important one by the courts as questions of the most economic insurance arrangement are intimately connected with the reasonableness test. Section 11(4) of the Unfair Contract Terms Act 1977 stating that regard should be had to:

"(a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and

(b) how far it is open to him to cover himself by insurance."

From the above wording of Section 11((4)(a) it appears that their must be a reasonable relationship between resources and the limitation of liability which it is thought to justify.

Unfair Terms in Consumer Contracts Regulations 1999

In accordance with the Unfair Terms in Consumer Contracts Regulations 1999 any terms, which have not been individually negotiated in contracts, between consumers and commercial sellers or suppliers of goods and services, will only be valid in so far as they can be regarded as fair contractual terms.

If any terms, which have not been individually negotiated in contracts, between consumers and commercial sellers or suppliers of goods and services, are held to be **'unfair'** by the courts **they do not bind the consumer**. In this context, an unfair term is any term, which is contrary to the requirement of good faith and causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

Schedule 2 of the Unfair Terms in Consumer Contracts Regulations 1999 sets out an indicative and non exhaustive list of terms, which may be regarded, as unfair. These include terms, which have the object or effect of:

- Excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier
- Inappropriately excluding or limiting the legal rights of the consumer vis-à-vis the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him
- Making an agreement binding on the consumer, whereas provision of services by the seller or supplier is subject to a condition whose realisation depends on his own will alone
- Permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to

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receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract

- Requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation
- Authorising the seller or supplier to dissolve the contract on a discretionary basis, where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him, where it is the seller or supplier himself who dissolves the contract
- Enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious grounds for doing so
- Automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express his desire not to extend the contract is unreasonably early
- Irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract
- Enabling the seller or supplier to alter the terms of the contract unilaterally, without a valid reason which is specified in the contract
- Enabling the seller or supplier to alter unilaterally, without a valid reason, any characteristics of the product or service to be provided
- Providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without, in both cases, giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded
- Giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract
- Limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality
- Obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his
- Giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement
- Excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

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Study Unit 7

Contract Law 3: Performance and Discharge

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A. PERFORMANCE

General

There are a number of rules affecting the performance of a contract. The cardinal one is that a person must perform exactly **what he/she has promised to do**. Doing something different from that agreed to, even though it may be commercially more valuable to the other party, is not performance in law.

In ***Re Sutro & Co. and Heilbut Symons & Co. (1917)***, it was **held** that a contract of carriage of goods by sea from Singapore to New York, with liberty to transship at other ports, was not performed by carrying them partly by sea and partly by rail.

Even the slightest deviation from the agreed terms will entitle the other party to claim that the contract has not been performed and to sue for damages or in certain cases, to treat the contract as discharged by reason of the breach.

In ***Re Moore & Co. and Landauer & Co. (1921)***, a contract was for the supply of 3,000 tins of canned fruit, to be packed in cases each of 30 tins. Part of the consignment was packed in cases of 24 tins.

HELD: The entire consignment would be rejected by the buyers.

This rule is, however, subject to the "*de minimis*" rule – that is, the law will not take note of trivial matters or indifferences.

If a contract entails no personal skill, a contracting party may get someone else to perform it on his/her behalf (although he/she, of course, remains liable). However, if it envisages the personal performance of the promisor, whether expressly or by implication, then he/she alone must perform.

Time of Performance

You would think, from the above rules, that, if a contract stipulated a time by which performance must be completed, and that time is exceeded, the innocent party could treat the contract as discharged, if he/she wished. However, that is not, normally, the case. At common law it was so but equity would always relieve a party from the harsh effects of such a rule, if it reasonably could.

The **Law of Property Act 1925**, Section 41, ensured that equity would prevail. Therefore, it is now in only **three** circumstances that "time is of the essence" of a contract. The effect of this is that, except as stated below, time of performance is merely a **warranty**, breach of which will give rise to a claim for damages only. It is not a **condition**, allowing the innocent party to rescind.

However, time is a condition in the following situations:

- Where the parties **expressly state in the contract** that time is of the essence or must be strictly complied with. The form of words used is not significant, provided the intention is clear.
- Where the circumstances of the contract or of the subject matter show that **strict compliance** with stipulations as to time was intended or should necessarily be implied.
- Where time was not originally of the essence but because of undue delay, one party has given notice that the contract must be performed by a **specified reasonable date**.

  In ***Charles Rickards Ltd v. Oppenheim (1950)***, Oppenheim ordered a Rolls Royce chassis in early 1947. In July, Rickards agreed that the body should be built for it "*within six or at most seven months*". Seven months later, it was not completed; so, Oppenheim agreed to the company taking a further three months. At the end of this

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time, it was still not ready. Oppenheim served notice on Rickards that, if the car was not ready in four weeks, he would cancel the order. It was not – so he cancelled. Three months later, the finished Rolls Royce was tendered but Oppenheim refused to accept it.

HELD: He was entitled to do so. Time was not, originally, of the essence, but because of Rickards' breach, the notice requiring completion in four weeks served to make time of the essence.

If a contract does not specify any time for performance or if vague words are used, such as "*as soon as possible*", or "*with all dispatch*", then an obligation is implied by law to perform within a reasonable time.

Partial Performance of an Entire Contract

The complete performance of an entire contract is, normally, a condition precedent to any liability on the other party – e.g. to make payment. The courts cannot apportion the consideration – so, unless the contract is completed, nothing is due on account of it. The classic example is ***Cutter v. Powell (1795)***. A seaman was engaged for a lump sum on completion of the voyage. He died part way through the voyage, and it was **held** that his executors could not claim any wages for the time prior to his death.

The common law rule on entire contracts was largely developed by building or "work and materials" contracts. So, unless the contract provided for stage payments, if a builder failed to complete a house, he/she could recover nothing, even though the owner would have derived substantial benefit from the work that had been done and materials provided (modern building contracts **always** provide for stage payments).

Likewise, a ship owner cannot recover freight if the goods are not carried to the agreed destination (bills of lading, therefore, always provide for freight to be payable, "cargo lost or not lost").

From these two examples, you will see that, by express words, a contract can allow for partial payment in the event of incomplete performance. In addition, to alleviate what could be an absurdity, the doctrine of **"substantial performance"** has evolved. This says that, if a person has completed the contract in all but an insignificant or unimportant part, he/she is entitled to payment for the whole, less any amount for the uncompleted work. What is "substantial performance" is a question of fact, depending on the circumstances and the details of the contract.

"Substantial performance" can be **excluded** by express words in the contract.

However, if a contract is only partially completed and the circumstances are such that the court can reasonably imply it, then it may imply a fresh contract to accept what has been performed and pay on a "*quantum meruit*" i.e. for what **has** been done. This is likely to occur by implication where the innocent party has actually accepted some benefit under the contract. For example, in contracts for sale of goods, a buyer is not compelled to accept a different quantity from that ordered. However, if he/she does accept them, they must be paid for at the contract rate for what has been taken.

A similar principle applies where an employee performs only part of his/her contract, e.g. as part of some industrial action. In ***Miles v. Wakefield Metropolitan District Council (1987)*** a Superintendent Registrar of Births, Marriages and Deaths refused to perform marriage ceremonies on Saturday mornings. His employers deducted from his salary the time spent on such refusal. He challenged the validity of the deductions.

HELD: The employers had behaved properly. They were not bound to choose between dismissing him and paying for incomplete work.

This principle was taken further in ***Wiluszynski v. Tower Hamlets London Borough Council (1989)***. Here the employer issued all employees working to rule (withholding specific duties)

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with a notice rejecting their part performance of the contract and informing them that they would not be required to work at all unless they were prepared to do all that their contract required. The Council also stated that if the employees wished to enter the offices and work, such work would, therefore, be deemed to be voluntary and unpaid. Whereas in ***Miles*** the employer had merely deducted a proportion of the salary representing the work not done, here the Council sought to avoid payment completely.

HELD: As the employees were offering only part performance the employer was within its rights to reject the part performance and refuse to pay at all.

On the other hand, if a contract is not "entire" but it is divisible, the court can treat each part as entire. Those divisible parts which are completed must be paid for.

Payment

A contract may provide for payment in a certain manner or at a certain time and if complied with, this serves to discharge the obligation to pay.

If there is no specific provision, the strict rule is that payment must be made in legal tender. If the creditor accepts a cheque, bill of exchange, or other negotiable instrument, he/she is, in reality, agreeing to a variation of the contract. However, if such a negotiable instrument is dishonoured, the creditor has **two** remedies: he/she can sue for the value of the dishonoured cheque or other instrument, or revert to the original contract, and sue for payment under it. In practice, it is, usually, simpler to sue in respect of the instrument, as then no proof is required that the contract has been performed, and the money due.

Should payment be made by a third party who is not jointly liable under the contract, then the debt is not discharged unless the third party pays as agent for the debtor and with his/her authority.

However, if the creditor requests the debtor to make payment to a third party, this, when made, discharges the debt.

The time of payment is a question of the construction of the contract. It may be expressly stated, or to be necessarily inferred from the terms. However, if nothing is stated or to be inferred, the debtor must pay when the work is completed and he/she has had a reasonable opportunity to inspect it. Money which is stated to be "payable on demand" must be ready and handed over when demanded.

The place of payment is, unless otherwise stated in the contract, or to be inferred from it, the place of business or residence of the creditor. It is the debtor's job to seek out the creditor and pay him/her.

Proof of payment may be given in any way. A "receipt" is only *prima facie* evidence of payment.

Tender

"Tender" is the act of attempted performance. It applies to both parties. One party may tender work in performance of his/her promise; the other may tender payment.

If the one party tenders work, and the other refuses to accept it, the tenderor may elect to treat the contract as repudiated, and sue for damages. On the other hand, if a debtor tenders payment, and the creditor refuses to accept it, the debt is not discharged. The debtor must continue and remain ready to pay the debt. Should the creditor sue, the debtor can plead that he/she duly tendered it – but must still pay the money into court.

As we said before, unless the contract provides otherwise, strictly speaking, tender of payment must be in legal tender. The creditor is not bound to accept a cheque or other instrument of payment. That is the old rule but nowadays, in commercial transactions, any

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recognised method of transferring money which gives the creditor immediate use of the funds will suffice.

Note: Specific rules as to payment and performance apply to contracts for the sale and supply of goods (see later).

B. DISCHARGE BY AGREEMENT

You would think that, as a contract comes into existence only by agreement, its discharge, or ending, could equally easily be effected by agreement. Up to a point, this is true but, in the same way as there are various technical rules governing the valid formation of the contract, so there are rules, some rather artificial, governing its **discharge**.

There are **four** ways in which a contract can be discharged by agreement: by "release"; by "accord and satisfaction", by "rescission" and by some provision contained in the contract itself. Let us look at these in some detail.

Release

If one party releases another from his/her obligations, there is, normally, no consideration for the act. This applies where the party releasing the other has fully performed all his/her obligations, while the other has not. If both of them still have obligations to perform, the consideration for each foregoing his/her rights is the foregoing by the other. However, if there is no consideration a unilateral release can be effective only if it is under seal. You will remember that a contract under seal is valid even if no consideration is present.

An agreement not to sue in perpetuity has always amounted to a "release". However, such a covenant for a limited time only was, at common law, not a valid release. Equity, however, would interfere to grant an injunction to prevent a party suing in breach of his/her agreement not to. Hence, as equity prevails, an agreement not to sue is, in effect, a valid release, whether it be in perpetuity or for a limited time, provided of course, the agreement is either for valuable consideration or under seal.

Accord and Satisfaction

Provided consideration is present, a contract can be discharged by agreement, even though only one party has fulfilled all his/her obligations. This is called "accord and satisfaction". The "accord" is the agreement; the "satisfaction" is the consideration. Provided that the satisfaction is valuable consideration (in exactly the same way as the consideration for the valid formation of a contract must be valuable), all is well. In this context, it can, of course, be some other performance than that of the original obligation.

You will remember that, earlier, we discussed the rule in ***Pinnel's Case***. This states that the payment of a smaller sum in satisfaction of a larger is not a good discharge of a debt. However, if the payment of the smaller sum is made in a different way, or at a different time from that prescribed for the larger sum, this difference constitutes adequate consideration to support the agreement for discharge of the whole debt. This is an example of discharge by accord and satisfaction.

There are two main exceptions to the rule requiring consideration for the discharge of a contract by agreement, where one party has not fully performed. The first is statutory. Under the **Bills of Exchange Act 1882**, no "satisfaction" is required for the discharge of a bill of exchange, provided either the discharge is in writing or the bill itself is delivered up to the person who accepted it.

The second exception, which is perhaps only a partial one, arises through the principle of what is known as **promissory estoppel**, which we mentioned earlier. This principle states that, if one party intimates to the other that she will not insist on her strict contractual rights and the

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second party, in reliance on that statement, incurs expense or obligations, then the first party will not be permitted, by equity, to go back on her promise. The principle was largely developed by Lord Denning in ***Central London Property Trust Ltd v. High Trees House Ltd (1947)***. In this case P leased a block of flats to D, in 1937, for £2,500 a year. In 1940, on account of the war, D was unable to let the flats to tenants, so P agreed to reduce the annual rent to £1,250. At the end of the war, the situation returned to normal, and all the flats could be let. P claimed that the full rent should be paid only from the end of the war in June 1945.

HELD: P succeeded but Lord Denning made it quite clear that, had they sued for a refund of the amounts underpaid from 1940, they would have been estopped by the promise from insisting on their strict legal claim. Because the lessees had acted to their detriment in reliance on a promise to forgo rights, the original rights could not be enforced.

So, promissory estoppel serves to postpone and not totally to obliterate the strict rights. Once the circumstances giving rise to the promise have disappeared, or reasonable notice has been given that **in future** strict performance will be required, the legal rights revive.

Rescission

While a contract is still executory, that is, it has not been fully performed by **both** sides, it can be discharged by mutual agreement, the consideration for the agreement being the **mutual giving-up of rights** under the contract. In the court context, the remedy is **rescission**: it recognises and enforces the contract termination.

The effect of joint repudiation is that the contract is discharged and rights under it cannot afterwards be revived, although money paid in respect of an agreement that has proved abortive can be recovered by an action for "money had and received" (quasi-contract). By the same token, a contract can always be varied by agreement. Here, the terms of the contract are altered but the original contract still subsists. Whether such an action is in reality a variation or whether it amounts to rescission of the original, followed by a new contract incorporating the altered terms, is a question of construction and scope.

In ***Morris v. Baron & Co. (1918)***, there was a contract for the sale of cloth. A dispute arose, and legal action started. The parties then agreed to stop their legal action, and that an extension of time for payment should be given to the buyer, and that, instead of having to take delivery of the balance of the cloth, he should have an option to take it only if he wished.

HELD: This amounted to a discharge of the original contract, followed by a substituted contract.

However, in ***Berry v. Berry (1929)***, a husband and wife separated, and the husband agreed to pay a certain annual maintenance. His income proved insufficient, so both parties agreed that the sum should be reduced.

HELD: This was a valid and enforceable variation.

A **waiver** is another variant on the same theme, and it is akin to a "release". This applies when one party agrees not to insist on the exact **method of performance** by the other fixed by the contract. He/she agrees to waive his/her rights to strict contractual performance. Unless the doctrine of promissory estoppel can be brought into play, there must be some valuable consideration for a waiver, or else it must be under seal.

Provisions Contained in the Contract Itself

This is fairly obvious. If the contract itself provides for its discharge in certain circumstances, then this is an agreed contractual term. The question of consideration does not apply, as it is part of the consideration for the contract.

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C. DISCHARGE BY BREACH

Earlier we defined the difference between "conditions" and "warranties" – a condition being a term of the contract which is fundamental, and breach of which entitles the injured party to rescind the contract. The contract is, therefore, discharged by breach. What this means is that the injured party is discharged from the necessity for further performance by reason of the breach of contract by the other.

The innocent party is not bound to rescind in the event of breach of a condition by the other; he has the **option**. He can rescind and claim damages or he can affirm the contract and carry on with his own performance. If he does affirm it, he is still able to claim damages for any loss resulting from the breach. In other words, he is electing to treat the condition breached as if it were a warranty.

In ***Poussard v. Spiers and Pond (1876)*** the plaintiff, an actress, agreed to play the leading role in an operetta to be produced by the defendants. Owing to illness she could not attend the last rehearsal or the first four performances and when she offered to take her part in the fifth performance the defendants refused. The plaintiff sued for wrongful dismissal, but the court said her participation in the first four performances **was a condition fundamental** to the contract and its breach by the plaintiff entitled the defendants to treat the contract as terminated.

If you look at the question from the other side, the person guilty of such a breach giving rise to a right of rescission brings this about in one of **three** ways: by renouncing her obligations to perform, by creating a situation whereby it is impossible for her to perform or by a complete or partial failure to perform her obligations.

Renunciation

If one of the parties, by his words or his actions, makes it plain that he has no intention of performing or continuing to perform his side of the bargain, he is said to renounce the contract.

In order to justify the innocent party then treating the contract as discharged, the renunciation must be substantially complete. A mere refusal to carry out a part is not sufficient, unless that part is an essential element of the contract. The test is: "Would a reasonable person conclude from his/her words or deeds that he/she no longer intended to be bound by the terms of the contract?"

Renunciation can occur either before the time for performance has arrived or during its course. In the latter event, the problem is straightforward.

Whether renunciation has occurred such as to entitle the innocent party to rescind is a matter of fact for the court.

However, in the former event the innocent party has a choice.

(a) He can wait for the time of performance to arrive, then sue for damages and if applicable, refuse himself to perform by reason of the renunciation.

(b) He can, forthwith, treat the renunciation as absolving him from the necessity to perform, and sue for damages. This is called **"anticipatory breach"**. If one party, by words or conduct, leads the other reasonably to believe that he does not intend to be bound by his agreement, the law does not require that other party to await the inevitable. To protect himself or to mitigate his loss, he is quite entitled to anticipate the inevitable event and act accordingly.

In ***Hochster v. De la Tour (1853)***, a travelling courier was appointed for a journey. Before the time for the start, the employer wrote to say he no longer required the services of the courier. The courier immediately sued for damages.

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HELD: He was entitled to do so. He need not await the inevitable.

A more recent case, which illustrates not only the doctrine of anticipatory breach but also what constitutes grounds for repudiation of a contract by reason of the renunciation of it by the other party, is ***Federal Commerce v. Molena Alpha (1979)***.

By identical charter-party agreements, the owners of three ships chartered them to charterers. Part of the agreements was that the ships' masters were entitled to issue "freight paid" bills of lading (i.e. warranting that the freight on cargo was duly prepaid), and that the charterers were entitled to make deductions from the hire charge in specified events. One of these was in respect of delay as a result of slow steaming.

The ships were delayed by engine repairs and slow steaming, so the charterers informed the owners that they were deducting a certain sum from the hire due. The owners refused to authorise the deduction, and demanded full payment. The charterers nevertheless deducted it. The owners retaliated by instructing the masters of their vessels not to issue any "freight prepaid" bills of lading. They well knew that this action would place the charterers in a very difficult situation.

When this happened, the charterers claimed that the owners' actions were a renunciation of the contract which they accepted as such, and which constituted a discharge of the contract.

HELD: By the House of Lords, in the first place, that the instruction to the ships' masters was an anticipatory breach of contract. Second, that, although the clause in question that had been breached was not one that automatically amounted to a repudiation, the fact was that it threatened to deprive the charterers of substantially the whole benefit of the contract. It therefore went to the root, and did entitle the charterers to terminate the contracts.

Lord Wilberforce had the following to add:

> *"A threat to commit a breach, having radical consequences, is nonetheless serious because it is disproportionate to the intended effect. Further, if a party's conduct is such as to amount to a threatened repudiatory breach, his subjective desire to maintain the contract cannot prevent the other party from drawing the consequences of his actions."*

Impossibility Created by One Party

If one party, by her own actions (or lack of them) creates a situation whereby it is impossible for her to perform, she is not allowed to rely on the impossibility as being an excuse for not performing. The other party is entitled to treat the contract as discharged. If the impossibility is created before the time of performance, it will often but not necessarily, give rise to anticipatory breach.

Universal Cargo Carriers Corporation v. Citati (1957)

The charterer of a ship contracted to nominate a berth, provide a cargo and load it; all before a given date. Three days before this date, he had done none of these things.

HELD: The ship owner could treat the contract as discharged, as it would be impossible to perform, owing to the charterer's own neglect.

Failure of Performance

In the event that one party fails to perform, whether wholly or partially, this may entitle the other to treat the contract as discharged. Whether or not he/she can depends on the extent and importance of the failure. Once again, the question is: "Did the failure to perform amount to a breach of a condition or a warranty?"

This is the classic view but, nowadays, courts often try to escape from the rigid definition of "condition" or "warranty", and they seek to equate the term to the commercial reality or

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importance of the breach with regard to the **commercial intentions** of the parties at the time they made their bargain.

In ***Hong Kong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha Ltd (1962)***, a ship on charter had a succession of engine breakdowns. The charterers claimed that it was an obligation of the owners to provide a seaworthy vessel (i.e. a condition). By reason of the breakdowns, she was not seaworthy; therefore, they were entitled to treat the contract as discharged.

HELD: Regard must be had to the consequences of the breach. These were not sufficient to frustrate the commercial purpose of the contract. Hence, the charterers could not refuse further performance and the contract was not discharged (but they were, of course, entitled to damages).

D. DISCHARGE BY FRUSTRATION

Introduction

So far, we have talked about contracts being discharged by agreement and by breach, in other words, as a result of some act or neglect on the part of one or both parties. The last category in which a contract can be discharged arises by operation of law and not by any volition of either party. It is called "frustration".

If some event occurs which is not the fault of either party and which could not reasonably have been foreseen, which so alters the whole character of the bargain as to make it a **totally different thing** from that intended, the contract may be discharged by frustration. It is essential to appreciate that the frustrating event must be something extraneous to the contract and that it must be such as to frustrate the commercial purpose of the contract. It is not up to the parties to agree on whether or not an event, **when** it occurs, has frustrated the contract. It is strictly a question of law to decide **if** that event did serve to frustrate. They can, of course, carry on with their bargain, on the same or altered terms but that has the effect of making a fresh contract after the old one has been discharged by operation of law.

This was not always the case and the concept of frustration is relatively new.

In ***Paradine v. Jane (1646)***, a man was ejected from his leased farm by an alien army and forcibly prevented from making the profits out of which the rent could be paid. His landlord sued for the rent.

HELD: He must still pay the rent.

However, by 1863 the situation had changed and a less harsh view prevailed.

In ***Taylor v. Caldwell (1863)***, the parties agreed that Caldwell should hire a music hall on four specified nights for concerts. After the contract was made but before the first night, the hall was burnt down.

HELD: Caldwell was not liable to damages. A term must be implied into the contract that the parties would be excused if performance became impossible, without the fault of the contractor, through the destruction of the subject matter.

Shortly afterwards, this concept of destruction of the subject matter was extended to the frustration of the adventure.

In ***Jackson v. Union Marine Insurance Co. (1874)***, the contract was for a ship to proceed from Liverpool to Newport (Gwent) to load a cargo for shipment to San Francisco. Just outside Liverpool, the ship ran aground, and it took nearly eight months to refloat and repair her.

HELD: The contract ended with the stranding.

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Test of Frustration

Various tests have been put forward for deciding when a contract is frustrated. Probably the most helpful is that given by the House of Lords in ***Davis Contractors Ltd v. Fareham UDC (1956)***. Frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. "*It was not this that I promised to do. There must be such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for*."

Illustrations of Frustration

Frustration commonly occurs as a result of war – but by no means necessarily.

Typical events are:

- Destruction by fire of the subject-matter
- Stranding or sinking of ships
- Requisition of the subject-matter by the government
- Seizure of a ship by a foreign government
- Death or some incapacity, such as illness, which is sufficiently severe that personal performance is impossible.

In ***Robinson v. Davison (1871)***, a pianist contracted to give a concert on a certain day but was prevented by illness. It was **held** that personal performance was at the root of the contract and since this became impossible the contract was discharged.

You should note that in cases other than those which require personal performance, death or illness does not excuse performance under the contract. In the event of death, the deceased's personal representative must assume the liabilities under the contract.

Furthermore, some circumstances arising may excuse part of a contract being performed, without frustrating the whole.

In ***Sainsbury (HR and S) Ltd v. Street (1972)***, a contract was made for the sale of 275 tons of barley from a certain farm. Through no fault of the farmer, the crop yielded 140 tons. The seller claimed to be excused from delivering any of it.

HELD: The contract was not frustrated. A term would be implied that the seller was bound, if the purchaser so required, to deliver as much as was grown (i.e. 140 tons).

Various classes of frustrating events can be distinguished:

(a) Cancellation of an expected event

These are the so-called "coronation cases", which all hinge on the same frustrating event. In 1902, just days before his coronation, King Edward VII had an operation for appendicitis. The coronation was postponed.

Contracts the sole purpose of which was directly connected with the event were, therefore, commercially frustrated.

In ***Krell v. Henry (1903)***, Krell agreed to hire rooms in his Pall Mall flat to Henry, for the day of the coronation. The rooms overlooked the route. Krell sued for the balance of hire.

HELD: Henry was not liable. The viewing of the procession was the sole basis of the contract, which was, therefore, frustrated.

The same result was arrived at on similar facts in ***Chandler v. Webster (1904)***.

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However, the situation was different in ***Herne Bay Steamboat Co. v. Hutton (1903)***. In this case Hutton contracted to hire Herne Bay's steamship to take passengers to view the Naval Review at Spithead and for a day's cruise around the fleet.

HELD: The contract was not frustrated. Although the Naval Review was cancelled, the fleet was still at anchor in Spithead, and passengers could still cruise around it.

(b) Subsequent legal changes or illegality

If a contract is made on the basis that the performance of it is lawful, and legal changes occur afterwards, making performance illegal, then this will, normally, serve to frustrate the contract.

In ***Metropolitan Water Board v. Dick, Kerr & Co. Ltd (1918)***, the company contracted with the Water Board in July 1914 to construct a reservoir and to complete within six years. In August, war broke out and in 1916, under statutory authority, the company was compelled to cease work on the reservoir.

HELD: The contract was frustrated.

On the other hand, a supervening legal prohibition which, to a substantial extent, destroyed the commercial purpose of a lease of a warehouse was held not to frustrate the lease.

In ***National Carriers Ltd v. Panalpina Ltd (1981)***, National Carriers leased a warehouse for ten years. Five years later, in 1979, the local authority closed the only street giving access to the warehouse. It was not reopened until 1981. National Carriers claimed that the lease was frustrated from the date of closure.

HELD: The doctrine of frustration could apply to a lease but, in this case, the disruption caused was not sufficient to frustrate the contract. There were still three years to run out of a balance of five years from the onset of the disrupting event.

(c) Outbreak of war

Outbreak of war can have two effects which may serve to frustrate a contract. In the first place, it renders all dealings or transactions with the enemy illegal. Contracts made but not yet fully performed are, therefore, discharged by frustration. This applies, even though the contract had envisaged the possibility and provided for its suspension during the course of hostilities.

In the second place, outbreak of war can frustrate the commercial purpose of a contract, even though the parties to it do not become alien enemies.

For example, in ***Bank Line Ltd v. Arthur Capel & Co. (1919)*****,** it was agreed that a ship should be chartered for 12 months. Before delivery, she was requisitioned by the government, and after four months she was released.

HELD: The commercial purpose of the charter agreement was frustrated.

However, this will not always apply.

In ***F A Tamplin Steamship Co. Ltd v. Anglo American Petroleum Products Co. Ltd (1916)***, a ship was chartered for five years, to run between specified ports. While the charter still had three years to run, the ship was requisitioned for use as a troop ship. The charterers were willing to continue to pay the freight but the owners, hoping to obtain higher compensation from the government, claimed that the contract was frustrated.

HELD: The interruption was not sufficient to frustrate the contract.

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This decision was by a bare majority of the House of Lords, and it is possible that the fact that it was the owners who wished to take advantage of the situation for their own profit may have affected the result.

The fact that the contract will be made more onerous, or more expensive, will not, in itself, serve to frustrate it, even though, as in the case of outbreak of war, this is a potentially frustrating event. In ***Tsakiroglou & Co. Ltd v. Noblee Thorl GmBH (1962)***, sellers agreed to sell and ship ground-nuts from Port Sudan to Europe. Before shipment, the Suez Canal was closed to navigation as a result of war. It would have been possible to ship them via the Cape of Good Hope, and this would have been far more costly, and have taken three times as long.

HELD: The extra time and cost of shipment were not sufficiently fundamental to frustrate the contract.

Had the commodity been perishable, the result would probably have been different.

In a more recent case, it was **held** that there was no rule or irrefutable presumption that a declaration of war prevented the performance of – and, therefore, discharged – a contract on which the war had a direct bearing. Unless the declaration of war made the contract illegal, it was the circumstances of the individual contract and the extent to which it was affected that was the governing factor – not the declaration of war *per se*.

This decision was made as a result of a ship being bottled up in the Shatt al Arab waterway by the Iraq/Iran war: ***Finelvet AG v. Vinava Shipping Co. Ltd – "The Chrysalis" (1983)***.

Self-induced Frustration

The essence of the doctrine of frustration is that the event must not have arisen by the fault of either party. If, therefore, it is induced by the act or neglect of one of them, he/she cannot rely on this to escape from his/her obligations.

In ***Maritime National Fish Co. Ltd v. Ocean Trawlers Ltd (1935)***, a trawler, the "St Cuthbert", was chartered. She was fitted with an otter trawl, and both parties were aware that it was illegal under the Canadian Fisheries Act to use an otter trawl without a licence. The charterers used five trawlers, including the "St Cuthbert", and they applied for five licences. Only three were granted, and the charterers chose not to apply one of these to the St Cuthbert. They claimed that the charter contract was frustrated.

HELD: They could not rely on this, as it was their own voluntary election that prevented the "St Cuthbert" being used.

It is not yet fully settled as to which act or neglect is necessary to debar a person from claiming frustration. For instance, a sentence of imprisonment on an employee is not considered as "self-induced" so as to prevent the contract of employment from being frustrated: ***Hare v. Murphy Bros Ltd (1974)***.

Legal Consequences of Frustration

At common law, if a contract is frustrated, it is not thereby made void *ab initio*. All that frustration does is forthwith to release both parties from any further performance. Originally, the loss lay where it fell. For instance, in one of the "coronation cases" we referred to previously, ***Chandler v. Webster (1904)***, the deposit paid for the rooms was irrecoverable. It was only the balance of rent due that did not have to be paid.

The harshness of this rule was later appreciated and partially corrected by the House of Lords in ***Fibrosa Spolka Akcyjma v. Fairbairn Lawson Combe Barbour Ltd (1943)***. In July 1939, a contract was made to deliver machinery to Poland. A deposit of £1,000 was paid. In

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September, England went to war with Germany and in the same month Poland was occupied by Germany. The contract was frustrated.

HELD: The advance consideration of £1,000 must be repaid as the consideration had wholly failed. The repayment claim did not arise out of the contract but under the equitable rule of "*money had and received* ". ***Chandler v. Webster*** was overruled.

However, although the deposit was repayable, the manufacturers could recover nothing for the work they had done and expense incurred up to the date of frustration. The result was that Parliament stepped in with the **Law Reform (Frustrated Contracts) Act 1943**.

This Act applies to any contract which has been frustrated or rendered impossible of performance. It does not specify what constitutes frustration; it merely alters the legal consequences, which are that :

- All sums paid before the date the contract is discharged become repayable and all future sums cease to be payable.

  However, the court has power to apportion such payments between the parties if it is just and equitable so to do.

- If any party has received a valuable benefit, other than the receipt of money, before the date of discharge, then the court can order him/her to pay such amount as may be just and equitable.

So, what the Act does is to ensure, as far as possible, that the loss from a frustrated contract falls to both parties fairly.

In ***Gamerco SA v. ICM/Fair Warning (Agency) Ltd (1995)***, the claimants, pop concert promoters, agreed to promote a concert to be performed by the defendant pop group at a stadium in Madrid. However, the stadium was found to be unsafe and the authorities banned its use. The permit issued to the claimants to hold the concert was revoked, a suitable alternative venue could not be found and the concert was cancelled.

The claimants sought to recover an advance payment made to the defendants. By way of counter claim the defendants sought damages for breach of contract by the claimants in failing to secure the permit.

HELD: It was an implied term of the contract that the claimants would use all reasonable endeavours to obtain a permit for the concert. The contract was frustrated, not because the permit had been revoked, but because the stadium, the proposed venue, had been found to be unsafe and its use banned. The **1943 Act**, Section 1, entitled the claimants to recover the advance payment made to the defendants and in all the circumstances of the case, the court's discretion would be exercised in favour of the claimants. Accordingly, the claimants' claim would succeed and the counter-claim would be dismissed.

The Act does, however, exclude charter-parties, except for time-charter-parties and charter-parties by way of demise, and carriage of goods by sea – the reason being that maritime practice has evolved adequate safeguards through the marine insurance industry.

Force Majeure

You may well have heard the term "*force majeure*" used. Strictly, it is a continental concept which is unknown to the law of England. It is akin to, but perhaps less draconian than, the English doctrine of frustration.

However, the term is recognised and commonly applied, especially in building and engineering contracts. The parties agree in their contract to have what is known as a "*force majeure*" clause. This means they agree that, in the event of either or both of certain specified events occurring, and any circumstances beyond the control of either party arising, they will act in a specified manner.

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It is, therefore, a contractual term and should one of the frustrating events occur, the remedy is agreed upon beforehand. The question, therefore, of frustration arising by operation of law does not occur. Provided the event is covered by the *force majeure* clause, the agreed remedy is enforceable. If the event is, however, outside the terms of the *force majeure* clause, the doctrine of frustration can come into play in the normal way.

E. REMEDIES FOR BREACH OF CONTRACT

Damages – General

The principal remedy for breach of contract is an award of damages. Hence, an appreciation of the nature and purposes of damages is important.

The essential point is that damages are **compensation** to the injured party for the loss she has suffered as a result of the other party's breach of contract, the object being to place her in the same position as she would have been in had the contract been properly performed. Damages are not a punishment, nor are they a means of intimidating a party into properly performing by fear of a penalty.

In ***Malik and Others v. Bank of Credit and Commerce International SA (1995)***, the claimants had held senior positions as employees of the defendant bank at its various branches. They were made redundant when the bank was forced into liquidation following discovery of large-scale fraud at director level within the bank and were unable to secure work within the financial services industry. They accordingly sought compensation for breach of an implied term within their contracts of employment that their employers would so conduct their business that no stigma would become attached to its employees.

HELD: The claimants' claim related to harm done to their existing reputations and could not succeed.

The court stated, "... *damages are not recoverable in contract for damage to or loss of an existing reputation*" because such damage or loss is not attributable to a failure to provide consideration for an aspect of the employment contract. Such cases where consideration had failed had been concerned with the nature of the contract itself, for example an apprenticeship contract when the apprentice had been dismissed for the absence of training and instruction which his employer was obliged to provide, or the loss of an opportunity to enhance a reputation in a theatrical artiste's contract because of failure to provide him with prestigious parts or roles: ***Withers v. General Theatre Corp. Ltd (1993)***.

A duty to mitigate or minimise the loss is often presumed by the courts, although the burden of proving that the claimant has not done so is placed on the defendant. The emphasis, however, is on what is "**reasonable**" in the circumstances. If, for example, a claimant in reasonably attempting to mitigate her loss actually makes it worse, she will not be penalised for her actions. She will be able to recover her actual loss even though she herself has increased it.

In ***Pilkington v. Wood (1953)*** a solicitor wrongfully advised Pilkington that the title to his new house was good (in effect this meant there were no legal difficulties in establishing ownership). The solicitor argued that Pilkington should have mitigated his loss by suing the seller for conveying a defective title.

HELD: It was unreasonable to expect Pilkington to embark on a lengthy and complicated action in order to protect his solicitor from the consequences of his own carelessness.

In ***Abrahams v. Performing Rights Society (1995)***, the claimant was employed on a five-year contract, under which he was entitled to two years' notice of termination of employment, or an equivalent payment in lieu of notice if his employment was terminated at the end of the five-year period.

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After the five years had expired, the parties were unable to agree on the terms of a new contract, but it was agreed that the claimant was to remain in his post for a further two years "*subject to the same terms as the previous contract*". When the claimant was dismissed seven months later, he claimed payment from the defendant for salary for the remainder of the two-year period. The defendant contended that the claimant was obliged to mitigate his losses.

HELD: The provisions of the old contract, relating to notice and payment in lieu, applied to the two year contract of employment. As the defendant had elected to terminate the contract before the end of the two year period, it was bound to pay the claimant the amount due in lieu of notice for the remainder of that period. The claimant had a contractual entitlement to this payment and there was no duty on him to mitigate his losses by seeking employment elsewhere for the remainder of the period.

There are various terms used to describe the different categories of damages.

(a) General and special damages

Loss has to be proved in order that damages may be assessed. However, it is not always possible precisely to calculate the exact amount of the loss. How do you exactly quantify loss resulting from pain and suffering"? You cannot – so, the law presumes that loss results from the infringement of certain legal rights or duties. The fact that loss has been sustained must be proved – but not the precise amount. These are called "general" damages. It is the job of the court to put a monetary figure to them. "Special" damages are those which can be **precisely calculated**.

(b) Nominal damages

These are awarded where a claimant's legal rights have been infringed, and he/she is entitled to damages, but he/she has, in fact, suffered no actual loss. They are, often, really only to establish the fact that a right has been infringed and they can be as little as 1p.

(c) Liquidated and unliquidated damages

If the parties have made no mention of the subject in their contract, then, in the event of any breach, the injured party must prove his/her loss. The resulting award is called "unliquidated" damages. However, for a variety of reasons, the parties may decide beforehand that, in the event of a specific breach, the loss suffered will be assumed to be a certain figure, or in accordance with a certain scale. It may be difficult or expensive and time consuming to have to calculate the exact figure so the parties make a **pre-estimate** of the likely loss and insert this in the contract as the sum payable if that breach does occur. These are called "liquidated" damages. If the particular breach does occur, the agreed sum becomes due, quite regardless of the actual loss sustained or indeed if any loss at all. The distinction between liquidated damages and penalties (or punishments) can be fine and we shall discuss it later in this study unit.

Damages – Causation

It is essential that the loss suffered must have been caused by the breach of contract. There must be a direct **chain of causation** between the breach of contract and the loss suffered. If something or someone intervenes to break this chain, it cannot be said that the breach caused the loss.

- The intervention can be by a third party. In ***Weld-Blundell v. Stephens (1920)***, P wrote a libellous letter which, in breach of contract, D left lying where a third party could read it. The third party was likely to – and, in fact, did – pass on the contents to the person libelled in the letter. The latter recovered damages from P. P then sued D for breach of contract.

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HELD: P could recover only nominal damages, and not the amount of the libel award and costs. The act of the third party broke the chain of causation and was a new and independent cause.

- If an event occurs which could not reasonably have been foreseen, this may break the chain of causation. In ***Monarch Steamship Co. Ltd v. Karlshamns Oljefabriker A/B (1949)***, a ship was chartered, in 1939, to carry a cargo from Manchuria to Sweden. It was a contractual term that the ship should be seaworthy. She should have reached Sweden in July. Owing to breach of the condition of seaworthiness, she was delayed until September, by which time war between England and Germany had broken out. By order of the British Admiralty, she was unloaded at Glasgow.

  A claim was made for the cost of shipping the cargo in a neutral vessel from Glasgow to Sweden.

  HELD: Reasonable businessmen, knowing of the possibility of war, would have foreseen that delay would lead to diversion. Hence, the breach of contract was the direct cause of the loss, which was, therefore, recoverable.

  Had the same situation arisen off the Falkland Islands in 1982, the result would, no doubt, have been different. Reasonable people could, probably, not have foreseen the Argentinian invasion.

Damages will **not** be awarded if a claimant's loss is regarded as **too remote**.

Only damages, which were in the contemplation of the parties at the time of entering into the contract, are recoverable. The parties must have considered the possibility of those damages arising if they were in breach of contract. Damages will not be awarded for something, which was unlikely to happen, i.e. something, which is too remote a consequence of the breach will not be compensated.

The principles to be applied in determining whether damage is too remote were set out by the court in ***Hadley v. Baxendale (1854)***: the plaintiff may recover damages:

- For loss arising naturally, in the 'usual course of things', as a probable result of the breach (known as **'normal loss'**)
- For loss which was in the 'reasonable contemplation' of both parties at the time the contract was made, as a probable result of the breach (known as **'abnormal loss'**).

As a consequence of the **first limb** of the rule in ***Hadley v. Baxendale,*** the party in breach is deemed to expect the normal consequences of the breach, whether they actually expected them or not i.e. it does not matter that they did not actually think of the consequences if those consequences were the natural outcome of their breach. Normal losses are those losses which can be recovered without recourse to what either party thought would happen if the contract was breached:

In ***Hadley v. Baxendale*** a firm of carriers took a mill shaft for repair. Because they were late in returning it the mill owners suffered losses. The court held that the carriers could not have known that it was the only mill shaft and therefore, would not have known that losses would result from the late return of the mill shaft. The phrase used by the courts is "in the contemplation of the parties". Therefore, only losses which are in the usual course of things can normally be recovered, not anything unusual. However, unusual losses will be recoverable if the other party has notice of them at the time of entering into the contract i.e. if in the present case Hadley had, at the time of making the contract with Baxendale, drawn his attention to the fact that he did not have a spare mill shaft and that if Baxendale was delayed in returning Hadley's only mil shaft from the repairers in Gloucester it would result in his mill being out of action until such time as Baxendale returned with the repaired mill shaft.

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In ***Victoria Laundry (Windsor) Ltd v Newman Industries Ltd (1949)*** the plaintiffs, a laundry company, ordered a large boiler from the defendants, on whose premises it was currently installed. The defendants' contractors while being dismantled damaged it and delivery was delayed about five months while the boiler was repaired. The plaintiffs claimed for their lost profits, arising from the expected increase in business following their increased capacity (the demand for laundry services at that time being particularly heavy) and from a lucrative dyeing contract they would have been able to bid for. Streatfield J said those claims must fail because they had not drawn the special purpose of acquiring the boiler (i.e. to expand their business) to the defendants' attention but the Court of Appeal said it was enough that the defendants knew the plaintiffs were in the laundry business and knew in general terms the state of the market. The plaintiffs were entitled to recover the lost profits from the expected general increase in trade but not those from the dyeing contract, which would not have been in the reasonable contemplation of the other party.

Under the **second limb** of the rule in ***Hadley v. Baxendale***, the party in breach can only be held liable for abnormal consequences where they have actual knowledge that the abnormal consequences might follow: The question that has to be asked in such cases is 'what would a reasonable man foresee as a result of a breach of this particular contract: Victoria Laundry (Windsor) Ltd v Newman Industries Ltd (1949).

In ***The Heron 11 (1967*)** the respondents had chartered a ship from the appellants to carry a cargo of sugar to Basrah. The ship made various unauthorised deviations during the voyage, and consequently arrived about nine days later than it should have done. During those nine days the price of sugar had dropped significantly and the respondents sued for the difference. The House of Lords dismissed the appellants' appeal from the Court of Appeal and upheld judgement in favour of the respondents. It is not enough, said Lord Reid, that a consequence may have been foreseeable as "a serious possibility" or "liable to result" (which is the rule in tort); the consequence must have been "quite likely" or at least "not unlikely".

The duty of mitigation

The innocent party in a breach of contract case has a duty to take all reasonable steps to reduce their losses. However, there is no duty to take extraordinary steps to mitigate. If you do not mitigate, the court will reduce your damages by the amount you could have mitigated. Another way of expressing this is to say that the plaintiff may not recover damages for losses, which could have been avoided. Mitigation can be divided into **three rules**:

- The plaintiff cannot recover for loss because of the defendant's breach of contract where he/she could have avoided it by taking reasonable steps
- The plaintiff cannot recover for any loss he has actually avoided even though he/she took more steps to mitigate than were actually necessary
- The plaintiff may recover loss incurred in attempting to mitigate even though he/she did not succeed.

The plaintiff cannot recover for loss because of the defendant's breach of contract where he/she could have avoided it by taking reasonable steps to minimise their loss sustained as a natural consequence of the defendant's breach: ***Brace v. Calder (1895)***.

In ***Payzu Ltd v Saunders (1919)*** after the plaintiff paid an instalment on goods late, the defendant offered to continue deliveries only if the plaintiff paid cash on delivery in future. Payzu refused, bought the goods at a higher price on the market and then took Saunders to court for the difference in price. The court held that the plaintiff had sustained an unnecessary loss, which he could have avoided by accepting the defendant's offer. Payzu had the cash and could have paid for the goods and still obtained them relatively cheaply from the defendant. No damages were awarded.

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Damages – Calculation

Two different measures can be used by the courts to calculate damages awards in breach of contract cases. The successful plaintiff has the right to choose which measure he would like the court to apply in calculating his unliquidated damages award.

(a) The expectation loss measure

If you did not expect to make a profit from the contract, this measure will not award you damages, as in order to claim contract damages, the plaintiff must have suffered a loss. Expectation loss compensates the innocent party for what he expected to gain from the contract. Obviously this will normally be loss of profit, especially in commercial contracts. However, it can be the cost of substitute performance. For example, if what you expected to gain from the contract was not a business profit but for example, a properly built swimming pool then expectation loss would be the cost of building the swimming pool or of remedying the defects in the swimming pool: ***Ruxley v Forsyth***. This is called cost of cure, which may be very different from the actual loss of value suffered because of the breach of contract. If the cost of cure is out of all proportion to the benefit obtained, it will not normally be awarded.

Generally speaking, if the plaintiff has contracted for a particular kind of benefit, he may be awarded the cost of cure for that particular benefit even though it is more expensive than is absolutely necessary, as the rule is that the plaintiff is allowed to insist on his or her full rights under the contract:

In ***Ruxley Electronics and Construction Ltd v. Forsyth (1995)***, the defendant contracted with the claimant company for the construction by the claimant company of a swimming pool in the defendant's garden, specifying a maximum depth for the pool of 7' 6". After completion of the work, it was discovered that the maximum depth was only 6' 9" and only 6' where swimmers would normally dive in. The defendant refused to pay the full contract price and counter-claimed against the claimant company for damages for breach of contract amounting to the cost of a new pool.

HELD: Although there had been a breach of contract, the shortfall in depth had not decreased the pool's value as a swimming pool and an entitlement of £2,500 for loss of pleasure and amenity would be awarded to the defendant. The court stated:

"Damages are designed to compensate for an established loss and not to provide a gratuitous benefit to the aggrieved party, from which it follows that the reasonableness of an award of damages is to be linked directly to the loss sustained .... The defendant has acquired a perfectly serviceable swimming pool, albeit one lacking the specified depth .... His loss is thus not the lack of a usable pool with consequent need to construct a new one. Indeed were he to receive the cost of building a new one and retain the existing one, he would have recovered no compensation for loss but a very substantial gratuitous benefit, something which damages are not intended to provide".

So, the position is that, in general, the full amount can be recovered of all types of damage that were reasonably foreseeable. This is so, even if the amount of damages under a foreseeable type is far more than could reasonably have been anticipated.

(b) The reliance loss measure

Sometimes reliance loss is a better measure of the loss suffered than expectation loss because it can be very difficult to establish the exact amount of expectation loss. This commonly occurs where the potential profit, which has been lost, was speculative and is therefore very difficult to quantify. You have acted in reliance on the contract. It is called reliance loss if you have suffered a loss because you relied on the contract. Usually you have spent money preparing your side of the bargain or you have lost the opportunity of entering into another contract you could have done because of the existing agreement. For example, a printer has agreed to do a print run, there is a breach of contract by the

other party, the printer has lost the opportunity to print somebody else's printing job. This can be claimed as contract damages. It is called reliance loss if you have suffered a loss because you relied on the contract.

Reliance losses can be claimed where the plaintiff has incurred substantial expenditure in reliance upon the contract. Damages may be recovered under this head even for expenditure incurred before the time the contract came into existence.

In ***Anglia Television v. Reed (1972)*** a television company, the plaintiffs, incurred various expenses in preparing a TV play and contracted with Oliver Reed to play the leading role. The defendant then repudiated the contract and the plaintiffs were unable to find a suitable substitute and so cancelled the play. The Court of Appeal said the plaintiffs could recover all their prior wasted costs because it must have been within the defendant's contemplation that there would have been such costs and that repudiation might lead to abandonment. These were reliance damages; any calculation of expectation damages would of course have been highly speculative. Lord Denning MR made it clear, however, that an injured party cannot have both expectation and reliance damages – that would compensate him twice for the same loss.

Liquidated Damages or Penalties

As we have seen, liquidated damages are permissible; penalties are not. Liquidated damages can be defined as "a genuine pre-estimate of the damage likely to occur in the event of breach of contract or a specific breach of contract". The essential thing is that they must be a **genuine pre-estimate**. These will be enforced.

If, on the other hand, the agreed sum is, in fact, a penalty to terrorise the other party into performing, then it is unenforceable. This does not mean that the guilty party gets off scot-free. All it means is that the so-called "liquidated damages clause" will be struck out, and the innocent party has to prove his/her **actual** loss. This could well be more than the supposed liquidated damages or penalty.

The distinction between liquidated damages and penalties was explained in ***Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Ltd (1915)***. Here a contract between the parties required the defendants to observe Dunlop's price list for certain products. The contract stated that for every sale other than at a listed price the defendants would be required to pay £5 by way of liquidated damages and not as a penalty.

HELD: The sum was liquidated damages and so was recoverable.

The House of Lords in this case made a number of general points which help to distinguish the two categories:

- The terms used by the parties are not conclusive since the distinction is a matter of law
- A sum will be treated as a penalty if it is "extravagant and unconscionable in amount" in comparison with the greatest loss that could conceivably be proved to have followed from the breach
- It will be a penalty if the breach consists of not paying a sum of money and the sum stipulated is far greater than the sum which ought to have been paid
- There is a presumption that it is a penalty when a single lump sum is payable by way of compensation on the occurrence of one or more of several events, some of which may occasion serious and others trifling damage.

On the other hand:

- It is no obstacle to the sum stipulated being a genuine pre-estimate of the damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility.

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In relation to the above five principles stated by the House of Lords in ***Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Ltd (1915)***, the following recent case should be noted.

In ***Nutting v. Baldwin (1995)***, the defendant was a member of an association composed of Lloyd's names from certain syndicates who had formed the association in order to bring actions against their managing agents for *(inter alia*) alleged negligent advice. The association resolved to levy additional subscriptions under powers contained in the association agreement, but the defendant did not pay them, was declared a defaulting member and accordingly disentitled himself from sharing in any damages awarded to the association.

He applied to the court for a declaration that the power to declare him a defaulting member contained in the association agreement was a contractual penalty and therefore unenforceable.

HELD: It was an essential part of the arrangement between the association's members that, if a member ceased to contribute his share of the cost of bringing the legal actions against the managing agents, he ran the risk of being excluded from his share of the benefit of the arrangement and therefore the provision did not constitute a penalty. To allow a member, who had not fully undertaken his share of the risk by paying, properly, all the agreed subscriptions on time, to come in after the litigation had been successfully concluded, so that there was no longer any further risk of loss, and still share in the fruits of the litigation, would undermine one of the fundamental objectives of the constitution of the association.

Specific Performance and Injunction

These two orders are equitable remedies which can be sought if damages would not provide an adequate remedy. "Specific performance" is an order by the court compelling one party to perform the contract in accordance with its terms. It is a **positive** remedy. An injunction is **negative**. It commands a party not to commit a threatened breach of contract.

Both of these are discretionary, whereas damages are an absolute right. Neither will be granted if the claimant is him-/herself at fault for the breach of contract, or if it would be unfair to grant them. Nor will they be granted if damages would prove an adequate remedy, or if the effect of such an order would be disproportionate to the damage caused by a breach of the contract.

In ***Jaggard v. Sawyer (1995)***, the defendant's house was at the end of a private cul-de-sac, and having purchased some land behind his house he applied for and was granted planning permission for the construction of a house on the land so purchased. However, access to this new house could only be gained by use of the private estate road and over the garden of the defendant's house.

The defendant failed to secure the consent of the other estate property owners for use of the private road for access purposes, and the development breached the covenants which bound all the property owners on the estate without such consent. The defendant nonetheless proceeded with the construction of the new house, and after the work had advanced to a substantial extent the claimant, who was one of the other estate property owners, instituted proceedings for an injunction restraining the defendant from continuing with the work to complete the new house.

HELD: An injunction is an equitable remedy granted in the discretion of the court and if the claimant delays instituting proceedings until it is too late, an injunction will be refused. This was the case here, because the construction of the new house had reached an advanced stage before the applicant took steps to lodge proceedings for an injunction. Her only remedy was in damages for the failure by the defendant to secure release of the covenants to enable the owner of the new house to use the private estate road for access purposes. She was

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awarded £694 damages for use by the new house owner of the private road immediately in front of her property.

The courts are particularly wary of enforcing contracts for personal services. The fear seems to be that to allow such contracts to be enforced, usually by an injunction, could give an unfair advantage to the claimant.

In ***Warner Bros Pictures Inc. v. Nelson (1937)*** the court overcame this problem by deciding that granting an injunction to the applicants would have the effect of **encouraging** the defendant, a film actress, to perform her contractual obligation to work only for the claimants. Thus, the effect of the injunction was considered not to be to compel her to work for the claimants alone (though it would certainly have been strong encouragement). She could easily obtain employment in other areas of work where the interests of the claimants would not be affected.

By contrast, in ***Page One Records v. Britton (1968)*** the court refused to enforce a term in a contract whereby the defendant would employ only the claimants as his manager. The court took the view that if the term were to be enforced it would place the defendant in the difficult position of either employing the claimants or remaining workless.

It is probable that the second case represents a more realistic approach to such a situation and it seems that the courts are more likely to adopt the second approach as the norm.

In ***Warren v. Mendy (1989)*** it was **held** that a boxer could not be obliged to comply with a requirement in his contract to employ Warren as his manager for three years. The court considered that the breakdown in trust between the parties meant that it was unrealistic to seek to enforce it, not least because the contract involved the maintenance of skill and talent.

A special type of injunction which has developed substantially over the last decade or so is the **Mareva injunction** (now known as a **Freeze Order**), which is granted to prevent defendants in proceedings before the High Court from removing assets out of the jurisdiction with the aim of avoiding or frustrating the enforcement of any judgment against them.

In ***"The Mareva" case (1980)***, the Court of Appeal upheld an injunction to restrain the defendants from removing or disposing out of the jurisdiction money standing to the credit of the defendants in a London bank. The claimants were ship owners and the defendants were charterers under a voyage charter. The defendants had received payments for the freight in that bank account, but they had failed to pay the hire charges due to the claimants. (The term Mareva injunction derives from the name of the ship in this case.)

Such an injunction will normally be granted where it seems likely that the claimant will obtain judgment against the defendant but there is good reason to believe that assets of the defendant will be disposed of or dealt with in such a way as to prevent enforcement of the judgment. However, a Mareva injunction will not be granted if its effect would be some considerable interference with the rights of third parties. Any person who has notice or knowledge of a Mareva injunction must do all that is reasonable to safeguard the assets in question. If he/she aids and abets the defendant to dispose of them, he/she will be liable for contempt of court and punished accordingly. For example, if a bank is given notice of the injunction, it may act immediately and automatically to rescind any instructions given by the bank's customer concerning his/her account.

This type of injunction may be granted in regard to claims for debts or other liquidated sums. It may be granted in any commercial action and in actions for damages for breach of contract.

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Anton Piller Order (Search Order)

Another valuable addition to contractual remedies which has evolved in recent times is the Anton Piller order (now known as a **Search Order**). Like the Mareva injunction, it is a pre-emptive remedy designed to prevent a defendant from disposing of or dealing with material, property or assets in such a way as to frustrate enforcement of a judgment.

A court has an inherent power to make an order requiring the defendant to permit access to his/her premises with the object of searching for illicit materials and documents. The order also has the effect of permitting such property to be taken away, detained and kept in safe custody until the full trial of the action. Such an order was made originally in the case of ***Anton Piller KG v. Manufacturing Processes Ltd (1976)***. A Search Order order may be granted on an *ex parte* application to the court (i.e. in the defendant's absence). This is permissible because surprise is essential – if the defendant were to have prior knowledge of the application, there would be a risk that he/she would destroy or hide the property in question.

The court may grant a Search Order where the property comprises articles which infringe the claimant's copyright, trade mark or other rights. It will seek to safeguard the defendant's rights by ordering that the items in question be placed immediately in the custody of a responsible person on behalf of the claimant. An order may also be made for the preservation of a document amounting to best possible evidence where there is a real danger of its being destroyed or hidden by the defendant.

Limitation of Action

It is considered wrong that a person should have the liability hanging over his/her head indefinitely. Consequently, the **Limitation Act 1980** provides that no action may be taken to enforce a contractual claim more than six years after the cause of action arose, in the case of simple contracts, or 12 years in the case of contracts under seal.

In ***Aiken and Others v. Stewart Wrightson Members' Agency Ltd (1995)***, the claimants were all Lloyd's names and sought damages for breach of contract from the defendants, who were their agents at Lloyd's. Some of the contracts in question had been made under seal. The question before the court was whether the claimants who were parties to those contracts were entitled to the benefit of the 12 year limitation period under Section 8(1) of the **Limitation Act 1980**, which states:

> *"An action upon a specialty shall not be brought after the expiration of 12 years from the date on which the cause of action accrued".*

HELD: The claimants were entitled to the 12 year limitation period under the Act because an "action upon a specialty" included an action based on a contract under seal. It was not possible to contend that the contractual relationship between the parties was governed by the ability of the claimants to seek specific performance of the contracts, which is in the discretion of the court, as the defendants had sought to do.

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Study Unit 8

The Sale of Goods 1: The Contract, Property and Title

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A. SALE OF GOODS

In the previous study units we have outlined the law of contract. These principles apply to all contracts, whatever their purposes, except in the rare instances where statute or common law modifies the general rules.

However, various special types of contract have additional rules superimposed on the general ones, which are applicable only to those particular contracts, namely:

- For the sale of goods
- Of agency
- Of instalment
- Of insurances
- Of carriage of people and goods by sea, land and air
- Of guarantee or suretyship, and so on.

In this course, the special types of contract we shall be looking at are sale of goods and agency, starting here with the former.

Sale of Goods Act 1979

This Act consolidates the previous law on sale of goods. Like its predecessor, **Sale of Goods Act (1893)** it is designed to complement and codify the common law. It sets out the rules, but in many instances allows for these to be altered or waived by agreement between the parties. In particular, Section 62(2) states:

> *"The rules of the common law, including the law merchant, except in so far as they are inconsistent with the provisions of this Act, and in particular the rules relating to the law of principal and agent and the effect of fraud, misrepresentation, duress or coercion, mistake, or other invalidating cause, apply to contracts for the sale of goods".*

The Sale of Goods Act 1979 has been amended by: the **Sale of Goods (Amendment) Act 1994**, which abolished the ancient custom of market overt; by the **Sale and Supply of Goods Act 1994**, which replaced the implied condition of "*merchantable quality*" with that of "*satisfactory quality*" and also amended the rules on acceptance of goods by a buyer; and most recently by the **Sale of Goods (Amendment) Act 1995**, which amended rules about partial deliveries. We shall discuss these amendments in later study units.

The Contract of Sale

It is important to appreciate just what a **contract of sale of goods** is.

Section 2(1) provides as follows:

> *"A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price".*

Section 61(1) extends this by stating:

> *"In this Act, unless the context or subject matter otherwise requires, 'contract of sale' includes an agreement to sell as well as a sale".*

Any other type of transaction in which the property in goods passes from one person to another is not a sale of goods such as to come within the ambit of the Act. For example, contracts for "work and materials" are not such, nor are contracts of barter. These are covered by the general law, not the Act.

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In fact, contracts for work and materials were brought substantially into line with the Act by virtue of the **Supply of Goods and Services Act 1982**, of which more later.

The important thing to remember is that, to be covered by the Sale of Goods Act, the transaction must be for a price in **money**.

Subject-Matter of the Contract

It is fairly obvious that the contract must be in respect of "goods". But what are goods? Section 61(1) defines them as follows:

> *"Goods includes all personal chattels other than things in action and money; and in particular 'goods' includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale".*

"*Things (or choses) in action*" are intangible rights that cannot physically be handled – such as patents, copyrights, shares, securities, etc. – and "*emblements*" are products created by annual industry, or the profits of a crop which has been sown. Wheat is an emblement, but grass is not.

So, in other words, "*goods*" covers not only those things which are **normally associated** with the word, but also agricultural produce, cut timber and so forth. In particular:

(a) **Motor cars** are in all respects goods.

(b) **Ships and aircraft** are covered by the definition, but they are subject to special rules, and certain aspects of the law of sale of goods cannot apply to them.

(c) **Coins**. Current coins of the realm are money, and therefore not goods. But collectors' pieces, even those which are current legal tender but which have a market value in excess of their face value, may be goods: ***Moss v. Hancock (1899)***.

(d) **Water, oil, gases** are capable of being bought and sold as goods, so come within the definition. For example, when you buy a cylinder of CO_2 for a soda stream, you are certainly buying goods other than just the metal cylinder.

(e) **Electricity**. There is some doubt about this. It is probably best to say that electricity is not goods but other forms of power may be.

In ***Bentley Bros v. Metcalfe & Co. (1906)*** a landlord hired a machine to his tenant. He also supplied the mechanical power by means of a shaft to drive it.

HELD: The power to drive the machine was consumed in the process; therefore it was bought and not hired.

(f) **Domestic animals** are goods but wild animals are not.

(g) **Buildings**, while attached to the land on which they stand, are not goods but if they are demolished and sold, the constituent parts then become goods.

Classes of Goods

Goods fall into different categories and inevitably somewhat different rules must apply to them.

- Section 5(1) of the Act breaks them down into "*existing goods*" and "*future goods*".

  "The goods which form the subject of a contract of sale may be either existing goods owned or possessed by the seller, or goods to be manufactured or acquired by him after the making of the contract of sale, in this Act called future goods".

- Goods can be "specific", "ascertained", or "unascertained". Section 61(1) defines specific goods as "*goods identified and agreed on at the time a contract of sale is*

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made". "Unascertained" goods are not defined by the Act, but by necessary inference mean goods which have not been specifically identified at the time of the contract as the actual goods, the ownership of which will pass to the buyer. (For a definition of "ascertained" goods, see below.)

Let us look at these categories in more detail.

(a) Existing goods

These present few difficulties. They are goods which are actually in existence – that is, substantially in a state in which the possession of them is capable of being transferred, at the time the contract of sale is made.

(b) Future goods

These are goods which are **not in existence** at the time of the contract. Therefore, there cannot be a sale of them at that time, but only **an agreement to sell** when the goods are actually in existence. Section 5(3) makes this clear:

> *"Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods".*

Goods that fall into this category may have to be manufactured before they become specific, or they may have to be grown. A contract to sell next year's barley crop from a particular field is an agreement to sell that crop **when it has been grown**.

An agreement to sell future goods is, of course, a contract like any other, and if the seller fails to produce the goods at the proper time he/she will be in breach. There are, however, two points to note. Firstly, this is one area where equitable principles **do not apply**. A buyer cannot get an order for specific performance of a contract for future goods.

In ***Re Wait (1927)***, W contracted to buy 1,000 tons of wheat from the USA which had not been shipped. Next day he sold 500 tons of this same wheat to a sub-buyer, who promptly paid for it. W then went bankrupt, and his trustee claimed to be entitled to the whole 1,000 tons. The sub-buyer sought an order for specific performance.

HELD: He could not obtain it.

(c) Specific goods

Specific goods are not only existing goods but are essentially the actual goods **which will pass under the contract**. If you want to buy a dozen screws, you can go to a DIY shop and take off the shelf a packet containing 12 screws. These are specific goods. Alternatively, you can go to an old-fashioned ironmonger, who will take down a box containing a gross of screws; they do not become specific until the 12 you are actually buying have been counted out.

(d) Ascertained goods

Ascertained goods are goods identified by both parties, e.g. "two of those bottles of port". In the Act, they are treated as specific goods.

(e) Unascertained goods

Goods which are in existence (usually), but which have not been specifically identified as the goods forming the subject matter of the sale, are "unascertained". When they have been so identified, they become "ascertained". In ***H R & S Sainsbury Ltd v. Street (1972),*** it was **held** that a contract to buy a specified quantity of produce to be grown in a particular field was a contract for unascertained goods.

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There can be complications. In ***Reardon Smith Line Ltd v. Yngvar Hansen-Tangen (1976)*** a contract was made to charter a ship which was to be built in Japan. Before construction started she was identified by a hull serial number.

HELD: It was a contract in respect of **ascertained** future goods.

The point of this is that the vessel could not be "specific" goods until completion, but the yard's serial number was sufficient identification to make her "ascertained" from the outset.

It is important to be clear on these definitions, as they will crop up throughout the subject, and different results will often flow depending on the type of goods involved.

B. DISTINCTION BETWEEN SALE AND OTHER SUPPLY CONTRACTS

As we have mentioned, a "sale of goods", within the meaning of the Act, is where goods are sold or agreed to be sold for a money consideration. However, there are many other transactions in which property in goods passes but which are not sale of goods.

Gifts and "Free" Promotional Offers

As you will doubtless remember from an earlier study unit, if no valuable consideration is given, an agreement to transfer the property in goods is a **gift**, not a contract (unless under seal). But whether under seal or not, it cannot be a sale of goods, because there is **no price**.

The situation is more complicated where a trader offers "free" goods to customers as an inducement to buy other goods (e.g. a garage offering a free glass tumbler for every ten litres of petrol bought).

In ***Esso Petroleum Co. Ltd v. Customs & Excise Commissioners (1976)***, the House of Lords **held** that in such a case there was no "sale". But the reason why was unclear. The House was divided on whether this was because the consideration for the "free gift" was not a money price as required by the Act, but instead the entering into of the main contract to buy petrol; or whether it was because the offer was a promise of a "gift", and therefore no contract.

But, for whatever reason, it is not a sale of goods.

Barter or Exchange

This occurs where the consideration for a sale is not a price in money, but **other goods**, in whole or in part. Where the deal is wholly goods for goods in return, the position is simple; the **Sale of Goods Act** has no application. Indeed, it was **held** in ***Read v. Hutchinson (1813)*** that a party to such a contract who had parted with goods in purported exchange for others could not sue for the price of them.

Where, however, the bargain is partly in goods and partly in money, the situation may be different.

In ***Aldridge v. Johnson (1857)***, a contract was made for 32 bullocks valued at £192 plus £23 in cash, in exchange for 100 quarters of barley valued at £215. The court construed this as a reciprocal sale of goods.

However, had the items not been valued, and the agreement merely been for bullocks plus cash for barley, then it would have been barter.

Where nowadays you get a consideration which is partly in money and partly in goods – i.e. a "trade in" such as you effect when trading in an old motor car in part exchange for a new

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one – the legal position can go either way, depending on the circumstances. It can be that the **Sale of Goods Act** will apply to both transactions, that is, a sale of a used car by one party, followed by the purchase of a new car by the same party. Or it can be construed as only one transaction – as the sale of the new car, together with a subsidiary agreement to deliver the used car for an agreed allowance off the price of the new. It will depend on the wording of the contract, and the circumstances.

Trading Stamps

The exchange of trading stamps for goods is barter: **Trading Stamps Act 1964**.

Work and Materials

It can sometimes be difficult to decide whether a contract whereby a person supplies goods as part of a wider contract to undertake work is, or is not, a sale of goods. At one end of the scale, there is the case of a builder erecting a house. As part of the contract he/she is required to provide the bricks, the plumbing and so on. The property in these items passes to the purchaser at one stage or another, but their provision is not covered by the **Sale of Goods Act**. It is strictly a contract for work and materials. However, what is the status of a contract with a tailor to make a suit of clothes? In ***Lea v. Griffin (1861)*** the test was laid down to be "*whether the contract was intended to pass the property*". On this test, the suit of clothes would be a sale of goods. On the other hand, in ***Robinson v. Graves (1935)*** a contract to paint a picture was **held** to be one for work and materials only.

Where materials are supplied wholly or mainly by the employer, then there can be a sale of goods only if there are **two** distinct transactions – firstly, the materials being transferred to the manufacturer, and secondly a sale back of the finished article.

In ***Dixon v. London Small Arms Co. (1876)***, rifles were made by the company for the Crown. The rough stocks and the barrels were supplied by the Crown, and an agreed set-off figure for them was deducted from the price.

HELD: It was a contract for sale of goods.

Fortunately, for the peace of mind of all of us, the distinction is somewhat academic. Previously, the courts invariably applied the provisions of the **Sale of Goods Act** by analogy to the goods supplied under contracts for work and materials, so the net result was the same. Now, the **Supply of Goods and Services Act 1982** has applied most of the implied warranties as to title, satisfactory quality, fitness for the purpose, etc. (see later study units for details) of the **Sale of Goods Act** to goods supplied under contracts for work and materials.

Hire

According to Section 6 of the **Supply of Goods and Services Act 1982**, a contract of hire is a contract under which a person bails or agrees to bail goods to another by way of hire.

As with contracts for the sale of goods, certain terms are implied – namely, that the goods hired shall be of satisfactory quality and that they shall be reasonably fit for the customer's purpose where the supplier has been notified of the intended purpose.

The main difference between sale and hire is that the **supplier of hired goods remains the owner** of them, and any failure by the hirer to take reasonable care of the goods hired may result in an action being taken against him or her. Since it is not the intention of the parties that the hirer should become the owner, any disposal by the hirer of the goods hired could result in a prosecution.

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C. FORMATION OF CONTRACT OF SALE

Agreement

The general principles of contract apply to the formation of a contract of sale of goods. However, there are a few aspects of the common law rules, which we have discussed in previous study units, that are particularly applicable to sale of goods contracts and which we should emphasise.

(a) Offers or invitations to treat

It is very well established at common law that goods displayed in a shop with a price label on them do not constitute an offer by the shopkeeper to sell at that price, or to sell at all. The offer to buy is made by presenting the goods to the shopkeeper or till cashier, and if no words are spoken it is implied that the purchaser is offering to buy at the price indicated on the label. Acceptance is made by the shopkeeper ringing up the price on the till, or making some other implied act of acceptance: ***Timothy v. Simpson (1834)***); ***Pharmaceutical Society of GB v. Boots Cash Chemists (Southern) Ltd (1952)***.

A statement of the price on a petrol pump is not an offer to sell: ***Esso Petroleum Co. Ltd v. Customs & Excise Commissioners (1976)***.

It has not been established whether the price on a "self-serve" pump is any different: is it an offer to sell, or an invitation to treat? I think this must be an exception. It is surely straining credulity too much to assert that putting petrol into the tank of your car yourself is only an "offer to buy". It must surely be an acceptance by implication. In which case, if this argument is correct, the price on the self-service pump must be an offer to sell at that price.

This view is supported by ***Thornton v. Shoe Lane Parking Ltd (1971)***, where it was **held** that a display in an automatic vending machine was an offer capable of acceptance by the customer by inserting the appropriate money.

(b) Sales by auction

There are special rules applicable to auction sales, which are codified by the **Sale of Goods Act 1979, Section 57**. The Section extends beyond merely the formation of the contract but for convenience we will summarise all the provisions here.

- Each "lot" is *prima facie* a **separate contract of sale**.
- The sale is completed when the auctioneer signifies acceptance by the fall of the hammer, or in any other customary manner. **Before that time**, any bidder may withdraw his or her bid.

  The principle of offer and acceptance is, of course, maintained. An offer can always be withdrawn at any time before acceptance (unless stated to be irrevocable). A bid at an auction is simply an **offer**.
- An auction sale may be subject to a "reserve" price, provided the existence of the reserve (but not its **amount**) is notified beforehand.

  The necessity for this is that if the existence of a reserve price is not announced, a disappointed buyer could sue the auctioneer for breach of an implied collateral contract that the sale would be "*without reserve*": ***Haslow v. Harrison (1858)***.

  The buyer could not sue for breach of the contract of sale, because no contract is concluded until the hammer falls. Provided notice of reserve has been duly given, the fall of the hammer is not conclusive evidence of acceptance if in fact the reserve price has not been reached: ***McManus v. Fortescue (1907)***.

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- A right to bid may be expressly reserved by or on behalf of the seller; however, if such a right has not been duly reserved, it is unlawful for the seller to bid himself, or for anyone else to do so on his behalf. Likewise, it is unlawful for the auctioneer knowingly to accept such a bid. If such does occur, the buyer can treat the sale as **fraudulent**.

(c) Standard or printed terms of contract – the "battle of the forms"

You will be familiar with the almost universal practice of having standard conditions of sale or purchase printed on the back of business documents. They present lawyers with fascinating problems, and their users with often unexpected results! The problem revolves around whose standard terms govern the contract, the seller's or the buyer's?

What happens is this:

- A buyer sends off a request for a quotation, with her terms of purchase on the back. This document usually has no contractual effect; it is merely a **request for information**.
- The seller replies, giving the price on the front, and his conditions of sale on the back. This constitutes an **offer to sell on his terms**.
- The buyer then sends in an order for the goods, with once again her conditions of purchase on the back. These are invariably different from the seller's, hence it amounts to a **rejection of the offer followed by a counter-offer**.
- The seller replies with an "acknowledgement of order" with his sale terms on the back. So we then have a **rejection of the counter-offer**, followed by a **counter-counter-offer**. (As you know from earlier study units, there can be no contract until offer and acceptance coincide.)

This process can go on ad infinitum, with neither side having the faintest idea of the legal realities of the situation. But, finally, the seller will despatch the goods and the buyer will accept them. Only when trouble then arises do people start to query whose conditions govern the contract.

The short answer is that it is the terms printed on the **last piece of paper to be sent off** before the goods were finally despatched or accepted as the case may be, which govern the contract. But that is an oversimplification. If it was clear from the circumstances as evidenced by the written documentation that the parties intended to contract on the basis of one set of conditions or the other, then this would override any subsequent standard printed terms on the back of the parties' paperwork.

In ***Butler Machine Tool Co. Ltd v. Ex-Cell-O Corporation (England) Ltd (1979)***, the sequence of events went very much as outlined above. In the Court of Appeal, Lord Denning MR had this to say:

> *"There are yet other cases where the battle depends on the shots fired on both sides. There is a concluded contract but the forms vary. The terms and conditions of both parties are to be construed together. If they can be reconciled so as to give a harmonious result, all well and good. If the differences are irreconcilable, so that they are mutually contradictory, then the conflicting terms may have to be scrapped and replaced by a reasonable implication .... But I think the documents have to be considered as a whole. And, as a matter of construction, I think the acknowledgement of the 5th June 1969 is the decisive document. It makes it clear that the contract was on the buyer's terms and not the seller's terms."*

(The acknowledgement referred to by Lord Denning was a "tear-off" acknowledgement of order slip attached to the buyer's standard order form.)

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(d) Unsolicited goods

At common law if unsolicited goods are sent to a person, this constitutes an **offer to sell**. His/her use of them, or any conduct which renders the goods impossible to restore to the sender in substantially the same condition, amounts to an implied acceptance. The price must then be paid; however, the **Unsolicited Goods and Services Act 1971** substantially amends the common law rules, as follows.

If the goods are sent to the recipient with the intention that she should acquire them, and the recipient has no reasonable cause to believe that they were sent for the purposes of her using them in a trade or business, and she has not agreed to either acquire or return them, then she may use and deal with them as if they were a **gift**. The rights of the sender are extinguished, provided

(i) That for the six months from the date of receipt, the sender has not repossessed them, and the recipient did not unreasonably refuse to allow him to do so or,

(ii) That no less than 30 days before the six-month period expires, the recipient notifies the sender that the goods were unsolicited, and during the 30-day period after giving notice, the sender has not repossessed the goods, or been unreasonably prevented from doing so.

Remember the distinction between void and voidable (i.e. avoidable) contracts.

Formalities

There are no particular formalities required for a sale of goods. Section 4 provides that "*subject to [**this and**] any other Act, a contract of sale may be made in writing (either with or without seal), or by word of mouth, or partly in writing and partly by word of mouth, or may be implied from the conduct of the parties*".

Note the words "***this and***", which I have emphasised and put in brackets. They are redundant, and refer to a similar provision of the **1893 Act** which was repealed in 1954. The draughtsmen of the Act have slipped up here!

"Other Acts" to which the provision is subject are, for example:

- The **Consumer Credit Act 1974**, which requires certain credit agreements to be in writing and in a certain form
- The **Merchant Shipping Acts 1894 - 1979**, which require that a registered ship can be transferred only by means of a bill of sale, in prescribed form, and duly registered.

Parties

A contract for the sale of goods can be bilateral or multilateral. Throughout, the Act talks about only two parties, but there is no difficulty in applying the provisions to situations where there are three or more parties.

- Section 3(1) states that "the capacity to buy and sell is regulated by the general law concerning capacity to contract and to transfer and acquire property". The section goes on to spell out the general law as relevant with regard to contracts with minors and others incompetent to contract.
- Section 3(2) states that "where necessaries are sold and delivered to a minor or to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price for them".
- In Subsection (2) above, "necessaries" means "goods suitable to the condition in life of the minor or other person concerned and to his actual requirements at the time of the sale and delivery".

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You will recall that we discussed contracts with minors, and other people without full capacity, in a previous study unit.

Price

It is stated in Section 2(1) of the Act that the price must be in **money**. Section 8 goes on to provide that the parties may:

- Fix the price
- Leave it to be fixed in a manner agreed in the contract, or determined by a course of dealing between the parties.

But where it is not fixed or agreed in any of these ways, then the buyer must pay a reasonable price. What is "reasonable" depends on the circumstances of each case.

In ***Acebal v. Levy (1834)***, it was **held** that a "reasonable price" may or may not be the current market price of the commodity in question.

If it so happens that the price is agreed to be fixed by the valuation of a third party, and the valuer cannot or does not do this, the agreement is avoided . However, if all or part of the goods concerned have been delivered, the buyer is bound to pay a reasonable price for them: Section 9.

D. PASSING OF PROPERTY

Goods, at least specific goods, are **tangible** things which you can physically handle. But the mere fact that I can handle something does not necessarily mean that I own it. I may have found it abandoned, or have been lent it, or have stolen it. In none of these instances am I the **rightful owner**.

There are then four definitions which are fundamental, and which occur throughout the subject. **It is most important not to confuse them**.

- **Property**

  The "property" in goods is the **ownership** of them – the highest right to those goods that a person can have.

- **Title**

  "Title" to goods is often used as being synonymous with "property". But strictly it is the "right" to a person's property in goods, or the means whereby the right has accrued to someone, and by which it is **evidenced**. Blackstone defined it over two centuries ago as: "*the means whereby an owner has the just possession of his property*".

- **Possession**

  This is the **physical control** of the goods, or possession of them. It has no necessary connection with the property in them. If I steal something, I have possession of it, but I do not have the property in it, nor any title to it. Indeed, I do not even have a **right** to possess, and the right to possess may be vested in X, neither in me nor in the owner.

- **Risk**

  The "risk" in goods is the responsibility for loss, damage or destruction of those goods. It is not necessarily coincident with either property in or possession of those goods. We shall be dealing with "risk" in the next study unit.

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The Title of the Seller

You will remember from the previous study unit that Section 2(1) of the Act defines a contract of sale of goods as "*a contract by which the seller transfers ... the property in goods ... for a money consideration, called the price*".

Now if the seller does not in fact have the right to transfer the property, at common law the contract of sale is not necessarily void. It may be that the seller genuinely thought he had the right to transfer the property, or he may be transferring only such rights as he himself possesses.

Consequently, Section 12(1) of the Act lays down that "*there is an implied **condition** on the part of the seller that in the case of a sale he has a right to sell the goods, and in the case of an agreement to sell he will have such a right at the time when the property is to pass*". This is subject to Subsection (3) of Section12, which "*applies to a contract of sale in the case of which there appears from the contract or is to be inferred from its circumstances an intention that the seller should transfer only such title as he or a third party may have*".

It is, therefore, a condition of the contract of sale that the seller has, or will have, a right to sell. Breach of a condition permits the injured party – in this case, the buyer – to rescind the contract, and not merely rely on damages. By the same token, as the seller has no right to sell the goods, the buyer acquires no title to them.

In ***Rowland v. Divall (1923)***, Divall bought a motor car in good faith from a thief. He sold it to Rowland, a car dealer, for £334. Rowland then put it in his showroom, and duly sold it to a third party for £400. A couple of months later the police seized the car and returned it to the true owner. Rowland repaid the £400 to the third party and sued Divall for the price he had paid.

HELD (in the Court of Appeal): He was entitled to succeed, even though both he and the third party had had use of the car for several months and could not return it. The consideration for the payment had totally failed, as the buyer (Rowland) had not received any part of what he bargained for, that is the property and right to possession of the car.

There is now an exception to the rule in ***Rowland v. Divall*** by virtue of the **Torts (Interference With Goods) Act 1977**, which provides that in such cases, where "improvements" are made to the goods or use has been made of them, then in any action by the buyer against the seller, an appropriate allowance is to be offset – provided, that is, he/she has acted in good faith.

Furthermore, "*a right to sell the goods*", as stated by Section 12(1), is more than merely an **ability to pass a good title**.

In ***Niblett v. Confectioners' Materials Co. Ltd (1921)*** a consignment of tinned milk to be shipped from New York to London was bought. The milk arrived, carrying the label "Nissy" brand. At the instance of a third party, who claimed infringement of trade mark, the consignment was seized by Customs.

HELD: Section 12(1) was breached, as the seller did not have the "*right to sell*". The fact that the buyers' rights over the goods could be curtailed by injunction as infringing the rights of third parties was sufficient to ensure that the sellers had no right to sell.

In the event of chain transactions where goods are sold many times over before being repossessed by the rightful owner, then if (as is usually the case) the original seller is insolvent or has disappeared, the **first buyer from him/her** is the one who has to bear the loss.

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Freedom from Encumbrance and Quiet Possession

Section 12(2) of the Act provides:

- That the seller **warrants** that the goods are free, and will remain free, until property passes, from any charge or encumbrance not disclosed to the buyer before the contract is made
- "*that the buyer will enjoy quiet possession of the goods except so far as it may be disturbed by the owner or other person entitled to the benefit of any charge or encumbrance so disclosed or known*".

A **charge** or **encumbrance** is a right over the goods possessed by a person other than the owner. For instance, goods may be charged or mortgaged as security for a loan. The chargee or mortgagee then possesses rights with regard to the goods. The seller therefore warrants that no such charges exist, or only such as he/she has previously disclosed.

"Quiet" possession does not mean absence from noise. It means that it is warranted by the seller that nobody with any better rights to the goods will disturb the possession of them by the buyer; nor is the warranty confined to defects in title existing at the time of the sale.

In ***Microbeads AG v. Vinhurst Road Markings Ltd (1975)***, goods were sold which were not at the time subject to any patent rights. Subsequently a patent specification was published and a patent granted. The Court of Appeal **held** that Section 12(1) was not breached (i.e. the right to sell) but that the seller was in breach of Section 12(2).

The Effect of Passing of Property

The effect of passing the property in goods to the buyer is to transfer to him/her the title and full legal interest in the goods, subject only to any rights in the goods retained by the seller or by any third parties. It is a condition of the contract that any such retained rights are first disclosed to the buyer.

Before the property has passed, the seller can dispose of the goods to a third party, albeit in breach of contract with the buyer, and the third party will thereby acquire a good title to them. The reason is that the title is still vested in the seller until the property passes, hence he/she is at liberty to pass that title to someone other than the buyer. The disappointed buyer is, of course, entitled to damages for breach of contract, but not to the goods themselves.

The **exact point in time** when the property **passes** is most important in the event that either buyer or seller goes bankrupt (or, in the case of a company, into liquidation or receivership). In the event of the seller becoming insolvent while still in possession of the goods:

- If the property **has passed** to the buyer, he/she can, on tendering the price, demand the goods themselves from the liquidator or trustee in bankruptcy
- If the property **has not passed**, all the buyer can do is to seek damages for breach of contract. If the seller is hopelessly insolvent, this right may be worthless.

The **Sale of Goods Act 1979** provides rules as to when the property in goods sold passes, which we shall consider in detail in the following sections.

Specific Goods

The cardinal principle is that the property passes when the parties to the contract **intend it to pass**. In the case of specific goods, this is enshrined in Section 17(1) of the Act. Subsection (2) goes on to state:

> *"For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case".*

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In other words, you must first look at the agreement that has been made, whether it be written or oral, to see if it has specifically agreed as to when the property in the goods shall pass, and, if not, whether the intention can reasonably be inferred from the terms or the surrounding circumstances.

However, if this cannot be done, Section 18 sets out the rules for ascertaining the presumed intention of the parties.

(a) Rule 1

> *"Where there is an unconditional contract for the sale of specific goods in a deliverable state the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment or the time of delivery, or both, be postponed."*

So, under this Rule, property passes **when the contract is made**. There is no necessary requirement for the buyer to have possession, or to have paid the price. The passing of property is quite separate from the buyer's right to get possession of the goods, or the seller's right to be paid for them.

This is not as illogical as it sounds, for Section 28 states that:

> *"Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of the goods".*

The effect, therefore, is that in the ordinary simple transaction of buying something, Rule 1 and Section 28 taken in conjunction ensure that although the ownership of the goods may pass to the buyer, she won't get possession of them until she has paid. However, the parties are perfectly free to make whatever arrangements they like as to credit or time of delivery without necessarily affecting the time at which the property passes.

But Rule 1 is not quite as simple as that. In the first place, it is stated to apply only to an "*unconditional contract*".

There is some doubt as to what the Act means by this phrase.

Can any contract be unconditional? The literal meaning of the word is probably not intended, as Section 2(3) of the Act states that "a *contract of sale may be absolute or conditional".* Hence the learned authors of a leading textbook, *Benjamin's Sale of Goods*, suggest that "*unconditional*" means "*not subject to any condition suspensive of the passing of the property*".

Secondly, the goods must be "*specific*". Section 61(1) defines these: "'*specific goods' means goods identified and agreed on at the time a contract of sale is made*".

In ***Kinsell v. Timber Operators and Contractors Ltd (1927)***, it was agreed that all timber of a given height in a specific Latvian forest be sold. The buyer had 15 years in which to cut the timber. Shortly after the contract was made, the forest was expropriated by the state.

HELD: The timber sold was not "*specific goods*" as some of it had not at the time reached the minimum height, so could not be identified at the date of the contract. As a result, the property in the timber had not passed under Rule 1. This case shows the difference between ascertained and specific goods.

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Thirdly, the goods must be in a "*deliverable state*".

Section 61(5) defines this as follows:

> *"Goods are in a deliverable state within the meaning of this Act when they are in such a state that the buyer would under the contract be bound to take delivery of them".*

In ***Underwood Ltd v. Burgh Castle Brick and Cement Syndicate (1922)***, a stationary engine was contracted to be sold "*free on rail*" (for) London. At the time of the contract, the engine was bolted on to a concrete bed at the seller's premises. During the process of unbolting and dismantling for delivery to the railways, it was damaged.

HELD: The property had not passed at the time of the accident, as it was not in a "*deliverable state*".

However, remember that the presumption in Rule 1 as to when the property passes is subject to any contrary intention, express or implied, in the contract: ***Re Anchor Line (Henderson Bros) Ltd (1937)***.

(b) Rule 2

> *"Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until the thing is done and the buyer has notice that it has been done."*

Under this Rule it must be a requirement of the contract that the seller is **bound to do what is necessary**. Only if this is the case will the passing of property be suspended until it is done **and** the buyer has received notice of the fact. Notice does not necessarily have to be given by the seller, but any circumstances under which the buyer can be shown to be aware or have knowledge that the necessary thing has been duly done will suffice to give him/her notice.

Note also that this Rule applies only if the work to be done upon the goods is to be accomplished **before** delivery, e.g. it will not apply if a seller agrees to do certain repairs **after** delivery.

(c) Rule 3

> *"Where there is a contract for the sale of specific goods in a deliverable state but the seller is bound to weigh, measure, test, or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until the act or thing is done and the buyer has notice that it has been done."*

The essential point of this Rule is that the thing to be done must be for the purposes of ascertaining the **price**, and it must be an **obligation of the seller** to do it. This requirement was clearly brought out by the Privy Council in the following case.

In ***Nanka-Bruce v. Commonwealth Trust Ltd (1926)***, cocoa was sold at a price per 60lb load. It was known to the seller that the buyer would resell the cocoa to sub-buyers, who would only then weigh it at their premises.

HELD: The weighing by the sub-buyers was not a condition of the contract, and therefore it had no effect on the passing of property in the goods as between seller and buyer. Lord Shaw said:

> *"To effect such suspension (on the passing of property) or impose such a condition would require a clear contract between vendor and vendee to that effect. In this case there was no contract whatsoever to carry into effect the*

weighing, which was simply a means to satisfy the purchaser that he had what he bargained for and that the full price claimed for the contract was therefore due."

(d) Rule 4

"Where goods are delivered to the buyer on approval or on sale or return or other similar terms the property in the goods passes to the buyer:

a. when he signifies his approval or acceptance to the seller or does any other act adopting the transaction;

b. if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection then, if a time has been fixed for the return of the goods, on the expiration of that time, and if no time has been fixed, on the expiration of a reasonable time."

Goods delivered "on approval" or "on sale or return" are a familiar type of transaction, but clearly the rules as to when the property in such goods passes must be different. Of course, the overriding requirement of Section 17 – that it is the intention of the parties that governs the matter – still applies. Only if this cannot be ascertained, or unless a different intention appears, do the Rules in Section 18 come into effect.

- The importance of the **intention** of the parties being the deciding factor, notwithstanding that the contract is one of "*on approval*" or "*sale or return*" was brought out in ***Weiner v. Gill (1906)***. In this case, the written contract stated: "*On approbation. On sale for cash only or return. Goods had on approbation or on sale or return remain the property of the seller until such goods are paid for or charged*."

  The buyer pledged the goods to a third party, and such pledge would ordinarily constitute an act "adopting" the transaction.

  HELD: Notwithstanding the adoption by the buyer, the goods remained the property of the seller according to the terms of the contract.

  Again, in ***Kempler v. Bravingtons (1925)*** the claimant was a diamond merchant and he delivered a quantity of diamonds to B "*on sale or return*". The note which accompanied the diamonds stated that the claimant would charge B's account with the price of any diamonds which were not returned within seven days but, until B's account was charged, the diamonds belonged to the claimant. As soon as he received the goods, B sold them to the defendant and disappeared with the money. As B's account was not charged with the price of the diamonds at the time he sold them, it was **held** that the property in them still rested with the claimant. For this reason the claimant was able to recover the diamonds from the defendant.

- That pledging goods on approval or sale or return ordinarily constitutes adopting the transaction was **held** in ***Kirkham v. Attenborough (1897)***. The Court of Appeal decided that the property in goods pledged to a pawnbroker passed to the buyer by virtue of the act of pledge.

- In the event that the buyer neither accepts the transaction nor adopts, sub-paragraph b. above comes into play. A notice of rejection serves to determine the contract, and give the seller an immediate right to repossess the goods, notwithstanding that any time limit has not yet expired. If no notice of rejection is given, what constitutes a "reasonable time" depends on the facts of the individual case, any prior course of dealing between the parties, custom of the trade, or other relevant factors.

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- The next problem is what happens if the buyer under such a contract cannot return the goods. If the buyer has parted with the goods by his own voluntary act, he will be deemed to have adopted the transaction. But in ***Re Ferrier (1944)*** goods held on sale or return were seized by the sheriff in execution of a judgment debt. It was **held** that they were not "*retained by the buyer*", so no property passed, and the seller could recover them.
- If the goods are destroyed or lost without default by the buyer, either before any fixed time has expired (or if none, before a reasonable time) then, as the property has not passed, the buyer is not liable for the price.

  In ***Elphick v. Barnes (1880)***, a potential buyer took possession of a horse on condition that he could try it for eight days, and if it was not suitable, he could return it. On the third day, the horse died through no fault of the buyer.

  HELD: He was not liable for the price. But if the buyer is unable to return goods held on approval or sale or return because they have been lost or destroyed through some act or default of his own, or of those for whom he is responsible, then he will be liable for the price: ***Poole v. Smith's Cars (Balham) Ltd (1962)***.

  Similar considerations apply if the goods are returned damaged.

Unascertained Goods

The last categories of goods to which the rules for the passing of property apply (in the event that the intention of the parties is not expressed or implied) are unascertained and future goods.

Rule 5

"(1) Where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods then passes to the buyer; and the assent may be express or implied, and may be given either before or after the appropriation is made.

(2) Where, in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailer or custodier (whether named by the buyer or not) for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is to be taken to have unconditionally appropriated the goods to the contract."

A contract for the sale of unascertained goods or future goods is not in reality a contract of sale, but an "agreement to sell". Hence, obviously, no property in such goods can pass until (in the first instance) the goods have become specific, or (in the second), they have been produced and also become specific.

The point in time at which unascertained goods (and also future goods which when produced are still unascertained) become specific, and so capable of having the property in them transferred is often difficult to ascertain. In the first place, the Act requires that the goods must be "*appropriated*" to the contract. This can mean either that the seller or the buyer has selected the particular articles to which the contract will apply, or it is the act of separating out from bulk goods the actual goods which will be sold. Secondly, the appropriation must be **unconditional**.

In ***National Coal Board v. Gamble (1959)***, the NCB supplied coal under a contract by loading it from a hopper on to a lorry. The lorry was then driven to a weighbridge to ascertain the precise weight.

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HELD: The property in the coal did not pass until it had been weighed, and a ticket given to, and accepted by, the buyer.

The point was that although the coal was appropriated to the contract when discharged from the hopper into the lorry, it was not "unconditional" until weighed. The quantity might have been more or less than that contracted for.

Furthermore, there can be no appropriation until the actual goods to be sold are separated from the bulk. In ***Laurie & Morewood v. John Dudin & Sons (1926)***, a warehouseman was in possession of maize belonging to A. A sold some of it to B who resold it to C. B did not pay, so A stopped delivery.

HELD: As the bulk had not been severed, property in the maize had not passed to C.

Again, in ***Aldridge v. Johnson (1857)***, Aldridge agreed to buy a quantity of barley out of a particular parcel that he had inspected. He also sent some sacks for the purpose.

HELD: The property passed as soon as the seller filled the sacks.

However, the appropriation must actually have been carried out, not merely ordered.

In ***Healey v. Howlett & Sons (1917)***, P was a fish exporter in Ireland; D ordered 20 boxes of mackerel, whereupon P sent them with others by rail, and instructed the railway to earmark 20 boxes for D, and the remainder for other customers. Before the boxes were actually earmarked the train was delayed, and the fish deteriorated.

HELD: It was still at seller's risk, as the property had not passed to D.

Goods can be ascertained and appropriated to a contract by a process of exhaustion of the rest of the bulk. If all that finally remains of the bulk is the amount required under the particular contract, then that remainder becomes specific: ***Wait and Janes v. Midland Bank (1926)***.

In relation to unascertained goods there are new rules introduced by the **Sale of Goods (Amendment) Act 1995** (see below). Section 20A inserted by the Act provides that where a purchaser buys a specific quantity of goods from an identified bulk source and has paid for some, or all, of the goods forming part of the bulk, the buyer becomes co-owner of the bulk. This provides some protection in the event of the seller becoming insolvent. Property in the goods, however, does not pass until the goods become ascertained.

Ascertained means unequivocally and unconditionally appropriated to the contract.

In ***Carlos Federspiel & Co. SA v. Charles Twigg & Co. Ltd (1957)***, a manufacturer of bicycles was contracted to despatch the goods to the buyer in Costa Rica. The goods were packaged and crated and delivered to the dockside at Liverpool for shipment to Costa Rica, and labelled with the buyer's name. The contract was stated to be free on board, a term which implies that the property and risk in the goods transfer when the goods pass over the ship's rail, and not before unless agreed otherwise. Thus the court decided that the goods had not been appropriated to the contract in the circumstances of this case.

As Pearson J said in the case:

> *"A mere setting apart or selection by the seller of the goods which he expects to use in performance of the contract is not enough. If that is all, he can change his mind and use those goods in performance of some other contract and use some other goods in performance of this contract. To constitute an appropriation of the goods to the contract the parties must have had, or be reasonably supposed to have had, an intention to attach the contract irrevocably to those goods, so that those goods and no others are the subject of the sale and become the property of the buyer."*

On the other hand, in ***Hendy Lennox (Industrial Engines) Ltd v. Graham Puttick Ltd (1984)*** it was **held** that generators had been appropriated to the contract since each buyer

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had been sent an invoice and a delivery note bearing the number of the particular generator purchased and also because the seller had earmarked each generator in accordance with the invoice and delivery note.

Sale of Goods (Amendment) Act 1995

This Act amends the **Sale of Goods Act 1979** in relation to the sale of unascertained goods forming part of an identified bulk and the sale of undivided shares in goods.

In Section 18 of the 1979 Act, at the end of Rule 5 there is added the following:

> *"Where there is a contract for the sale of a specified quantity of unascertained goods in a deliverable state forming part of a bulk which is identified either in the contract or by subsequent agreement between the parties and the bulk is reduced to (or to less than) that quantity, then if the buyer under that contract is the only buyer to whom goods are then due out of the bulk -*
>
> *(a) the remaining goods are to be taken as appropriated to that contract at the time when the bulk is so reduced, and*
>
> *(b) the property in those goods then passes to the buyer."*

Section 1(2), Sale of Goods (Amendment) Act 1995: "*Bulk*" means a mass or collection of goods of the same kind which

- Is contained in a defined space or area and
- Is such that any goods in the bulk are interchangeable with any other goods therein of the same number or quantity.

Section 1(2) of the 1995 Act applies also (with the necessary modifications) where a bulk is reduced to (or to less than) the aggregate of the quantities due to a single buyer under separate contracts relating to that bulk and he/she is the only buyer to whom goods are then due out of that bulk.

Section 1 of the Sale of Goods (Amendment) Act 1995 now describes and deals with the circumstances in which property may pass in goods where there is a contract for the sale of a specified quantity of unascertained goods forming part of an identified bulk. The section allows a buyer of unascertained goods to become the owner in common of an identified bulk of goods, defines the legal relationship between buyer and seller in such circumstances and gives statutory effect to the doctrine of "ascertainment by exhaustion".

Section 1(3) of the 1995 Act introduces two new sections into the **Sale of Goods Act 1979**: Sections 20A and 20B, relating to undivided shares in goods forming part of a bulk.

The new Section 20A of the 1979 Act so introduced states as follows:

> *"(1) This section applies to a contract for the sale of a specified quantity of unascertained goods if the following conditions are met -*
>
> *(a) the goods or some of them form part of a bulk which is identified either in the contract or by subsequent agreement between the parties, and*
>
> *(b) the buyer has paid the price for some or all of the goods which form part of the bulk.*
>
> *(2) Where this section applies, then (unless the parties agree otherwise), as soon as the conditions specified in paragraphs (a) and (b) of subsection (1) above are met or at such later time as the parties may agree -*
>
> *(a) property in an undivided share in the bulk is transferred to the buyer, and*
>
> *(b) the buyer becomes an owner in common of the bulk.*

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(3) Subject to subsection (4) below, for the purposes of this section, the undivided share of a buyer in a bulk at any time shall be such share as the quantity of the goods paid for and due to the buyer out of the bulk bears to the quantity of goods in the bulk at that time.

(4) Where the aggregate of the undivided shares of buyers in a bulk determined under subsection (3) above would at any time exceed the whole of the bulk at that time, the undivided share in the bulk of each buyer shall be reduced proportionately so that the aggregate of the undivided shares is equal to the whole bulk.

(5) Where a buyer has paid the price for only some of the goods due to him out of a bulk, any delivery to the buyer out of the bulk shall, for the purposes of this section, be ascribed in the first place to the goods in respect of which payment has been made.

(6) For the purposes of this section payment of part of the price for any goods shall be treated as payment for a corresponding part of the goods."

Section 20B deals with deemed consent by a co-owner to dealings in bulk goods and states as follows:

"(1) A person who has become an owner in common of a bulk by virtue of Section 20A above shall be deemed to have consented to -

(a) any delivery of goods out of the bulk to any other owner in common of the bulk, being goods which are due to him under his contract;

(b) any dealing with or removal, delivery or disposal of goods in the bulk by any other person who is an owner in common of the bulk in so far as the goods fall within that co-owner's undivided share in the bulk at the time of the dealing, removal, delivery or disposal.

(2) No cause of action shall accrue to anyone against a person by reason of that person having acted in accordance with paragraph (a) or (b) of subsection (1) above in reliance on any consent deemed to have been given under that subsection.

(3) Nothing in the section or Section 20A above shall -

(a) impose an obligation on a buyer of goods out of a bulk to compensate any other buyer of goods out of that bulk for any shortfall in the goods received by that other buyer;

(b) affect any contractual arrangement between buyers of goods out of a bulk for adjustments between themselves; or

(c) affect the rights of any buyer under his contract."

Note the concept of **"*undivided shares*"**. If co-owners become owners in common, the interest of each co-owner is in a fixed share of the bulk. Although each owner in common has a fixed share, the bulk is not *per se* physically divided to give effect to those shares hence, it remains in undivided shares.

Reservation of the Right of Disposal – Commonly Called "Retention of Title"

Section 19 of the 1979 Act permits the seller of specific goods, or of goods which are subsequently appropriated to the contract, to reserve the right of disposal of the goods until specified conditions are met. Notwithstanding delivery, the property in goods does not then pass until those conditions have been met.

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"Reserving the right of disposal" means that the seller has the right to prevent the buyer from dealing with the goods as if they were his/her own, notwithstanding that he/she has possession of them.

The usual condition is payment of the price. If the seller does this, then as between buyer and seller, if the buyer in breach of the contract does dispose of the goods by, say, selling them to a third party, then he will be liable to the seller for "conversion". But by virtue of S.25, as between the buyer and the third party, if the third party takes the goods without knowledge of the original seller's reservation of lien, then he, the third party, acquires a good title. The transaction has the same effect as if the buyer were a mercantile agent in possession of the goods, or document of title to the goods. A mercantile agent in such a situation can pass on a good title, notwithstanding any defect in his/her own title: **Factors Act 1889**.

That was, at least until 1976, quite straightforward. Provided you are dealing with an homogeneous product which is bought and sold in its existing state, no great problems arise. However, in 1976 the Court of Appeal upset the applecart!

In ***Aluminium Industrie Vaassen BV v. Romalpa Aluminium Ltd (1976)***, now always referred to as "***Romalpa***", the facts were as follows. A sold Romalpa aluminium foil, reserving the right of disposal with these conditions:

- Property was to pass only when **all** sums owing to A had been paid
- Romalpa was to store the foil so that it was shown to be the property of A
- Articles manufactured from the foil were to become the property of A as surety for full payment
- Romalpa were to hold such articles for A in their capacity as "fiduciary owners", i.e. as it were, as trustees for A, their equitable owner
- Romalpa were entitled to sell such articles, but only on condition that they would hand over to A such rights as they possessed against sub-purchasers.

Romalpa duly manufactured articles from the foil, and sold them. Sub-purchasers paid Romalpa, but Romalpa went into receivership owing A money. A sought to recover unused foil, and claimed they had a charge over money received from sub-purchasers.

HELD: By reason of the relationship of bailor and bailee, a fiduciary relationship arose, and A were entitled to claim the proceeds of the sub-sales in priority to general creditors.

That case opened the floodgates and allowed unpaid sellers who had inserted appropriate "reservation of title" clauses in their contracts to claim money back from insolvent buyers long after the original goods had been turned into something quite different and sold. They are called **"Romalpa clauses"**.

However, the courts soon realised that ***Romalpa*** went too far, and they have been frantically backtracking ever since. The reasoning used is esoteric in the extreme, and goes far beyond the requirements of your examination. But briefly there are **two** facts:

- Depending on the precise wording of the Romalpa clause in each individual case, a seller may have reserved a "legal" title to the goods – that is, a title which is absolute and good against the whole world; or he/she may have reserved only an "equitable" title – that is, a title which is a fiduciary one only and which can be displayed by a person holding the **legal title**.

Or the seller may reserve both a legal and an equitable title.

- Under the **Companies Act 1985, Section 395(1)** (formerly the **Companies Act 1948, Section 95(1)**), if a company creates a "charge" over its property, that charge is void against a receiver or creditor if it is not **registered** as such. In certain circumstances a

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buyer allowing reservation by a seller of an equitable title is deemed to have created a charge over his/her property. It is almost inconceivable that he/she would in fact register it as a charge.

The first shot fired in the battle was in ***Re Bond Worth Ltd (1980)***. In that case, the clause in the contract reserved only "*equitable and beneficial*" title to the seller. It was **held** void against the creditors for non-registration.

At much the same time came ***Borden (UK) Ltd v. Scottish Timber Products Ltd (1979)***. Resin was sold to a manufacturer of chipboard, and the seller purported to reserve to himself the ownership of the chipboard made from the resin, until he had been paid in full.

HELD: Once the resin had been incorporated in chipboard it ceased to exist as such and therefore, the seller's title to it was destroyed.

Much the same result occurred in ***Re Peachdart Ltd (1983)***. Leather was sold with a reservation of title clause attached. The leather was made into handbags.

HELD: Once an individual piece of leather was appropriated to a handbag, it ceased to be the sole property of the seller, who then had only an equitable charge over it. This charge was void for non-registration.

However, in ***Hendy Lennox (Industrial Engines) Ltd v. Graham Puttick Ltd (1984)***, diesel engines were sold, and the buyer attached these engines to generators to produce diesel generator sets.

HELD: Provided the engines could be readily separated by merely unbolting them from the generators, the seller could effectively retain title to the engines.

The whole issue was described by Staughton J in ***Hendy Lennox*** as "*a maze if not a minefield*". The law is unclear; however, it is probably safe to assert that a seller can validly and effectively reserve title to goods sold if:

- He/she expressly reserves the **legal title**, and not merely the equitable title
- He/she expressly or by implication creates the relationship of **bailor and bailee**, especially by requiring the goods to be stored separately from other goods
- The goods retain their **existing state**, and are not converted into other articles.

E. TRANSFER OF TITLE BY NON-OWNERS

"Nemo dat quod non habet"

Literally translated this means "no one may give what he does not have".

It is a general maxim of English law that no one can transfer a better title than he/she possesses him/herself.

However, there are exceptions. In ***Bishopsgate Motor Finance Corporation Ltd v. Transport Brakes Ltd (1949)***, Denning LJ (as he then was) expressed it thus:

> *"In the development of our law, two principles have striven for mastery. The first is for the protection of property: no one can give a better title than he himself possesses. The second is for the protection of commercial transactions: the person who takes in good faith and for value without notice should get a good title. The first principle has held sway for a long time, but it has been modified by the common law itself and by statute so as to meet the needs of our own times."*

The first principle stated by Lord Denning is partially enshrined in Section 21(1) of the 1979 Act. "*Subject to this Act, where goods are sold by a person who is not their owner, and who does not sell them under the authority or with the consent of the owner, the buyer acquires*

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no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell."

Estoppel

The last part of Section 21(1) provides statutory force to the common law principle of estoppel. If a person leads someone to believe a certain fact, and that person reasonably acts on that belief, and suffers loss as a consequence, then the representor will be estopped from denying its truth.

In ***Eastern Distributors Ltd v. Goldring (1957)*** M owned a van and wanted to raise money on the security of it. He persuaded a car dealer to represent to the finance company that M wished to take the van on hire purchase. M signed all the necessary forms, including one stating that he had taken delivery of the van. The effect of this was to enable the dealer to represent to the finance company that he, the dealer, was the owner of the van, and had a right to sell it.

HELD: M, having consented to this, was by his conduct estopped from denying the dealer's apparent ownership. The finance company, therefore, acquired a good title under Section 21(1) of the Act.

The courts have been reluctant to establish the principle that an estoppel can arise through negligence. To create such an estoppel the owner of the goods must have owed a duty of care to the buyer, who was misled into believing that someone else owned them. The notion was rejected in ***Moorgate Mercantile Co. Ltd v. Twitchings (1976)***. Here the prospective buyer of a car checked with H P Information Ltd, a company that keeps details of all hire-purchase agreements registered with it, to establish whether the car was subject to any hire purchase. No agreement had been registered and so the buyer bought the car. In fact, the car was subject to hire purchase in favour of M Ltd, but it had not been registered. M Ltd repossessed the car.

HELD: M Ltd could repossess the car. They owed no duty to T to register the hire-purchase agreement and the statement by H P Information Ltd that no agreement was registered could not constitute an estoppel. Registration was voluntary, not compulsory.

Sale under a Voidable Title

A "voidable title" is one whereby a person who is in possession of goods and is the apparent owner of them in fact does not possess a good title. The true owner can assert his/her better right to goods, and "avoid" the possessor's title.

Section 23 of the 1979 Act gives protection to a person who buys in good faith and without notice of the seller's defective title, by providing that the buyer in such circumstances acquires a good title to the goods, provided the true owner has not at the time of sale avoided the seller's title.

In ***Car and Universal Finance Co. Ltd v. Caldwell (1965)***, Caldwell was fraudulently induced by N to sell him a car, which N paid for by cheque. The cheque was later dishonoured, whereupon Caldwell notified both the police and the AA. Neither of these were able to contact N. Meanwhile N sold the car to the finance company who acquired it in good faith and without notice of N's defective title.

HELD: Caldwell, having done all that was possible to avoid N's title, had effectively done so. Hence he retained title to the car.

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Mercantile Agents

The **Factors Act 1889**, Section 1(1) defines a "*mercantile agent*" as follows:

> *"The expression 'mercantile agent' shall mean a mercantile agent having in the customary course of his business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods".*

The **Factors Act** then goes on to provide in Section 2 that where a mercantile agent is in possession of goods with the owner's consent, any disposition of those goods in the ordinary course of his/her business as a mercantile agent shall be as valid as if he/she had been expressly authorised by the owner to make that disposition; provided, that is, that the person taking the goods under the disposition does so in good faith without notice of any lack of actual authority of the agent.

We shall be dealing in later study units with the law relating to agents, but from the point of view of sale of goods, this Act provides a statutory exception to the "*nemo dat*" rule. A person whose normal business is to sell or buy or consign goods for sale as an **agent** for another person (the principal) is a mercantile agent. If, therefore, such a person is in possession of a principal's goods, with the principal's consent, then he/she can give a good title to any third party (subject to good faith, etc.) for those goods, notwithstanding that he/she is not the owner of them, nor has the principal's authority to dispose of them. The reason for this exception is, of course, commercial necessity. If someone buys from an agent dealing in goods, he must know that it is safe for him to do so and that his title to the goods he buys cannot be impeached by the true owner. Otherwise the whole mercantile system would collapse.

The definition of a mercantile agent is such that a clerk, a warehouseman or other bailee of goods, or a carrier, is not a mercantile agent. Such people cannot pass a good title under the terms of the Factors Act.

The **Sale of Goods Act 1979**, Section 62(2) provides that the law relating to mercantile agents (amongst others) shall apply to contracts for sale of goods.

Seller in Possession of Goods

Section 24 of the 1979 Act provides another exception to the "*nemo dat*" rule. This section reads as follows:

> *"Where a person having sold goods continues or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of the previous sale, has the same effect as if the person making the delivery or transfer were expressly authorised by the owner of the goods to make the same".*

As we have seen, the usual rule is that the property in goods passes to the buyer when the contract is made. He/she is therefore the owner of them. But if **after** the contract of sale is made, but before delivery to the buyer, the seller, inadvertently or otherwise, sells the goods a second time, and delivers them to the new buyer, then that new buyer gets a good title to them. The seller has no title which he/she can pass, but, notwithstanding, the second buyer acquires a good title. The original buyer is, of course, left with a remedy of damages against the seller for breach of contract.

The essential things to remember are that the seller must remain in **possession** of the goods or documents of title to the goods (e.g. a bill of lading), **and** he/she must actually

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transfer the goods or the documents of title to the second buyer. Only then does the second buyer get a good title.

In ***Nicholson v. Harper (1895)*** a vendor sold wine to Nicholson which was stored in a warehouseman's cellars. He later pledged the wine with the same warehouseman as security for a loan.

HELD: Section 24 of the Act did not apply, as there had not been any delivery or transfer to the warehouseman after the sale to Nicholson. The warehouseman did not therefore get any title, so the pledge was ineffective as security.

On the whole, more modern cases tend to take a more flexible approach to the interpretation of Section 24. You can see this in the case of ***Worcester Works Finance Ltd v. Cooden Engineering (1974)***. G, a car dealer, bought a car from C. He later sold it to W under a hire-purchase agreement. Without W's knowledge or consent he retained possession of it. Meanwhile, since his cheque to C had bounced, he allowed C to recover possession of the car. W sued C.

HELD: The action failed.

- At the time of the car being repossessed by C, the car dealer was a "*person having sold goods*" for the purposes of Section 24. The fact that his continued possession was wrongful and was not known to W was irrelevant.
- The necessary delivery which the seller in possession must make to the third party could arise where the third party seizes possession of the goods with the seller's consent.

Buyer in Possession of Goods

Exactly the same result obtains if a **buyer** has possession of goods with the seller's consent, and before the property has passed the buyer sells or disposes of them, or of documents of title, to a sub-buyer. Provided the sub-buyer acts in good faith without knowledge of any lien of the original seller, or lack of title of the buyer, then he/she acquires a good title if the goods, or documents of title to them, are actually transferred to him/her. This is provided for by Section 25 of the 1979 Act. It has effect as if the buyer were a mercantile agent.

A good example of where two of the exceptions to the "*nemo dat*" rule potentially applied was ***Newtons of Wembley Ltd v. Williams (1965)***. Newtons agreed to sell a car to A, providing that the property in it should not pass until it had been paid for. A drew a cheque for the full price, and with Newtons' consent took possession of the car. The cheque was dishonoured, and Newtons forthwith purported to rescind the contract. Meanwhile, however, A sold the car to B in Warren Street car market. B resold it to Williams.

HELD (Court of Appeal) that:

- B acquired a good title under Section 25, as A was in possession of the car with the true owner's consent.
- Williams had a good title, by virtue of B's title. However, even if B's title was defective, Williams's title was good, as he had bought in market overt (an established market where a buyer who purchased in good faith without notice of any defects in title acquired a good title to the goods).
  (Remember that market overt was abolished by the **Sale of Goods (Amendment) Act 1994**.)

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Study Unit 9

The Sale of Goods 2: Terms and Conditions

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A. FRUSTRATION

You will remember from an earlier study unit on contract law that frustration of a contract occurs by **operation of law**, and not by agreement between the parties, when some outside event occurs without the fault of either party, and which could not reasonably have been foreseen, which renders the contract something totally different from what the parties had bargained for.

The principles of frustration apply to contracts for the sale of goods exactly as they apply to any other contracts. However, the **Sale of Goods Act 1979** makes provision for a particular type of frustration. Section 7 states:

> *"Where there is an agreement to sell specific goods and subsequently the goods, without fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is avoided ".*

Specific Goods that Perish

Section 7 applies only to specific goods, and only if they perish before the risk in them has passed. The section was inserted in the **1893 Act** (and re-enacted by the **1979 Act**) as a result of the decision in the following case.

In ***Howell v. Coupland (1876)***, Coupland agreed to sell to Howell 200 tons of potatoes to be grown on a specified field. Due to a partial failure of the crop, Coupland was able to deliver only 80 tons.

HELD: Coupland was relieved of liability to deliver the remaining 120 tons.

This section of the Act thus removes the difficulties which are apparent in the ***Howell*** decision. In the first place, when the contract was made, the goods were not specific; they were future goods. Secondly, 80 tons were actually delivered, so it was left open as to whether Howell could have refused to accept the quantity that was available and offered.

The consequence of frustration under Section 7 is that the contract is **avoided**, and both parties are relieved of their obligations under it. If the price, or part of it, has been paid, it must be **refunded**. In the event that part of the goods under the contract have been delivered before the remainder perish, then the buyer is liable for the price of that part that he/she has **accepted**.

Unascertained Goods that Perish

It is very unlikely that the doctrine of frustration will be called into play in the event of unascertained goods perishing. The seller will normally be in a position to obtain alternative supplies from elsewhere. This is probably the reason why the Act makes no mention of the matter. It is only if it was the intention of the parties at the time of the contract that the goods were to come from one particular source, and no other, that the contract would be frustrated by the goods perishing before becoming ascertained.

Other Instances of Frustration

The four other likely causes of contracts for sale of goods being frustrated are as follows:

- Owing to the **outbreak of war**. Under the **Trading with the Enemy Act 1939**, the supply of goods to or for the benefit of the enemy is a criminal offence; consequently contracts made before the outbreak of war, but which have not been fully executed, are frustrated.
- **Supervening illegality** may cause a contract to be frustrated. If, after the contract is made, new legislation renders its performance impossible, or to be of such a character

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or duration as to make it something totally different from that contemplated by the parties, then frustration will ensue.

- The imposition of **import** or **export prohibitions** may have the same effect. There are, of course, various parameters. The prohibition may be **absolute**, in which case the contract will be frustrated.

  On the other hand, it may be only temporary, or make import or export subject to the possession of a **licence**, in which case the legal results will depend entirely on the circumstances.

- **Requisitioning** of the goods will not normally cause the contract to be frustrated, unless they cannot be supplied from any other source, or it is an essential part of the contract that those particular goods, and no other, are the subject matter.

Consequences of Frustration

The effect of the frustration of a contract for the sale of goods is forthwith to relieve the parties from further performance. The consequences are provided for in the **Law Reform (Frustrated Contracts) Act 1943**. However, this Act specifically **exempts** from its operation any contract to which the **Sale of Goods Act 1979**, Section 7 (re-enacting the **1893 Act**) applies. We have already mentioned the consequences flowing from Section 7 frustration. Under the **1943 Act**, which will, therefore, normally apply only to unascertained goods:

- All sums **paid** or **payable** at the time of frustration shall be repaid, or cease to be due
- Any **expenses** incurred by the party to whom the sums were due (the seller) can be recovered subject to the court's discretion
- If a party (the buyer) has acquired a **valuable benefit** (other than money), then the value of the benefit is recoverable by the other party (the seller).

The effect of the Act is, therefore, to ensure firstly that no further liability arises, secondly that the price of goods paid for in advance is recoverable, thirdly that goods supplied prior to the frustrating event are paid for, and fourthly that reasonable expenditure may be recovered.

In ***BP Exploration Co. (Libya) Ltd v. Hunt (No 2)(1979)***, Hunt owned an oil concession in Libya. He agreed with BP that they would develop the concession at their own expense, and recoup part of the cost if and when the oil field came on stream from Hunt's share of production. Afterwards they were to share production and development costs. It was later agreed that BP's preliminary expenses would be reimbursed by receipt of 50 million barrels of oil, and that BP could not recover sums paid to Hunt. The field came on stream in 1967. In 1971, the Libyan government expropriated BP's interest, and in 1973 Hunt's. By that same time BP had received about one-third of the 50 million barrels.

HELD:

- The contract was frustrated in 1971.
- At the date of frustration, Hunt had obtained a valuable benefit, in that the value of his share had been enhanced by BP's contractual performance. This would be taken into account in calculating the sum due to him.
- The sum due to BP would take into account the reimbursement oil already received by them.

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B. DELIVERY

General Points

Section 27 of the 1979 Act states:

> *"It is the duty of the seller to deliver the goods, and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale".*

At first reading, this may well appear to be a particularly unnecessary statement of the obvious. But there is more to it than meets the eye.

- In the first place, "*delivery*" in ordinary speech implies **transportation** – the physical act of moving the goods from seller to buyer. In law, this is not necessarily the case. Section 61(1) defines "*delivery*" as the "*voluntary transfer of possession from one person to another*". So there is no need for any **physical movement** at all. If you buy something in a shop, it is "delivered" when it is handed to you after payment. Equally, goods lying in a warehouse are "delivered" when the seller signifies to the warehouse that they are to be held for or to the order of the buyer. If a document of title (e.g. a bill of lading) is transferred, it constitutes "delivery" of the goods.
- Secondly, as we have already seen, the property in and possession of goods are not the same thing. Property may well have passed, but in order for the buyer to get physical possession, the act of **delivery** is necessary to complete the transaction. Further, the delivery must be **voluntary**. If the buyer just walks in and takes the goods that is not delivery. At best it is "conversion", at worst theft.
- Thirdly, the seller must deliver the **particular goods** contracted for, if the contract is one for the sale of specific goods. He/she cannot deliver other goods which are similar. However, if the contract is for unascertained goods, the seller is free to deliver any goods which are the same as those specified in the contract.
- Fourthly, the buyer has a duty to **accept** the goods. The seller may be ready and willing to deliver, but if the buyer refuses to accept, the sale remains incomplete.
- Fifthly, the buyer must **pay** for the goods. The **time of payment** depends on what has been agreed in the contract, or has become the usual time through a course of dealing. In other words:

  (i) The **contract** may specifically **state** the time of payment

  (ii) The **buyer** may have a previously agreed **periodic** (e.g. monthly) **account**

  (iii) It may have become **customary** over a period of previous trading that the buyer pays after a certain period; if the seller has consistently accepted this, that period will constitute the time of payment through a course of dealing.

  However, in the event that no such prior agreement, express or implied, has been reached, then Section 28 states:

  > *"Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of the goods".*

  This is, of course, the normal arrangement when buying something from a shop.

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- Lastly, the expenses of putting the goods into a **deliverable state**, and expenses incidental to this, are, unless otherwise agreed, the responsibility of the **seller**: Section 29(6). You should note that this does not mean the costs of delivery, but merely the expense of **preparing the goods** for delivery. This includes packing costs.

  From a practical point of view, therefore, if a supplier invoices you for "packing costs" which have not previously been agreed specifically or provided for in his/her "conditions of sale" or otherwise, then strike them out. He/she has no right to charge.

Method of Delivery

Goods can be delivered in any way the parties agree. It may be direct from seller to buyer, or they may be delivered to a third party nominated by the buyer: ***Bull v. Stibbs (1799)***. Alternatively, delivery may be **constructive**; for example, handing the buyer the keys of a room in which the goods are stored, or the keys of a car that he/she has bought. The delivery of **shipping documents**, such as a bill of lading, is also constructive delivery of the goods.

If no such agreement is reached as to actual or constructive delivery, the seller's duty is discharged if he/she makes the goods available to the buyer, at the place and time envisaged by the contract, and in a deliverable state, so as to enable the buyer to take possession of them: ***Smith v. Chance (1819)***.

There are, of course, other parameters:

- If the goods are in the possession of a third party, Section 29(4) provides that: "*there is no delivery by seller to buyer unless and until the third party acknowledges to the buyer that he holds the goods on his behalf* ". The act of acknowledgment is called "attornment".
- The transfer of documents of title to goods has the effect of delivery of the goods, and of giving constructive possession to the recipient.
- Delivery of goods to a carrier is provided for by Section 32(1):

  > *"Where, in pursuance of a contract of sale, the seller is authorised or required to send the goods to the buyer, delivery of the goods to a carrier (whether named by the buyer or not) for the purpose of transmission to the buyer is prima facie deemed to be a delivery of the goods to the buyer".*

  Points to note about this subsection are firstly that delivery to the carrier is only *prima facie* evidence of delivery to the buyer. The presumption can be upset by the terms of the contract, or surrounding circumstances pointing to another intention. Secondly, if the carrier is the seller himself, or a servant or agent of his, then the subsection is not applicable: ***Dunlop v. Lambert (1839)***.

  Notwithstanding that delivery is normally effected by delivery to a carrier, the seller is still able to exercise his/her right of "stoppage in transit" in the event of non-payment. We shall be dealing with this right in a later study unit.

- Section 32(2) deals with the contract of carriage of goods from seller to buyer:

  > *"Unless otherwise authorised by the buyer, the seller must make such contract with the carrier on behalf of the buyer as may be reasonable having regard to the nature of the goods and the other circumstances of the case; and if the seller omits to do so, and the goods are lost or damaged in course of transit, the buyer may decline to treat the delivery to the carrier as delivery to himself, or may hold the seller responsible in damages".*

  So if the seller is authorised by the contract to transmit the goods to the buyer, in making the contract with the carrier he/she is acting as agent for the buyer.

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In Young (T) & Sons v. Hobson & Partner (1949), electric engines were despatched under a "*free on rail*" (f.o.r.) contract. The seller arranged the contract of carriage which provided that the engines were carried at "*owner's risk*". They could, however, have been carried at "carrier's risk" for the same cost. The engines were damaged in transit.

HELD: The contract made by the seller was not a reasonable one in the circumstances, and the buyers were entitled to resist an action for the price.

The duty of the seller to make a reasonable contract of carriage does not extend to a duty for him/her to **insure**, unless otherwise agreed.

Place of Delivery

The **Sale of Goods Act 1979** does not provide any rule as to whether or not the seller is bound to send or carry the goods to the buyer. It depends upon the terms of the contract, but at common law the seller is *prima facie* not bound to send or carry the goods. His duty is only to **make them available** for the buyer to **collect**: ***Smith v. Chance (1819)***.

Section 29(2) of the Act does, however, provide that, subject to contrary agreement, the place of delivery is the **seller's place of business**. If he/she does not have one, it is his/her **residence**. This, of course, ties in with Section 32(1) that delivery to a carrier – naturally normally at the seller's place of business – constitutes delivery to the buyer.

Section 29(2) goes on to specify that if the contract is for the sale of specific goods which to the knowledge of both buyer and seller **at the time the contract was made** are at some other place than the seller's place of business, then that place where they **actually are** is the place of delivery.

Time of Delivery

If a time is stated in the contract for the delivery of goods, it may be a **condition** of the contract, breach of which entitles the buyer to rescind the contract and refuse to take delivery; or it may be a **warranty**, which entitles the buyer only to seek damages for any loss entailed by reason of late delivery.

Section 10(2) of the 1979 Act leaves the question open:

> *"Whether any stipulation as to time is or is not of the essence of the contract depends on the terms of the contract".*

Time being "*of the essence*" means that it is a **condition**.

If, therefore, the contract does not expressly state that time shall be of the essence, or make any other statement to the same effect, the common law looks to the **nature** of the contract and the **character** of the goods dealt with to resolve the question: ***Hartley v. Hyams (1920)***.

In commercial contracts there is a rebuttable presumption that terms as to the time of delivery are conditions of the contract: ***Wimshurst v. Deeley (1845)***.

Of course, even if the contract specifically states that time is of the essence, the buyer is not bound to reject goods if delivery is delayed. He/she may elect to treat the condition as a warranty, and seek only damages.

However, time of payment is not of the essence, unless a different intention appears from the terms of the contract (Section 10(1)).

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Quality of Goods Delivered

The Act makes provision for the buyer's rights should the seller deliver the wrong quality of goods. The seller has a strict duty to deliver the precise quantity stipulated in the contract, and if he/she fails to do so the buyer is entitled to reject them. Section 30 sets out the buyer's options:

- Where the seller delivers **less** than the correct quantity, the buyer may reject them all. But if he does accept what has been delivered, he must pay pro rata at the contract rate (e.g. if the contract was for ten articles at £1 each, and eight are delivered, then if the buyer accepts them he must pay £8).
- Where the seller delivers **more** than the contract quantity, the buyer has **three** options: she can reject them all; she can accept the correct quantity and reject the rest or she can accept the whole lot and pay at the contract rate for all.
- Where the seller delivers the correct type of quality of goods **mixed with others of a different description** not included in the contract, the buyer can reject the whole, or he can accept the correct goods and reject the incorrect ones. Although the Act does not in this instance specify, it must be implied that if the buyer adopts the latter option, he must pay at the contract rate for the goods he **accepts**.
- Finally there is a let-out, in that the section is "*subject to any usage of trade, special agreement, or course of dealing between the parties*".

In spite of the seller's duty to supply the correct quantity being strict, the "*de minimis*" rule applies. This means that if the difference in quantity is minute, and such as not to have any effect on the contract as a commercial reality, the buyer will not be permitted to take advantage of a trivial variation in order to escape from his/her liability to accept and pay.

In ***Shipton Anderson & Co. v. Weil Brothers & Co. (1912)***, the seller delivered 55 lbs of wheat over and above a contractual quantity of 4,950 tons.

HELD: The buyer could not reject.

Delivery by Instalments

Section 31(1) states that: "*unless otherwise agreed, the buyer of goods is not bound to accept delivery of them by instalments*".

That is quite straightforward. The buyer can reject the goods if the seller sends other than the full quantity. However, if the contract does provide for delivery by instalments, various things can go wrong, and Section 31(2) caters for some of them, as follows:

> *"Where there is a contract for the sale of goods to be delivered by stated instalments, which are to be separately paid for, and the seller makes defective deliveries in respect of one or more instalments, or the buyer neglects or refuses to take delivery of or pay for one or more instalments, it is a question in each case depending on the terms of the contract and the circumstances of the case whether the breach of contract is a repudiation of the whole contract or whether it is a severable breach giving rise to a claim for compensation but not to a right to treat the whole contract as repudiated."*

So in the event of a breach of contract by either one or more instalments not being delivered, or being incorrectly delivered, or the buyer failing or refusing to accept one or more instalments, then the court must look at the whole circumstances. If the contract can properly be "severed" so as to treat each individual instalment as if it were a separate contract, then the innocent party will be bound in respect of the correct instalments. He/she will, of course, be able to seek damages for any loss, but will not be allowed to rescind the whole contract.

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If, on the other hand, the contract cannot be severed, and is in reality one entire entity, albeit being performed at different times, then the innocent party will be entitled to rescind the whole.

In ***Jackson v. Rotax Motor and Cycle Co. Ltd (1910)*** there was a contract for the sale of 600 motor horns, "*delivery as required*". They were delivered in 19 cases over two months.

HELD: The words "*delivery as required*" implied that the parties contemplated delivery by instalments. Although there was no specific provision for separate payment, it must be implied that this was the parties' intention, and the contract was therefore severable.

Another leading case is ***Mersey Steel and Iron Co. v. Naylor Benson & Co. (1884)***. Here the seller delivered two instalments of a contract of sale before going bankrupt. The buyer refused to pay for these instalments after receiving erroneous advice that he should do so without leave of the court, but he expressed his willingness to pay for and accept delivery of these and further instalments if permitted to do so.

HELD (by the House of Lords): The buyer's conduct, in the circumstances, was not a renunciation of the contract. It was a genuine mistake as to the law. The seller could not therefore treat the contract as repudiated.

C. ACCEPTANCE AND PAYMENT

Acceptance

Like many words in law, "acceptance" of goods is not necessarily used in its literal sense. It is not always the same as taking delivery. For instance, a carrier drops a consignment of goods at your premises. You move them into the warehouse pending examination. Later you inspect them, find they are not what you ordered, and promptly inform the supplier that you reject them. You have physically taken temporary possession of those goods, but you have not "accepted" them.

The **Sale and Supply of Goods Act 1994** amends the **Sale of Goods Act 1979** as regards acceptance of goods and the opportunity of examining them.

New Sections 35 and 35A are incorporated into the **1979 Act**, as follows:

Section 35:

(1) "The buyer is deemed to have accepted the goods:

(a) when he intimates to the seller that he has accepted them, or

(b) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller,

subject to sub-section (2).

(2) Where the goods are delivered to the buyer, and he has not previously examined them, he is not deemed to have accepted them under sub-section (1) until he has had a reasonable opportunity of examining them for the purpose:

(a) of ascertaining whether they are in conformity with the contract, and

(b) in the case of a contract for sale by sample, of comparing the bulk with the sample.

The buyer is also deemed to have accepted the goods when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them.

The buyer is not deemed to have accepted the goods merely because:

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(a) he asks for, or agrees to, their repair by or under an arrangement with the seller, or

(b) the goods are delivered to another under a sub-sale or other disposition."

Section 35A:

"If the buyer:

(a) has the right to reject the goods by reason of a breach on the part of the seller that affects some or all of them, but

(b) accepts some of the goods including, where there are any goods unaffected by the breach, all such goods, he does not by accepting them lose his right to reject the rest."

There are, therefore, **three** ways in which a buyer can be deemed to have accepted goods.

- If she **intimates to the seller** that she has accepted them. This is straightforward, either words or conduct suffice to intimate acceptance.
- If he does any **act** in relation to the goods inconsistent with the ownership of the seller.

  Such acts usually, but not necessarily, involve the buyer reselling or otherwise treating the goods as if they were his own. Look at the following two cases.

  In ***Hardy & Co. Ltd v. Hillems & Fowler (1923)***, wheat from South America was contracted to be sold. The carrying vessel arrived at Hull on 18 March. On 21 March, the buyer sold part of the wheat, and despatched it to the sub-buyers. But the buyer did not have any opportunity to examine the wheat until 23 March; it then turned out to be defective.

  HELD: By reselling it on 21 March, the buyer had done an act inconsistent with the seller's ownership. He had therefore accepted the wheat in accordance with Section 35.

  In ***E & S Ruben Ltd v. Faire Bros & Co. Ltd (1949)***, it was **held** that the delivery of goods by the seller to a carrier for despatch to a third party constituted the sellers acting as agents for the buyers. The goods were therefore deemed to have been notionally delivered to the buyers, hence the delivery to the carriers constituted an act inconsistent with the seller's ownership.
- If after **lapse of a reasonable time** the buyer retains the goods without intimating that she has rejected them.

  If the buyer intends to reject the goods, he must therefore inform the seller promptly. If he fails to do so, he will be deemed to have accepted them. What constitutes a "reasonable time" depends on the circumstances.

Payment

It is the **buyer's duty** to pay for the goods in accordance with the contract of sale. By Section 28 of the 1979 Act, delivery of the goods and payment of the price are concurrent conditions, unless agreed otherwise. Now a term as to payment should include not only the **amount**, but also the **method**, the **time**, and the **place** of payment.

- **Method**

  Unless otherwise agreed, the buyer should pay or tender the price in **cash**, and the seller cannot be compelled to accept other than legal money. Nowadays in commercial transactions, an agreement to pay by **cheque** or by **credit transfer** will be readily implied. If payment is sent by post, it is at the **buyer's** risk: ***Luttges v. Sherwood (1895)***.

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- **Place of Payment**

  This again depends on the terms of the agreement, express or implied. However, if there is no such intention to be inferred, the general rule is that the place of payment is the **seller's place of business**.

- **Time of Payment**

  The time of payment is by agreement, and does not necessarily bear any relation to possession or transfer of property or risk.

  If goods are sold on "credit", payment is not due until the period of credit has expired: ***Price v. Nixon (1814)***. In the event that payment is delayed, there is no obligation on the buyer to pay interest, unless it has been so agreed in the contract: ***Gordon v. Swann (1810)***.

D. STATEMENTS RELATING TO GOODS

Before dealing with the terms covering the general subject of defects in goods, and the terms which the **Sale of Goods Act 1979** implies into contracts regarding the goods, it is necessary to be clear as to the classification of statements which may be made about goods. These broadly fall into two types:

- Statements about goods which **do not** involve the maker in legal liability
- Statements which **do** involve legal liability.

Statements not Involving Legal Liability

(a) "Mere puffs"

These are statements describing or extolling the goods, which are not intended to be taken seriously or literally. They are frequently made in advertising.

In ***Walker v. Milner (1866)***, a safe was described as "*strong, holdfast, thiefproof*". A burglar broke into it in half an hour using ordinary tools.

HELD: A "mere puff" involving no liability for the statement.

But on the other hand, a car dealer, describing one of his stock as "*a good little bus; I would stake my life on it; you will have no trouble with it*", was **held** to have been giving a warranty giving rise to contractual liability: ***Andrews v. Hopkinson (1957)***.

(b) Statements of opinion

In order to constitute an actionable misrepresentation, a statement must be one of fact, not of opinion, provided, that is, that the opinion is **genuine**, and not made with the intention of deceiving.

(c) Statements of intention

Again, a statement of intention is not normally one of fact. If, however, it can be shown that such a statement was not genuinely made, then it can constitute the tort of **deceit**.

Statements Involving Legal Liability

(a) Misrepresentations

We have dealt with the subject of misrepresentation in an earlier study unit on the law of contract. It, of course, applies to contracts for the sale of goods exactly as to any other contract.

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(b) Warranties

As we saw in another study unit, a "warranty" is a term of a contract, breach of which entitles the injured party to damages, but not to rescind the contract. Section 61(1) of the 1979 Act defines it thus:

> *"Warranty means an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated."*

It is therefore used in precisely the same sense in a contract for the sale of goods as in other types of contract.

But whether any particular statement made prior to the formation of a contract of sale is in reality a warranty, or whether it is a statement of opinion or a "mere puff", is more difficult. As long ago as 1688, Chief Justice Holt made this comment:

> *"An affirmation at the time of a sale is a warranty provided it appears on evidence to have been so intended."*

That is still the basis, but in this century the trend has been towards treating statements more objectively, and looking rather at the impression that a statement or an act creates on an impartial observer than to the subjective intention of the maker.

In ***Dick Bentley Productions Ltd v. Harold Smith (Motors) Ltd (1965)*****,** Lord Denning said:

> *"The question of whether a warranty was intended depends on the conduct of the parties, on their words and behaviour, rather than on their thoughts. If an intelligent bystander would reasonably infer that a warranty was intended, that will suffice."*

In that case, a car dealer stated the mileage done by a second-hand car, and it was **held** to be a warranty. On the other hand, in ***Oscar Chess Ltd v. Williams (1957)*** a private seller of a car innocently stated it was a 1948 model, when in reality it was a 1939 model.

HELD: The statement was not a warranty.

(c) Condition

Again, as we have seen, a "condition" of a contract is a fundamental term, breach of which entitles the injured party to rescind the contract as well as to seek damages for loss suffered. The 1979 Act does not define "condition", but in several places it uses the word in that sense.

For instance, Section 11(2) states:

> *"Where a contract of sale is subject to a condition to be fulfilled by the seller, the buyer may waive the condition, or may elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated."*

Whether a term of a contract of sale (either express or implied) is a condition or a warranty depends on two main factors. The Act lays down or implies that certain terms are one or the other. In default of guidance from the Act, it is a question of the proper construction of the contract. In ***Bentsen v. Taylor, Sons & Co. (1893)***, Lord Justice Bowen said:

> *"There is no way of deciding that question except by looking at the contract in the light of the surrounding circumstances, and then making up one's mind whether*

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the intention of the parties ... will best be carried out by treating the promise as a warranty ... or as a condition".

(d) Intermediate or innominate terms

The strict dichotomy indicated in the Act between "conditions" and "warranties" has of recent years been tempered by the realisation that it can involve an over-simplification of a complex commercial transaction.

There is perhaps something in between, the breach of which term should depend not on an arbitrary distinction between whether it is a condition or a warranty, but on the particular circumstances of the case and the breach in question. In ***Hong Kong Fir Shipping Co. Ltd v. Kawasaki Kisen Kaisha Ltd (1962)*****,** a certain term was **held** to be neither a condition nor a warranty, and the effect of its breach depended on the "*nature and effect of the breach*". In ***The Hansa Nord (1976)*****,** Lord Justice Roskill said:

"In principle, contracts are made to be performed and not to be avoided according to the whims of market fluctuation and where there is a free choice between two possible constructions I think the court should tend to prefer the construction which will ensure performance and not encourage avoidance of contractual obligations".

E. STATUTORY IMPLIED TERMS AS TO DESCRIPTION AND QUALITY

Correspondence with Description

The **Sale of Goods Act 1979**, Section 13(1) states:

"Where there is a contract for the sale of goods by description, there is an implied condition that the goods will correspond with the description".

So what is a "*sale … by description*"? Basically there are two types:

- A sale of unascertained or future goods will almost invariably be such. If a seller purports to sell, say, 500 tons of "*best Welsh steam coal*", that is a sale of unascertained goods, and it is a sale by description. Likewise an agreement to sell "*the whole crop of King Edward potatoes to be grown on such and such a field*" is a sale of future goods by description.
- Where specific goods are sold, and the seller either describes them, or a description can be inferred as having been given from the circumstances, it is a sale by description. In ***Varley v. Whipp (1900)***, the seller sold an article which was lying elsewhere as "*a second-hand self-binder reaping machine*".

  HELD: It was a sale by description. It was stated that the term "*must apply to all cases where the purchaser has not seen the goods, but is relying on the description alone*".

But, as we shall see, the term is not restricted to specific goods which have not been seen by the buyer. If at any time the seller describes the goods, even when they are before the buyer, and the buyer relies on the description, then it constitutes a sale by description.

This is specifically provided for in Section 13(3), which states:

"A sale of goods is not prevented from being a sale by description by reason only that, being exposed for sale or hire, they are selected by the buyer".

So even if the buyer him/herself selects the particular item he/she wishes to buy which is either displayed alone, or amongst others, this can be a sale by description. There must, of

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course, be some description of the goods, either written or verbal. A notice stating "Golden Delicious" above a pile of apples on a greengrocer's stall would suffice.

It is an implied condition that goods will **correspond** with the description. On the face of it, therefore, if they do not correspond, then the buyer is entitled to rescind the contract. However, it is not always as simple as that. Descriptive words can apply to the whole article sold – e.g. "Golden Delicious apples". In this case, it seems clear that the description is a condition but the words can apply to only a part of the article, or to some characteristic of it e.g. a "green 2007 Ford Mondeo". If the car in question was indeed a 2007 Mondeo, but it was not green, is it still a condition entitling the buyer to repudiate the bargain? Or is it merely a warranty, giving rise to damages (the cost of re-spraying the car green, perhaps)? Common sense would indicate the latter alternative.

Although the Act is specific on the point, the courts have tended to apply the common sense approach, and hold that a description must apply to the **whole article** for breach of it to constitute a condition. Look at the following cases.

In ***Harrison v. Knowles and Foster (1918)***, two ships were sold, and in the stated particulars they were said to have a dead weight capacity of 460 tons each. This fact did not appear in the actual memorandum of sale. It transpired that the capacity of each was only 360 tons.

HELD: The statements of capacity were mere representations.

In ***Reardon Smith Line Ltd v. Yngvar Hansen-Tangen (1976)***, a ship not yet built was chartered and sub-chartered. She was described in the sub-charter as "*Japanese flag motor vessel called Yard No 354 at Osaka described as per clause 24*". As built, she had been sub-contracted to another yard at Oshima, where she was designated No 004.

HELD: The sub-charterers must take the vessel.

However, in a consumer-type sale, the Court of Appeal took a stricter view.

In ***Beale v. Taylor (1967)***, a car was advertised for sale as a "*Herald Convertible 1961*". Actually the car consisted of two parts welded together, only one of which was from a 1961 model.

HELD: The description "*1961*" was a contractual condition.

In the case of sales by description which entail articles or commodities which have other ingredients added to or deleted from them, or which have deteriorated to such an extent as to make the article sold somewhat different, the test appears to be whether it has lost its **commercial identity** as a result.

In ***Ashington Piggeries Ltd v. Christopher Hill Ltd (1972)***, herring meal became contaminated by a chemical reaction when a preservative was added. It became toxic to mink and other small animals.

HELD: It complied with the description "*herring meal*".

Finally in Section13, Subsection (2) states:

> *"If the sale is by sample as well as by description it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description".*

We shall be coming on to sales by sample later in this study unit, but otherwise the sub-section is straightforward.

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Satisfactory Quality and Fitness for the Purpose

The quality of goods and whether they are fit for the purpose for which they were sold are the next terms implied by the 1979 Act. These are similar concepts, but different in detail. The Act here differentiates between where the seller is selling in the course of a business, and where he/she is selling privately. The status of the **buyer** i.e. whether he/she is in the course of a business or not, is immaterial.

The term "selling in the course of a business" is very wide. It does not merely include dealers in goods of the kind in question. If a person (or a company) sells as part of his business, then he will be considered to be "selling in the course of a business", whatever he may have occasion to sell. For example, if the business of a company is selling ironmongery, and it happens to sell one of the office desks second-hand as surplus to requirements, then that particular sale will still be "in the course of business".

A "business" also includes professions, and government or local authorities. It is probable that non-profit-making organisations such as schools, universities and charities, which have occasion to sell will also be considered to be doing so in the course of a business. It is really only the **genuine private individual** who will not be so.

Section 14(1) of the Act pays lip service to the principle of "*caveat emptor*" as follows:

> *"Except as provided by this section and Section 15 below and subject to any other enactment, there is no implied condition or warranty about the quality or fitness for any particular purpose of goods supplied under a contract of sale".*

It is the exceptions which will apply in all cases except private sales.

Satisfactory Quality

A major change made by the **Sale and Supply of Goods Act 1994** is the replacement in the **Sale of Goods Act 1979** of the implied condition of "merchantable quality" with that of "**satisfactory quality**".

A new Section 14(2) is incorporated into the **1979 Act** which states:

> *"Where the seller sells goods in the course of a business, there is an implied term, that the goods supplied under the contract are of a satisfactory quality".*

The implied term will not apply (Section 14(2C)):

- As regards defects specifically drawn to the buyer's attention before the contract is made
- If the buyer examines the goods before the contract is made, as regards defects which the examination ought to reveal or
- In the case of a sale by sample, as regards defects which would have been apparent on a reasonable examination of the sample.

Section 14(2) defines "*satisfactory quality*" as follows:

> *"Goods are of a satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.*
>
> *The quality of goods includes their state and condition and the following (among others) are in appropriate cases aspects of the quality of goods:*
>
> *(a) fitness for all the purposes for which goods of the kind in question are commonly supplied,*
>
> *(b) appearance and finish,*

(c) freedom from minor defects,

(d) safety, and

(e) durability."

You will have noted that Section 14(2C) provides three exceptions to the implied condition that goods shall be of satisfactory quality. The first is if defects in the goods are **specifically drawn to the buyer's attention** before the contract is made. This is straightforward common sense. If you buy a second-hand car and the dealer first tells you it has a crack in the cylinder block, you can hardly complain when it duly seizes up.

The second exception is where the buyer **examines the goods** before contracting, as regards defects which that examination **ought to reveal**. This can be more difficult. If a defect is hidden, and no reasonable examination could have detected it, there is no problem. However, if the prospective buyer examines the article in a cursory or slapdash manner and fails to spot a defect, what then? The Act says "*the*" examination; taken literally, it means the examination which the buyer actually made. Therefore, if it was made in a cursory fashion, then the goods would be of satisfactory quality except as regards defects which a cursory examination would reveal. There is no authority as yet to assist us on this question.

What does appear to be implied is that if a person makes an examination, but he/she is incompetent, he/she will be bound to the same extent as regards defects which that examination ought to have revealed, as a fully competent person.

Goods may be of satisfactory quality when bought but for how long does the law require them to remain in that state? There is no clear indication in the Act on this point, and the solution must be found in common law.

The general rule is that they are required to be of satisfactory quality only **at the time of sale**. Any deterioration afterwards is no more than a possible indication that they were not in fact of satisfactory quality at the time of sale. For how long this indication will apply must depend entirely on the circumstances of the particular case, the type of goods, and so on: ***Rogers v. Parish (Scarborough) Ltd (1987)***.

Fitness for the Purpose

Section 14(3) of the 1979 Act provides:

> *"Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known:*
>
> *(a) to the seller ... any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied under the contract are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgement of the seller".*

It should be noted that, where the buyer sells goods in the course of a business and the buyer, expressly or by implication, makes known any particular purpose for which the goods are being bought, there is an implied condition that the goods are reasonably fit for that purpose, as illustrated by **Grant v Australian Knitting Mills (1936)** where the plaintiff contracted dermatitis from chemicals still in a pair of underpants manufactured and sold by the defendant. The Privy Council said that where an article sold is clearly meant for just one purpose, it is not of merchantable quality unless it is fit for that purpose. Simple washing would have removed the chemicals, but it was **not reasonable** to expect the plaintiff to wash the pants before wearing them.

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Satisfactory quality and fitness for the purpose are related, though different. An article can be of adequate quality without being fit for a particular purpose, and vice versa.

(a) The first essential to bring the implied condition into play is the same as for Section 14(2), i.e. that the seller must be **in the course of a business**. The meaning of the phrase is the same.

(b) The second is that the buyer must expressly, or by implication, make known to the seller the **actual purpose** for which she requires the goods, and that she is relying on the seller's knowledge and experience of the goods to provide something that will do the job.

Express notice of the purpose is obvious, but implied notice can take various forms. A propeller ordered for a specific ship under construction was **held** to be notice of the purpose (***Cammell Laird & Co. Ltd v. Manganese Bronze & Brass Co. Ltd (1934)***). The same result occurred when 500 tons of coal were ordered "*for the steamship Manchester importers*": ***Manchester Linen Ltd v. Rea Ltd (1922)***.

If the description of what is required points to one use only, then notice of that purpose is readily implied.

In ***Priest v. Last (1903)*** a customer in a shop asked for "*a hot water bottle*". When it burst it was **held** to be unfit for the purpose.

It often happens that goods can be suitable for a number of different purposes, in which case the buyer must indicate, expressly or by implication, **which particular purpose** he/she requires, in order for the seller to be liable.

(c) The Act does not require goods to be perfect; merely reasonably fit for the purpose.

In ***Bristol Tramways, etc. Carriage Co. Ltd v. Fiat Motors Ltd (1910)*** the bus company ordered buses for heavy passenger work in Bristol. Bristol is a hilly city, and they were not up to the job.

HELD: They were not reasonably fit for the purpose.

The seller is not required to warrant the goods absolutely fit, even when new. In the case of second-hand goods, the duty is even less onerous. A car was **held** to be reasonably fit, even though it was known to require repairs done when it was bought: ***Bartlett v. Sidney Marcus Ltd (1965)***.

Nor will a seller be liable under Section 14(3) because some undisclosed factor in the buyer's particular case necessitates goods of a special type being bought. In ***Griffiths v. Peter Conway Ltd (1939)***, a thread coat was bought by a lady with unusually sensitive skin. She subsequently got dermatitis from wearing it.

HELD: The coat would not have harmed a normal person, so the seller was not liable.

However, if the goods are not reasonably fit for the purpose, the seller will be liable for breach of the implied condition, even though he/she could not have detected the fault by using the utmost skill and care – e.g. faulty goods in a sealed tin: ***Bigge v. Parkinson (1862)***.

(d) It is not sufficient to defeat liability to show that goods sold are reasonably fit only for their usual purpose.

As you can see from the language of the section, it is about relying on the seller's skill or judgement, and provided the buyer indicates the actual purpose for which he/she requires the goods, they must be fit for that particular purpose, even though it is not one for which such goods are usually sold.

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(e) Provided the purpose has been notified to the seller, she can escape liability under Section 14(3) only if she, or the surrounding circumstances, can show that the buyer was not relying on the seller's skill and judgement, or that it was unreasonable that he should so rely. The implication is that the buyer does rely on the seller's skill and judgement, and the onus is on the seller to rebut this presumption: ***Wormwell v. R H M Agriculture (East) Ltd (1987)***.

However, it is always open to the seller to intimate to the buyer that his/her skill should not be relied on, and such intimation can equally be implied. In this case, the section will be **excluded**. Where an implied condition in a particular section is excluded in this way, it simply means that the parties are regarded as having not intended the condition to be implied. This well illustrates the nature of these **implied conditions**. This will probably apply where the buyer selects goods for him-/herself. The section will also be excluded where it is unreasonable for the buyer to rely on the seller's skill. For example, if you want to buy some specialist tool from a large self-service DIY store it would be unreasonable to rely on the skill of a young girl on the checkout till. Look at these four cases.

In ***Teheran-Europe Co. Ltd v. S T Belton (Tractors) Ltd (1968)***, air compressors were bought, and the seller had notice that they were for resale in Iran. They were unsuitable.

HELD: The buyers were deemed to have relied on their own skill and judgement as to what was suitable for use in Iran.

In ***Henry Kendall & Sons v. William Lillico & Sons Ltd (1969)***, an importer, who wished to introduce Brazilian groundnut extract from a new source, was aware that the buyer, a wholesaler, intended to resell it in small quantities to be mixed with other substances in cattle and poultry food. The extract proved poisonous to poultry, although it was alright for cattle.

HELD: The knowledge of the importer as to the use to which the extract would be put was sufficient to bring Section 14(3) into operation.

In ***Baldry v. Marshall (1925)***, a buyer asked a dealer to recommend a "*comfortable car, suitable for touring*". The dealer recommended an eight cylinder Bugatti (a fast sports car).

HELD: The car was not suitable for the stated purpose.

In ***Slater v. Finning Ltd (1996)***, the defendant company were in business as marine engine suppliers and contracted with the claimant, Mr Slater, to repair the engine of one of his fishing vessels. They fitted a new type of camshaft to the vessel's engine but this failed at sea, as did two later replacements of the same type. Mr Slater claimed damages for breach of the implied condition of reasonable fitness for purpose contained in Section 14(3) of the **Sale of Goods Act 1979**.

The court found that the engine failure was not attributable to the camshafts themselves but to an external feature peculiar to the ship of which the defendant company were ignorant.

HELD: Mr Slater's claim could not succeed. The court stated: "*Where a buyer purchases goods from a seller who deals in goods of that description there is no breach of the implied condition of fitness where the failure of the goods to meet the intended purpose arises from an abnormal feature ..., not made known to the seller, ... in the circumstances of the use of the goods by the buyer .... In these circumstances, it would be totally unreasonable that the seller should be liable for breach of Section 14(3)* ***Sale of Goods Act 1979***".

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Sale by Sample

Goods are, of course, frequently sold by sample. A small piece or quantity is brought by the seller for the buyer's inspection. The bulk is then sold on the strength of an examination of the sample. Section 15 of the Act makes provision for this:

> *"(1) A contract of sale is a contract for sale by sample where there is an express or implied term to that effect in the contract.*
>
> *(2) In the case of a contract for sale by sample there is an implied condition:*
>
> *(a) that the bulk will correspond with the sample in quality;*
>
> *(b) that the buyer will have a reasonable opportunity of comparing the bulk with the sample;*
>
> *(c) that the goods will be free from any defect, rendering them unsatisfactory, which would not be apparent on reasonable examination of the sample".*

(a) The first point to notice is that Subsection (1) provides that a sale is by sample only if the contract says so, or it can be implied. The mere exhibition of a sample during negotiations does not of itself make the subsequent sale one by sample.

(b) The word "*bulk*" can include both unascertained and specific goods. It can also include future goods which have to be manufactured.

(c) The bulk must correspond with the sample in **quality**. The degree of correspondence is somewhat subjective, and depends to an extent on the type of goods and the intentions of the parties. For example, it is unlikely that the section would be breached if the buyer treated a sample to tests or analysis not usually employed in the trade, and then tried to claim that the bulk did not match up to such exhaustive testing.

On the other hand, if the bulk is not of the quality of the sample, there is a breach of the section even though the fault in the bulk could be put right at trivial cost: ***E and S Ruben Ltd v. Faire Bros & Co. Ltd (1949)***.

(d) The buyer must have a reasonable opportunity of comparing the bulk with the sample.

In ***Lorymer v. Smith (1822)***, a buyer was refused an opportunity to examine goods prior to delivery.

HELD: He was entitled to refuse to take delivery.

(e) The goods must be free from any defect, rendering them unsatisfactory, which would not be apparent on reasonable examination.

The examination which the buyer makes need not thus be exhaustive. The extent of it depends on the nature of the goods, the requirements and practices of the trade, and other relevant circumstances.

In ***Jurgensen v. F E Hookway & Co. Ltd (1951)***, a retailer buying plastic catapults tested one of them by pulling back the elastic. Later, one of the catapults proved to be of unmerchantable quality (i.e. "*unsatisfactory*" quality under the **Sale of Goods Act 1979**, as amended).

HELD: The examination was reasonable, and the seller liable.

(f) Unlike in the case of Section 14, Section 15 is not confined to sales "in the course of a business". The condition applies to **any sale by sample**.

(g) As we have already noted, by virtue of Section 13(2), if a sale is by both sample and description, the bulk of goods must correspond with both sample and description. So, correspondence with the sample provided will not be enough if there was a description given in advance and the goods do not correspond with it.

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F. Exclusion Clauses

Introduction

Human nature being what it is, few people want to incur liability for anything if they don't have to. Hence parties to contracts have always tried to insert clauses into their contracts exempting or restricting their liability for breach of contract or negligence. In the heyday of the Victorian theory of "freedom of contract", this licence probably did little harm.

Monopoly power in those days was rare, and contracts tended to be between people of roughly equal bargaining power (with the obvious exception of contracts of employment, with which we are not concerned in this study unit). Even nowadays, the **Sale of Goods Act 1979** permits the practice. Section 55(1) states:

> *"Where a right, duty or liability would arise under a contract of sale of goods by implication of law, it may (subject to the **Unfair Contract Terms Act 1977**) be negatived or varied by express agreement, or by the course of dealing between the parties, or by such usage as binds both parties to the contract".*

However, especially during the 20th century, the balance has altered. Large monolithic companies have arisen, which by virtue of their size and power can, if unchecked, virtually dictate to their customers the terms under which they are prepared to trade – "Take it or leave it!" This applies whether the customer is a private individual buying for him-/herself, or a small commercial concern.

These abuses of power usually took the form of standard conditions of sale, excluding the seller's liability for virtually any breach of contract or any act of negligence. They were drafted in obscure legal language, and printed in small lettering on the backs of all relevant contractual documents. The result was that most people did not read them. If they did, they did not usually understand them. The rare individual who both read and understood the conditions could do nothing about them anyway! Heads I win, tails you lose!

These exception or exclusion clauses were perfectly lawful, but they created such injustice that the courts were forced to go to extreme lengths in their endeavours to ensure fair play. Lord Denning MR in ***George Mitchell v. Finney Lock Seeds Ltd (1983)*** had this to say on the subject of exclusion clauses prior to the **1977 Act**:

> *"Faced with this abuse of power, by the strong against the weak, by the use of the small print of the conditions, the judges did what they could to put a curb on it. They still had before them the idol, 'freedom of contract'. They still knelt down and worshipped it, but they concealed under their cloaks a secret weapon. They used it to stab the idol in the back. This weapon was called 'the true construction of the contract'. They used it with great skill and ingenuity. They used it so as to depart from the natural meaning of the words of the exemption clause and to put on them a strained and unnatural construction. In case after case, they said that the words were not strong enough to give the big concern exemption from liability, or that in the circumstances the big concern was not entitled to rely on the exemption clause."*
>
> *"We should no longer have to go through all kinds of gymnastic contortions to get round them (exemption clauses). We should no longer have to harass our students with the study of them. We should set about meeting a new challenge. It is presented by the test of reasonableness."*

Unfair Contract Terms Act 1977

This Act is designed to put a statutory curb on the use of unfair exemption clauses in all contracts, including those for the sale of goods. It introduces, firstly, a distinction between contracts where one of the parties "is in the course of a business" and the other is a "consumer" – a consumer being a person who in his/her capacity as a party to the contract in

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question is not acting in the course of a business. Secondly, there is a distinction between a party seeking to rely on its own standard written terms of business, and reliance on terms which have been separately negotiated. Thirdly, there is the concept that terms excluding or restricting liability should be enforceable only if they are **reasonable in all the circumstances**.

The Act applies to all contracts, and it extends to the use of contract terms to exclude or limit liability for negligence.

The relevant parts of the **Unfair Contract Terms Act 1977** provide as follows:

(a) Section 1(1) defines "*negligence*" for the purposes of the Act as breach:

> *"1. of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;*
>
> *2. of any common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty)".*

(b) Subsection 1(3) ensures that the relevant provisions apply only to **business liability**, that is liability arising "*from things done or to be done by a person in the course of a business (whether his own business or another's)*". The exception to this is that in the case of contracts for the sale of goods, the relevant provisions of the Act apply to all such contracts, not merely where business liability is concerned, as follows:

- The implied condition as to title: **Sale of Goods Act 1979, Section 12**, cannot be excluded or restricted by any contract term.
- Implied conditions as to description: Section 13, satisfactory quality and fitness for the purpose: Section 14 and sample: Section 15, cannot be excluded or limited where the other party is a consumer, and where he/she is not, they can be excluded or restricted only to the extent that it is reasonable.

(c) Section 2 deals specifically with attempts to exclude liability for negligence. It is subject to the proviso contained in Section 1 that its terms apply only to things done in the course of a business.

A person cannot by means of any term of a contract, or by means of a notice given to people generally or any particular person, exclude or restrict his liability for death or personal injury resulting from negligence. In the case of other types of loss or damage, he can exclude or restrict his liability for negligence only in so far as it is reasonable. Section 2 goes on to provide that a person's awareness of or agreement to such a term or notice is not of itself to be taken as showing his voluntary acceptance of any risk i.e. the maxim "*volenti non fit injuria*" does not apply.

The clause is therefore not only controlling the use of **terms**, whether written or oral, of a negotiated contract, and **written standard terms**, but also notices of **contractual terms** which are displayed on public view or given to individual people. These include such notices as are posted up outside car parks, referred to on railway or bus tickets, or displayed in shops.

(d) Section 3 applies to contract terms where the party seeking to impose them is either dealing with a consumer, or is dealing on her own written standard terms of business.

In either event, that person can seek to exclude or restrict liability for her own breach of contract, or claim to be entitled to render a substantially different contractual performance from that reasonably expected of her, or render no performance at all in respect of all or any part of the contract, only to the extent that it is reasonable for her to do so.

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- In ***St Albans City and District Council v. International Computers Ltd (1994)***, the claimant local authority bore the responsibility of fixing and collecting the community charge rate for its administrative area and entered into a contract with the defendant company for the supply of computer software for the purpose. The contract was contained within the defendant company's liability to £100,000. Because of a mistake in the software supplied, the claimant's community charge was fixed too low, with the result that they sustained a total loss in excess of £1 million.
- The claimant authority contended that the defendant company was liable for its total loss of over £1 million in view of Section 3 of the **Unfair Contract Terms Act 1977** which states:

  "(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.

  (2) As against that party, the other cannot by reference to any contract term – when himself in breach of contract, exclude or restrict any liability of his in respect of the breach ... except in so far as ... the contract term satisfies the requirement of reasonableness".

  The defendant company argued that their liability was limited to £100,000 as stated in the contract.

  HELD: The defendant company had failed, on the facts, to establish that the exclusion clause was fair and reasonable and the claimant authority was accordingly entitled to recover its total loss in excess of £1 million.
- A "consumer" is someone who is not acting in the course of business where the other party is. So, if you buy, for instance, a second-hand suite of furniture from a "private" individual, you are not dealing as a consumer, because the other party isn't dealing in the course of business. If you buy a suite of furniture from a furniture showroom, or if you sell your unwanted Victorian wardrobe to an antiques dealer, you would be dealing as a consumer. In addition, where the contract relates to the supply of goods, the goods must be of a type which it is usual to find supplied for private consumption. Excluded from the definition of consumer are buyers who buy at an auction or by competitive tender.

  Small businesses can sometimes be treated as consumers where, though the goods concerned are being bought for the business, the fact that the firm's name was used is simply a convenience. Thus the courts have refused to draw a watertight distinction between the small business and its proprietors.

  In ***R & B Customs Brokers v. United Dominions Trust (1988)***, a firm, consisting of a husband and wife, decided to buy a second-hand car using the business name. Though bought in the firm's name, it was the intention that the car should be intended for the proprietors' personal use. The car was later found to leak excessively. UDT argued that since the car had been bought in the firm's name, the exclusion of liability contained in the contract meant that there was no remedy i.e. the restriction was valid.

  HELD: In reality the sale was a consumer sale so the exclusion clause contained in the contract was invalid.

(e) Section 4 prevents a consumer from being made liable by any contract term to indemnify any other person, whether a party to the contract or not, in respect of liability for negligence or breach of contract incurred by that other person, unless, that is, the indemnity clause is reasonable.

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(f) Section 5 deals with the problem of "guarantees" given by the manufacturers of goods normally supplied for private use or consumption. Such "guarantees" cannot exclude or restrict the liability of the manufacturer or distributor of the goods for defects due to negligence.

(g) The **Unfair Contract Terms Act** also attempts to close any loopholes in its provisions by preventing evasion by means of **secondary contracts**, by outlawing restrictive or onerous conditions in contracts, and by preventing people avoiding its provisions or prejudicing the rights of people who seek to pursue remedies.

As will be apparent, in the majority of cases, especially where the contracting parties are both in the course of a business, the Act does not prohibit contract terms which exclude or restrict liability. What it does is to allow them provided that they are **reasonable**.

(h) Schedule 2 lays down the following guidelines for the application of the test of "reasonableness".

> *"The matters to which regard is to be had ... are any of the following which appear to be relevant:*
>
> *a. the strength of the bargaining positions relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;*
>
> *b. whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;*
>
> *c. whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);*
>
> *d. where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;*
>
> *e. whether the goods were manufactured, processed or adapted to the special order of the customer."*

Other criteria which the court will take into consideration in deciding on the reasonableness or otherwise of a contract term include:

- Advertising methods and content
- Responsibility for insurance
- Choices available to the parties
- The resources of the respective contracting parties
- The price of the goods
- Any defined maintenance obligations
- The terms of any relevant codes of practice in the trade or industry concerned
- The typeface used in contractual documents, and the relative prominence of the exclusion clause.

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Unfair Terms in Consumer Contracts Regulations 1994

These Regulations implement the EU Directive on Unfair Terms in Consumer Contracts. They do not replace the **Unfair Contract Terms Act 1977**, and companies which do not supply goods or services to consumers are unaffected by the Regulations.

(a) Consumer contracts

The Regulations cover **consumer** contracts. Regulation 2 defines a consumer as "*a natural person who, in making a contract to which these Regulations apply, is acting for purposes which are outside his business*". Contracts between two consumers are not governed by the Regulations.

(b) Pre-formulated contracts

The UK Regulations apply to those consumer contracts for the supply of goods or services which include terms which **have not been individually negotiated between seller and consumer**. The Regulations provide that a contractual term will always be regarded as not having been individually negotiated where it has been drafted **in advance** and the consumer has not been able to influence "*the substance of the term, particularly in the context of a **pre-formulated standard contract***". The burden of proving that a term has been individually negotiated falls on the supplier.

(c) Unfair terms

The general principle is that any term will be unfair if it causes a significant imbalance in the rights and obligations arising under the contract to the detriment of the consumer. Contracts must be written in plain, intelligible language, and if there is any ambiguity or obscurity the interpretation more favourable to the consumer will apply.

In addition to these overall criteria, the Regulations contain a long list of specific terms which are unfair. These include:

- Irrevocably binding the consumer to terms with which he had no chance to become familiar before the contract was entered into
- Requiring consumers to pay disproportionately high sums in compensation where the consumer terminates the contract
- Allowing the seller to terminate the contract at will where the consumer has no such right, or allowing sellers to retain sums paid for services not yet supplied at the time of termination
- Allowing the seller unilaterally to alter the characteristics of a product or service without a valid reason
- Determining the price at the time of delivery or increasing the price later without giving the consumer the right to reject the goods
- Giving the seller the right to decide if the goods conform to the contract or the exclusive right to interpret contract terms. (Clauses stipulating that allegedly defective goods must be returned to the seller who will assess whether these do constitute defects will be unenforceable under this provision.)

Interpretation of Exemption Clauses

The common law has evolved a variety of rules for interpreting the meaning of exemption clauses. Since the passing of the **Unfair Contract Terms Act**, such methods have been less necessary, and a more literal interpretation has often been possible. The object is therefore to give effect to the **manifest intention** of the parties.

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The principal rules still in common use are:

(a) "*Contra proferentem*"

An exclusion clause will be construed strictly against the person who **inserted it**. In other words, the other party is given the benefit of any doubt.

(b) Negligence

If a party wishes to exclude liability for negligence in the performance of his/her contract, he/she must use **very clear** words. Any looseness or ambiguity will cause the term to be rejected.

(c) Particular duties

If a clause exempts a party from complying with specific duties or matters, then **all other duties or matters** will remain in full force.

(d) General words

The wording used must be clear, precise and unambiguous, otherwise it will be ineffective. **General words** used in an exemption clause will not normally absolve the person who tries to rely on them from liability.

The House of Lords had occasion to review the construction of exemption clauses in ***Ailsa Craig Fishing Co. Ltd v. Malvern Fishing Co. Ltd (1983)***. Here, Lord Wilberforce laid down the following rules:

> *"(1) Whether a condition limiting liability is effective or not is a question of construction of that condition in the context of the contract as a whole.*
>
> *(2) If it is to exclude liability for negligence, it must be clearly and unambiguously expressed.*
>
> *(3) It must be construed contra proferentum.*
>
> *(4) One must not strive to create ambiguities by strained construction. The relevant words must be given, if possible, their natural plain meaning.*
>
> *(5) Clauses of limitation are not regarded by the courts with the same hostility as clauses of exclusion; this is because they must be related to other contractual terms, in particular to the risks to which the defending party may be exposed, the remuneration which he receives and possibly also the opportunity of the other party to insure."*

In short, therefore, clauses attempting totally to exclude liability are to be construed **strictly**. Clauses which merely limit the liability to an agreed amount are to be given their **natural** and **intended meaning**, and allowed to stand if **reasonably possible**.

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Study Unit 10

The Sales of Goods 3: Disputes and Remedies

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A. REMEDIES OF THE SELLER

Should the buyer be in breach of a contract of sale, the seller has various remedies open to him/her, depending on the circumstances. The types of breach of which a buyer may be guilty are by the nature of a contract of sale of goods limited to:

- Failure to pay the price
- Failure to take delivery, either at all or later
- Wrongful rejection of the goods.

The remedies open to the seller depend partially on whether he/she still has **possession** of the goods at the time of the buyer's breach, and whether or not the **property** in the goods has passed to the buyer. He/she will always have a right of action for breach of contract, and may also have a remedy in respect of the goods themselves.

Before looking at these remedies in detail, we must first establish just who "the seller" is, and when his/her primary right to be paid the price is in default.

Section 38(2) of the 1979 Act defines a seller as including "*any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid (or is directly responsible for) the price*".

The definition is therefore more extensive than that which you would normally think of as a seller. Anybody who has documents of title to the goods assigned to him, or who has paid, or has a legal duty to pay, the original seller or any intermediate seller for the goods, is deemed to be "*a seller*" within the meaning of the Act. The definition is also wide enough to include a surety for the buyer. Until the buyer defaults, the liability of a surety is only contingent. But once he has been called upon to pay the buyer's default, then he is subrogated to the rights of the seller – that is to say, he steps into the seller's shoes as far as enforcing the seller's rights against the buyer to be paid. He is then a person "*who is in the position of a seller*".

As we have said, the primary right of a seller is to be paid the price.

Section 38(1) provides as follows:

> *"The seller of goods is an unpaid seller within the meaning of this Act:*
>
> *(a) when the whole of the price has not been paid or tendered;*
>
> *(b) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise".*

You should note that a seller is "*unpaid*" while any part of the price has not been paid or tendered. "*Tendered*" refers to the offer of payment in satisfaction of the price. If the seller refuses to accept a tender of payment in accordance with the contract, then he/she ceases to be an "unpaid seller". By the same token if, according to the terms of the contract, payment in whole or in part is not due, the seller remains an "unpaid seller" (e.g. if the contract provides for payment by instalments, or after an agreed period of credit).

Payment by means of a negotiable instrument, usually these days a cheque, is only a **conditional payment**: conditional that is, on the instrument being duly honoured on presentation in accordance with the terms of its issue. If it is dishonoured (or "bounces") then the condition is unfulfilled, and the seller's rights revert.

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Remedies Affecting the Goods

Three specific rights in respect of goods are given to an unpaid seller by Section 39:

> *"(1) Subject to this and any other Act, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such, has by implication of law:*
>
> *(a) a lien on the goods or a right to retain them for the price while he is in possession of them;*
>
> *(b) in case of the insolvency of the buyer, a right of stopping the goods in transit after he has parted with the possession of them;*
>
> *(c) a right of resale as limited by the Act.*
>
> *(2) Where the property in goods has not passed to the buyer, the unpaid seller has (in addition to his other remedies) a right of withholding delivery similar to and co-extensive with his rights of lien or retention and stoppage in transit where the property has passed to the buyer".*

We will now look at these rights in detail.

Lien

A lien is the right of a person such as a bailee, in possession of goods, to retain those goods until any claim he/she has on or in respect of them has been satisfied.

This is a common law right, and applies to any goods which a person has in his/her possession with the consent of the owner. If you leave your car with a garage for repairs or servicing, the garage has a lien on it, and a right to retain it until you have paid the bill.

However, the lien of a seller is **special**, not general. He/she has no right to retain the goods until any other debts owed by the buyer are paid, but only in the precise circumstances allowed by the Act.

Section 41 sets out the rules:

> *"(1) Subject to this Act, the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases:*
>
> *(a) where the goods have been sold without any stipulation as to credit;*
>
> *(b) where the goods have been sold on credit but the term of credit has expired;*
>
> *(c) where the buyer becomes insolvent.*
>
> *(2) The seller may exercise his lien or right of retention notwithstanding that he is in possession of the goods as agent or bailee or custodier for the buyer."*

Subsection (1) is straightforward. Subsection (2) is spelling out the situation where the property has passed to the buyer. In order for a lien to exist, the goods must be owned by **someone else**. Hence, if this is the case, the seller is acting as agent or bailee or custodier of the goods for or on behalf of the owner. Which category she is in will depend on the individual circumstances. The reason for this sub-section being inserted is because it changes the common law rule, which was that only a seller **in possession** was entitled to a lien. She lost the right if she retained possession only as an agent or bailee.

However, the right of lien given by the Act is only in respect of payment or tender of the **price**. It does not subsist in respect of other charges arising out of the goods e.g. storage charges: ***Somes v. British Empire Shipping Co. (1860)***.

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Where the contract provides for delivery by instalments, or where part-delivery only has been made, Section.42 permits an unpaid seller to exercise his/her lien in respect of any instalment or part not already delivered.

You should note that a lien exists only if the seller is in possession. It does not entitle him/her to repossess goods from the buyer or from any other party who is actually in possession. It is therefore different from the right of stoppage in transit, which we will look at in the next section.

The Act makes this clear in Section 43, which covers the termination of the seller's lien and states:

> *"(1) The unpaid seller of goods loses his lien or right of retention in respect of them:*
>
> *(a) when he delivers the goods to a carrier or other bailee or custodier for the purpose of transmission to the buyer without reserving the right of disposal of the goods;*
>
> *(b) when the buyer or his agent lawfully obtains possession of the goods;*
>
> *(c) by waiver of the lien or right of retention.*
>
> *(2) An unpaid seller of goods who has a lien or right of retention in respect of them does not lose his lien or right of retention by reason only that he has obtained judgment or decree for the price of the goods."*

We discussed "reserving the right of disposal" earlier in this module, and in the context of lien it usually arises when the seller takes a bill of lading in respect of the goods made out to his/her order. It is only when the seller **endorses** that bill of lading to the buyer or some other party that the right of disposal is transferred.

The "waiver" of lien can arise in a number of ways. It can be express, as a term of the contract, or more commonly waiver can be implied from the **seller's conduct**. The granting of credit at the time of the contract amounts to a waiver for the period of credit. Should the seller deal with the goods in a manner inconsistent with the right of retention, she will be deemed to have waived her lien. For instance, if she wrongfully sells the goods to a third party in circumstances where the Act does not allow a right of resale, she cannot rely on her right of lien to justify her action. A lien would also be deemed to have been waived if the seller takes some security for the goods, the terms of which are inconsistent with the right of lien.

Stoppage in Transit

The right of "stoppage in transit" is of ancient origin, and is derived from mercantile custom. The first reported case was ***Wiseman v. Vandeputt (1690)***, and the doctrine was approved and accepted by the House of Lords in ***Lickbarrow v. Mason (1793)***. However, it is now governed by the **Sale of Goods Act 1979**, Sections 44–46.

(a) The principle is that normally once a seller delivers goods to a carrier for transmission to the buyer, he loses his right of lien. Hence if the seller is unpaid, and during the course of transit the buyer becomes insolvent, then the unpaid seller can reassert his lien by instructing the carrier not to deliver the goods to the buyer and instead hold them to the seller's order. It is important to note that the right of stoppage in transit arises only if the buyer becomes **insolvent**. It cannot be exercised merely because he does not pay, or even merely because he calls a meeting of creditors: it could be he just needs more capital.

The definition of insolvency for the purposes of sale of goods (which is not necessarily the same as insolvency for other legal purposes) is contained in Section 61(4) of the 1979 Act:

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> *"A person is deemed to be insolvent within the meaning of this Act if he has either ceased to pay his debts in the ordinary course of business or he cannot pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he has become a notour bankrupt or not".*

(A "*notour bankrupt*" is a term used only in Scots law, and means a state of insolvency which is notorious or well known.)

(b) Section 44 defines the right of stoppage in transit:

> *"Subject to this Act, when the buyer of goods becomes insolvent the unpaid seller who has parted with possession of the goods has the right of stoppage in transit, that is to say, he may resume possession of the goods as long as they are in course of transit, and may retain them until payment is tendered of the price".*

So the first thing is that the exercise of the right does not serve to determine the contract of sale. It is merely a right to repossession of the goods, until such time as the buyer pays or tenders the price, or until the contract is rescinded and a right of resale by the seller arises (see the next section).

Thus, if the buyer defaults in payment while the goods are in transit, no problem of proof of insolvency is likely to arise. Delivery is merely stopped until he/she pays, or the seller takes steps to assert his/her right of resale. If, on the other hand, payment is not due until after the expected date of delivery to the buyer, then the seller risks having to prove the insolvency in court if he/she stops the goods in transit.

(c) The next problem that arises is just when, and in what circumstances, goods are deemed to be "*in transit*".

Section 45, Subsections (1)-(7), gives rules for determining the duration of transit, for the purposes of the seller exercising his right of stoppage. The essential thing is that during transit the goods must be in the possession of a third party or "intermediary" who is neither the buyer or the seller, nor the exclusive agent of either.

- The first and straightforward situation is that goods are deemed to be in transit from the time they are delivered to a carrier or other bailee, etc. for the purposes of transmission, until the buyer or his/her agent takes delivery of items from the carrier or bailee.
- If the buyer or his/her agent gets delivery before the goods arrive at their appointed destination, the transit is at an end. Unless there are special terms in the contract of carriage, the consignee is generally entitled to demand the goods from the carrier at any place en route: ***Cork Distilleries Co. v. G S & W Railway (1874)***.
- If after the goods have arrived at their appointed destination, the carrier or bailee acknowledges to the buyer or his agent that he is holding them on the buyer's behalf (attorns), and he continues in possession as bailee for the buyer, then the transit is at an end. It is immaterial that the buyer may have indicated a further destination for the goods. It is essential in this situation that the carrier or bailee should have **expressly consented** to hold the goods as a warehouseperson or bailee for the buyer. **Mere silence** is not sufficient.
- In the event that the buyer rejects the goods, and the carrier or bailee remains in possession, then the transit is not deemed to have ended, even though the seller has refused to take the goods back.
- If goods are delivered to a ship which has been chartered by the buyer, it is a question depending on the particular circumstances whether they are in the possession of the master of the ship as a carrier or as an agent of the buyer.

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If the facts show that the master is acting in a capacity as carrier, the transit will subsist. On the other hand, if he/she is deemed to be an agent of the buyer, then the transit will end (if indeed it ever began) under Rule (2) when the goods are loaded.

In ***Berndtson v. Strang (1868)*** it was **held** that the proper test to apply was whether the ship's master was a servant of the owner, or of the buyer in his capacity as charterer. It will depend on the terms of the charter as to whether or not the buyer is deemed "owner" of the ship for the voyage (a demise charter). If he is not, the master is still a servant of the actual owner, and so a carrier.

- The transit ends if the carrier or bailee wrongfully refuses to deliver the goods to the buyer or his/her agent.
- Where part-delivery of the goods has been made, the remainder may be stopped in transit, unless the part-delivery was made in such circumstances as to show an agreement to give up possession of the whole of the goods.

(d) Section 46 details the rules as to how a stoppage in transit may be effected. The unpaid seller can exercise his/her right of stoppage by taking actual possession of the goods, or by giving notice of his/her claim to the carrier or bailee in whose possession they are. By the nature of things, the latter course is the most likely to arise, unless the unpaid seller has an agent in the place of destination.

Notice of the exercise of the right is equally valid if given to the person in actual possession of the goods, or that person's principal. However, if given to the principal, it will be ineffective unless given in sufficient time to allow the principal, by using due diligence, to communicate the notice to his/her servant in possession to prevent delivery being made.

When notice of stoppage in transit is given by the seller to the carrier or bailee, the carrier or bailee is under a duty to redeliver the goods to the seller, or deal with them in accordance with the directions of the seller. The expenses of redelivery or other action must be borne by the seller.

In this event, of course, the carrier or bailee, being in possession, has a lien on the goods for payment of freight or other charges in connection with both the original carriage and the redelivery.

(e) The question of what happens if the buyer has resold the goods in the meantime is covered by Section 47. Both the right of lien and the right of stoppage in transit are unaffected, **unless** the seller has assented to a resale or other disposition of the goods by the buyer. Where, however, a **document of title** to the goods (e.g. a bill of lading) has been lawfully transferred to the buyer, and he/she has in turn transferred it by way of sale to a sub-buyer who takes it in good faith and for valuable consideration, then the original unpaid seller's rights of lien or stoppage in transit are defeated. If, however, the transfer of the document to a third party was by way of pledge not sale, then the original seller's rights can only be exercised subject to the rights of the pledgee.

Note that stoppage is appropriate where property has not passed. You cannot have a lien on your own goods.

Resale

A lien on goods, or a right of stoppage in transit, would be of only limited value to an unpaid seller if he/she did not also have a right to resell the goods. The difficulty is that the contract of sale is not rescinded by the exercise of a lien or stoppage in transit by the seller.

This common law rule is specifically spelled out by Section 48(1).

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Hence, unless a power of resale is given, the unpaid seller would be in breach of contract if the **property** in the goods had passed to the buyer. If it had, he/she could not pass a good title to the sub-buyer. Section 48(2), therefore, provides that on a resale after exercise of lien or stoppage in transit, a sub-buyer acquires a good title as against the original buyer. Section 48(3) lays down the rules under which the unpaid seller may resell the goods:

> *"Where the goods are of perishable nature, or where the unpaid seller gives notice to the buyer of his intention to resell, and the buyer does not within a reasonable time pay or tender the price, the unpaid seller may resell the goods and recover from the original buyer damages for any loss occasioned by his breach of contract".*

For obvious reasons, perishable goods may be sold at once. But in the case of non-perishable goods, the unpaid seller is first required to give notice, and a reasonable time for the buyer to remedy his/her breach of contract and pay the price. Failure to do so constitutes a repudiation of the contract by the buyer. However, even if the unpaid seller wrongfully resells, whether or not given the necessary notice or too short a period of notice, by
Section 48(2) the sub-buyer gets a good title. The unpaid seller may be liable to the buyer for damages.

One problem with Section 48(3) which the courts have not clearly solved is whether the resale rescinds the contract, in which case all the seller can do is to claim damages for non-acceptance, having returned the buyer's deposit or any other payment, or whether the resale is simply affirming the contract, in which case the seller can claim for any loss he/she suffers on the resale. Such problems do not affect lien or stoppage since they do not rescind the contract of sale.

In ***R V Ward Ltd v. Bignall (1967)*** the Court of Appeal **held** that a resale rescinds the original contract. Hence, the seller could only claim damages for non-acceptance. Having made a loss on the resale, he could not recover that loss from the buyer.

But in ***Clough Mill Ltd v. Martin (1984)*** the Court of Appeal felt that it was possible for the unpaid seller to recover any shortfall in the original price where he had been forced to resell by reason of the buyer's default. Nevertheless, the Court pointed out that the buyer must be credited with any deposit or part-payment.

Finally, Section.48(4) states that if the seller has expressly reserved a right of resale in the event of default by the buyer, and he/she duly exercises this right, then the original contract of sale is rescinded, but without prejudice to any claim for damages the seller may have.

Other Remedies of the Seller

Rights in respect of the goods – i.e. lien, stoppage in transit, and resale – are, of course, not the only rights an unpaid seller possesses. These can apply only if he/she, or a carrier, is in possession of the goods. They are called "real" remedies, because they are applicable to **things**. The other remedies are "personal" because they are applicable to the defaulting **buyer him-/herself**, and are quite irrespective of the actual goods. Personal remedies can be sought either in addition to, or in substitution for, the real remedies.

(a) Claim for the price

Section 49 states:

> *"(1) Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods.*
>
> *Where, under a contract of sale, the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay*

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> *such price, the seller may maintain an action for the price, although the property in the goods has not passed and the goods have not been appropriated to the contract."*

An action for the price is distinct from a claim for damages. The price is an amount fixed by the contract and is a **debt** owing from the buyer to the seller. Damages, on the other hand, are the **loss** suffered by the seller in respect of the buyer's breach of contract. The amount of loss has to be **proved**, and it may be more or less than the price.

Under Subsection (1), if the property has passed, the seller can forthwith sue for the price as soon as the due day of payment has passed. This presents few problems. Should the seller still be in possession, his/her lien on the goods will ensure that the defaulting buyer does not get delivery until the judgment debt for the price is paid.

But if the property has not passed, it is more difficult. In the first place, payment of the price must be due by the contract of sale on "a day certain". In ***Shell Mex Ltd v. Elton Corporation Dyeing Co. Ltd (1928)***, it was **held** that this was "*a time specified in the contract not depending on a future or contingent event*". In other words, it is a time which is fixed **independent** of any action by either party. If the property has not passed, and the price is not payable on a day certain, then the seller's only remedy is for **damages**.

It follows, of course, that when the price is received, whether voluntarily or as a result of a judgment, the seller will be bound to pass the property in the goods, and if applicable, give possession of them to the buyer.

(b) Damages

The alternative remedy where the buyer wrongfully neglects or refuses to accept the goods, or wrongfully rejects them, is an action for damages for "non-acceptance". By the nature of it, the seller is necessarily repossessed of the goods, and if they are of a type for which there is a market he/she can resell them; Section 50 provides for this remedy.

Firstly, "*the measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract*".

It was **held** in ***Hadley v. Baxendale (1854)*** that the quantum of damage does not depend only on the buyer's actual knowledge of any special circumstances likely to cause loss, but firstly on "imputed" knowledge – that is, "*what reasonable businessmen must be taken to have contemplated as the natural and probable result if the contract was broken. As reasonable businessmen, each must be taken to understand the ordinary practices and exigencies of the other's trade or business*" (Lord Wright in ***Monarch Steamship Co. Ltd v. Karlshamns Oljefabriker A/B (1949)***).

Secondly, it depends on actual knowledge of any **special circumstances** likely to cause loss.

The second available measure of damages is as stated in Section 50(3):

> *"Where there is an available market for the goods in question, the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted or (if no time was fixed for acceptance) at the time of the refusal to accept".*

The test for an "*available market*" is either some actual market or exchange where the goods can be sold (***Dunkirk Colliery Co. Ltd v. Lever (1878)***); or "*a particular level of trade in a particular locality*": ***Heskell v. Continental Express Ltd (1950)***.

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The market or current price for an aggrieved seller is the actual selling price of the commodity in the market or locality.

The rule is, of course, easier to apply to new goods. Where the goods are second-hand, the courts are more likely to calculate the damages on the basis of lost profit. In ***Lazenby Garages v. Wright (1976)*** the buyer of a second-hand BMW defaulted on the purchase. The dealers were able to sell the car at the same price. The dealers claimed damages. The court refused to apply the market rule, pointing out that in such a case it was no help, and instead decided the issue on the basis of lost profit. Since the dealers had suffered no loss, they could get nominal damages only.

You should note that the damages are not necessarily the price the seller actually gets on resale; they are the current price pertaining on the day the buyer **ought to have accepted the goods**, or when he/she **actually refused to accept them**, as the case may be. Inevitably, the actual sale will be later, so the seller may recover more or less, depending on the fluctuations in the market. It is only in the case of **anticipatory breach** that the seller might be in a position to sell earlier.

The seller will also be able to recover any **expenses** reasonably incurred in making the sale.

(c) Miscellaneous remedies

There are various additional remedies which may be available to the seller. They do not specifically appear in the **Sale of Goods Act 1979**, but are part of the general law. For instance:

- Recovery of possession of the goods under a specific term of the contract
- Damages for the tort of "conversion" for wrongful interference with goods
- Forfeiture by the buyer of deposits or pre-payments
- An order for specific performance of the contract.

B. REMEDIES OF THE BUYER

Damages

For obvious reasons, the "real" remedies of lien and stoppage in transit (remedies attached to the **thing**, or **res**) are not possible for a buyer in the event of breach of contract by the seller. His/her principal remedies are **damages** for the various types of breach which the seller may make.

(a) Damages for non-delivery

These are covered by Section.51 and are effectively exactly the same as those available to a seller in the event of non-acceptance. The "market price" is, of course, the buying price in the market or locality, either at the time when the goods should have been delivered according to the contract, or the time when the seller refused to deliver.

Complications can, however, arise in the event that the buyer had contracted to resell the goods to a sub-buyer before the seller's failure or neglect to deliver became known. The market price in such a situation would not necessarily be a fair measure of the buyer's loss if he were unable to complete his contract with his sub-buyer. Even if there is an available market in which the buyer can purchase in order to fulfil his contract of sub-sale, he may well have contracted to sell at a very different price from that pertaining in the market at the time in question.

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Due to the wording of the Act – that damages are *prima facie* the difference between the contract price to the buyer and the market or current price – the actual price the buyer has to pay in order to complete his sub-sale contract is ordinarily irrelevant. However, in certain circumstances, his **loss of profit** on the sub-sale may be recoverable.

These circumstances are akin to those mentioned under the ruling in ***Hadley v. Baxendale***, namely, the seller must have either **actual** or **imputed** knowledge that the buyer was, or was likely to be, reselling the goods in question.

The leading case is ***Hall v. Pim (1928)*****.** Here an unascertained cargo of 7,000 tons of Australian wheat was purchased on c.i.f. terms, and the contract specifically recognised that the buyers might resell during the voyage. In the event, the buyers did resell at a higher price than the contract price. On the ship's arrival, the sellers failed to deliver. The market price had by then dropped. The buyers claimed the difference between the contract price, and the price at which they resold to their sub-buyer.

HELD (House of Lords):

- That the terms of the contract contemplated that the cargo might be resold, and anyway it was the custom in the trade to resell cargoes on the high seas.
- The liability of the seller would be limited to the loss of normal profits under a resale made on the terms usual in the trade.
- However, he would also be liable for the damages incurred by the buyer in the event that due to his failure to deliver, the buyer was unable to make delivery to his sub-buyer.

(b) Damages for delay in delivery

Delay, as opposed to non-delivery, is not specifically mentioned in the 1979 Act. It is, of course, a breach of contract, and entitles the buyer to damages for loss suffered as a result. This must be dependent partially on whether the buyer is a trader, buying the goods for resale, or whether she is buying for her own use.

In the former event, the market price is relevant only to the extent that the buyer will have to purchase in the market goods to fulfil any contract she has with a sub-buyer. Alternatively, if she has not resold the goods prior to actual delivery, she will do so as soon as they are delivered. On the authority of ***Koufos v. Czarnikow (1969)*** it appears that in this event the measure of damages is the difference between the market price at the time the goods should have been delivered, and the price when they were in fact delivered. In general, however, as in the case of non-delivery, the effects of sub-sales are ignored unless the contract actually **contemplates a sub-sale**, and the erring seller has either actual or imputed knowledge of it.
A controversial case on this subject was ***Wertheim v. Chicoutimi Pulp Co. Ltd (1911)***. Here the seller was late in delivering goods. The market price when the goods should have been delivered was 70 s (£3.50) a ton. When they were actually delivered it had dropped to 42 s 6 d (£2.13) a ton. However, the buyer was able to resell at 65 s (£3.25) a ton.

HELD (Privy Council): The buyer was entitled only to the difference between 70 s (£3.50) and 65 s (£3.25) a ton.

This decision has been criticised as it appears to go against the normal rule of ignoring sub-contracts. The defaulting seller benefited solely because the buyer chose not to buy alternative goods in the market immediately after the default.

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If the goods are not bought for resale, but are profit-making articles, the buyer may recover damages for **loss of use** during the period of delayed delivery, but not loss of profits in respect of an unusual or exceptional use.

In ***Victoria Laundry (Windsor) Ltd v. Newman Industries Ltd (1949)***, the buyers purchased a new boiler for their laundry business. Unbeknown to the sellers, they had secured a highly lucrative dyeing contract with the Ministry of Supply. The sellers were late in delivering the boiler.

HELD (Court of Appeal): The buyers were entitled to recover for the loss of business and profits from normal and foreseeable usage of the boiler, but not for loss of profit on the dyeing contract, which was not reasonably foreseeable.

(c) Damages for defective quality

Quality of goods may be either a condition or a warranty of the contract. If the seller is in the course of a business, the quality and fitness for the purpose are implied conditions (Section 14). Hence the buyer has an option. He/she can reject defective goods, and sue for damages for breach of condition. The damages will then be equivalent to those where the seller has failed to deliver. Alternatively, he/she can treat (or be compelled to treat) the breach as merely a breach of warranty. In this event, Section 53 provides:

> *"(1) The buyer may*
>
> *(a) set up against the seller the breach of warranty in diminution or extinction of the price, or*
>
> *(b) maintain an action against the seller for the breach of warranty.*
>
> *(2) The measure of damages for breach of warranty is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty."*

This applies to all breaches of warranty by the seller. We have already discussed the effects of Subsection (2). However, Subsection (3) goes on to state:

> *"In the case of breach of warranty of quality such loss is prima facie the difference between the value of the goods at the time of delivery to the buyer, and the value they would have had if they had fulfilled the warranty".*

So the damages are assessed on the assumption that the defective goods have a value in that state, and amount to the difference between that value and the value of goods of the correct quality. If the buyer chooses to retain them (if possible), then the cost of so doing is irrelevant, unless they are such that there is no market value for them. In this event only, the measure of damages will be the cost of putting them into the contractual state.

Repayment or Diminution of the Price

For any breach of warranty, the buyer may claim repayment or diminution of the price: Section 53(1) and such action does not prevent him/her from claiming damages in addition if he/she has suffered further loss: Section 53(4).

Other Remedies

The principal additional remedy in the case only of specific or ascertained goods is an order for **specific performance**. This option is given by Section 52(1) which, as for all equitable remedies, is granted only if the court thinks fit. However, the section authorises the court to order specific performance "*without giving the defendant the option of retaining the goods on payment of damages*".

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C. SUPPLY OF GOODS AND SERVICES ACT 1982

The **Sale of Goods Act 1979** applies only to contracts of the sale of goods as defined. Other contracts under which the property in goods passes, but which do not fall into the definition, are not covered. The common law has for long applied many of the provisions of the Act by analogy to such other contracts.

So in 1982 this common law practice was given statutory authority, to an extent anyway, by the **Supply of Goods and Services Act 1982**. This Act applies to all contracts where goods are transferred and the property passes, **other than** contracts:

- For the sale of goods
- For hire purchase
- Where property in goods passes in exchange for trading stamps
- For transfer under seal where there is no consideration
- Where transfer is by way of mortgage, pledge, charge or other security.

The Act implies into all relevant contracts effectively the same conditions or warranties as those of the **Sale of Goods Act 1979**, namely:

- A right to transfer the property
- Freedom from charge or encumbrance
- Quiet possession
- Correspondence with sample and/or description
- Satisfactory quality and fitness for the purpose.

Similar provisions, with the necessary changes, are made in respect of goods which are hired and in which, of course, the property **does not pass**.

Part II of the Act deals with the supply of **services**. In such contracts for services, whether or not the property in goods also passes, it is implied that:

- The supplier will carry out the service with **reasonable skill and care**
- If the time for performance is not fixed, it will be carried out within a **reasonable time**
- Where the consideration is not fixed by the contract, or implied from a course of dealing, the charge made by the supplier will be **reasonable**.

Subject to the **Unfair Contract Terms Act 1977**, these implied warranties can be negatived or varied by agreement.

D. ROLE OF THE COMMERCIAL COURT

Mercantile Law

As early as 1895, it was appreciated that mercantile disputes were in a somewhat different category from ordinary private litigation. The disputes of merchants and traders were, therefore, assigned to a special "commercial list" at the High Court in London, and tried under a simplified and relatively speedy procedure.

This was, perhaps, not so great a departure from established legal practice as it might appear. In medieval times, the affairs of merchants were resolved in local Borough Courts and similar, which applied the **law merchant** (as distinct from the then infant common law of England). These local mercantile courts were gradually assimilated by the Royal Courts.

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However, even in the 19th century, special courts were not unheard of. The High Court of Admiralty was established in 1340, primarily to deal with piracy and prize questions, but it quickly assumed a civil jurisdiction. As a result of the **Judicature Act 1875**, it became a division of the High Court (linked, strangely enough, with Probate and Divorce).

Modern Courts and Procedure

The commercial lists of the High Court continued until 1970, when a Commercial Court was constituted as part of the Queen's Bench Division of the High Court. The judges of the Commercial Court are normal "*puisne*" judges of the High Court, nominated by the Lord Chancellor to the court, and they acquire a competence and expertise in commercial matters not normally associated with the High Court. The court primarily deals with those branches of law which stem from mercantile custom, rather than the common law (such as insurance, banking and mercantile agency), and with mercantile documents such as bills of lading, charter-parties and negotiable instruments. Ordinary disputes concerning contracts and tort between companies or individuals are not, usually, dealt with in the Commercial Court.

The Court sits in London, Liverpool and Manchester. Its procedure is simpler and more flexible than the normal procedure and greater use is made of documentary evidence. If both parties consent (as they usually do), the strict rules of evidence are relaxed.

Judges of the Commercial Court may (with the consent of the Lord Chancellor) accept appointment as sole arbitrators (or umpires) in disputes of a commercial nature under the terms of arbitration agreements. Arbitration is covered at the beginning of this study manual

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Study Unit 11

Law of Agency 1: Agency Agreements and Agents

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A. GENERAL NATURE OF AGENCY

"He who does an act through another is deemed in law to do it himself."

This is a maxim of the common law, and it is the basis of the law of agency. Subject to the terms of the **Contracts (Rights of Third Parties) Act (1999)**, under the normal rule of privity of contract, if one person contracts with another, a third party can derive no benefit, nor incur any obligations, under that contract. However, if one person authorises another to do an act on his behalf, that other becomes the **agent** of the first. The act of the agent, then, under the maxim quoted above, becomes the act of the first person who "steps into the shoes" of the agent and becomes liable for the act (and able to enjoy its benefits) **as if he himself had done it in the first place**. The agent has no personal liability; he "drops out" of the transaction.

In commercial matters, the relationship of agency usually arises as a result of a contract between **two** people, for one (the agent) to effect a contract on behalf of the other. However, this is by no means the only way in which the relationship can arise, nor is the effecting of a contract the only duty an agent can perform.

The fundamental principle is that, by the agreement of both parties, the agent is enabled directly to affect the legal relations of another person. Except in the case of "agency of necessity", about which we shall talk later in this study unit, nobody can have an agency relationship forced upon him/her, nor can it arise other than by **agreement** (express or implied).

Definitions

There are a number of definitions on which, even at this early stage, you should be clear. We shall be discussing them in greater detail later but, in outline, the essential ones are as follows:

- **Principal**

  The "principal" is the person who agrees, expressly or by implication that another shall do an act for and on his behalf, and that he shall be **legally bound** by that act. (Note re spelling: it should be a principle to spell "principal" correctly!)

- **Agent**

  The agent is the person who acts on behalf of her principal, and **binds** her principal **in law**.

- **Authority**

  The authority of an agent is the act(s) and thing(s) which he is permitted or is authorised to do by his principal, and which will bind the principal. There are several different types of authority, some express, some implied but in general (subject to exceptions), the principal will be bound by an act only if that act is **within the authority** of the agent to do on the principal's behalf.

Other Types of Relationship

There are certain basic relationships which arise out of a contract whereby one person commits an act (or several acts) for another but which are not (or not wholly) agency relationships.

- **Master and Servant** (this covers most employer/employee situations)

  This is not primarily a matter of agency. A servant is under the contract and direction of the master, and the master is vicariously liable for the acts of the servant. However,

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vicarious liability arises by virtue of the **relationship**, not by reason of the servant's acting as an agent and the relevant liability is generally in **tort**, particularly negligence. If a servant makes a contract on behalf of his employer, then he does so as agent for the employer. However, the liability of the employer is much wider than if it were a strictly agency relationship, and it extends to torts (e.g. negligence) committed by the servant in the course of his employment. There is inevitably an overlap between the two relationships, that of agency and that of master and servant, but essentially an employee acts by virtue of a contract of employment, and it is only when he has occasion to contract on behalf of his employer that he assumes the mantle of an agent for that matter only. Some employees cannot be said to be servants because they are not sufficiently under the control of their employers, but even most doctors working in hospitals are now regarded as "servants".

- **Independent contractor**

  This is not an agency relationship. Again, the concept arises principally in negligence. An independent contractor carries out duties or work or services for another by virtue of a contract. However, the "employer" of an independent contractor is not liable for the acts of the contractor (except in rare instances). If the contractor makes a contract with a third party in connection with his/her employment, he/she is solely liable in respect of it. The "employer" is not liable either vicariously or under the law of agency.

- **Partnership**

  By virtue of the **Partnership Act 1890**, Section 5:

  > *"Every partner is an agent of the firm and his other partners for the purpose of the business of the partnership."*

  That is to say, a partner can bind the firm by an act done in the course of the business of the partnership. The "firm" is not a legal entity in England (unlike in some other jurisdictions) but each partner is **jointly liable** for all the debts of the partnership. Their liability for debts incurred by their other partners arises by virtue of the agency, not vicariously. However, the relationship of partners with each other extends far wider than that of principal and agent.

Capacity

(a) To act as principal

Any person who is capable of acting in his/her own name is capable of so acting through the agency of another. For instance, a minor can be a principal – but only in respect of those matters which the law permits him/her to do so. As Lord Denning MR said in ***G(A) v. G(T) (1970)***:

> *"Whenever a minor can lawfully do an act on his own behalf, so as to bind himself, he can instead appoint an agent to do it for him."*

A corporation can appoint an agent to do an act which is *intra vires* (within its powers permitted by its Memorandum of Association). Conversely, an appointment of an agent to do an *ultra vires* act does not bind the corporation, nor is it bound by any contract entered into by an agent which is *ultra vires* the corporation: ***Ashbury Railway Carriage Co. v. Riche (1875)***.

Of course, in such circumstances an innocent third party is not left without a remedy. Under the common law, any director who authorised such a contract would be personally liable. By virtue of the **European Communities Act 1972**, Section 9, the company may itself be bound notwithstanding the fact that the contract was *ultra vires*, if it was one entered into by the directors. The company may be liable but it cannot, normally, enforce the benefit of an *ultra vires* contract against the other party.

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An alien enemy cannot appoint an agent, because it is unlawful to contract with an enemy in time of war.

A possible exception is in the case of **mentally disordered persons**. You will remember that a contract with such a person is voidable, unless it is made during a lucid period. However, it has been **held** that a power of attorney executed by a person under a mental incapacity is **void** (not merely voidable), and a deed executed under the power was likewise void (***Daily Telegraph Newspaper Co. Ltd v. McLaughlin (1904)***). Furthermore, it was **held** in ***Yonge v. Toynbee (1910)*** that, where the principal (unknown to the agent) was insane, then the agency was terminated. It seems, therefore, that such persons are incapable of acting as principals, even though, in lucid periods, they are quite competent to contract on their own behalf.

(b) To act as agent

Strangely enough, people can validly be agents even though they cannot validly act on their own behalf. All people of sound mind are competent to act, and to contract, as agents. This includes minors and others with limited or no capacity to contract on their own behalf.

However, any personal liability of an agent arising out of exceptional circumstances from a contract entered into on behalf of a principal will arise only if she would have had the capacity to contract on her own behalf. Normally, as we shall see, an agent is not liable **personally** in respect of contracts into which she enters in her capacity as agent. However, in certain circumstances e.g. if she exceeds her authority, she may be personally responsible. It is only this latter liability that will be affected by her own legal capacity or incapacity to contract. An example of where a person under a legal incapacity can validly act as an agent is ***Foreman v. GWR (1878)***. In this case, a farmer sent some cattle by rail. His driver, who was unable to read, signed a consignment note which contained the railway's conditions of carriage.

HELD: The farmer was liable. The personal liability of the driver was limited because he would not have been fully liable if he had entered into the contract personally.

Acts that May Be Done through or by an Agent

A person may appoint an agent to do any act which he himself is capable of, except such acts that require his personal skill, knowledge or discretion, or which he must, by statute, do himself.

Certain contracts can only be executed by the principal **personally**. For example, I would be extremely cross if I engaged a well-known surgeon to carry out an operation and he appointed his 16 year old son to carry it out as his agent!

Equally, **statute** decrees that certain acts must be done personally. A will, for example, can only be executed personally.

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B. HOW AGENCY ARISES

An agency relationship can arise in a number of ways.

By Express Agreement

By far the commonest way is by **agreement** between principal and agent. Such agreement can be contractual or not. If contractual, the normal rules of contract apply, that is, there must be **offer, acceptance** and **consideration**. Such mitigating factors as misrepresentation, mistake, duress or illegality affect an agency contract in exactly the same way as any other contract. Unless the agency is of a character which requires it to be in writing e.g. a power of attorney, it is equally valid whether written or oral.

However, an express agency agreement need not be contractual. There may be no consideration, or one or both parties may lack contractual capacity. As we have seen, minors can be both principals and agents, so an express agency agreement between two young people is perfectly valid as between themselves. Alternatively, if it is not intended that legal relations between principal and agent shall subsist, the relationship cannot be contractual.

For instance, a husband may agree to be the agent of his wife or a son agent of his mother and so on. Relations between such parties would rarely have a legally intended basis. Nevertheless, such an agent can effectively bind his principal to a contract, or act in some other way on his behalf. The principal is legally bound by the act of the agent, regardless of whether the relationship *inter se* is contractual or not. The only difference is that the degree of care which the agent must exercise must differ. We shall discuss this further in a later study unit.

Of course, we are assuming that the contract entered into by the agent on behalf of the principal is itself legally binding, and is not a domestic arrangement as in ***Merritt v. Merritt (1970)*** or ***Gould v. Gould (1970)***.

In ***Merritt v. Merritt (1970)***, during a period of formal separation, the husband prepared and signed a document stating that in consideration of his wife paying all the charges relating to the matrimonial home, including the mortgage repayments, he would agree to transfer the home to his wife's sole ownership. The wife paid the mortgage off but the husband did not subsequently transfer the property to her, contending that the agreement was a family arrangement not intended to create legal relations.

HELD: The agreement was enforceable by the wife – it had been made during a period of formal separation, the husband had received valid consideration in that he had been personally relieved of the responsibility of the mortgage repayments, and the wife was entitled to the relief sought.

In ***Gould v. Gould (1970)*** a husband, on leaving his wife, agreed to pay her £15 per week "*so long as I can manage it*".

HELD: The uncertainty of this term negatived a legally binding agreement.

To make the position clear, we list four situations:

- An adult principal and an adult agent – a commercial transaction. The agent oversteps her authority and may be personally liable.
- Same situation, but the agent suffers from a disability. If he would not be **personally** liable on his **own** contract, he **cannot** be on his principal's.
- A family arrangement, simply domestic, not legally binding. No different if negotiated through an agent.

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- A simple case of a husband acting as his wife's agent. No need for an agency contract.

By Implication

An implied agency arises where both principal and agent have behaved towards each other in such a way that it is reasonable to **infer** from their conduct that they have both agreed to the relationship.

The consent of the principal is likely to be implied where he/she has put another person in such a position that, in accordance with ordinary principles and practice, that person could be understood to be his/her agent. The same applies where the principal has used such words that a reasonable person would infer that he/she had agreed to another acting as agent on his/her behalf. However, as with any other contract, silence does **not** imply consent. Hence, where a person purports to act on behalf of another, the first will not be agent by implication, unless the other gives some indication of agreement.

Consent of an agent to act as such is perhaps easier to imply. It usually arises where he/she acts on behalf of the principal, although merely doing something that a person requires done does not, of itself, mean that that thing was done on behalf of the requester.

Thus, it is implied from the particular position held by individuals that they have the authority to enter into contractual relations on behalf of their principal, as illustrated by **Panorama Developments v. Fidelis Furnishing Fabrics Ltd. (1971)** where it was decided by the court that a company secretary had the implied authority to make contracts in the company's name in relation to the day-to-day running of the company.

By Estoppel

This form of agency is also known as 'agency by holding out' and arises where the principal has led other parties to believe that a person has the authority to represent him or her (the authority possessed by the agent is referred to as his 'apparent authority'). In such circumstances even though no agency/principal relationship exists in fact, the principal is prevented (estopped) from denying the existence of the agency relationship and is bound by the action of his or her purported agent as regards any third party who acted in the belief of its existence. However, to rely on an agency of estoppel the following two conditions must be satisfied:

- The principal must have made a representation as to the authority of the agent to so act as demonstrated by **Freeman & Lockyer v. Buckhurst Park Properties Ltd. (1964)**. In this case a property company had four directors but one director effectively controlled the company and made contracts as if were the managing director, even though he had never actually been appointed to that position and, therefore, as an individual, had no authority to bind the company. However, the other directors were aware of this activity and acquiesced in it. When the company was sued in relation to one of the contracts entered into by the unauthorised director, it was **held** that the company was liable. The board which had the apparent authority to bind the company had held out the individual director as having the necessary authority to enter into such contracts on behalf of the company and this was therefore, a case of agency by estoppel.
- The party seeking to use it must have relied on the representation as demonstrated by **Overbrooke Estates Ltd. v. Glencombe Properties Ltd. (1974).** In this case a notice, which expressly denied the authority of an auctioneer to make such statements, was successfully relied upon as a defence by the auctioneer's employers.

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Agency of Necessity

The implied agency of necessity between husband as principal and wife as agent was done away with by the **Matrimonial Proceedings and Property Act 1970**. There are, however, circumstances where one person is deemed to act as the agent of another, even though no agreement or consent has been given by the principal, either expressly or by implication. This can arise only in an emergency where it is necessary for a person to act on his/her own initiative to protect the property or interests of another which are in imminent jeopardy as a result of that emergency. This is called "agency of necessity".

If, as a result of such an emergency, a person does of necessity act without any authority to protect another's interest, that person is by operation of law vested with all the rights and immunities of a properly constituted agent. However, the emergency must be **genuine**, and the action taken **necessary**. Such a situation could arise from any number of causes, but most of the reported cases are those of shipmasters before the days of wireless or radio, or carriers of goods who could not contact the owners.

Now with modern systems of communication, agency of necessity has become a rare and very limited class of agency. You should also note that the courts have always been reluctant to extend the doctrine of agency of necessity.

It is probably easier for there to be agency of necessity where there is a pre-existing relationship between the parties. Agency of necessity very unusually covers the situation where a total stranger deals with the goods of the principal. It is also rare for the courts to find that agency of necessity exists where the goods are not perishable, though the High Court has a general discretion under the Civil Procedure Rules to order the sale of goods where it is reasonable to do so.

The following **three** rules have been developed as to what constitutes necessity.

- It must be practically impossible – or, at least, impracticable – for the agent of necessity to **contact** the principal
- The action taken must be necessary and for the **benefit** of the principal. What is necessary is objective – what a reasonable person would consider necessary, not necessarily what the agent thought to be necessary
- The agent must have acted *bona fide* in the **interests** of the principal.

An important proviso is that this type of agency applies only where there already exists some relationship of a contractual nature between the principal and the person acting on his/her behalf. Thus, if Adam asks his neighbour, Belle, to keep an eye on his house while he is on holiday, this **might** be construed as a contractual relationship, depending on the facts. However, in the absence of such a request from Adam, Belle cannot claim to have acted as an agent of necessity when she arranged for the repair of Adam's greenhouse which was severely damaged in a storm while Adam was on holiday. The fact that Adam might rightly be considered to owe a moral obligation to Belle does not, in itself, constitute an agency of necessity.

The following case amplifies the requirement of an actual **commercial** emergency or necessity.

In ***Prager v. Blatspiel Stamp & Heacock Ltd (1924)*** S, as agents for P in 1915 and 1916, bought skins to the value of £1,900, to be dispatched to P, a fur merchant in Bucharest. P paid for the skins. Owing to the occupation of Romania by the German forces, it was impossible to send the skins to P or to communicate with him. In 1917 and 1918, S sold the skins, which had increased in value.

HELD: As the skins were not likely to deteriorate in value if properly stored, there was no necessity for the sale, and S was liable in damages to P.

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Formalities of Appointment

In general, no special formalities are needed for the appointment of an agent. The appointment may be under seal, or in writing, or oral. However, statute decrees that certain appointments must be made in a certain way.

For example, the **Powers of Attorney Act 1971** (as amended) Section 1(1) requires that any instrument creating a power of attorney must be made **under seal**. The **Law of Property Act 1925**, Sections 53 and 54, requires certain instruments to be in writing, and written authorisation is to be given to an agent to sign on behalf of the principal.

Under the common law, the authority of an agent to execute a deed on behalf of a principal must, itself, be given under seal: ***Steiglitz v. Eglinton (1815)***.

C. RATIFICATION

As we have said, the agent must be authorised by a principal to act on the principal's behalf. Such authorisation may be express or implied. However, if an agent does an act without authorisation, the principal can always "ratify" the act afterwards. If he/she does so, the act then **binds** him/her to exactly the same effect as if it had been properly authorised in the first place. This applies equally whether the person purporting to act as agent was, indeed, an agent but was merely exceeding his/her authority or whether he/she had no authority to act at all.

In general, the ratification of an act serves to authorise only **that particular act**, and does not serve to give the agent implied authority to do any other acts or indeed, the same type of act again. However, a series of ratifications may well serve to imply an authority to do **similar** acts in the future.

What Can Be Ratified?

Any lawful act which can be done by an agent can be ratified by the principal. Also, most (but not all) unlawful acts can be ratified. By "unlawful" we don't necessarily mean "criminal" but tortious acts, or contractually unlawful acts (you will remember that a tort is a civil wrong not arising out of a contract).

The principle is that, if an act which is unlawful or voidable when done by an agent can be made lawful (or no longer voidable) by ratification, then that ratification will be valid, whereas if the act was initially totally void or of no legal effect then no purported ratification can cure what is incurable.

Some acts done by an agent which were a wrong against the principal can be converted into lawful acts if the principal ratifies them. Say, an agent sells goods belonging to the principal, which he/she has no authority or right to sell. This amounts to the tort of conversion. However, plainly, the principal can ratify the transaction and, by so doing, exonerate the agent from liability.

Alternatively, if neither principal nor agent has a right to sell those goods, ratification by the principal relieves the agent of liability for conversion and substitutes the principal as the party liable. The wrong could be righted.

On the other hand, an act which is totally void from inception cannot be ratified. If the directors of a company make a contract which is *ultra vires* – that is, outside the scope of the Memorandum of the company – then it is not possible for the shareholders to ratify that contract: ***Ashbury Railway Carriage Co. v. Riche (1875)***. (Note, however, that the **Companies Act 1989** has now largely abolished the *ultra vires* rule as between companies and outsiders. The validity of something done by a company cannot be questioned on the ground that there is no power to act in the company's Memorandum of Association and

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anyone dealing with the company in good faith is entitled to assume that there are no limits on the directors' powers.) In this instance, the directors would be acting as agents for the company, as principal. Equally, a forgery cannot be ratified. A principal cannot ratify a document which is null and void from its inception.

Some illustrations may make this clearer.

In ***Hilberry v. Hatton (1864)***, A, purporting to act as B's agent but without any authority, bought an article from C. C had no right to sell it, and A's purchase amounted to conversion. B ratified A's purchase.

HELD: B was liable for conversion.

In ***Eastern Counties Railway v. Broom (1851)***, the agent of a company assaulted a person on behalf of the company. The company ratified the assault.

HELD: The company incurred a civil liability for the assault.

In ***Brook v. Hook (1871)***, an instrument was signed by A in B's name, and without his authority. A's intention was to defraud.

HELD: B could not ratify the act.

Who Can Ratify an Act?

Only the person **on whose behalf** an act was purported to be done can ratify that act. That person, the principal, must be in existence and capable of being ascertained at the time the act was done and must, both at the time of the act and at the time of ratification, be competent to ratify.

The fact of being in existence normally refers to companies. An agent cannot do an act on behalf of a company which has not yet been formed, and subsequently have that act ratified by the company after its incorporation: ***Kelner v. Baxter (1866)***.

In ***Newborne v. Sensolid Ltd (1954)***, the claimant, Newborne, formed a limited company called Leopold Newborne Ltd. Before the company was registered as a limited company, a document bearing the name and address of the company was submitted to Sensolid Ltd. The document was signed "Yours faithfully, Leopold Newborne (London) Ltd" with the name of Leopold Newborne underneath. Sensolid Ltd signed the document and thereby agreed to purchase certain goods from Leopold Newborne Ltd: they later failed to accept the goods.

The claimant's solicitors then discovered that Leopold Newborne Ltd had not been registered at the time of the contract, and so they substituted the name of Leopold Newborne for that of the company. Sensolid Ltd contended that Newborne was in fact trying to sue on a contract which he had not personally made but which purported to have been made by a limited company which had not been registered.

HELD: No valid contract was formed upon which the claimant could sue. The company did not legally exist when the contract was made and Newborne himself could not sue as agent on behalf of a non-existent legal person.

The position has now been clarified by Section 36 of the **Companies Act 1985** which makes the company promoter personally liable on any pre-incorporation contracts.

It is not necessary that the purported principal is actually named at the time the act is done but it must be possible, if necessary, to describe him/her as the person who will be bound or at least, the type of person e.g. "I act on behalf of a well-known firm of London estate agents".

The intended principal must be competent at the time of the act. In ***Boston Deep Sea Fishing & Ice Co. v. Farnham (1957)***, a trawler owned by a French company was lying in an English harbour. The German occupation of France in 1940 turned the French owners

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into an alien enemy. A person, without the authority of the company, acted as manager of the trawler.

HELD: As the French company was an alien enemy at the time of the act, it was not lawfully competent to contract with a British subject. It could not, therefore, ratify the acts of the manager.

The principal must also be competent to ratify **at the time of ratification**. A mentally disordered person, for example, cannot ratify while still mentally disordered. Although the **Companies Act 1989** has now largely abolished the *ultra vires* rule for contracts made by the company with outsiders, it still applies to internal matters within the company, e.g. if the directors are exceeding their powers. Thus, as principal the company can ratify an *ultra vires* act if the contract was made with an outsider.

Rules and Conditions of Ratification

(a) Ratification by a principal can have a **retrospective** effect – that is, the principal is, in effect, bound by the contract from the time when it was made by the agent, even though it was ratified only later. This is known as the rule in ***Bolton Partners v. Lambert (1888)***. It was **held** in this case that a ratification was effective notwithstanding the fact that a third party had given notice to the principal (between the time when the contract was made by the agent and the time it was ratified) that he was withdrawing from it.

This rule is subject to the proviso that, in the event that the agent made the contract specifically or by necessary implication subject to ratification by the principal, the offer or acceptance can validly be withdrawn prior to ratification: ***Watson v. Davies (1931)***. The reason for this is that, if the contract is made "subject to ratification", this is a **condition precedent to validity**. It is, hence, not a fully valid contract until ratified.

(b) Even if the principal initially refuses to recognise a contract purported to be made on his/her behalf by an agent, and then subsequently changes his/her mind, this latter ratification will be as effective as if made in the first place – provided, however, that any third party could not be **unfairly prejudiced** by the principal's change of mind.

(c) However, ratification is not allowed in any case where a third party would be unfairly prejudiced by it. For example, if an act has to be done by or within a certain time, then it cannot be ratified after this time if to do so would be detrimental to a third party. Where there is no contractual term as to date of performance, ratification of a contract must be effected within a **reasonable** time and, in any event, before the time for performance by the other party to the contract: ***Metropolitan Asylums Board Managers v. Kingham & Sons (1890)***.

(d) A principal must have full knowledge of all **relevant circumstances** relating to the contract before he/she can properly ratify it, unless it can be shown that he/she intended to ratify the agent's act regardless of the surrounding circumstances.

For example, in ***Freeman v. Rosher (1849)***, an agent had his principal's authority to distrain for rent – that is, to seize a person's belongings for non-payment of rent.

The agent seized a fixture, which he was not entitled to do, sold it and paid the proceeds to the principal. The principal received the money without knowing that it was a fixture that had been sold.

HELD: The principal had not, thereby, ratified the wrongful act of his agent.

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What Constitutes Ratification?

There are a number of rules as to what constitutes ratification.

- It may be either **express** or **implied**. Ratification by implication will occur if the principal, by his/her conduct shows that he/she has adopted all or part of the contract. The receipt and retention of money derived from the contract with knowledge of the circumstances will count as adoption. Likewise, if the principal uses or disposes of goods derived from the contract, it will amount to ratification by implication.

  If an agent exceeds his/her authority, mere **silence** by the principal after knowledge of the act will amount to ratification.

- If the principal adopts part of a contract, this will serve to ratify the **whole**.

- **Oral** ratification of a written contract is valid. However, if the contract is under seal, it can be ratified only by a document in writing and under seal.

Effect of Ratification

As we have seen, ratification is the adoption of the act of an agent who was not previously authorised to do that act, by the principal, so as to bind the principal. It serves to place all the parties involved in the transaction in the same position as they would have been in had the agent been properly authorised from the outset, that is, with the same rights, duties and liabilities.

In ***Buron v. Denman (1848)***, the Royal Navy, at the time, was bent on suppressing the slave trade. The captain of a British warship released the slaves and destroyed the property of a Spanish subject resident in Africa and carrying out slave-trading. The Foreign Secretary ratified the act of the captain.

HELD: Ratification turned the act into an Act of State, from which the aggrieved Spanish subject had no legal redress.

A more commercial example is ***Cornwal v. Wilson (1750)***. A factor (that is a person similar to a "land agent") contracted to buy goods on his principal's behalf. The contract price exceeded the limit of authority of the factor as agent. The principal subsequently took the goods and disposed of them.

HELD: By disposing of the goods, the principal had effectively ratified the contract and he was, therefore, bound to pay the factor the full contractual price.

D. CATEGORIES OF AGENTS

The scope for agency relationships is, of course, infinitely wide. Wherever one person acts in matters of contract for or on behalf of another, he/she is an agent. An agent can act for profit or reward, or can act gratuitously. However, there are various categories of commercial agent who, broadly speaking, earn their living by being agents for others. Some of these act solely as agents; others include agency duties within a wider sphere of activity.

Factors and Brokers

A **factor** is a person who is entrusted with the goods of another – with both their possession and their control – for the purpose of **sale**. A **broker**, on the other hand, buys and sells goods, or "things in action", such as stocks and shares but he/she does not, normally, have **physical possession** or **control** over the items in which he/she deals.

Factors – or "mercantile agents", as they are sometimes called – had a very important commercial role in the 19th century, but this is less true today. As a result of instant

communication and rapid transport, their function has, to a large extent, been taken over by brokers. However, an understanding of the law relating to factors is important, as it impinges on both sale of goods and on agency. Furthermore, a person who carries out the functions of a factor, by whatever name he/she uses, is governed by the law relating to factors. Such people may, nowadays, call themselves "brokers", or "shipping agents", or "commercial agents", or whatever. However, if they have the goods of another in their possession and under their control for the purposes of sale, or if they purchase such, they are factors. New regulations were introduced in 1993 concerning commercial agents and their contracts and these are covered later in this unit.

Factors Act 1889

The law relating to factors – partially statute and partially common law – was consolidated and amended by the **Factors Act 1889**. Section 1 of the Act defines a factor or mercantile agent, as follows.

> *"The expression mercantile agent shall mean a mercantile agent having in the customary course of his business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods."*

So, he must act as a mercantile agent in the course of a business as such. The mere fact of having the goods of another for sale does not, of itself, make that person a factor, and so, enable him to enjoy the benefits and incur the liabilities. He must be in the **course of a business** as such a factor.

The main provisions of the Act are outlined below.

(a) Where a mercantile agent is in possession of goods or documents of title thereto with the consent of the owner, then any sale or other disposition of those goods by him/her in the ordinary course of business is as valid as if he/she had the express authority of the owner to make that disposition.

In other words, as far as the purchaser is concerned, the agent's authority is unimpeachable and the owner cannot claim that the agent had no authority to make the sale or disposition.

There are additional provisions to safeguard a purchaser in the event of the agent's authority having been withdrawn without the purchaser's knowledge and in the event of sale by a clerk or other such person with the authority of the agent.

(b) Where a person, or a mercantile agent acting for him/her, who has either sold goods, or bought them and is in possession of them, redisposes of them, then the **subsequent** buyer of those goods acquires as good a title as if the original owner had expressly authorised the sale. Again, this ensures the protection of third parties dealing with mercantile agents acting in the ordinary course of their business as such.

A broker or other person who does not have goods in his/her possession is subject to the normal law of agency, and third parties dealing with him/her have no special protection. We shall be discussing this issue later.

Estate Agents

A person employed by the seller of a house to effect a sale is commonly called an estate agent and she is only a **limited** agent. Of course, by express agreement she can be invested with full agency powers, but her implied authority is far less. She has implied authority to **describe the property**, and to bind the vendor in respect of **statements** as to its value, but she does not have implied authority to conclude a **contract of sale** on behalf of the vendor. Nor does she have implied power to receive a **deposit**. In the event that the vendor instructs an estate agent to sell, the agent has implied power only to sign a standard

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contract of sale, and not one containing special conditions. The agent has a duty to inform her principal of the highest offer received at all times before a binding contract has been entered into.

Auctioneers

An auctioneer is the agent of the seller. We have outlined earlier the provisions contained in the **Sale of Goods Act 1979** relating to auction sales. In addition to these, at common law, an auctioneer does not have implied authority to give any warranties on the goods he sells, unless he is expressly so authorised. He does, however, have implied authority to accept **deposits** where it is the custom of the trade so to do e.g. in sales of land or houses at auction. Furthermore, he has a **lien** on the goods he sells for the purchase price.

Bankers

Bankers are good examples of people who act as agents for their customers in respect of certain transactions, while acting in the capacity of debtor and creditor in other aspects of their duties.

Other Examples

We can now consider eight classes of people who are agents in respect of all or part of their duties.

- **Masters of ships**

  These are, in many respects, the agents of the owners. They can, in certain circumstances, also act as agent for the cargo owners.

- **Solicitors**

  These have implied authority as agents to appear for a client, and accept service of writs, etc. Clients are bound by the actions of solicitors done on their behalf, carried out in the ordinary course of the practice. Both solicitors and barristers have an implied authority as agents to effect compromises on behalf of their clients on matters connected with litigation.

- **Travel agents**

  These are, generally, agents of the client for the purchase of travel tickets and the making of travel arrangements. They may also be the authorised agents of the carriers e.g. airlines and rail companies, to sell tickets.

- **Insurance brokers**

  These are, *prima facie*, the agents of the client to effect insurance. The fact that the broker's commission is paid by the insurance company does not affect this presumption, nor does the fact that he/she may solicit business on behalf of an insurance company provided, he/she is acting on his/her own initiative and not under instructions from the insurance company.

- **Stockbrokers**

  These are, essentially, the agents of the client. They have considerable implied authority as such but their function is outside the scope of this course.

- **Shipbrokers**

  Shipbrokers are agents who are employed by shipowners to negotiate ships' charters and to carry out all the transactions connected with the vessels while they are in port. The shipbroker attends to the entering and clearing of the ships and to the collection of freights from the charterers.

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- **Patent agents**

  As a general rule, an inventor who wishes to patent an invention employs a patent agent on his/her behalf. This is, no doubt, owing to the fact that the law and procedure in connection with patents are extremely complicated. All patent agents must be registered.

- **Commission agents**

  Commission agents are, generally, employed by foreign principals to buy and sell goods for a fixed commission. There are many types of commission agent, and no hard and fast rule can be applied to all cases. In some instances, the commission agent is, actually, a principal but he/she takes his/her reward in the form of a fixed percentage instead of the best profit obtainable.

Del Credere Agents

These are special agents who (for an additional commission) are responsible to their principal for the solvency of and payment of the price by the buyer. The normal agency rule, as we shall see later, is that an agent who effects a sale on behalf of a principal is not liable to the principal if the buyer fails to pay. A *del credere* agent assumes this liability towards his/her principal. If the buyer fails to pay, the *del credere* agent must do so out of his/her own pocket.

E. DUTIES OF AGENTS TO THEIR PRINCIPALS

A paid agent owes various duties to his/her principal. Some of these arise out of the contract of agency, others apply in varying degrees, depending on whether the agency is for reward or gratuitous and are implied by the common law or equity.

Contractual Agents

(a) Duty to perform

The fundamental duty of an agent appointed under a contract is to carry out the agency contract in accordance with its terms, express or implied, and not exceed his/her authority. In ***Ferrers v. Robins (1835)***, an auctioneer was instructed to sell goods for cash only. Instead, he sold them, and accepted a bill of exchange in payment. The bill was later dishonoured.

HELD: The agent was liable for the price.

If the principal's instructions (or the terms of the contract) are ambiguous, the agent will not be liable for breach if he/she fairly and in good faith interprets them one way, and acts accordingly. However, if the ambiguity is apparent, the agent must (if practicable) seek clarification before acting.

(b) Duty to obey instructions

An agent is required to comply with all reasonable and lawful instructions given by the principal in connection with the subject-matter of the agency, or the manner of carrying out his/her duties. This duty can, of course, be modified or even excluded altogether, by the terms of the agency contract and it is, in many cases, subject to the custom and usages of the trade. This is especially so in the case of a professional person acting as agent, who normally has a higher duty in respect of the rules and ethics of his/her profession.

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(c) Trade or professional custom

The custom or usages of the particular trade or profession often serve to imply terms into a relevant agency contract.

However, before such a term will be implied, evidence must be given concerning the custom. It must be a genuine custom of the trade, and not merely what is normally done in the ordinary course of business. The courts will apply an **objective test** to ascertain whether the parties must have intended to contract subject to the particular custom or usage alleged to have been incorporated – that is, "would a reasonable person have expected it to apply?" In ***Hutton v. Warren (1836)***, Parke B had this to say:

> *"It has long been settled that, in commercial transactions, extrinsic evidence of custom and usage is admissible to annex incidents to written contracts, in matters with respect to which they are silent. The same rule has also been applied to contracts in other transactions of life, in which known usages have been established and prevailed; and this has been done on the principle of the presumption that, in such transactions, the parties did not mean to express in writing the whole of the contract by which they intended to be bound, but a contract with reference to those known usages."*

However, before a custom will be inferred into an agency contract, the party who asserts it must provide evidence that it is:

- Reasonable
- Universally accepted in the trade or profession, or in the locality concerned
- Certain, i.e. not ambiguous or vague
- Not unlawful.

Nor must the custom be **inconsistent** with **other terms** of the contract.

A further use of custom is to explain technical terms of the contract, or to clarify terms which may be used in a different sense from the ordinary meaning of those words.

An example of an alleged custom not being implied was provided in ***Gibbon v. Pease (1905)*****.** An architect claimed he was entitled to retain plans and drawings after his work had been completed and he had been paid. He alleged that it was the custom.

HELD: If such a custom indeed existed, it was unreasonable, and would not be implied into the contract.

(d) Duty to perform the contract with diligence

It will, normally, be implied in every agency contract that the agent will carry out his duties with reasonable diligence. If he is unable to carry them out within a reasonable time, or is not prepared to, then he has a duty to notify his principal of this fact.

This is no more than the requirements placed on a party to any contract to perform it within a reasonable time if the contract does not specify a time for performance. Time is not of the essence of a contract unless the contract provides for it to be so.

Reasonable diligence is, of course, a matter dependent on the circumstances of the case. In ***Barber v. Taylor (1839)***, an agent was instructed to purchase goods from abroad, and send the bill of lading to his principal. He failed to release the bill of lading until several days after the vessel had arrived in the UK.

HELD: The agent was in breach of contract by failing to deliver the bill of lading within a reasonable time; 24 hours after arrival was considered a reasonable time.

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(e) Duty to exercise due skill and care

The common law duty of an agent acting for reward is to exercise such skill and care in performing his/her duties as is reasonable and normal in the trade, profession or business in which he/she is engaged.

This common law duty now has statutory force by virtue of the **Supply of Goods and Services Act 1982**, Section 13. We have already mentioned this Act in an earlier module, with regard to the supply of goods. Part II of the Act covers the supply of services, and the performance of an agency contract is one of service, even though the service entails the supply or purchase of goods. Section 13 states:

> *"In a contract for the supply of a service where the supplier is acting in the course of a business, there is an implied term that the supplier will carry out the service with reasonable care and skill."*

Section 14 of the Act provides, likewise, that, in default of any stipulated time for performance, the service must be carried out within a **reasonable** time. In the context of an agency contract, this relates to the common law duty of diligence.

The duty of skill and care is a contractually implied term. However, failure to exercise reasonable skill and care also constitutes the tort of **negligence**. A long line of cases involving different types of person has established that (in most instances) claims for failure to exercise the necessary degree lay in contract and not in tort. A leading case is ***Bagot v. Stevens, Scanlon & Co. Ltd (1966)***, where the Court of Appeal **held** that, in the case of an architect, the duty lay primarily in contract.

Whether a claim against a professional person for failure to use proper skill and care is pursued in contract or in tort may seem to be of academic interest only. However, this is not necessarily so. There are different rules in contract and in tort as to which damages can be claimed (**remoteness** of damage) and when a cause of action arises (affecting the **limitation period**, i.e. over what period an action may be brought). Hence, there may be advantages for a principal to proceed against his/her agent who has failed to exercise proper skill or care under one or other of the heads. However, until recently, there was no option. The action lay in contract only unless, in certain cases, the aggrieved party could claim that a professional person, as well as failing to exercise due care, had also failed in his/her duty to exercise professional **competence**.

However, in ***Batty v. Metropolitan Property Realisations Ltd (1978)***, the Court of Appeal **held** that to restrict the right to sue in either contract or tort to cases involving strictly professional negligence was illogical. It seems, therefore, that the breach of a contractual duty to exercise due care can now also be pursued in tort, if the conduct complained of does also constitute the tort of negligence.

The degree of skill and care to be exercised by an agent depends on his/her business or profession. It is that degree that is expected of the **ordinary competent practitioner** in the business or profession concerned. A doctor is not judged by the standards of the top Harley Street specialist but by those of the average qualified doctor, and so on.

An agent is not expected to be perfect – merely to be reasonably competent, qualified as necessary, and up to date. He/she must act within these parameters.

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Gratuitous Agents

Agents who are not acting for profit or reward owe duties to their principals – but not of such a high order. The standard of skill and care required is only that which people **ordinarily exercise in their own affairs**. If the gratuitous agent has held out to the principal that he/she possesses a particular skill or expertise, then the standard of care required of him/her will be that ordinarily shown by people who do possess that skill or expertise.

A gratuitous agent is not a contractual one. Hence, the duty she owes her principal lies only in tort. On the authority of the decision in ***Hedley Byrne & Co. Ltd v. Heller & Partners Ltd (1964)***, such an agent is free to restrict or exclude all or any liability, if she wishes. As no contract is involved, the provisions of the **Unfair Contract Terms Act 1977** will not apply.

In ***Hedley Byrne***, a customer asked its bank to give a banker's reference on a prospective client. The bank sought this from the client's bankers. They duly replied, giving a favourable reference but adding that it was given "*without liability*". In fact, the client was in dire financial straits, and its bank was aware of this. It was **held** by the House of Lords that the bank owed a duty of care to the original enquirer, and that it had been negligent. However, it was saved from liability for the ensuing loss by its disclaimer.

A gratuitous agent cannot be held liable for failing to carry out the work he has been given, because there is no contract between him and the principal. However, it is probable that some liability will arise in tort, based on the principle of **estoppel**. If the principal has relied on the promise of his gratuitous agent, and so failed to find someone else to do the work, the agent would, it is suggested, be estopped from denying that he had agreed to perform, and so owe a duty of care to undertake the work properly. However, there is no authority for this proposition.

The standard of care required of a gratuitous agent, if he undertakes the work, is not easy to define. It has been suggested that he will be liable only for "gross negligence". While "gross negligence" is a term of common use and is a standard used in other jurisdictions, it is not known to English law. There are no grades of negligence: a person is either negligent, as understood by the legal definition of the term, or not. Hence, it is probable that the standard of care required is "that which may be reasonably expected of him in the circumstances". (The tort of negligence is of considerable complexity and this is outside the scope of this course.)

Fiduciary Duties of all Agents

An agent is said to be in a fiduciary relationship towards a principal; she is, loosely speaking, in a position of **trust**. However, she is not a trustee in the legal sense. A trustee owes a higher degree of integrity and duty towards a beneficiary than an agent does towards a principal. Perhaps, we can best sum this up by saying that an agent must behave honourably and loyally in all her dealings with her principal.

Having said that, let us look at the various situations in which an agent is required to behave in a certain way.

(a) Duty to make full disclosure

An agent is required to act in the best interests of his principal; or, at least, in what he reasonably considers to be his principal's best interests. If, as often happens, his principal's interests conflict with his own, he is not automatically barred from acting but he must first make a full disclosure to the principal of his own personal interests in the matter. If full disclosure is made, the principal is then in a position to decide whether to proceed with the matter or whether to find another agent.

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Examples of where an agent's interests are likely to conflict with those of the principal are if the agent:

- Buys the principal's property, or sells his own property to the principal
- Receives commission from both parties to a transaction
- Stands to receive a benefit or a profit from some person other than the principal
- Is in a position to exploit his personal interest as a result of the agency.

In any instance where the agent's personal interests do (or may) conflict with his principal's, the agent has a duty to make a full and complete disclosure of all the material circumstances, and of the precise manner and extent of his personal interest. If the principal, with full knowledge, then consents to the agent's acting, all well and good. Furthermore, it is the agent's responsibility to give this information; it is not sufficient if he merely indicates a possible clash of interest, and leaves it to the principal to ascertain the details.

Disclosure must be made if a conflict of interest **may** arise – it does not matter that a conflict does not, in fact, occur.

In ***Boardman v. Phipps (1967)***, a trust fund held shares in a private company. The solicitor to the trust fund used his position and the knowledge he had acquired by virtue of his position to acquire additional shares in the company, both for himself and for the trust fund. In fact, both the fund and he personally profited by the transaction.

HELD (by the House of Lords): He was in breach of his fiduciary duty as, had the trust asked for his opinion on the advisability of acquiring additional shares, he would not have been able to give an unbiased view, because of his personal interest in the matter.

Boardman v. Phipps is the leading modern case on this subject and, although it involved a trust, it is equally applicable to a pure agency situation.

(b) Dealing with the principal

Should an agent enter into a contract or other transaction with her principal, then she must make a full disclosure of the circumstances, and of all that she knows about the subject-matter. This situation is likely to arise where the agent proposes either to buy the principal's property herself or to sell her own property to the principal.

If this does occur without the principal's informed consent, he can either rescind the contract or require that the profit the agent has made be handed over to him.

A director of a company, for example, is not permitted to sell to the company goods that either she, or another company in which she has an interest, has manufactured: ***Aberdeen Railway Co. v. Blaikie (1854)***.

(c) Secret profits and bribes

A contractual agent receives an agreed fee or commission for his services. He is **not** allowed to make any additional profits as a result of the agency unless he discloses them (these are called "secret profits"). Should he do so, the principal can require the secret profits to be handed over to him.

A **bribe** falls into the category of secret profits. Under the **Prevention of Corruption Act 1906**, both the agent who accepts a bribe and the person offering the bribe are liable to criminal penalties (fines or imprisonment). The acceptance of a bribe by an agent produces an irrebuttable presumption that he/she has been influenced by the bribe. It is of no consequence that the agent has not, in fact, been influenced, nor that the principal has not, in fact, suffered any loss. The mere acceptance of a bribe is a **breach of fiduciary duty**. Not only may the agent be required to hand over the

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amount of the bribe but, also, he/she forfeits the right to receive any fee or commission in respect of the transaction.

A further instance of secret profits is where an agent acts for both parties to a transaction without the knowledge of the respective principals. An agent who is employed to negotiate a loan for his/her principal may not accept a commission from the lender: ***Re a Debtor (1927)***, nor may an insurance broker who is an agent of the insured act as agent for the underwriters for the purpose of getting an assessor's report.

Where an agent accepts any bribe or secret commission, the principal may exercise any or all of the following remedies, according to the circumstances:

- Dismiss the agent without notice
- Recover the secret commission from the agent, if it has been paid over or, if it has not been paid over, then from the person who has promised it
- Bring an action for damages against the person who gave or promised the bribe
- Refuse to pay the agent any commission or remuneration in connection with the transaction; he/she may recover any commission which has been paid
- Repudiate the whole transaction.

(d) Using the position as agent to acquire personal benefit

If an agent uses his position to acquire a benefit or secret profit from a third party, he is required to account for it to his principal: ***Keech v. Sandford (1726)***.

Property was leased to a trust. The lease was determined by the landlord, whereupon a trustee acquired the lease for himself.

HELD: The trustee held the lease in trust for the beneficiaries. It was stated by the court:

> *"If the agent uses a position of authority, to which he has been appointed by the principal, so as to gain money by means of it for himself, then also he is accountable to the principal for it."*

(e) Using property of the principal to acquire a personal benefit or profit

Property includes not only goods or physical possessions but also intangible rights. Hence, an agent is not permitted to use her principal's goods or confidential information she has acquired as a result of her duties to make a personal profit for herself.

In the Court of Appeal, in the case of ***Boardman v. Phipps (1967)***, quoted above, Lord Denning MR said:

> *"It is quite clear that if an agent uses property, with which he has been entrusted by his principal, so as to make a profit for himself out of it, without his principal's consent, then he is accountable for it to his principal. Likewise with information or knowledge which he has been employed by his principal to collect or discover, or which he has otherwise acquired, for use of his principal, then again if he turns it to his own use, so as to make a profit by means of it for himself, he is accountable."*

(f) Money received for the principal's account

An agent has a duty to pay or account on demand for any money he receives, or which he holds, which is for the account or use of the principal. In other words, an agent cannot hold on to money which, in reality, belongs to his principal, if the principal requires it to be handed over. This rule applies notwithstanding the fact that third

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parties may have claims on that money, and even if the money was received by the agent as a result of a void or an illegal transaction.

For example, a turf-commission agent is employed to place bets for his customers (principals). If these bets result in winnings, the agent is required to pay over such winnings actually received by him. This is so, even though as a result of the **Gaming Acts 1845 and 1892** (as amended) the actual bets are void and in the event of non-payment of the stake by the customer, the agent could not recover from him: ***De Mattos v. Benjamin (1894)***.

(g) Accounting requirements

Agents are required to keep property or money belonging to the principal separate from their own. It is also their duty to keep proper and accurate accounts of all transactions carried out in the course of their agency. They must produce such accounts and supporting books and documents to the principal or his/her agent on demand.

(h) Acquiring the principal's property in the agent's own name

If an agent acquires property for or on behalf of her principal, but in her own name, then she is, of course, the legal owner of it. However, she holds it as a **trustee** for the principal.

Contracts between a Principal and a Third Party

The general rule, which is of the very essence of the relationship of principal and agent, is that an agent is not liable on contracts which he makes, in his capacity as agent, between his principal and a third party.

Although the agent actually makes the contract with the third party, he does so on behalf of the principal, and it is the **principal's** contract. Having made it, the agent, in effect, drops out. We consider exceptions to this in a later study unit.

F. RIGHTS OF AGENTS AGAINST PRINCIPALS

An agent has numerous duties and responsibilities *vis-à-vis* his/her principal – but he/she also has **rights**.

Payment

It is interesting that an agent is not entitled to any payment or remuneration for services **as of right**. His/her only entitlement is if the contract of agency expressly or by implication provides for it. This means that a non-contractual agent has no entitlement to be paid, and is truly a "gratuitous agent".

On the other hand, where the agency is contractual, and the agent is in the course of a business as such, then remuneration will be very readily implied if the contract makes no express provision for it. In the case of professional agents who charge on a fixed scale, this scale does not automatically apply, unless it can be shown that a term of the contract, express or implied, so provides. Frequently, however, in such cases, the custom of the trade or profession will ensure that the scale is implied into the contract.

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Assuming the agency contract does provide for remuneration, there are various rules as to if and when it is, in fact, payable.

(a) Effecting a transaction

If the agent's remuneration is due on the occurrence of some future event, she is not entitled to it unless and until that event actually **occurs**. If it does not occur, she has no right to payment for services rendered on the basis of work done (*quantum meruit*).

Frequently, agents receive their commission only when they actually effect some transaction. Much of the litigation in this area has revolved around the rights of estate agents to charge commission in respect of property sold through their efforts. Ultimately, the whole question hinges on the proper construction of the contract but very clear and unambiguous words must be used if an estate agent is to get any commission unless an actual sale takes place.

The reason for this, as was pointed out by the House of Lords in the leading case of ***Luxor (Eastbourne) Ltd v. Cooper (1941)***, is that the agent does not promise to do anything, nor is any obligation put upon him. In effect, all the contract says is:

> *"If the agent introduces a purchaser, and a sale takes place, then he is entitled to commission."*

Consequently, if the vendor sells his house himself to a person who was not introduced by the agent, the agent is not entitled to a penny. Further, if a prospective purchaser who has been introduced by the agent withdraws after the contract of sale has been made, but before completion, the agent is not entitled to any commission. He has not "introduced a purchaser": ***James v. Smith (1931)***. However, as we have said before, it all really depends on the **wording** of the contract.

(b) Effective cause of transaction

Where the contract provides for commission to be paid on a transaction to be brought about by the agent, it will not be due unless the agent is the **effective cause** of the transaction occurring. If it occurs without the involvement of the agent, he/she is not entitled to commission.

In ***Miller, Son & Co. v. Radford (1903)***, a vendor employed an agent to find a purchaser for his property or failing that, a tenant. The agent introduced a tenant, and his commission was duly paid. Just over a year later, the tenant purchased the property. The agent claimed commission on the purchase.

HELD: He was not the cause of the purchase; hence, there was no entitlement to commission.

(c) Implied term

On the other hand, a term will readily be implied in business agency contracts that the principal will not prevent the agent from earning his/her commission. For example, in ***G Trollope & Sons v. Martyn Bros (1934)***, the Court of Appeal **held** that the vendor of a property would be liable to the agent if he **unreasonably** withdrew from negotiations with a prospective purchaser, and so prevented the agent earning his commission. However, in ***Rhodes v. Forwood (1876)***, a colliery owner appointed a sole agent for seven years for the sale of his coal in Liverpool. After four years, he sold the colliery.

HELD: There was no breach of contract. The owner was not obliged to sell coal in Liverpool and he was free to sell it anywhere he liked. If this did not constitute a breach – which it didn't – then selling the whole colliery was not a breach either.

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(d) Breach of duty

An agent is not entitled to any remuneration in the event of serious misconduct or breach of duty. This, therefore, extends further than the rule we have previously mentioned – that an agent who accepts a bribe forfeits his/her remuneration.

However, it appears that not all breaches of duty will deprive an agent of remuneration. In ***Robinson Scammell v. Ansell (1985)***, an estate agent had entered into a contract with clients to sell their home. A purchaser was introduced to the clients by the agent, and the clients accepted the purchaser's offer. The clients were, in turn, attempting to buy another property for themselves. The estate agent then found out that the clients' own purchase of a house had fallen through and, before telling his clients of this, he informed the prospective purchaser of their current home that the agreed sale might not proceed and he suggested alternative properties for him to look at.

When the clients discovered what the agent had done, they informed the agent that they no longer wanted him to act for them. In the event, they then dealt personally with the prospective purchaser of their house and did, in fact, complete the sale of the house to him. The agent then requested payment of £920 commission, and the ex-clients refused to pay. In the county court, it was **held** that the agents were in breach of duty to their clients and that the clients were, therefore, entitled to treat the contract as repudiated and refuse payment of the commission.

The Court of Appeal **reversed** this decision, and ruled that, in the circumstances, the estate agent, who had acted in good faith, was entitled to his commission, even though he was in breach of duty to his clients. Although an agent might commit a repudiatory breach of contract which would entitle the principal to bring the contract to an end, this did not, in itself, deprive the agent of rights which had already accrued to him under the contract. On the other hand, it was noted, certain breaches of duty by an agent might result in the agent losing his right to remuneration. For example, in ***Andrews v. Ramsey (1903)***, an agent who had made a secret profit, in breach of his fiduciary duty to his client, was not only required to account to his principal for the secret profit but was also deprived of his commission.

Indemnity

An agent is entitled to be reimbursed all expenses **properly incurred** on the principal's behalf, and to be indemnified against all losses and liabilities incurred in the **execution** of the agency.

This is a general rule, and subject to exceptions, especially in the case of expenses. It may very well be that the contract envisages, or expressly provides, that the expenses incurred by the agent are included in the commission or fee paid. The custom of the trade or profession will, often, be an important factor. However, an indemnity against liabilities is more universal – although, again, the actual contract is the deciding factor.

In ***Warlow v. Harrison (1859)***, an auctioneer was instructed to sell certain property, and he incurred liabilities in connection therewith. The principal then revoked his instructions.

HELD: The auctioneer was entitled to be indemnified by the principal for the liabilities incurred.

However, an agent is not entitled to indemnity, nor reimbursement:

- Incurred as a result of his/her own negligence or default
- For any unauthorised act which is not, subsequently, ratified by the principal
- In respect of any knowingly unlawful act.

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Lien

All agents, *prima facie*, have a lien on the goods or chattels of their principals in respect of lawful claims they may have against them for remuneration, charges, loss, or liabilities incurred in the course of the agency.

However, the lien of an agent can be displaced by express or implied agreement in the agency contract, or if goods or chattels are delivered to the agent for a special purpose or directions for disposal are given inconsistent with the agent's lien.

Normally, the lien of an agent is a "particular" lien – that is, it applies only to goods or chattels being retained by the agent as security against debts or liabilities arising in respect of those particular goods or chattels. In other words, if an agent has in his possession goods in connection with one transaction, he cannot exercise his lien over those goods in respect of debts which arise in connection with a separate transaction.

However, a particular lien can be extended into a general lien by agreement. A general lien applies to all goods or chattels of the principal which are in the agent's possession, irrespective of how or in respect of which transaction, the debt or liability arose.

For a lien – whether particular or general – to operate, the agent must be **lawfully in possession** of the principal's goods or chattels. Or possession must be held by a third party for or on behalf of the agent.

The third party who actually holds them must have acknowledged ("attorned") that he/she holds them on behalf of, or to the order of, the agent. Furthermore, the goods or chattels must have been lawfully obtained by the agent.

You should note carefully that an agent's lien extends only to the goods and chattels belonging to her principal or documents of title to goods e.g. bills of lading, or to securities such as share certificates. It does not cover **money** belonging to the principal held by the agent. Therefore, subject to any contrary agreement or trade custom, an agent has no right to offset her remuneration against money she holds for the principal. The right to set off strictly applies only if and when the principal sues the agent for repayment of money owed.

An agent loses his lien or it is extinguished:

- When the sum due to him is **tendered**; so, if he refuses to accept the tender, he loses his right to retain the goods
- If he acts in any capacity or enters into any contract which is **inconsistent** with retention of his lien; for example, an agent who had a lien on his principal's goods permitted the principal to have free access to the goods, and to use them for his own purposes, provided they were returned – he is **held** to have lost his lien: ***Forth v. Simpson (1849)***
- If he **waives** it; waiver occurs whenever the agent expressly, or by his conduct, acts in such a way as to lead to the reasonable conclusion that he no longer considers the lien to be subsisting
- If the agent **voluntarily gives up possession** of the goods which are the subject of the lien.

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Goods Bought in an Agent's Name

Should an agent buy goods in her own name, without disclosing to the seller that she is, in reality, acting as an agent then the agent becomes personally liable to the seller for the price. The result of this, as between principal and agent, is that the property in those goods vests in the agent until such time as the principal pays the price. When he does, the property in the goods is transferred to him – the normal rule being, of course, that, where the agent buys as an agent, and discloses this fact, then the property in the goods bought passes direct to the principal, and at no time vests in the agent.

G. COMMERCIAL AGENTS (COUNCIL DIRECTIVE) REGULATIONS 1993

The UK, unlike many Continental European countries, has not previously had specific legislation regulating the relationship between principals and commercial agents. However, under a 1986 EC Directive, it became necessary for the UK to issue regulations to cover this matter, bringing the UK broadly into line with other European Union member states and Continental practice. This was brought about by the issue of the **Commercial Agents (Council Directive) Regulations 1993**, which came into effect on 1 January 1994. The Regulations apply to all companies, individuals and partnerships who sell their products through commercial agents in the UK and, unusually, are retrospective in effect, i.e. the they cover not only **new** contracts with such agents, but also **existing** contracts. The general effect of the Regulations is that commercial agents automatically receive much better legal protection for the duration of the contract.

Additionally, a commercial agent is entitled to more favourable treatment on termination, and has enhanced rights to claim compensation or be indemnified which may include, in some circumstances, the payment of commission following termination of the agency agreement. The parties (i.e. the principal and the agent) are not able to agree between themselves to contract out of many of these provisions, and any term in an agreement which is contrary to the Regulations will be void.

Definition of a Commercial Agent

Under the Regulations, a "commercial agent" is defined as:

> *"a self-employed intermediary having continuing authority to negotiate the sale or the purchase of goods on behalf of another person ('the principal') or to negotiate and conclude the sale or purchase of goods on behalf of and in the name of his principal".*

Although the definition refers to "*self employed*" intermediaries, the Regulations apply whether the agent is an individual or a company.

Agents for the provision of services **only** do not fall within the Regulations, nor do any of the following persons:

- An officer empowered to bind a company or association, e.g. a director
- A partner authorised to bind his/her partners
- An insolvency practitioner
- A commercial agent who does not charge for his/her services
- A person who is operating on a commodity exchange or in a commodity market
- Crown Agents for Overseas Governments and Administrations
- A person whose activities as an agent are secondary. Unless the contrary is established it will be presumed that the agency activities of, say, a mail-order catalogue

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agent for consumer goods and consumer credit agents will be secondary to their other activities.

You should also note that the Regulations do not apply to distributors or intermediaries acting on a "one-off" basis or for a limited number of transactions (i.e. who do not have **continuing** authority) and apply only to the sale or purchase of goods. It is important to note that, if the agent takes title to the goods, he/she does not qualify for protection under the Regulations.

Summary of the Regulations

We can summarise the key points of the Regulations as follows:

All commercial agency agreements falling within the scope of the Regulations must:

(a) Specify the precise method and amounts of remuneration, commission and compensation or indemnity to be paid to the agent. (If an agency agreement is silent in regard to an agent's remuneration, the agent will be entitled to a level of remuneration which would customarily be payable or in the absence of custom and practice, an agent will be entitled to reasonable remuneration taking into account all relevant considerations.)

(b) Provide for the exchange of certain information, which may necessitate changes to procedures and records. For example, the principal must:

- Notify the agent within a reasonable period of any unexpected downturn in business volume i.e. when it is anticipated that the volume of commercial transactions will be significantly lower than that which the agent would have expected under normal circumstances.
- Keep the agent informed in writing of all acceptances, refusals or non-execution of orders which have been arranged by the agent.

(c) Specify the notice period required to terminate the agreement and payments which may become due following termination. On renewal or continuation of an agreement after the expiry of an initial term of three years or more, the Regulations stipulate that the agent is entitled to a minimum notice period of three months. The agent may, under the terms of the contract, be entitled to receive payments ("an indemnity") to the extent that, for example, he or she has expanded the principal's business by bringing in new customers or increasing the volume of business from existing customers, and the principal continues to derive substantial benefit from these customers.

Additionally, the Regulations:

(d) Entitle the commercial agent, in certain circumstances, to claim compensation following termination (this would take into account the commission that the agent would have earned if he/she had been able to continue with the contract and may include payment of commission on orders arising after termination). For example, compensation may be payable by the principal where he/she is in breach by giving too short a notice to terminate the agreement with the agent.

(e) Limit the scope and duration of restrictive covenants on a commercial agent following termination. Any provisions restricting an agent's activities after the agreement is terminated will only be valid if they are in writing. In addition, these clauses must be reasonable in their scope in terms of products, geographical areas and customers. Also, no restriction can be for more than a two-year period following the date of termination of the agency agreement. However, the courts may continue to apply shorter periods, looking to the existing common law considerations and six months, as opposed to two years, is probably a more realistic assessment of a possible restriction on an agent's activities.

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Study Unit 12

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A. AUTHORITY OF AGENTS

In the previous study unit, we referred to the "authority" of agents. There are a number of different types of authority, derived from different sources, which an agent may possess. It is necessary to study these in some detail but first, let us define them.

Definition of Terms

- **Actual authority**

  This is the actual authority given by the principal to the agent. It may be **express** or **implied**, that is, given by express words or implied from conduct or the circumstances of the case.

- **Apparent authority, or ostensible authority**

  These are two terms for the same thing. In this study unit, we shall always refer to "apparent" authority – but remember that, if you see the term "ostensible" authority used elsewhere, it is the same thing. Apparent authority is the authority the agent has **as it appears to others**.

  An agent can plainly appear to have a certain authority which he/she does not actually possess.

- **Incidental authority**

  The authority given to an agent will normally be in respect of his/her primary tasks. However, it is implied that he/she also has authority to do all such things as are **necessarily incidental** to the performance of the duties given by his/her actual authority.

- **Usual authority**

  Agents in particular trades or professions usually carry out certain set duties e.g. insurance brokers, stockbrokers, solicitors. Hence, if a person in one of these trades or professions is employed in respect of that business as an agent, then he/she is presumed to have the authority to do whatever is usually done by agents in that particular business.

- **Customary authority**

  This is similar to usual authority but it is applied to the customs or usages of a particular **place**, as opposed to a particular business.

- **Presumed authority**

  Certain relationships inevitably involve one person acting as agent for another e.g. husband and wife. In such cases, the agent is presumed to have a certain authority.

Actual Authority

(a) Express actual authority

The capacity of an agent to act is the same as the capacity of his/her **principal**. Subject to exceptions already mentioned, anything the principal can lawfully do can be done for him/her by an agent. Hence, the express actual authority of an agent can be co-extensive with the powers of the principal.

Express actual authority can be conferred by deed, in writing, or orally. Authority by deed is, usually, called "a power of attorney" and as such, it is a formal document and construed more strictly than other types of express authority.

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Authority granted by virtue of a power of attorney is only such as is actually given by the **wording** of the power, by necessary implication, and it is necessarily incidental for effective execution. Strict tenets of construction should be used.

The construction of the authority given by a document not under seal, or given orally is much more liberal, and it is designed to give effect to the object of the agency, and to the ordinary usages of business: ***Poole v. Leask (1860)***.

However, if the express authority given to an agent is ambiguous or uncertain, then any act he/she does **in good faith** which can be attributed to any of the possible meanings of the authority will be deemed to have been properly authorised. This is so even though the meaning the agent ascribed to the authority was, in fact, different from that intended by the principal: ***Ireland v. Livingston (1872)***. This case was, of course, decided before the days of telephone and e-mail; hence, it is suggested that, nowadays, if an authority was ambiguous on the face of it (as opposed to patently ambiguous), the agent would be under a duty to query the matter, if possible.

The facts in ***Ireland v. Livingston (1872)*** were that a principal in England instructed his agent in Mauritius to buy and ship 500 tons of sugar, "*50 tons more or less of no moment, if it enabled him to secure a suitable vessel*". The principal stated that he would prefer shipment "*to London, Liverpool or the Clyde, but if not possible to Liverpool or London*". The agent shipped 400 tons on a vessel direct to London, which was not amenable to further orders.

HELD: It was doubtful what the instructions meant, and the agent's action was, therefore, within the scope of his authority.

(b) Implied actual authority

Implied actual authority is whatever authority is necessary or incidental to the effective carrying-out of the agency in the usual way. It, therefore, includes "incidental", "usual" and "customary" authority. However, it is more; it is also the authority necessary to give **business efficiency** to the agency contract.

This does not mean that an agent has discretion to contravene the express instructions of the principal if he/she considers them ill advised or impractical; it does mean that additional ancillary powers will be implied if they are not expressly given. For instance, consider the following points.

- An agent who has express authority to receive payment or **money** has, *prima facie*, implied authority to receive it other than in cash e.g. by cheque.
- A managing agent has implied authority to do all those things necessary or usual **effectively** to manage.
- A professional agent has implied authority to do all those things which are usual in the profession or trade but this does not extend to **unusual** things.
- Every agent has implied authority to act in accordance with the customs or usages of the trade or market in which he/she operates, and with the usual and prevailing commercial customs.

  However, this implied authority is subject to the rules for the implication of all customs: they must be **reasonable**, **notorious** (i.e. well-known), **certain** and **not unlawful**. The fact that the principal was not aware of the custom does not affect the issue. If it is shown that such authority is customary in the particular business or place, and such custom fulfils the necessary criteria, then it will be implied as part of the authority of the agent. Some customs are, in fact, so well known that judicial notice is taken of them. This means that their existence and application do not have to be proved by the person asserting them.

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- In certain cases, authority will be implied from a **course of dealing** between principal and agent. This can occur where an agent has enjoyed a particular authority which has not been expressly granted, and the principal has not over a period of time, either objected to or queried it. In either case, which period of time is necessary to establish a course of dealing will depend on the **circumstances**.

Apparent Authority (sometimes called Agency by Estoppel)

This type of authority occurs either where the principal has led third parties to believe that his/her agent has a particular authority (called "holding out"), or where the agent has assumed a certain authority to the principal's knowledge, or where the principal becomes aware that the agent has assumed this authority but takes no steps to correct the error or inform the third party of the fact that the agent does not possess such authority. If this situation develops without correction, so that the third party reasonably assumes the agent has the relevant authority, then the principal will be bound to the same extent as if the agent were properly authorised.

Consider the following points:

- The principal places restrictions on the agent's "usual" authority. If the agent then disobeys the instruction, he/she is liable to the principal but the principal will still be liable to the third party who deals with the agent in good faith and without notice of the restriction. If there are no suspicious circumstances the third party can treat the contract as valid.

  In ***Waugh v. Clifford & Sons (1982)***, solicitors acting for a firm of builders in a dispute concerning property were offered a compromise involving an independent valuer. They sought their client's instructions but the instruction not to accept the compromise did not reach the partner concerned in time.

  HELD: The builder was bound by the compromise. It was within the authority of a solicitor to agree to such a compromise and the other side could rely on the solicitor's apparent (i.e. apparent) powers.

- It is essential that it is the principal who "holds out" the agent as having authority. The third party cannot enforce a statement by the agent that he/she has authority when there has been no such "holding out".

  In ***Armagas Ltd v. Mundogas S A (the "Ocean Frost") (1986)*** an agent, claiming to act on behalf of his principal, negotiated an unusual three year charter of a ship. The contract was clearly outside the scope of the agent's usual powers, and the principal had not held out the agent as having authority to negotiate on his behalf. Nevertheless, the third party accepted the agent's statement that he had authority. It was **held** that the principal was not bound by the contract. Since there had been no holding out by the principal there was no apparent authority.

- It seems that the apparent authority given by the principal to the agent can continue after the agent has left the principal's employment, provided, of course, that the third party had no actual or constructive notice of the termination of authority.

  In ***Discount Kitchens Ltd v. Crawford (1988)*** a representative of a company gave C plans for a fitted kitchen. When he returned some months later he did not disclose that he now worked for Discount Kitchens (D). However, the order form which C signed named D as the supplier. The work was defective and C sued both D and the other company (the original employers) on the basis that the representative had apparent authority to act on D's behalf.

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It was **held** that although such authority could continue after an agent had ceased to be employed by the principal, this could not apply where the third party had actual or constructive notice of the termination of the agent's employment. Since the order form was in the name of D, C should have realised that the representative had no further authority from the original employer and the alleged estoppel therefore failed.

- If the principal is undisclosed, any restrictions on the agent's rights will not affect a third party who has been allowed to believe that he is dealing solely with the agent and who therefore cannot know of the restraints.

  In ***Watteau v. Fenwick (1893)*** Fenwick, the owner of a hotel, allowed the former owner to remain as manager and the manager's name appeared as licensee. The manager ordered cigars on credit from Watteau. This order was in breach of specific instructions from Fenwick but there was nothing to make Watteau suspect this. It was **held** that Fenwick was liable for the price.

Presumed Authority

Certain relationships are such that the agency of one party has been presumed to include a certain authority. It does not arise in commercial affairs but we must mention it briefly, for the sake of completeness.

(a) Husband and Wife

While husband and wife were living together and maintained a household, it was presumed that the wife had authority to pledge her husband's credit for necessaries suitable to the style of life which they were leading. This presumption could be rebutted if the husband had forbidden her to pledge his credit and notified the relevant tradespeople of this fact, or advertised it in a local newspaper; or, if she was already well supplied with such necessaries; or the husband had given her a sufficient allowance to cover such expenditure.

In ***Miss Gray Ltd v. Cathcart (1922)***, a wife was supplied with clothes to the value of £215, and the husband refused to pay for them. On his being sued by the tradesman, the husband proved that he paid his wife £960 a year, as an allowance. It was **held** that the husband was not liable.

Note that, in ***Ryan v. Sams (1848)***, it was **held** that a **housekeeper** is in a similar position to a wife, so far as the question of agency is concerned. It is the fact of **cohabitation** which raises the presumption of agency.

(b) Parent and Child

But there is **no** presumption that a child has authority to pledge the credit of the parents, even for the supply of necessaries.

You will recall the special rules regarding minors in the law of contract, and that contracts for necessaries are valid.

B. DELEGATION OF AUTHORITY

General Rules

The general rule is that an agent cannot, without the **express authority** of his principal, delegate his authority to another or appoint a sub-agent to act for him in the whole or in part of his duties. The Latin maxim is "*delegatus non potest delegare*": someone to whom something is delegated cannot sub-delegate.

The reason for this rule is that the appointment of an agent involves a principal in liability and risk; that is the purpose of it. An agent makes contracts or does acts on the principal's

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behalf which bind the principal. Hence, the principal is entitled to expect and rely on the fact that the agent will not pass the task(s) over to someone else, probably unknown to the principal.

If an agent does delegate without authority, or appoint a sub-agent likewise, the principal is not bound by the contract, and the agent is **personally liable** upon it.

There are, however, **five partial exceptions** to this otherwise strict rule.

- The first and obvious one is that the principal is always at liberty expressly to **authorise** the agent to delegate or appoint a sub-agent.
- If the task to be delegated is of a "ministerial" character, that is, one of merely carrying out an instruction in a routine fashion, and not involving any discretion or any confidence. For example, an agent who sent out manuscripts to be typed by a secretarial agency could not be deemed to be delegating or appointing a sub-agent.
- In certain trades, businesses or professions, the use of sub-agents is not only customary but also **necessary**. Delegation in the course of such a business, etc. would not breach the rule of "*delegatus non potest delegare*". For instance, in the shipping and forwarding business, an agent in the country of despatch will almost invariably employ a sub-agent in the country of destination of the goods.
- If, during the course of agency, **unforeseen circumstances** arise, it may become essential for the agent to delegate.
- Power to delegate or to appoint a sub-agent will be **inferred** if the principal was aware, at the time of the agency contract, of the agent's intention to appoint a sub-agent, or where the conduct of the parties has been such as to show an authority or an intention to do so.

Position of the Sub-agent

There is no privity of contract between the principal and a sub-agent. Hence, if the principal has cause to take proceedings against a sub-agent, he/she cannot do so directly in contract but must sue the agent, who, in turn, will join the sub-agent in the action.

However, if the principal has either expressly or by implication authorised the appointment of a sub-agent (and, perhaps, also if appointment is customary) the sub-agent will owe the principal a "duty of care", so as to enable the principal to sue direct in tort for negligence. In ***Junior Books Ltd v. Veitchi Co. Ltd (1982)***, the House of Lords **held** that a "nominated" sub-contractor in a building contract owed the building owner a duty of care falling only just short of a contractual relationship (a "nominated" sub-contractor is one named and approved by the employer). It is suggested that an authorised sub-agent would fall into this category.

A sub-agent or delegated agent is, of course, the agent of the **agent**. So, in this respect, the agent is the principal of the sub-agent or delegatee. As between themselves, the normal agency rules apply. By the same token, provided the real principal has authorised or ratified the appointment of the sub-agent or delegatee, she will, in effect, be bound by that person's acts in the same way as she is bound by the acts of her agent.

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C. RIGHTS AND LIABILITIES OF THE PRINCIPAL TO THIRD PARTIES

In Respect of Contracts

As we have said before, a contract made by an agent on behalf of a named principal is the contract of the **principal**. Hence, he/she can both sue and be sued in respect of it. The agent assumes no personal liability on the contract.

That is the rule where both principal and agent are English. However, where an agent in England makes a contract on behalf of a foreign principal, the situation may be different. Until fairly recently, there was a very strong presumption in such a case that the agent had no authority to bind the principal and was, in fact, assuming personal liability in respect of the contract.

However, in ***Teheran-Europe Co. Ltd v. S T Belton (Tractors) Ltd (1968)***, the Court of Appeal recognised that even the law merchant can change, and that the presumption that the agent was contracting personally where the principal was a foreigner no longer applied. It was a factor to be considered, but no more.

However, normally, if an agent does some act which is beyond the scope of his/her actual or apparent authority, the principal will **not be bound** by that act. Furthermore, if the third party has notice of the actual authority of the agent, then the apparent authority of the agent will not be relevant. The principal will not be bound by any acts in excess of the agent's **actual** authority.

Undisclosed Principal

It sometimes happens that an agent will negotiate or contract with a third party, disclosing that he is an agent but not stating the name of his principal. He may also not even disclose the fact that he is acting as an agent at all.

Plainly, this must affect the situation. The third party cannot be expected to be bound by a contract if he does not know with whom he is contracting; even more so if he does not realise that the person with whom he is dealing is not, in fact, the principal at all but acting for some unknown principal.

In such cases the rules are as follows:

- An undisclosed principal can sue or be sued in respect of any contract made on his behalf by his agent. So, as far as the **principal** is concerned, he can act in the normal way as if his name has been properly **disclosed**.
- Likewise, he can sue or be sued in respect of money paid or received on his behalf by his agent provided the agent was acting within the scope of his **actual** authority.
- The undisclosed principal can also intervene in any contract made by his agent and for example, take the benefit of it for himself. The exception to this rule is that, if the personality of the agent is of prime importance, then the principal cannot himself intervene.

  In ***Said v. Butt (1920)***, an agent obtained tickets for the first night of a show at a theatre, without disclosing that he was acting as agent.

  HELD: The real principal could not intervene to take the benefit of the contract for himself. The personality of the contracting party was an important consideration in the making of the particular contract.

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- The real principal can neither intervene, nor sue or be sued, if an express or implied term of the contract is **inconsistent** with such a right. In ***Humble v. Hunter (1848)***, an agent executed a charter-party for a ship, and was described in the contract as the owner of the vessel. He was, in fact, only an agent for the real owner.

  HELD: The real owner could not give evidence to show that the agent had contracted on his behalf in order that he might sue in respect of the contract, because this would be inconsistent with the contractual term that the agent was the owner.

  The courts now seem to be moving away from the principle in this case and will make the agent personally liable only where he/she has contractually warranted that he/she was the only principal or the agent's personality was regarded by the third party as essential to the performance of the contract.

- As far as the **third party** is concerned who has contracted with an agent for an undisclosed principal, or with a person who has not disclosed that she is acting as an agent, he can sue either the agent or (when he discovers the identity or existence of the principal) he can sue the principal.

  The corollary of this is, of course, that the agent is herself **personally liable** on the contract. She has a right to be indemnified by the real principal but if, say, the principal is insolvent, this right is not of much value!

- However, although the third party can choose to sue either the agent personally or when he discovers the identity, the principal, if he elects to sue the agent and gets judgment, then, if the judgment is not satisfied, he cannot later turn round and sue the principal (***Priestley v. Fernie (1863)***).

- The fact that an undisclosed principal has, in fact, paid an agent in settlement of a debt owing to a third party does not discharge the undisclosed principal from liability if the **agent** does not pay the money over to the third party.

In Respect of Money Paid or Received

As stated above, payment by an undisclosed principal to his/her agent does not absolve him/her of liability to the third party. The same applies if the principal is disclosed. In respect of normal disclosed principals, the situation is not always what you would expect.

If a third party settles the debt he owes the principal by paying the agent, that third party will be discharged from liability only if the agent has actual (express or implied) or apparent authority to receive payment. Further, the third party has no right to set off against what he owes the principal sums that are owed to him by the agent: ***Fish v. Kempton (1849)***.

D. LIABILITY OF THE PRINCIPAL FOR THE WRONGS OF THE AGENT

Fraud

Fraud by an agent while acting within the scope of his/her actual or apparent authority does not affect the liability of the principal. The principal is still bound by the act of the agent, even though the agent was acting fraudulently and to further his/her own interests. However, this rule does not apply unless the agent was actually authorised (whether expressly or by implication), or apparently authorised, to do the act in question. Nor does it, probably, apply if the principal is undisclosed.

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In ***Hambro v. Burnand (1904)***, B authorised A to underwrite insurance policies as his agent. Contrary to his authority, and in his own interest, A underwrote a guarantee policy in B's name. The underwriting of such policies was in the ordinary course of business for a Lloyd's underwriter, which A was.

HELD: B was bound by the policy, even though it was in fraud of him.

Torts Committed by the Agent

The liability of a principal for torts committed by an agent depends, to an extent, on the **status** of the agent.

If the agent is an **employee** of the principal, then the normal law of master and servant applies; the employer is liable for damage or loss caused by the wrongful act of the employee, while acting in the course of his/her employment. This means that the employee must have been engaged in or about the service of the employer when the wrongful act was committed, and not operating strictly on his/her own account. Say, a person is driving a company car, and he has an accident through his own fault. If he was on the company's business when the accident occurred, the employer would be liable. If, on the other hand, he was driving his wife shopping at the weekend, using the company car, the employer would not be liable. In the latter case, the driver would not have been in the course of his employment. This is called **vicarious liability.**

In the case of **all** agents, whether they be servants or not, the principal will be liable for a wrongful act of the agent in the following instances.

- If the act was either authorised or ratified by the principal. This is fairly obvious and no more needs to be said about it.
- If the wrongful act was done in the course of the business of the agency, and it was in connection with matters within the actual or apparent authority of the agent. In other words, if the tort was committed as part of or in connection with the agent's ordinary agency business, the principal will be liable. This applies even if the wrongful act was done for the benefit of the agent, and not the principal. In ***Colonial Mutual Life Assurance Society Ltd v. Producers' and Citizens' Co. of Australia Ltd (1931)***, an insurance company was **held** by the Australian High Court to be liable for defamation committed by its agent while soliciting business.

Money Misappropriated by the Agent

Frequently, agents, as part of their duties, receive money from third parties which is for the account of their principals. An estate agent acting for the vendor of a house will, for instance, receive a deposit paid by the purchaser. Or the agent may receive money from the principal, or from a third party, which is for the account of another party. In all these cases, should the agent, having received the money while acting within the scope of her authority, misapply or misappropriate it, the principal will be liable. He will be bound to make it good to the third party. The principal will, of course, have a right of action against the agent but the primary liability remains with him.

Notice Given to the Agent

A notice given to an agent within the scope of her actual or apparent authority is deemed to be notice duly given to the **principal**. So, if the agent fails to communicate the notice to her principal, the principal will still be liable as if he had actually received it.

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Bribery of the Agent

This is one of the few instances where a principal is not liable for the act of his/her agent.

Any contract made by an agent while under the influence of bribery is voidable by the principal. Furthermore, the person who bribed the agent is jointly and severally liable with the agent for any loss occasioned to the principal.

E. RELATIONS BETWEEN AGENTS AND THIRD PARTIES

The general rule is that where an agent makes a contract in her capacity as agent between her principal and a third party, the agent is not liable to the third party in respect of it. The contract an agent makes is the contract of the **principal** and, once made, the agent drops out of the transaction.

However, in a number of instances this will **not apply**.

If the Agent Contracts Personally

When a person contracts as agent for another it does not necessarily follow that he did not also contract personally, whether by accident or design. The third party must know with whom he is contracting, and who is liable to him on the contract. Hence, if he thinks that the agent is fully liable, or he is led to believe this, then, in general, the agent will be personally liable. Alternatively, the agent may intend to perform the contract himself, and make himself liable in respect of it, either solely or jointly with the principal.

So, having stated the general rule that the agent is not liable, we must now look at the cases where he is or may be so liable.

- The first and obvious instance is that of a totally undisclosed principal, where the agent contracts on the basis of **personal liability**. Whether, in any particular case, he has done so can be ascertained only from the contract itself or the surrounding circumstances.
- **Partners** are automatically liable jointly with all their other partners for the debts and obligations of the firm: **Partnership Act 1890**, Section 9.

  Furthermore, "*every partner is an agent of the firm and his other partners for the purpose of the business of the partnership*": **Partnership Act 1890**, Section 5.

  Hence, every partner who does any act within the scope of the usual business of the partnership is, in the first place, an **agent** and in the second place, is **personally liable,** together with the other partners, for the consequences.
- The agent may guarantee or stand surety for the obligations of his principal. This will, obviously, have the same effect as if he had contracted personally, albeit his liability is **secondary** to that of his principal.
- The agent may disclose the fact that he is acting as an agent but **not identify the principal**. Cases in this instance hinge on whether the identity of the principal **matters**. In some contracts, it is plainly essential that the third party knows precisely who the principal is. It may be that performance by the principal involves special skill or expertise, or perhaps that it involves substantial liability. In the first such example, the third party will want to be satisfied that the principal possesses such skill. In the second, he will need to know whether the principal is sufficiently substantial to be able to meet any likely liability. So, in all cases where the identity of the principal is a material factor, if the agent fails to disclose the name of his principal, he will be deemed to be personally liable on the contract, in addition to the liability of his principal.

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On the other hand, in certain types of contract, the identity of the principal is irrelevant. Such a case would be at an auction. The auctioneer is agent for the vendor. A prospective buyer bids, and it is plainly of no significance whatsoever who the vendor is. Hence, the agent is not personally liable if he does not disclose his principal's identity.

It all depends on the **construction** of the contract and the surrounding **circumstances**.

- There used to be a very strong presumption that an agent who contracted on behalf of a foreign principal was contracting personally. This dated from the days before rapid communications, and when details of foreign businesses were not readily available in England. However, (as we saw earlier), in ***Teheran-Europe Co. Ltd v. S T Belton (Tractors) Ltd (1968)***, it was **held** that this rule was out of date. The fact that the principal is foreign is merely a factor to be considered if the question of the personal liability of the agent arises. It may, perhaps, indicate that the agent intended to undertake liability in addition to the principal.
- ***Del credere* agents** always undertake personal liability. They are agents of the **seller**, and they guarantee to their principals that, if the buyer does not pay, they will do so. In this respect, their liability is not, of course, to the third party. They do not guarantee to him that the principal will perform.

Contracts under Seal and other Written Contracts

Because of the importance of and strict rules regarding deeds and other contracts under seal, the rules as to the agent's personal liability are correspondingly strict.

The rule here is that, if an agent executes a deed, it must be perfectly clear that what she is doing is executing the **principal's** deed. Hence, if she executes it in her own name, she is personally liable. It does not matter that she may have been described as acting for a named principal. The deed must make it absolutely clear that the agent is the properly authorised agent or attorney of the principal for the purposes of executing the deed.

- When drawing, endorsing or accepting a cheque, a bill of exchange or promissory note, an agent who writes after her signature words indicating that she is doing so as agent for a named principal is not personally liable on the instrument.

  However, if she merely writes the word "agent" or similar, without disclosing the name of the principal, she will be personally liable in respect of it.
- In the case of written contracts other than deeds or negotiable instruments, it is a question of the proper construction of the contract as to whether personal liability will fall on the agent.

  If an agent signs a contract in her own name without stating that she does so as agent, she will be personally liable, unless the contract itself plainly indicates that she is signing in a representative capacity. However, merely describing herself as "secretary", "director", "agent", etc. does not of itself indicate that she is not intending to contract personally. Once again, depending on the wording of the whole document it is usually necessary for the principal or person on whose behalf she purports to contract to be named.

  In the case of a person signing on behalf of a company, he is usually signing as the company, and not merely as an agent for it. In the former case, personal liability will not arise.

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Non-existent Principals

Apart from straightforward criminal fraud, with which we are not concerned, the instances where an agent contracts on behalf of a non-existent principal are likely to arise where he/she purports to contract on behalf of a company which has not yet been formed. This problem will arise when you study company law but it is not always possible to keep legal matters in watertight compartments, so a brief survey here will not come amiss.

The principle is that a company is a **legal person**. Before it is "born" or to be accurate, properly registered according to the law of the country in which it is formed, it does not exist.

However, acts and things often need to be done by the promoter of the company before it is actually formed. It may be that the intention is that the company shall purchase certain property, or exploit certain patents, or other rights. Whatever it is, the promoter may wish to tie things up before actually forming the company. If he/she does this, it cannot be done on behalf of, or as agent for, a non-existent entity. The principal is always **personally liable** on such contracts and the company, when it is formed, **cannot be bound** by them: ***Re English and Colonial Produce Co. Ltd (1906)***.

Nor can the company itself, when formed, enforce a contract made before its incorporation, against the other party to it: ***Natal Land, etc. Co. v. Pauline Colliery Syndicate Ltd (1904)***. Strictly speaking, a company cannot, after its formation, ratify a contract made before incorporation: ***Kelner v. Baxter (1866)***. What happens is that the promoter makes the contract in his **own** name, and then, when the company is duly formed, he **assigns the contract** to it. He may protect himself at the time of originally making the contract by inserting a provision that it will be a condition precedent to the validity of the contract that the company duly does adopt it.

However, usually through ignorance, people often do purport to enter into a contract as agent for a non-existent company, in other words, for a non-existent principal.

The common law rule in such an event is that the agent is **personally liable**. This is reinforced by statute. The **Companies Act 1985** states:

> *"Where a contract purports to be made by a company, or by a person as agent for a company, at a time when the company has not been formed, then subject to any agreement to the contrary the contract has effect as one entered into by the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly."*

Where the Agent is really the Principal

Sometimes, a person will describe himself as an agent when he is, in fact, the principal himself. Such a situation arose in ***Gardiner v. Heading (1928)***. A builder had, in the past, done work for a company, the order for it being signed by Mr Heading, a director. Then, Mr Heading ordered further work, purporting to do so on behalf of the company. The work was duly done and part of the charges were paid by the company. The builder was then told that the work was not for the company at all but for other principals. It was **held** that Mr Gardiner was the person who gave the order, and he was the true principal. He was, accordingly, personally liable.

By the same token, of course, if the agent is the real principal, he is entitled himself to sue in respect of the contract.

Breach of Warranty of Authority

An agent may be liable to a third party in respect of a contract, if it can be shown that she warranted to the third party that she had an authority which she did not, in fact, possess. There is a general presumption that, if a person purports to act as agent for or on behalf of

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another, she is deemed to represent that she is duly authorised. This is, in reality, an offshoot of the law of misrepresentation, which we have discussed in a previous study unit. Consequently, if a person is induced to contract, and does, in fact, contract as a result of a representation of agency, then, if he suffers loss or damage by reason of the representation being untrue, the purported agent will be liable.

For example, in ***Yonge v. Toynbee (1910)***, it was **held** by the Court of Appeal that an agent was liable for breach of warranty of authority after his authority had, unbeknown to him, been terminated by the insanity of his principal. It was, at one time, thought that this liability was a tort, and could arise only if the agent had been negligent. However, this is not so, as ***Yonge v. Toynbee*** shows. It stems from the **contractual relations** of agent and third party.

The agent warrants only that he has **authority to contract** for his principal. He does not warrant that the principal is solvent, or that he will properly perform the contract, or even that he will perform at all.

Of course, if an agent does not have actual or apparent authority, he will normally be personally liable anyway, so the question of imposing an additional head of liability, called "breach of warranty", is not likely to be necessary. However, this will not always be so, and it is, therefore, a "fallback" position for an injured third party to take. For instance, in ***Starkey v. Bank of England (1903)***, a stockbroker, acting in good faith, induced the Bank of England to transfer some consols i.e. funds emanating from the Consolidated Fund, to a purchaser, on the strength of a power of attorney which was, in fact, forged. The holder of the consols had a right of action against the bank for restitution. The stockbroker, as agent, was **held** liable to indemnify the bank against the claim by reason of his breach of warranty of authority.

Liability of Agents in Respect of Money

Normally, if an agent receives money for her principal, she is not liable to repay it to the third party. However, in certain circumstances she may be:

- The obvious case is where the agent has contracted personally (by accident or design). In that event, the third party who paid the money looks to the agent **as principal** and therefore, the agent is liable for any repayment that may be due.
- If the agent has acted **fraudulently** or has obtained the money by means of **duress**, then she is liable to repay it.

Liability of Agents for Wrongs they Commit on the Principal's Behalf

Should loss or injury be suffered by a third party as a result of some wrongful act or omission of an agent, then the agent is liable for it to the third party. This applies regardless of whether the agent was acting with the principal's authority or not, and the liability is the same as if the agent were acting purely on his own behalf.

This form of liability will usually arise as a result of a tort committed by the agent. If, for instance, he is negligent, or if he deceives the third party, he will be liable.

Of course, as we have already mentioned, if the agent is also a **servant**, his employer will be vicariously liable if the tort was committed in the course of the agent's employment. However, if he is not a servant, or was not in the course of his employment, then the agent is personally liable.

In ***Bennett v. Bayes (1860)***, a distress warrant was signed by an agent. (A distress warrant is a warrant for the seizure of property after a judgment debt has not been paid). The warrant was issued but before it was executed, a tender of payment was made by the debtor. The agent wrongfully refused it.

HELD: The agent was personally liable for the damage caused by the illegal distress.

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F. TERMINATION OF AGENCY

By Revoking the Agent's Authority

An agent who is appointed by contract may be appointed under numerous circumstances and conditions. The appointment may be for a **specific task** (e.g. to sell a house), or for a **limited time** e.g. for one year only, or it may be **indefinite**. Consequently, the agency contract may terminate under equally diverse circumstances. As between principal and agent, the termination of the contract serves to **revoke the agent's authority**. However, as between agent and third party this may not necessarily be the case. The agent's actual authority will be revoked but if the third party is unaware of the revocation, then the agent's apparent authority may subsist.

The seven circumstances under which an agent's **actual** authority is revoked are set out below.

(a) Agreement

Like any other contract, an agency can be terminated by agreement between principal and agent. This is self-evident.

(b) Completion

If the agency is for a specific task, the authority of the agent automatically ends when that task is **completed**.

For example, in ***Blackburn v. Scholes (1810)***, a broker was employed to sell goods for the principal. It was **held** that, immediately the sale was completed, his authority ceased, so he could not subsequently alter the terms of the contract by agreement with the purchaser without new authority from the principal.

Likewise in ***Gillow & Co. v. Lord Aberdare (1892)***, an estate agent was commissioned either to sell or to lease a house. He succeeded in letting it but then later negotiated the sale of it. It was **held** that, having let it, his job was done, and he had no authority to sell. He was not entitled to commission on the sale.

(c) Expiration

If the agency is for a specific period of time, it is determined when that time has **expired**.

Equally, if it can be reasonably inferred from the circumstances that the agency was for a limited (although not specific) time then it will lapse after a **reasonable** time.

For instance, in ***Lawford & Co. v. Harris (1896)***, a stockbroker was instructed to buy shares subject to fixed limits. It was **held** that his authority ceased at the end of the current account period.

(d) Specified event

It may have been agreed, or be inferred, that the agency will cease if a certain event occurs. Then, it will terminate if and when that event **does occur**.

(e) Frustration

The frustration of the contract of agency will serve to terminate the authority of the agent. This is likely to occur if the subject-matter of the agency is destroyed e.g. if an estate agent is commissioned to sell a house and, before sale, it is burnt down. Or if something happens which makes either the agency or its objects illegal or impossible e.g. an agent in a foreign country becoming an alien enemy owing to outbreak of war between the UK and that country.

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(f) Death/winding-up

The authority of an agent, is, normally, terminated by the **death** or **insanity** of either the principal or the agent, or the **bankruptcy** of either. (Re insanity, see ***Yonge v. Toynbee (1910)***. However, under the **Enduring Powers of Attorney Act 1985**, it is now possible to create an enduring power of attorney, which will not be brought to an end by the donor's mental incapacity). In the case where either party is a limited company, the **winding-up** of the company has the same effect.

(g) Revocation

Lastly, if either the principal or the agent **revokes** the agency or **renounces** it, whether or not the act of so doing is in breach of the contract, the agent's authority will be revoked. If it is done in breach of contract, then the innocent party, principal or agent will have the right to seek damages for breach of contract. However, this will not affect the fact that the authority of the agent is terminated. In certain circumstances, the innocent party may also be able to get an order of specific performance from the court, compelling the guilty party to carry out the contract in accordance with its terms; or, if relevant, an injunction to prevent the guilty party from revoking the agency. However, neither of these equitable remedies will be granted if the relationship between principal and agent is a personal one, that is, if the character, skill, experience, etc. of the agent is an **essential element** of the relationship.

Irrevocable Agency

An agency contract may be irrevocable, either by agreement or by implication, as a result of the circumstances. However, this is not straightforward. The mere fact that the parties have agreed that the agency shall be irrevocable does not, of itself, make it so. There is nothing to prevent one party renouncing in breach of the contract, notwithstanding that he/she has agreed not to. Something more is necessary to render the contract legally irrevocable.

(a) Appointment by deed or valuable consideration

If the authority is given to the agent by **deed**, or for **valuable consideration**, for the purpose of effecting a security, or for protecting an interest of the agent, then this authority cannot be withdrawn while he/she is at risk as a result of the agency duties.

Two examples may clarify this. In ***Gausson v. Morton (1830)***, the principal owed money to the agent. So, he gave him a power of attorney (a deed) to sell certain land and deduct the amount of the debt from the purchase money.

HELD: The power of attorney was irrevocable.

However, in ***Smart v. Sandars (1848)***, the agent was a factor, and the principal consigned goods to him for sale. The agent advanced money to the principal on the credit of the goods. Later, the principal cancelled his instructions for his agent to sell.

HELD: As the authority of the agent was not given for valuable consideration, the principal was permitted to revoke the authority. (Note that, had the factor's authority been given **under seal**, the outcome would have been different.)

(b) Powers of Attorney Act 1971

By virtue of the **Powers of Attorney Act 1971**, Section 4, in certain circumstances (see below), such a power may be expressed to be irrevocable, and in this case it will be so. This section is, in fact, merely codifying the common law rule outlined above, but the difference is that, under the Act, the power must be **actually expressed to be irrevocable**, whereas at common law this is not necessary.

The relevant circumstances under the Act are where the power has been given to secure a proprietary interest of the recipient (the donee), or to secure the performance

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of an obligation owed to the donee by the donor. In either of such events, the power cannot be revoked while the interest or the obligation is still undischarged, without the consent of the donee. Nor can it be revoked as a result of the death, insanity or bankruptcy of the donor, or if it is a company, by its winding-up.

In other words, the Act is designed to ensure that, where the agent obtains a power of attorney which is stated to be irrevocable, in good faith and on the understanding that its purpose is to give the agent security for some debt or other interest, the principal cannot arbitrarily cancel it.

(c) Personal liability to a third party

Other instances of irrevocability of agency authority are where the agent incurs a personal liability to a third party in pursuance of agency duties. The principal will not be permitted to revoke the authority if, by so doing, he/she will destroy the agent's right to indemnity or reimbursement from the principal. This is really only common sense. If, in reliance on his/her legal right to be reimbursed or indemnified by the principal, the agent incurs a liability, it would, plainly, be most unjust to allow the principal to escape from the bargain by withdrawing the agent's authority.

Effect of Revocation on Third Parties

As we said earlier, a revocation serves to terminate the actual authority of the agent, whether that revocation is or is not in breach of contract. The only exceptions are those mentioned above. However, the withdrawal of actual authority will not necessarily destroy the **apparent** authority of the agent. Nor will his/her **usual** authority necessarily be removed.

The principle involved is that, if a principal has held out to third parties that his agent has authority to do certain things, then the principal will not be allowed to deny that the agent was so authorised to third parties who have dealt with the agent in good faith and without knowledge of his lack of authority. The holding out of the agent's authority may be by words or by conduct, or it may be by permitting some other person to so hold out, without dissenting. So, if the agent's authority is withdrawn, it is up to the principal to notify all third parties who may be affected of this fact. If he neglects to do so, he will be bound by the acts of his former agents.

This, in principle, is no different from the situation where the agent is acting under apparent authority in other circumstances – where, for example, he/she has exceeded his actual authority but it becomes more difficult where the authority of the agent is revoked owing to the death, bankruptcy or insanity of the principal. In the case of death or bankruptcy, the principal is in no position to notify third parties. As a result, the doctrine of apparent authority does not apply. In ***Blades v. Free (1829)***, a man who was living with a woman held out to certain tradesmen that she had authority to pledge his credit. She duly did so and, for some years, she purchased goods in his name. Then he went abroad, where he died. The woman continued to run up bills for his account.

HELD: The man's estate was not liable for the debts incurred to tradesmen who were not aware of his death.

Logically, the same should apply in the event of the insanity of the principal but it appears that this is not so. In ***Drew v. Nunn (1879)***, a husband held out that his wife had authority to pledge his credit (see the previous study unit, Section A). He subsequently went insane. A tradesman, relying on the authority originally given by the husband, and without knowledge of his insanity, supplied goods to the wife on credit.

HELD: The husband was liable for the price.

Of course, in all these instances the innocent third party is not totally without redress. Provided the agent was aware at the time she made the contract that her authority had been revoked, for whatever reason, the third party will have grounds to sue the agent for breach of

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warranty of authority. The effect will be the same: he will get his money, indirectly by way of damages instead of directly by way of debt.

In the case of powers of attorney, the **Powers of Attorney Act 1971**, Section 5, provides that, where a power is revoked, any person dealing with the attorney without knowledge of the revocation is protected, in the sense that the transaction is deemed to be valid to the same extent as if the power were still in existence. Likewise, the attorney is protected if he/she is not aware of the revocation. He/she incurs no liability to the donor of the power (the principal), nor to any other person.

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Study Unit 13

Employment Law 1: The Contract of Employment

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A. DISTINCTION BETWEEN INDEPENDENT CONTRACTOR AND EMPLOYEE

Definitions

(a) The difference between a contract *of* service and a contract *for* services

The basis of the employer/employee relationship is the contract of employment, which in general is an agreement whereby an employee agrees to provide work or a service in return for remuneration by the employer. The contract of employment is a contract of service and not for services.

- Under a **contract of service** a person places his/her labour at the disposal of another and a relationship is constituted which in past days was called that of master and servant.
- In the **contract for services**, on the other hand, a person who operates an independent business agrees to carry out a task for another and the relationship is that of employer and independent contractor.

Amar's chauffeur is her employee, but a taxi-driver is an independent contractor. If Ben wants to build a garage on his land, he has two courses open: he can employ a bricklayer and other tradespeople under contracts of employment or he can entrust the work to a builder as an independent contractor.

(b) Employment by a corporation

The majority of employers in the UK are corporations, whether a corporation set up by statute, e.g. a limited company under the **Companies Acts**, or by charter, e.g. the British Broadcasting Corporation. Try to remember the following points which will help you to identify who the employer is:

- **A corporation** is a legal entity which is totally separate from the persons who actually form the company. Therefore, no matter which particular individual gives orders or carries out acts on behalf of the company, it is the company which is responsible.
- **A director of a company**, even though he/she may be one of the owners of the company, is not the employer. The company is the employer. A director is merely acting on behalf of the company.
- **A manager**, no matter how high in the managerial hierarchy, is not the employer. He/she may well have the authority to act for the employer, or even as the employer in certain situations. Because a corporation is an **abstract** legal entity, it must carry out its actions through various individuals; in practical terms it can do nothing of itself. Therefore in many cases a manager or director, because of his/her actions, may appear to the employees to be the employer. Nevertheless, the corporation is the employer, and normally must accept ultimate responsibility for the actions of its delegates.

It is important to distinguish between employees and independent contractors, although the distinction is sometimes hard to draw. Over the years, the courts have formulated various tests for deciding between employee and independent contractor.

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Control Test

This has been the test perhaps most frequently relied on by the courts, and is one of the main factors considered.

Control means that the employer has the right to tell the other party to the contract not only **"what"** to do but **"how" to do it**. In other words, he/she controls not only the "ends" but the "means".

The general rule is that wherever this type of control exists, the person thus controlled is an employee.

In our present society, however, the control test has been shown to have certain deficiencies, and it is doubtful nowadays whether control or lack of control indicates conclusively whether a contract of employment exists.

Industrial society today is totally different from the society which existed when the control test was first formulated, since nowadays the employer very rarely has the exact skill and knowledge of his/her employees. It is very difficult to say that the hospital authorities may control the actions of a doctor, or a local authority the actions of a surveyor.

This was shown very clearly in ***Cassidy v. Minister of Health (1951)***. This case solved many of the problems relating to skilled people. Although the employer could not control the actions of the doctor in the strict sense, the doctors and nurses concerned were permanently employed and salaried members of the staff, and were subject to the standing orders of the employers; also the employers were in a position to make rules concerning the organisation of the doctor's work. For these reasons, he was an employee, despite the lack of control in the old sense.

The problem of control in the case of skilled persons was also illustrated in ***Mersey Docks and Harbour Board v. Coggins & Griffiths (Liverpool) Ltd (1947)*** where the crane driver stated "*I take no orders from anybody*" (see later for further discussion of this case).

Integration Test

This suggests that the individual is "part and parcel" of the employer's organisation. This idea was to some extent suggested in ***Cassidy v. Minister of Health (1951)***, where, as has already been said, the medical staff were on the permanent establishment of the hospital and subject to the standing orders of the hospital. As a result, Professor Kahn-Freund, in an article in the *Modern Law Review*, suggested that the decisive test might be "*Did the alleged servant form part of the alleged master's organisation?*" In ***Stevenson Jordan & Harrison v. MacDonald & Evans Ltd (1952)***, Lord Denning developed this test as follows:

> *"Under a contract of service, a man is employed as part of the business and his work is done as an integral part of the business; whereas under a contract for services, his work, although done for the business, is not integrated into it, but is only an accessory to it."*

In ***Whittaker v. Minister of Pensions (1967)*** a trapeze artist (who might normally have been held to be an independent contractor) was **held** to be an employee, since in addition to performing on the trapeze, she had to act as usherette, sell programmes, put out the seats, and generally help in the running of the circus:

> *"[She] had to carry out her contractual duties as an integral part of the business of the company."*

The Multiple or Economic Reality Test

This is the test which is applied by the courts today. It is a test which seeks to look at the economic reality underpinning the employment relationship. This test was established and subsequently applied by MacKenna J. in *Ready Mixed Concrete v. Minister of Pensions & National Insurance (1968)* where MacKenna J stated that*: "A contract of service exists if these three conditions are fulfilled.*

(a) *"The servant agrees that, in consideration of wage or other remuneration, he will provide his own work and skill in the performance of some service for his master."*

It should be noted that Mackenna J also went on to say that the *"freedom to do a job either by one's own hands or by another's is inconsistent with a contract of service, though a limited or occasional power of delegation may not be*" – i.e. he took account of the situation where a person would need a colleague to stand in for them because they were sick, for example.

(b) *"He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control to a sufficient degree to make that other master."*

It should be noted that Mackenna J also said that *"control includes the power of deciding the thing to be done, the way in which it shall be done, the means to be employed in doing it, the time when and the place where it shall be done. All these aspects of control must be considered in deciding whether the right exists in a sufficient degree to make one party the master and the other his servant. The right need not be unrestricted***"**.

(c) ***"****The other provisions of the contract are consistent with it being a contract of service."*

Leading on from this, the primary factors consistent with the existence of a contract of service are:

- Mutuality of obligation – i.e. the employer is under an obligation to offer the worker work, and the worker is under an equivalent obligation to accept it
- The worker is under no financial risk
- The worker is not responsible for paying his own tax and national insurance
- The worker is provided with all the tools and equipment that he needs for his work
- The worker is not responsible for hiring his own substitute and/or another worker to assist him with the completion of his work.

The following two judgements are very helpful when trying to determine whether or not a worker satisifies the **second and third** conditions of Mackenna J's multiple test. The judgement of Mummery LJ in ***Hall v Lorimer (1992)*** when it was heard in the Court of Appeal in; and that of Cooke J in ***Market Investigations v Minister of Social Security (1969)*** when it was heard in the Queens Bench Division of the High Court.

The multiple test was further developed by Cooke J in ***Market Investigations v. Minister of Social Security (1969***) where Cooke J stated that:

> *"The fundamental test to be applied is this: 'Is the person who has engaged himself to perform these services performing them as a person in business on his own account?' If the answer to that question is 'Yes', then the contract is a contract for services. If the answer is 'No', then the contract is a contract of service. No exhaustive list has been compiled and perhaps no exhaustive list can be compiled of the considerations which are relevant in determining that question, nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases.*

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The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors which may be of importance are such matters as

(i) whether the man performing the services provides his own equipment,

(ii) whether he hires his own helpers, – the applicant's in ***Ready Mixed Concrete*** *and* ***Express & Echo Publications Ltd. v. Tanton (1999)*** *failed on this, amongst other things,*

(iii) what degree of financial risk he takes,

(iv) what degree of responsibility for investment and management he has, and

(v) whether and how far he has an opportunity of profiting from sound management in the performance of his task."

Make use of the points above when determining whether an applicant in a scenario question passes the second and third condition of the multiple test as established by MacKenna J in ***Ready Mixed Concrete***.

Moreover, in ***Hall v. Lorimer (1992)*** Justice Mummery observed, in relation to Cooke J.'s test (Cooke J had given more guidance on the things that should be considered when determining whether or not an applicant will pass MacKenna J's multiple test) that:

"In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a checklist to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another... The decided cases give clear guidance in identifying the detailed elements or aspects of a person's work which should be examined for this purpose. There is no complete exhaustive list of relevant elements."

The list includes

- The express or implied rights and duties of the parties
- The degree of control exercised over the person doing the work – link this to Mackenna J's second condition where he stated that: *"control includes the power of deciding the thing to be done, the way in which it shall be done, the means to be employed in doing it, the time when and the place where it shall be done. All these aspects of control must be considered in deciding whether the right exists in a sufficient degree to make one party the master and the other his servant. The right need not be unrestricted. "What matters is lawful authority to command so far as there is scope for it. And there must always be some room for it, if only in incidental or collateral matters*."
- Whether the person doing the work provides his own equipment and the nature of the equipment involved in the work – link to ***Market Investigations***, and ***Ready Mixed Concrete***
- Whether the person doing the work hires any staff to help him – link to ***Ready Mixed Concrete*** and ***Tanton***

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- The degree of financial risk that he takes, for example, as a result of delays in the performance of the services agreed (link to ***Ready Mixed Concrete*** and there being a delay in the delivering of concrete)
- The degree of responsibility for investment and management
- How far the person providing the services has an opportunity to profit from sound management in the performance of his task
- It may be relevant to consider the understanding or intentions of the parties – link to the need to determine whether the 'label' **given to an employment relationship by the parties** is a genuine one. If an applicant is genuinely labelled as self-employed he will fail the third condition of Mackenna's multiple test
- Whether the person performing the services has set up a business like organisation of his own – ***Hall v Lorimer*** problem
- The degree of continuity in the relationship between the person performing the services and the person for whom he performs them – mutuality of obligation can be implied in those cases where there is a series of engagements with the same employer ***Nethermere (St Neots) Ltd v. Taverna and Gardiner (1984)*** and /***Market Investigations***
- How many engagements he performs and whether they are performed mainly for one person or for a number of different people. It may also be relevant to ask whether the person performing the services is accessory to the business of the person to whom the services are provided or is "part and parcel" of the latter's organisation." – compare and contrast ***Hall v Lorimer*** and ***Market Investigations***. The applicant in ***Hall*** failed the multiple test whereas the applicant in ***Market Investigations*** passed it.

Again use the points above to determine whether or not an applicant passes the second and third conditions of MacKenna J's multiple test.

Application of the multiple test

The multiple test was applied by the Court of Appeal in the case of **Express & Echo Publications Ltd. v. Tanton (1999)** and the applicant failed all three conditions of MacKenna's multiple test, the court stating that:

> *"it is necessary for a contract of employment to contain an obligation on the part of the employee to provide his or her services personally…." . "Where a person who works for another is not required to provide his or services personally, as a matter of law the employment relationship between the worker and the person for whom he and she works is not that of employee and employer, for it is wholly inconsistent with a contract of employment, and the only conclusion that can be properly reached in such cases, is that the agreement is a contract for services"*

Mr Tanton failed the first two conditions of the multiple test because he could substitute himself if he was 'unable or unwilling' to work and he was also held responsibility for hiring his own substitute. He also failed the third condition because, amongst other things, he was subject to financial risk when he was sick because he had to pay somebody else to do his work for him.

In ***Market Investigations Ltd. v. Minister of Social Security (1969)*** a market research interviewer worked under a succession of fixed-term contracts requiring her to conduct interviews for a company in accordance with interview instructions issued by the company. There was no provision for holiday or sick pay and she was free to work for other employers whilst working for Market Investigations Ltd who contended that she was not their employee. It was **held** that she was an employee.

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The reasons for this included the fact that, in the event she was unable to work, she could only substitute herself with another of their market researchers who was hired and paid for by them. The company did have some control over her work because she was required to conduct standard interviews within a specified time period even though she had no specified hours of work. Moreover, she did not provide her own tools and took no financial risk. She was, therefore, not *'in business on her own account'* and was an employee and not an independent contractor. The court also emphasised that there was 'no exhaustive test complied, or strict rules laid down' as to factors which identified a contract of service. Note – also implied mutuality of obligation here, as series of assignments over a period of time with the same employer, Market Investigations. She, therefore, passed all three conditions of the multiple test.

Leading on from the above, it was also held by the Court of Appeal in the case of ***Nethermere (St Neots) Ltd v. Taverna and Gardiner (1984)*** that mutuality of obligation being implied from the lengh of a working arrangement. In this case, outworkers making garments at home on a piecework basis were held to be employees of the garment manufacturers, largely because of the regular long standing arrangement, which showed the necessary mutuality of obligations to do and to be provided with the work.

In ***MacFarlane v. Glasgow City Council (2001)*** the applicants also passed all three conditions of the multiple test and were held to be employees. The points of issue in this case revolved around a Mrs MacFarlane who had previously worked as gymnastic instructor for Glasgow City Council on a casual basis when in 1992 the City Council attempted to regularise her employment relationship by sending her a document setting her terms of engagement. She declined to sign the document and in 1998 claimed unfair dismissal. The preliminary matter was whether she had been engaged under contracts of service or contracts for service. Some of the case facts found by the Employment Tribunal included

- The City Council, in conjunction with the sports governing body, specified the courses which were to be taught
- The City Council provided the venue, equipment and support staff to set up the equipment
- Mrs Macfarlane was required to wear a uniform provided by the City Council
- The City Council monitored her work
- Timesheets were completed and payment was made on the basis of the number of hours worked
- Mrs Macfarlane was also required to have their own public liability insurance
- There was no entitlement to sick pay, holiday pay or pensions.

The Employment Tribunal hearing the case concluded that she was not an employee and hence her claim for unfair dismissal failed. However, on appeal to the employment appeal tribunal **(EAT)** her claim succeeded. The most important factor in the EAT's view being that in the event that she was unable to attend work, a substitute had to be arranged but only from the register of coaches maintained by the City Council to cover her classes i.e. she only had a limited right of delegation, they exerted control over who did her work instead and she was under no financial risk if she could not attend work herself because she was unwell. She, therefore, passed all three conditions of the multiple test and her unfair dismissal claim succeeded.

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For a contract of employment to exist there *must be* 'mutuality of obligation'

This links in with what has been said above and meeting the third condition of the multiple test.

In ***Carmichael v National Power Plc (2000)*** an arrangement under which tour guides worked at a power station, following an exchange of letters referring to "employment" and training was not regarded as telling the whole story. It was open to the Employment Tribunal to find that the parties did not intend the letters to be the sole record of their agreement but intended that it should be contained partly by those letters, partly in oral exchanges at interview or elsewhere and partly left to evolve by conduct as time went on: ***Lord Hoffmann at (1999) ICR 1226, 1234***. Although the words *"casual as required"* in the documentation were thought by the House of Lords not to impose any mutual obligation, in any event the Employment Tribunal was entitled to find as a fact from these other sources that there was no mutual obligation – in this case upon the company to provide work, and the tour guides to do it. Accordingly, there was no contract of employment.

Other factors may also be looked at, such as the employer's right to the exclusive services of the individual; sickness pay; payment of national insurance contributions and income tax; hours of work, provision of equipment and so on.

It is unlikely that any of these factors in isolation would be conclusive and the courts tend to look at the whole agreement and all the relevant factors when reaching their decision.

The 'label' given to an employment relationship by the parties is not conclusive

When all the facts have been gathered, it is then necessary to stand back and look at the bigger picture. If the case is borderline, it is then and only then, that the intentions of the parties are considered. Where there is mutual intention for a contract of service or for a contract for services that will determine the status of the worker.

In ***Massey v Crown Life Insurance Co. (1978)*** giving the leading judgment of the Court, Lord Denning M.R. stated that:

> *"The law, as I see it, is this: If the true relationship of the parties is that of master and servant under a contract of service, the parties cannot alter the truth of that relationship by putting a different label upon it…On the other hand, if their relationship is ambiguous and is capable of being one or the other, then the parties can remove that ambiguity, by the very agreement itself which they make with one another. The agreement itself then becomes the best material from which to gather the true relationship between them."*

Moreover, Lord Justice Lawton commented similarly. He stated:

> *"It is clearly established that the parties cannot change a status merely by putting a new label on it. But if in all the circumstances of the case, including the terms of the agreement, it is manifest that there was an intention to change status, then in my judgment there is no reason why the parties should not be allowed to make the change."*

In ***Massey v. Crown Life Insurance (1978)*** Mr Massey, a Branch Manager of Crown Life Insurance, a professional man whom made a perfectly genuine agreement, following consultations with his accountant, with his employer to change his employment status from "employee" to "self-employed independent contractor", believing that this was for his long-term financial benefit. On his dismissal by his employers, he alleged that he was still an "employee" for the purpose of claiming protection against unfair dismissal. His claim failed.

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In the words of Lord Denning MR in relation to Mr Massey reaping the financial benefits of self-employed status, namely avoiding tax deductions and getting his pension contributions returned:

> *"I do not see that he can come along afterwards and say it is something else in order to claim that he has been unfairly dismissed. Having made his bed as being self-employed, he must lie on it. He is not under a contract of service."*

Perhaps, a different decision would have been made in ***Massey*** if he hadn't been a "professional man" whom having taken independent expert advice had made a declaration which he at that time genuinely believed would be to his benefit. This was in direct contrast to the builder's labourer in ***Ferguson v. John Dawson and Partners (Contractors) Ltd (1976)*** [discussed below} who was unadvised and could not be said to have consciously chosen to be a self-employed contractor -with a detailed knowledge of the legal & economic consequences involved.

Leading on from the above, the court has stated that it must look to the realities of the situation and not the form alone, particularly not the label which the parties put upon a worker: ***Ferguson v. John Dawson and Partners (Contractors) Ltd (1976)***. In this case Mr Ferguson successfully sued his employer for breach of the implied duty to protect him against reasonably foreseeable risks to his health and safety. Because the court found that irrespective of the label put on his employment relationship by the respondents (of a self-employed labour only subcontractor) he was in reality their employee. Consequently, he was entitled to sue from for damages having suffered personal injury as a direct result of their failing to have an adequate guardrail on the roof of their construction site (Ferguson fell off the roof due to this).

Furthermore, when the case of ***Lane v. Shire Roofing Co (Oxford) Ltd (1995)*** was being heard in the Court of Appeal, Henry L.J. stated in relation to Mr Lane's employment status and health and safety at work, generally, that:

> *"When it comes to the question of safety at work, there is a real public interest in recognising the employer/employee relationship when it exists, because of the responsibilities that the common law and statutes."*

B. OTHER CATEGORIES

In most cases, using one of the tests discussed already, it is possible to see whether an individual is an employee or an independent contractor. Alternatively, one company may use a second company to carry out certain work, e.g. the firm which brings in a building contractor to carry out certain building work, where it is obvious that this second firm is an independent contractor.

Certain problem areas have arisen, however, which we must look at in more detail since the specific details decide what position these people hold.

Loaned Servants

It may be difficult where one employer lends an employee to another employer, to decide who is acting as the employer for certain purposes. It is generally thought that where a person is loaned together with his/her equipment, he/she is more likely to continue as the employee of the original employer, particularly for purposes of vicarious liability. Also, there would have to be extremely strong evidence to show that a loaned employee was for all purposes the employee of the second employer.

the **main case** in this area is ***Mersey Docks and Harbour Board v. Coggins & Griffiths (Liverpool) Ltd (1947)*** and you must make sure that you understand and learn it. Here, a crane-driver was lent, together with his equipment, to Coggins & Griffiths. The driver caused

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injury to a third party through his negligence, and it had to be decided which employer was vicariously liable. Coggins & Griffiths could tell the crane-driver which loads to move, and where to move them, but had no rights over his method of working.

As we saw earlier, the crane-driver stated that no one could tell him how to operate his crane. In the contract of hire between the companies, it was stated that the driver should, for all purposes, be the servant of Coggins & Griffiths.

Nevertheless, the court **held** that he remained the employee of the Board. They retained overall control of the driver. It was also stated that an employee could not be made the servant of another person merely by stating so in a contract (of hire in this case). This was for the courts to decide on the facts of the case.

Actors and Artistes

While the control test was the sole criterion for determining who was an employee, it was difficult to bring people who provide specialised services into the ambit of contracts of employment because no employer can control as such an artiste's performance. Such a person is the possessor of some innate skill, which only he/she can control.

However, in ***Stagecraft Ltd v. Ministry of National Insurance (1952)*** this problem was dealt with by the Court of Session. Here, a variety comedian was engaged by the claimants and agreed to take part in their productions for six months. He was to act in certain sketches as the claimants required, attend rehearsals, play all parts assigned to him, obey the directions of the stage manager, and was liable to be transferred to other theatres controlled by the claimants. He was paid a weekly salary. The court stated that this was obviously a contract of employment, because the employer could exercise such strict control over all the incidentals of employment.

On the other hand, leading actors and singers and other "stars", who agree to do a particular performance for a fixed fee, are probably independent contractors.

Doctors and Nurses

As we saw in ***Cassidy v. Minister of Health (1951)*** it has been decided by the courts that the medical staff of a hospital have, in general, contracts of employment with the hospital authorities.

However, no case has yet decided the position of the consultant, although Lord Denning suggested in ***Cassidy's case*** that they ought to be treated in the same way as the rest of the medical staff. The answer may depend on the type of agreement actually drawn up between the consultants and the hospital. Lord Denning has said that his view is that, servants or not, in a vicarious liability situation the hospital would still be liable for them.

Labouring Gangs

This is a more modern problem, which has arisen in the construction industry. There are several variations in the way in which a gang of labourers may be employed by the employer. Some will very obviously be employees, e.g. where the supervisor, who is an employee, selects a particular group of people to work under him. On the other hand, some will be independent contractors, e.g. the labour-only sub-contractors, where the workers are referred to as self-employed, or where they are employees of a gang leader who acts as an independent contractor to various construction companies.

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Agency Workers

As mentioned above, there is a problem with agency workers who frequently do not have the obligation to accept work offered by an agency. There is no doubt that they are not employees of the organisation with which they are placed, because of the rules of privity of contract outlined much earlier. The contract is between the agency and the organisation.

The contract between the worker and the agency has frequently been seen as one which is not employment, as in ***Wickens v. Champion Employment (1984),*** but in two cases this position has been reviewed. In ***McMeechan v. Secretary of State for Employment (1997)***, the House of Lords ruled that lack of mutuality is only another factor and thus on the balance of all the factors the worker was an employee; and in ***Clark v. Oxfordshire Health Authority (1996)*** nurses retained on a "bank" i.e. agency workers, were in fact employees according to the Employment Appeal Tribunal.

The issue of control may mean that the agency worker is employed by the client company, and the longer the exclusive relationship between him/her and the client company, the more likely it becomes that an employment relationship exists. See ***Franks v. Reuters Ltd (2003)***, ***Dacas v. Brook Street Bureau (UK) Ltd (2004)*** and ***Cable & Wireless plc v. Muscat (2006)***.

The **Conduct of Employment Agencies and Employment Businesses Regulations 2003** now affect the operation of these bodies.

Apprentices and Trainees

The **Employment Rights Act 1996** makes specific reference to apprentices and states that they are to be classed as employees (see ***Flett v. Matheson (2006)***). However, other persons employed on a training contract are often considered not to be employees, because the nature of the contract is to learn, not to provide labour: ***Wynn v. Wiltshire Police Authority (1978)***: a police cadet was not an employee).

C. CONSEQUENCES OF EMPLOYMENT STATUS

The individual has to be placed in the correct category if we are to ascertain exactly what his/her rights and duties are.

The individual's exact status will be important in all the following areas:

Employment Protection Rights

Only employees have the following statutory rights, assuming that in redundancy and unfair dismissal cases they have accrued the qualifying period of continuous service (respectively two year's and one year respectively):

- Not to be unfairly dismissed by his employer: Section 94(1), Employment Rights Act 1996: ***Massey v. Crown Life Co. (1978)***.
- To receive a written statement of employment particulars within two months of the commencement of employment: Section 1, Employment Rights Act 1996: ***Carmichael v. National Power Plc (2000)***. In this case tour guides' claim that they were entitled to a written statement of employment particulars was struck out by the House of Lords because one of the essential pre-requisites for existence of a contract of employment was missing. There was no mutuality of obligation i.e. their employer was not under an obligation to provide them with work and they were not under an equivalent obligation to do the work offered. Consequently, they were held not to be entitled to a Section 1 statement as this right only belongs to 'employees'.

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- To receive a minimum period of notice of his employer's intention to terminate his employment: Section 86(1), Employment Rights Act 1996.
- To receive a redundancy payment: Under Section 155 of the Employment Rights Act 1996 'employees' are entitled to a redundancy payment if they have served the qualifying period with their employer of two years continuous service.

Common Law Employment Terms

The implied rights and duties which apply in the employer/employee relationship under a contract of service do not apply to the same degree to a contract for services. At common law, certain terms are implied into every contract of employment, but not into any other form of employment relationship. For example: the implied duty to maintain trust & confidence, which in the words of Kilner Brown J in the case of ***Robinson v. Crompton Parkinson Ltd ([1978)*** "*In a contract of employment, and in conditions of employment, there has to be mutual trust and confidence between master and servant…..Consequently says of his employer* [or employee], *'I claim that you have broken your contract because you have clearly shown you have no confidence in me, and you have behaved in a way which is contrary to that mutual trust which ought to exist between master and servant', he is entitled in those circumstances*,…. *to say that there is conduct which amounts to a repudiation [termination] of the contract….".* Leading on from this, the he breach of this implied common law duty is often grounds for constructive dismissal under Section 95(1)(c) of the Employment Rights Act 1996 on the grounds that the employer's conduct amounts to a fundamental breach of the employee's contract of employment, and, if the employee concerned has accrued one years continuous employment at his effective date of termination the basis for an unfair dismissal claim as demonstrated by Mr Robinson's successful claim.

In ***United Bank Ltd v. Akhtar (1989)*** a junior bank employee, whose contract contained an express mobility clause, was instructed to move from Leeds to the Birmingham offices of his employer, at only six days notice and with no financial assistance. He refused, partly due to family circumstances, left and claimed constructive dismissal, owing to his employer's breach, inter alia, of their implied duty of mutual trust and confidence. His case was successful, despite the express mobility clause, the Employment Appeal Tribunal (EAT) holding that it was necessary to imply into the contract a requirement that the employer should not exercise a term in such a way that the employee was unable to comply with it, and more importantly there was an 'overriding requirement' of mutual trust and confidence, which was independent of and in addition to the literal interpretation of the express terms of the contract. This in effect means that given that there is an implied term of mutual trust and confidence in the employment contract, the employer must exercise the contractual right reasonably, otherwise he will be in breach of the implied term.

All employers also have an implied duty to protect their employees' against reasonably foreseeable risks to their health and safety which is arguably the most important implied duty owed by an employer. The common law obligations of an employer bear a strong resemblance to the Section 2(2), Health and Safety at Work Act 1974 employer duties in relation to his own employees.

The common law duty owed by an employer to his employees encompasses the obligation to provide:

(a) Safe plant & appliances

This means that all equipment, tools, machinery, plant etc. where the employee works shall be reasonably safe for work.

In ***Bradford v. Robinson Rentals (1967)***. the plaintiff was instructed by the defendant, his employer, to travel several hundred miles from Exeter to Bedford, a 500 mile round trip, in a van with no heater in extremely bitter weather (in January 1963). The weather

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was particularly cold and the Automobile Association were advising motorists not to travel unless it was necessary. The plaintiff protested but was again told to go: both vans were unheated, he had to drive with the window open to keep the windscreen clear and on several occasions he had to get out to remove snowdrifts or top up a faulty radiator.

The plaintiff suffered frostbite and the defendants were **held** liable: it was reasonably foreseeable in the circumstances that the plaintiff would suffer some cold-related injury, so they were liable for his frostbite even though that particular condition is very rare in England: ***per Rees J***.

(b) A safe system of work

The employer must ensure that there is a safe system of work, commensurate with the risk involved in undertaking the job. Consideration must be given to all factors, which concern the manner in which the employee's work is done, or will be done: the layout; the systems currently in place; the training and supervision; the provision of warnings, protective clothing, safety equipment, special instructions and so forth, are all relevant. This will also include ensuring that there are sufficient numbers of employees to carry out the work without danger: ***Lane v Shire Roofing (Oxford) Ltd (1995)*** and ***Ferguson v. John Dawson & Partners (Contracters Ltd (1976)***.

(c) Reasonably competent fellow employees

If an employer engages an incompetent person, whose actions injure another employee, the employer will be liable for failing to take reasonable care. If the employer knows that an employee has tendencies for violent horseplay or actual assault, he has a duty to take precautions to ensure that his employees are not injured: ***Hudson v. Ridge Manufacturing Co. Ltd. (1957)***.

The Statutory Duty to Protect Employees against Risk to Health, Safety and Welfare

An employer has a legal responsibility to create a safe and healthy working environment for all his/her "employees" so far as is reasonably practicable. The general principles are set out in Section 2 of the Health & Safety at Work Act 1974 and are made specific in the Management of Health & Safety at Work Regulations 1999 [reg. 3(1)], and in a number of other pieces of Safety legislation. In addition, the Health & Safety Executive (HSE) produces Guidance and Codes of Practice for employers, regarding Health & Safety at Work. In accordance with Section 2(1) of the Health and Safety at Work Act 1974 it is the duty of every employer, so far as is reasonably practicable, "employer to ensure, so far as is reasonably practicable, the health, safety and welfare at work of all his employees". Section 2(2) of the 1974 Act going on to identify the matters to which this general duty extends in the following terms Section 2(2) of the Act goes on to identify the matters to which the duty extends.

Under Section 2(2) the general duty of employers under Section 2(1) '*to ensure, so far as is reasonably practicable, the health, safety and welfare at work of all his employee's"* extends to:

(a) the provision of such information, instruction, training and supervision as is necessary to ensure, so far as is reasonably practicable, the health and safety at work of his employees;

(b) making arrangements for ensuring so far as is reasonably practicable, safety and absence of risks to health in connection with the use, handling, storage & transport of articles and substances;

(c) the provision of such information, instruction, training and supervision as is necessary to ensure, so far as is reasonably practicable, the health and safety at work of his employees;

(d) so far as is reasonably practicable as regards any place of work under the employer's control, the maintenance of it in a condition that is safe and without risks to health and the provision and maintenance of means of access to and egress from it that are safe and without such risks;

(e) the provision and maintenance of a working environment for his employees that is, so far as is reasonably practicable, safe, without risks to health, and adequate as regards facilities and arrangements for their welfare at work.

The scope of the general duty, contained in Section 2 of the 1974 Act, is qualified by the words *"reasonably practicable".* The meaning of this phrase *"reasonably practicable"* is, therefore, crucial in determining the scope of an employer's duty. For it would be wrong to assume that it imposes a standard of care comparable with the duty to take reasonable care at common law. The statutory duty requires the employer to take action to ensure health & safety unless, on the facts, it is impracticable in the circumstances. This has been taken to mean that in determining the scope of general duties, cost-benefit considerations must be taken into account: ***Edwards v. National Coal Board (1949)***.

In ***Latimer v AEC Ltd (1953)*** oil had spread on the factory floor because of flooding. When an employee slipped and injured himself on a small patch of oil which still remained on the floor the employer was held not to be liable because he had taken 'reasonable' steps to clear up the oil e.g. by using all available sawdust. What is more, the cost of shutting down the factory for a day outweighed the risk of injury.

Entitlement to Welfare Benefits

Entitlement to many social security benefits is reserved almost exclusively to employees. The National Insurance contribution rates payable under the social security legislation differ as between the employed (under a contract of service) and the self-employed, or independent contractor (under a contract for services) and there are also differences in entitlement to benefits and statutory sick pay. It should be noted that only employees as payers of Class One National Insurance Contributions are entitled to, amongst other things:

- Statutory maternity pay and
- Industrial disablement benefit: In the case of ***Whittaker v. M.P.N.I. (1967)*** Ms Whittaker held to be entitled to industrial disablement benefit because applying the integration test as expounded by Denning in the case of ***Stevenson, Jordan & Harrison Ltd. v. MacDonald & Evan (1952)*** the court found that Ms Whittaker was an employee. Consequently, the injured trapeze artist, who fell off her trapeze, was held to be entitled to industrial disablement benefit.

Liability for Taxation

This varies according to whether a person is an 'employee' or 'self-employed'. Deductions must be made by an employer for income tax under Schedule E (known as PAYE) from salary paid to employees under a contract of service, whereas the self-employed are taxed under Schedule D and are directly responsible to the Inland Revenue for all due deductions. The more favourable tax situation afforded to the self-employed under Schedule D, namely getting your pension contributions, are paying less tax (can offset your liability against reasonable business expenses in most cases) is one of the main attractions of being self-employed: ***Massey v. Crown Life Insurance (1978)***. It should be noted that the fact that a worker is responsible for paying their own tax and national insurance is not conclusive as to whether or not they are an employee. Irrespective of the fact that such a finding is

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inconsistent with the employment status of an employee: ***Ferguson v. John Dawson & Partners (Contractors Ltd (1976)***.

Vicarious Liability

An employer is generally vicariously liable for the tortuous acts committed by his employees during the 'course of their employment' but such liability is severely restricted in the case of a contract for services. The employer will normally only be liable in such circumstances if he **delegated performance** to another. Whether or not an employee is 'acting in the course of employment' is a question of **fact** as demonstrated by the case of ***Rose v. Plenty (1976)***. Moreover, an employer will not avoid being vicariously liable due to the negligence being entirely that of the employee: ***Century Insurance v. Northern Ireland Road Transport Board (1942)***: This case involved the driver of a petrol lorry destroying an underground garage after he negligently lit a match on parking up in the said garage.

Protection in the Event of Insolvent Liquidation

Under the Employment Rights Act 1996 an *'employee'* as defined by Section 230(1) of the Act who loses his job when his employer becomes insolvent can claim through the National Insurance Fund arrears of wages, holiday pay and certain other payments, which are owed to him, rather than rely on the preferential payments procedure. Any payments so made must be authorised by the Secretary of State for Trade & Industry (the DTI is now called BERR or the department of Business Enterprise and Regulatory Reform) and the legal rights and remedies in respect of the debts covered are transferred to the Secretary of State, so that he can recover from the assets of the insolvent company the cost of any payments made, up to the preferential rights the employees would have had.

There is no qualifying period of continuous service for the above rights.

D. CONTRACT OF EMPLOYMENT

Employment and Self-employment

The legal relationship between employer and employee (or, as it used to be termed, master and servant) is based on the assumption that a contract exists between the two parties. This contract is known as a contract of employment or a contract of service.

In most cases, it will be clear whether a person is an employee or self-employed. Nevertheless, there are grey areas which have occupied the attention of the courts for many years. In 1980, the Court of Appeal held that to determine the **terms of a contract** is a matter of **fact** but to determine whether or not these amount to a **contract of employment** is a matter of **law**.

Following the extension of employment protection legislation over the past 20 years, the courts are probably less inclined to decide that a person is not an employee. This coincides with the approach of the HM Revenue and Customs, which does not look with favour on the greater opportunities for tax avoidance or evasion open to the self-employed.

For example, in 1981, the Employment Appeal Tribunal (EAT) **held** that a bar steward was an employee although he was appointed "*on a self-employed basis*" with responsibility for his own tax and national insurance contributions. He also hired and fired the bar staff and took money from the till to pay himself and the other staff. The EAT's approach is summed up in the following:

> *"If you had asked Mr Withers while he was running the club bar 'Are you your own boss?', could he honestly have given any other answer than 'No'? In our judgment, clearly not."*

The question illustrates the basic test that the courts will often apply in these cases:

> *"Is the person concerned performing services as a person in business on his own account?"*

Moreover, the courts will look at the actual facts of a situation, not at the label which the parties attach to it.

Relations between Employer and Employee

For many years, the relationship between employer and employee was largely regulated by the general law of contract. This situation was changed by the introduction of a new body of statute law. In this study unit, we shall consider mainly the areas of equal pay and of individual employment rights. These are covered in the following two statutes:

- **Equal Pay Act 1970**
- **Employment Rights Act 1996**

The latter Act amalgamated and consolidated the provisions of earlier Acts on employment rights. It is now the main statute in this sphere. It covers such areas as unfair dismissal, redundancy, maternity rights, and minimum notice, and wages provisions under what was previously the **Wages Act 1986.**

Identifying the Terms of the Contract

As is the case with contracts generally, a contract of employment does not usually need to be in writing in order to be enforceable. Indeed, it is probably the case that most contracts of employment are not expressed fully in written form. This can lead to difficulties if disputes arise and the terms of the contract need to be identified. In such circumstances, the courts will examine one or more of the following sources.

(a) Sources of contract terms

These include:

- Minimum statutory standards, such as the minimum notice periods laid down in the **Employment Rights Act 1996**. With few exceptions, it is not possible to contract out of such standards
- Express statements of the parties to the contract contained in, for example, letters of appointment, formal contracts, oral statements on terms and conditions, and the "written particulars" specified in the **Employment Rights Act 1996**
- Collective agreements between unions and employers which cover the particular circumstances
- Works or company rule books
- Custom in the particular industry or company
- Implied duties of employers and employees.

(b) Written particulars

In order partially to deal with the difficulty in identifying the terms of an employment contract, Section 1 of the **Employment Rights Act 1996** requires an employer to give the employee "*written particulars of terms of employment*" within two months of starting work.

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If an employee does not receive such a statement or one that complies with the requirements, he/she can apply to an employment tribunal to determine the particulars which ought to have been included. These include such items as:

- Names of the parties
- Date of starting work
- Start date of period of continuous employment
- Rate and frequency of remuneration
- Hours of work
- Holidays
- Sick pay
- Pension entitlements (if any)
- Length of notice
- Title of job
- Disciplinary rules
- Grievance procedures (as amended by the **Employment Act 2002 (Dispute Resolution) Regulations**)
- Place of work
- Details of any collective agreement which applies to the contract.

Not all the information needs to be issued to each individual employee; it is permissible to refer the employee to accessible notices or other documents. If there are less than 20 employees, the employer need not give details of disciplinary procedures.

If there is a change in any of the matters particulars of which are required to be included in the written statement of terms of employment, the employer must give the employee a written statement containing details of the change.

Certain employees are exempted from the need to be provided with written particulars of employment. These are mainly those in employment outside Great Britain, and mariners.

An employee also has the right to be given by an employer, at or before the time at which any payment of wages or salary is made, a written itemised pay statement, containing details of:

- The gross amount of the wages or salary
- The amount of any deductions from that gross amount and the purposes for which they are made
- The net amount of wages and salary payable
- Where different parts of the net amount are paid in different ways, the amount and method of payment of each part-payment.

Although many workers refer to the above particulars as their "contract of employment", it is important to appreciate that they are not a contract but merely **evidence of certain terms** of the contract, which may indeed, be contradicted by other evidence.

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Implied Terms

Unless the contract expressly provides otherwise, case law implies into every contract of employment the following duties.

(a) Duties of employees

- **To be ready and willing to work**

  An employee must be prepared to work under the direction of the employer in return for the agreed wages. Absence from work without excuse amounts to breach of contract.

- **To exercise reasonable skill and care**

  An employee who takes on a job professes his ability to do that job and is required to be not unduly negligent in carrying it out. If he fails in these duties, he is again in breach of contract. This duty is similar to the statutory duty of reasonable care under the **Health and Safety at Work Act 1974**.

- **To obey lawful orders**

  An employee must obey the orders of the employer, provided that they are lawful, that they fall within the scope of the contract and that they do not involve exceptional danger.

  Orders that are genuinely considered by the employee to be contrary to safety may be refused under the **Health and Safety at Work Act 1974** as amended, and under the **Employment Rights Act 1996**; a dismissal for such a reason is automatically unfair.

- **To act in good faith**

  This covers a number of aspects. For example, an employee must be honest in her relationship with her employer. He must disclose any defect in herself which might make her employment more hazardous, and must not make a secret profit from his employment or work for a competitor while working for his main employer. He should not do anything which would harm the reputation of the company.

- **To take care of employer's property**

  If an employee fails to take reasonable care of the employer's property, he is required to indemnify the employer against any loss sustained.

- **To maintain confidentiality during and after employment**

  In ***Faccenda Chicken Co. v. Fowler (1988)*** the courts ruled that an employee must not only keep his employers' secrets whilst working for them, but also has a duty not to disclose trade secrets or sensitive commercial information after he has left. This is in addition to any clause in restraint of trade (see earlier notes on contract clauses).

  He must keep his employers' secrets, and this goes so far as to not reveal information about illegal or unethical practices by the employer (so called "whistle blowing") unless the revelation is to an enforcement agency such as the Health and Safety Executive in the case of unsafe practices, or the Environment Agency or local environmental health department in the case of pollution issues. Here the employee is protected against dismissal.

  However, you should note that, unless there are express terms to the contrary, the law will not imply a duty on the employee to devote the whole of his/her services to the work of his/her employer i.e. it will not impose a ban on

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"moonlighting", nor will it imply a duty to refrain from political activities: ***Dell v. London Borough of Tower Hamlets (1994)***, where an employee was filmed when taking part in a National Front rally and was dismissed; the dismissal was deemed unfair.

(b) Duties of employers

- **To provide work**

  This is particularly significant when the employee is paid under some form of payment by results scheme. There is an obligation on the employer to provide sufficient work to enable the employee to earn reasonable or expected wages.

- **To pay remuneration**

  The employer is obliged to pay the contractually agreed remuneration and failure to do so constitutes a breach of contract.

- **To provide for the safety of employees**

  There is a common law obligation on employers to provide a safe system of work. This obligation has been given statutory form in the **Health and Safety at Work Act 1974** which we shall discuss in more detail later.

- **To indemnify employees**

  The employer must reimburse employees against all expenses, losses and liabilities incurred in the execution of orders, or in the reasonable performance of the employment. However, there is no implied term that the employee must be indemnified against his/her own negligence or when obeying an obviously unlawful order.

- **To give references which are accurate and fair**

  An employer is under no obligation to give a character reference for an employee or former employee but is under an implied duty not to make untrue statements or to be malicious if a reference is given: ***Spring v. Guardian Assurance (1994)***.

- **To maintain trust and confidence**

  The employer has an implied duty to maintain the trust and confidence of the employee and if they do not then they will be in breach of the contract entitling the employee to resign and claim constructive dismissal (see later). Examples of this include an employer who sought to move an employee from Leeds to Birmingham, with no notice or redeployment allowances: ***Akhtar v. United Bank (1989)***; an employer who undermined the employee by suggesting he was mentally unstable: ***Bliss v. South East Thames Regional Health Authority (1987)***) and not providing training and support to an inexperienced bar manager in a troublesome bar: ***Smyth v. Croft Inns Ltd (1996)***.

E. EQUAL PAY

The **Equal Pay Act 1970** covers not only pay in the strict sense but also other terms and conditions of employment which are pay-related or part of a remuneration package, such as pensions and perks. It does not cover discrimination in relation to other non-pay related terms which are covered by the **Sex Discrimination Act 1975**. These two Acts therefore are seen to be mutually exclusive.

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The **1970 Act** states that:

> *"if the terms of a contract under which a woman is employed at an establishment in Great Britain do not include (directly or by reference to a collective agreement or otherwise) an equality clause, they shall be deemed to include one".*

Note that, although the Act refers to a woman being able to claim equality with a man (and this was its primary purpose), it applies equally in reverse and enables a man to claim equality with a woman. You should bear this in mind when reading the following paragraphs.

As originally enacted, the **Equal Pay Act** allowed a woman to claim equal pay with a man working for the same employer in one of two ways:

Like Work

The comparison is made with a man doing the "same" or "broadly similar" work, e.g. men and women shop assistants in different sections of the same department store. Such a claim may be resisted on one of two grounds:

(a) There is a **"*difference of practical importance*"** between the work done by the man and the woman. For example, a woman cleaner claimed equality with a male cleaner but the latter also spent 18% of his time on driving duties; this was **held** to be sufficient to disallow the claim.

(b) There is a **"*material difference*"** between the individuals concerned in relation to what they personally bring to a job, e.g. experience, skills, qualifications.

In ***British Coal Corporation v. Smith (1993)*** a five-stage test as to the existence of a material difference was proposed:

- Was the difference in pay genuinely due to a material factor other than sex?
- Was that factor "tainted with sex"?
- If so, in what way?
- If the difference was genuinely discriminatory then the employers would have failed in their defence
- If the factor is indirectly discriminatory, then can it be justified irrespective of sex?

Work Rated as Equivalent

A woman is entitled to equal pay when she is employed on a job which, although different from that of a man, has been given an equal value under an existing job evaluation scheme. (The Act does not require employers to undertake job evaluation.)

The Act was extended by the **Equal Pay (Amendment) Regulations 1983**, introduced as a result of a decision of the European Court of Justice. The Treaty of Rome, on which the European Union is based, contains provisions to ensure equality of pay between men and women; this is implemented across Europe by the **Equal Pay Directive** and this is as much part of English law as the 1970 Act. However, the 1970 Act was ruled not to go as far as the Directive and the UK had to amend the 1970 Act to come in line.

The Regulations came into effect on 1 January 1984. Under these Regulations, a claim can now be made on the basis of work of equal value.

Work of Equal Value

A woman can now compare herself with a man doing a completely different type of job but which is of equal value "*in terms of the demands made on her (for instance, under such headings as effort, skill and decision)*". A tribunal can order the two jobs to be evaluated by an independent job evaluation expert.

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In the first successful case under the Regulations, a canteen cook employed by a firm of shipbuilders claimed equal pay with that of three male shipyard tradesmen – a painter, a joiner and a thermal insulation engineer: ***Hayward v. Cammell Laird Shipbuilders Ltd (1984)***. There is only one defence to such a claim and that is that the difference in pay is due to a genuine material factor which is not related to the gender of the employee. The full effects of the Regulations remain to be seen, although there is evidence that they are becoming a factor which is taken account of in the collective bargaining process.

F. OTHER TERMS AND CONDITIONS

Protection of Wages

Under the **Employment Rights Act 1996**, certain conditions are imposed on the ability of employers to deduct amounts from employees' wages, and on payments to employers. The nature of the employment is sometimes the determining factor.

(a) Deductions by employer

An employer shall not make a deduction from the wages of a worker employed by him/her unless:

- The deduction is required or authorised to be made by virtue of a statutory provision or a relevant provision of the worker's contract; or
- The worker has previously signified in writing his/her agreement or consent to the making of the deduction.

This restriction does not apply to a deduction from a worker's wages made by his/her employer where the purpose of the deduction is the reimbursement of the employer in respect of:

- An overpayment of wages or
- An overpayment of expenses incurred by the worker in carrying out his/her employment,

made (for any reason) by the employer to the worker.

(b) Payments to employer

An employer shall not receive a payment from a worker employed by him/her unless:

- The payment is required or authorised to be made by virtue of a statutory provision or a relevant provision of the worker's contract or
- The worker has previously signified in writing his/her agreement or consent to the making of the payment.

This restriction does not apply to a payment received from a worker by his/her employer where the purpose of the payment is the reimbursement of the employer in respect of:

- An overpayment of wages or
- An overpayment in respect of expenses incurred by the worker in carrying out his/her employment

made (for any reason) by the employer to the worker.

(c) Limits on the amount and time of deductions for workers in retail employment

If the employer of a worker in retail employment further to the above arrangements makes, on account of one or more cash shortages or stock deficiencies, a deduction or

deductions from wages payable to the worker on a pay day, the amount or aggregate amount of the deduction or deductions shall not exceed one-tenth of the gross amount of the wages payable to the worker on that day.

(d) Reference to employment tribunals

A worker may present a complaint to an employment tribunal:

- That his employer has made an unauthorised deduction from his wages
- That his employer has received an unauthorised payment from him
- That being in retail employment his employer has made an unauthorised deduction from his wages.

Where a tribunal finds such a complaint to be well founded, it shall make a declaration to that effect and make an appropriate order against the employer, with which he must comply.

Guarantee Payments

These are provided for by the **Employment Rights Act 1996**.

If, throughout a working day during any part of which an employee would normally be required to work in accordance with the terms of his/her contract of employment, the employee is not provided with work by the employer by reason of:

- A diminution in the requirements of the employer's business for work of the kind which the employee is employed to do or
- Any other occurrence affecting the normal working of the employer's business in relation to work of the kind which the employee is employed to do,

the employee is entitled to be paid by the employer an amount in respect of that day (hereinafter referred to as "the guarantee payment").

An employee, however, is not entitled to such a guarantee payment unless he/she has been continuously employed for a period of not less than one month ending within the day before that in respect of which the guarantee payment is claimed.

Neither is an employee who is employed:

- Under a contract for a fixed term of three months or less or
- Under a contract made in contemplation of the performance of a specific task which is not expected to last for more than three months,

entitled to a guarantee payment, unless he/she has been continuously employed for a period of more than three months ending with the day before that in respect of which the guarantee payment is claimed.

An employee is disentitled from claiming a guarantee payment in respect of a workless day if the failure to provide him/her with work for that day occurs in consequence of a strike, lockout or other industrial action involving any employee of his/her employer or of an associated employer.

An employee is also not entitled to a guarantee payment in respect of a workless day if:

- His/her employer has offered to provide alternative work for that day which is suitable in all the circumstances and
- The employee has unreasonably refused that offer.

The amount of a guarantee payment in respect of any day shall not exceed £14.50.

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Any complaint by an employee relating to guarantee payments may be referred by him/her to an employment tribunal.

Rights not to Suffer Detriment in Employment

(a) Health and safety cases

An employee has the right under the **Employment Rights Act 1996** not to be subjected to any detriment by any act, or any deliberate failure to act, by his/her employer done on the ground that:

- Having been designated by the employer to carry out activities in relation to the prevention or reduction of risks to health and safety at work, the employee carried out any such activities.
- Being a representative of workers on matters of health and safety at work or a member of a safety committee, the employee performed any functions as such a representative or a member of such committee.
- Where there were no such safety representatives or safety committees, she brought to her employer's attention, by reasonable means, circumstances connected with her work which she reasonably believed were harmful or potentially harmful to health or safety.
- In circumstances of danger which the employee reasonably believed to be serious and imminent, she took appropriate steps to protect herself or other persons from the danger or otherwise left or refused to return to her place of work or any dangerous part of her place of work.

(b) Trustees of occupational pension schemes

An employee has the right not to be subjected to any detriment by any act, or any deliberate failure to act, by his employer done on the ground that, being a trustee of a relevant occupational pension scheme which relates to his employment, the employee performed any functions as such trustee.

(c) Employee representatives

An employee has the right not to be subjected to any detriment by any act, or any deliberate failure to act, by her employer done on the ground that, being:

- An employee trade union representative or
- A candidate in an election in which any person elected will, on being elected, be such an employee trade union representative,

she performed any functions or activities as such an employee trade union representative or candidate.

(d) Enforcement

An employee may present a complaint to an employment tribunal that he has been subjected to a detriment in contravention of any of the above provisions.

Time Off Work

An employee has the right under the **Employment Rights Act 1996** to be permitted by his employer to take time off during the employee's working hours to discharge the office of justice of the peace. He also has the right to take such time off work to discharge his public duties as a member of:

- A local or police authority or statutory tribunal
- A relevant health or education body

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- The environment agency or the Scottish Environment Protection Agency or
- A board of prison visitors or a prison visiting committee.

An employee also has the right, if she has been given notice of dismissal by reason of redundancy, to be permitted by her employer to take reasonable time off during working hours before the end of her notice to:

- Look for new employment
- Make arrangements for training for future employment,

subject to a condition that she must have been continuously employed for a period of two years or more prior to the expiry of her notice.

She is entitled to be paid for the time so taken off and has a right to lodge a complaint with an employment tribunal for non-compliance with these provisions by the employer.

Similar provisions provide for time off work by a qualifying employee in respect of:

- Ante-natal care
- Trustee membership of an occupational pension scheme
- Appointment as an employee representative for the purposes of the **Trade Union and Labour Relations (Consolidation) Act 1992** or an election as candidate for such appointment.

Suspension from Work

(a) Suspension on medical grounds

An employee who is suspended from work by his employer on medical grounds is entitled to be paid remuneration by his employer while he is so suspended for a period not exceeding 26 weeks, provided that he has been continuously employed for a period of no less than one month ending with the day before that on which the suspension began: **Employment Rights Act 1996**.

An employee who is employed:

- Under a contract for a fixed term of three months or less or
- Under a contract made in contemplation of the performance of a specific task which is not expected to last for more than three months,

is not entitled to the above remuneration, unless he has been continuously employed for a period of more than three months ending with the day before that on which the suspension began.

(b) Suspension on maternity grounds

An employee is suspended from work on maternity grounds if, in consequence of any relevant requirement or relevant recommendation, she is suspended from work by her employer on the ground that she is pregnant, has recently given birth or is breast-feeding a child.

An employee who is suspended from work on maternity grounds is entitled to be paid remuneration in accordance with the provisions in the **Employment Rights Act 1996** by her employer while she is so suspended.

Where an employer has available suitable alternative work for an employee, the employee has a right to be offered to be provided with the alternative work before being suspended from work on maternity grounds. "Alternative work" for this purpose is as defined in the Act.

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An employee is entitled to lodge a complaint with an employment tribunal in relation to unauthorised suspension from work.

Maternity and Other Parental and Family Rights

Certain rights relating to pregnancy and maternity have been granted to female employees by statute. Briefly, these are as follows:

(a) Ante-natal care

The **Employment Act 1980** (as amended by the **Employment Act 2002** and the **Work and Families Act 2006**) introduced a right to paid time off during working hours for ante-natal care. This is now embodied in the **Employment Rights Act 1996**. There is no qualifying period of service needed; a pregnant woman who joins a new employer is immediately entitled to this right.

(b) Maternity pay

Statutory Maternity Pay is payable for a nine-month period. Subject to meeting certain conditions, a woman can claim from her employer a weekly payment, for a period of six weeks, of 90% of a week's pay, less the amount of the state maternity allowance. For the remaining 20 weeks, the pay amounts to either 90% of her usual weekly pay or a prescribed annually reviewed rate, whichever is the lowest. The employer can reclaim the amount paid from the state Maternity Fund.

(c) Maternity leave

An employee who is absent from work at any time during her maternity leave period is, subject to notification of leave commencement and pregnancy, entitled to the benefit of the terms and conditions of employment which would have been applicable to her if she had not been absent through pregnancy and childbirth. An employee's maternity leave period commences with the earlier of:

- The date she notifies her employer on which she intends her period of absence from work on account of pregnancy to commence and
- The first day after the beginning of the sixth week before the expected week of childbirth on which she is absent from work wholly or partly because of pregnancy.

The above right does not *per se* confer any right to remuneration.

Since April 2007, all pregnant women, regardless of length of service or hours of work, are entitled to 52 weeks' maternity leave. An employee who has both the right to maternity leave under the provisions of the **Employment Rights Act 1996** and another right to maternity leave under a contract of employment or otherwise may not exercise the two rights separately but may, in taking maternity leave, take advantage of whichever right is, in any particular respect, the more favourable.

An employee's maternity leave period continues, subject to conditions specified in the Act, for the period of 18 weeks from its commencement or until the birth of the child, if later.

(d) Right to return to work

An employee who acquires the above statutory right to maternity leave also has the right to return to work at any time during the period beginning at the end of her maternity leave period and ending 29 weeks after the beginning of the week in which childbirth occurs. Her terms and conditions of employment must be no less favourable than they were on commencement of her maternity leave period and her seniority and pension rights must be preserved.

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Under certain circumstances, suitable alternative employment can be offered and there are less onerous obligations on small employers (those with five or fewer employees). If a woman is refused her job back, she can claim for unfair dismissal.

A woman who is unable to return to work may be suspended from work on guarantee pay until she is fit to return.

In addition to the rights and protection offered to pregnant women, recent legislation has also provided rights for parents in general (i.e. for fathers as well as mothers), including in respect of adoption, and also for carers:

- The Employment Relations Act 1999 implemented a Parental Leave Directive, allowing an employee with at least one year's continuity of service the right to up to 13 weeks' unpaid leave to care for a child for whom he/she has or expects to have parental responsibility. Such a right lasts up to that child's fifth birthday and applies to every child for whom parental responsibility is claimed.

  The employee taking such leave has the right to return to his/her old job, with the usual protection afforded from unfair dismissal and redundancy.

- The Paternity and Adoption Leave Regulations 2002, together with the provisions of the Work and Families Act 2006, introduced the right to paternity and adoption leave for up to 26 weeks, which have been extended from April 2007 to 52 weeks.

- The right to request flexible working, introduced by the Employment Act 2002, allows qualifying employees (of 26 weeks' continuous service) to apply to an employer for a change in the terms and conditions of employment, in order to care for a child for whom the employee has responsibility. The Work and Families Act 2006 extended this right to those caring for an adult spouse, partner, civil partner or near relative.

Holidays

Periods of paid holiday have tended to increase, particularly for manual workers. As in the case of sick pay, differences in holiday entitlements have been one of the distinguishing features between "staff" and "non-staff" employment. In many schemes, holiday entitlement is based on length of service and on seniority. Apart from entitlement, holiday schemes also cover such points as rates of holiday pay and the periods of the year during which holidays may be taken.

The **Working Time Directive** of the European Union, effective in the United Kingdom from 1 October 1998, gives all workers covered by the Directive a statutory entitlement to a minimum of four weeks' paid holiday in each year. No employer can refuse this entitlement and it cannot be bought out by a payment in lieu of holidays.

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Study Unit 14

Employment Law 2: Termination of the Contract, Discrimination and Tribunals

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A. NOTICE

If a contract of employment is for a specified period, the employment ceases at the end of that period without notice. If the contract is not for a definite period then, if either party wishes to end it, they must give the period of notice specified in the contract. If no period of notice is expressly stated, the period of notice required is that which is customary in the trade or reasonable in the circumstances. A court will decide the latter point in view of such factors as the nature of the work and the intervals at which wages are paid.

If a contract is terminated without notice, the injured party may sue the other party to the contract for whatever damages he/she has suffered. In practice, this is most likely to occur when an employer dismisses an employee without giving the required notice. It is most unusual but not completely unknown, for an employer to sue an employee under these circumstances.

B. CONSTRUCTIVE DISMISSAL

Constructive dismissal occurs when an employee leaves an employment, with or without notice, "in circumstances such that he is entitled to terminate it without notice by reason of the employer's conduct". In other words, although the employee has taken the initiative in leaving the employment, he is regarded as having been dismissed and can, for example, claim for unfair dismissal. However, for a constructive dismissal to occur the employer's conduct must involve a significant breach of the terms of the contract; unreasonable or unfair behaviour is not enough. In Western Excavating ***(ECC) Ltd v. Sharp (1978)*** the Court of Appeal stated that the essential question was whether the employer was guilty of conduct, which was a significant breach going to the root of the contract, or which showed that he no longer intended to be bound by one or more of its essential terms. If this was so, the employee was entitled to treat himself as discharged.

Examples of conduct which have been held to amount to constructive dismissal are:

- Unilateral reduction in basic rate of pay
- Unilateral change in job duties
- Handing an employee over to the police on suspicion of theft without any discussion
- Breach of implied terms of mutual trust and confidence: ***Omilaju v. Waltham Forest LBC (2004)***.

Note that the employee must react promptly to the employer's conduct. If the employee delays too long before leaving, he/she may be regarded as having accepted the change in the terms of the contract.

C. UNFAIR DISMISSAL

Who is Qualified to Present a Claim for Unfair Dismissal?

In general, to be **able to claim** unfair dismissal a worker must:

- Be an employee within the meaning of Section 230(1) of the Act: Section 94(1), Employment Rights Act 1996 (ERA 1996)
- Have been dismissed in accordance with Section 95(1) of the ERA 1996
- Have presented his complaint within three months of the effective date of termination of his contract of employment: Section 97, ERA 1996

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- Have been employed by the same or an associated employer for the qualifying period of continuous employment of one year (unless their reason for dismissal is one which the ERA 1996 categorises as automatically unfair): Section 108(1), ERA 1996
- Be ordinarily resident and working in Great Britain
- Not work in an **excluded** category of employment e.g. Share fisherman and civil servants.

Automatically Unfair Dismissal

There are five main reasons for dismissal by an employer that are regarded as automatically unfair:

(a) Dismissal on the grounds of pregnancy or childbirth

Section 99, ERA 1996 provides that an employee's dismissal will automatically be unfair if the reason or principal reason for the dismissal was that she was pregnant or for any other reason connected with her pregnancy, including the fact that she took maternity leave.

(b) Dismissal on the grounds of trade union activities or membership

Section 152 of the Trade Union and Labour Relations (Consolidation) Act 1992 provides that a dismissal will be held to be unfair if the main reason for it was:

- That the employee was, or proposed to become, a member of an independent Trade Union or
- Had taken part, or proposed to take part, in the activities of an independent Trade Union, if the activities were outside the hours or
- In accordance with an arrangement with the employer permitting the employee to take part in such activities during working hours or
- That the employee was not a member of a Trade Union, or had refused or proposed to refuse to become or remain a member.

The burden of proving that the reason for the dismissal was union-related is upon the employee where he would otherwise lack sufficient qualifying service to complain of unfair dismissal; in all other cases it is for the employer to prove the reason for the dismissal in the normal way.

(c) Dismissal on the grounds of health and safety activities, e.g. for acting as a Safety Representative: Section 100, ERA 1996

The relevant health & safety grounds defined in Section 100 are five-fold. Employees will be held to be unfairly dismissed on the grounds of health and safety activities if their employer dismisses them (or selects them for redundancy when others in similar circumstances are not selected) because they are, for example, carrying out health & safety activities as an employer-designated representative; drew attention to what they 'reasonably believed' to be a health or safety risk to the employer's attention or left or refused to return to their place of work because of what is 'reasonably believed to be a serious and imminent danger and took appropriate steps to protect themselves or others in circumstances of serious and imminent danger.

(d) Dismissal on the grounds of asserting a statutory right

Employment legislation provides that employees will be held to be unfairly dismissed on the grounds of asserting a statutory right if their employer dismisses them (or selects them for redundancy when others in similar circumstances are not selected) because they brought proceedings against the employer to enforce a right of his, which

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is a relevant statutory right, or alleged that the employer had infringed a right of his which is a relevant statutory right.

The relevant statutory rights include:

- Any right conferred by the Employment Rights Act 1996 for which the remedy for its infringement is by way of a complaint or reference to an employment tribunal
- The right to a statutory minimum period of notice of termination of their employment contract under Section 86(1) of the ERA 1996
- The rights conferred by the Working Time Regulations 1998: Section 101A, ERA 1996
- The rights conferred by the National Minimum Wages Act 1998: Section 104A, ERA 1996
- The rights conferred by the Public Interest (Disclosure) Act 1998 which covers whistleblowing: Section 103A, ERA 1996.

(e) Dismissal without following the statutory dismissal procedur

Failure to follow procedural requirements: Section 98A, ERA 1996. Where an employer fails to follow the statutory disciplinary and dismissal procedure when dismissing an employee, the dismissal will be held to be automatically unfair dismissal and lead to an award of at least 4 weeks' pay being made to the ex-employee, further compensation being increased by between 10% and 50%. Conversely, if employees fail to take advantage of the procedure to appeal against their dismissal, any subsequent compensation they may win if their dismissal is found to have been unfair must be reduced by between 10% and 50% by the tribunal – procedure contained in Schedule 2 of the Employment Act 2002.

Reason for Dismissal

When it has been established that the applicant is an employee and not excluded from making a claim, the onus of proof moves to the employer, to establish the reason for dismissal. If the employer cannot prove a reason for it, the dismissal is deemed to be unfair.

In order to be believed the employer must tell a consistent story and may not put forward a different reason at the employment tribunal from that which he stated in his notice of appearance, nor on appeal, from that relied upon before the employment tribunal: ***Nelson v BBC (1977)*** nor on an internal appeal, from that initially tendered.

In ***Monie v Coral Racing Ltd (1981)*** the applicant was dismissed for dishonesty and he exercised his contractual right to have an internal appeal. This was heard by the managing director who confirmed the dismissal, but since he found no evidence of dishonesty against Mr Monie, he gave as the reason that his failure to exercise the authorised cash control procedures justified dismissal. The court thought that the reason must be that which operated at the time of the dismissal. The internal appeal made no difference. If the employer had no reason for dismissal such a sacking constitutes unfair dismissal.

In the absence of an automatically unfair reason for dismissal a dismissal the employer must establish a potentially fair reason for dismissing his employee, and that he acted reasonably in the circumstances i.e. a reasonable employer would have taken the decision to dismiss rather than to suspend the employee concerned

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Fair Dismissal

In all cases, it is for the employer to show that the principal reason for the applicant's dismissal is one of the statutory fair reasons cited Section 98(1)(b) and Section 98(2)(a) – (d) of the Employment Rights Act 1996: Section 98(1)(a), ERA 1996.

There are **six** statutory reasons for dismissal which are potentially fair:

(a) That the employee lacks the capability or qualification to perform the work of the kind which he was employed to do: Section 98(2)(a), ERA 1996

This is the situation in which the employee is either unable due to sheer incompetence or ill health to do his job **or** unqualified to do his job.

The only guidance in relation in 'capability' as a reason for dismissal is its definition in Section 98(3)(a) which states that 'capability' includes 'skill, aptitude, health or any other physical or mental quality'. So as 'incapability' through incompetence is concerned, the general rule is that 'the employee's incapacity as it existed at the time of dismissal must be of such a nature and quality to justify dismissal'. It need not be reflected in one particular incident but may arise from several indications: ***Lewis Shops Groups Limited v. Wiggins (1973)***.

However, employment tribunals are often not very well equipped to measure intangible examples of poor work performance. To this end, Lord Denning stated in ***Taylor v. Alidair Ltd (1978)*** that:

> *"Wherever a man is dismissed for incapacity or incompetence it is sufficient that the employer honestly believes on reasonable grounds that the man is incapable or incompetent. It is not necessary for the employer to prove that he is in fact incapable or incompetent".*

Thus, to dismiss an employee who is not capable of performing his job properly will be fair provided the employer acted reasonably in the circumstances.

'Capability' dismissals related to the applicant's competence to do the job for which he was employed include ***Alidair Ltd v. Taylor (1978)***. This case had particularly strong primary facts since the applicant, Mr Taylor, was an airline pilot, dismissed by his employers because he was thought to be at fault for a bad landing which had caused serious damage to the respondent's aircraft. According to the Court of Appeal, the employers had reasonably demanded a high degree of care and fairly dismissed him when he failed to measure up to it on one occasion. He was engaged in a special category of: *"activities in which the degree of professional skill which must be required is so high, that the potential consequence of small departures from that high standard is so serious that the failure to perform in accordance with those standards is sufficient to justify dismissal."* The Court of Appeal in this case specifically approved of Bristow J's examples of other such employees as, *"the scientist operating nuclear reactors, the chemist in charge of research into the possible effects of, for example, thalidomide, the driver of the Manchester to London Express, the driver of an articulated lorry full of sulphuric acid"*. Few procedural safeguards are necessary to dismiss such employees'.

The only guidance in relation to what constitutes a **'qualification'** as a reason for dismissal is given in Section 98(3)(b) which states that 'qualification' means 'any degree, diploma or other academic, technical or professional qualification relevant to the position which the employee held'.

Although 'qualifications' is widely defined in Section 98(3)(b) if an employee is to be dismissed on this ground the 'qualification' concerned must relate to 'performing work of the kind which he was employed by the employer to do': ***Blue Star Ship Management Ltd. v. Williams (1978)***.

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In order to be dismissed fairly on the grounds of lack of 'qualifications' there must be a contractual obligation (express or implied) to hold the relevant qualification: ***Litster v. M Thom & Sons Ltd (1975)***.

'Capability' dismissals on the grounds of the applicant's inability to do the job on **health** grounds include ***Coulson v. Felixstowe Dock & Railway Co Ltd (1975)***. In this case the claimant was off work due to ill-health for considerable periods of time. He could no longer perform his duties and was put on light clerical work. He was told that if he could not return to his old job he would be re-graded and was given six months in which to prove his fitness. However, he fell ill again and was dismissed. It was held that the employer had treated the employee with every consideration but there must come a time when the employer cannot be expected to keep someone on whom is not doing his work. The tribunal had to consider fairness to the business as well as to the employee.

In deciding what action to take in these cases employers will need to take into account the likelihood of an improvement in health and subsequent attendance (based where appropriate on professional medical advice); the availability of suitable alternative work; the effect of past and likely future absences on the organisation, how similar situations have been handled in the past and whether the illness is a result of a disability as defined by the Disability Discrimination Act 1995.

In all cases, it is for the employer to show that the principal reason for the applicant's dismissal is one of the statutory fair reasons cited Sections 98(1)(b) and 98(2)(a) – (d) of the Employment Rights Act 1996: Section 98(1)(a), ERA 1996.

(b) That the employee's conduct is unacceptable: Section 98(2)(b), ERA 1996.

Misconduct by an employee is a ground frequently relied on by employers to **justify** dismissal. If the principal reason for dismissal relates to serious misconduct, which the employer **reasonably** believes has been committed by the employee, then the dismissal can be regarded as prima facie fair. Over the years case law has established various types of misconduct which will justify dismissal. Such reasons include: abusive language; disobedience; drink and drug abuse; personal appearance; theft and dishonesty; violence and fighting; assault; racial or sexual harassment, lateness or absenteeism. All of the aforementioned reasons may ultimately fall within the sphere of misconduct and so be fair reasons for dismissal under Section 98(2)(b) subject to the application of the test of fairness in Section 98(4).

'Conduct' dismissal cases include the following.

If a job applicant is deliberately dishonest on his or her application form this will normally make any subsequent decision to dismiss prima facie fair: ***Torr v. British Railways Board (1977)***. In this case the EAT held that the employers

"were justified in deciding to dismiss the employee as soon as they appreciated that he had obtained employment as a guard by dishonest concealment of a criminal conviction carrying a sentence of three years imprisonment, even though the conviction was as far back as 1958 and the employee had apparently been working satisfactorily as a guard for sixteen months".

The sentence was of such a duration not to be covered by the Rehabilitation of Offenders Act 1974 and neither could the philosophy behind the Act be extended to render a dismissal in the circumstances unfair:

"It is of utmost importance that an employer seeking an employee to hold a position of responsibility and trust should be able to select for employment a candidate in whom he can have confidence. It is fundamental to that confidence that the employee should truthfully disclose his history so far as it is sought by the intending employer".

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When determining whether an employer has acted within the 'range of reasonable responses', in deciding in dismiss, rather than a lesser disciplinary sanction, such as suspension, following a discovery that his employee has made a misstatement on their application form, all the circumstances of the case should be considered, including the significance of the misstatement, their length of continuous service, and whether or not his or her work has been satisfactory: ***Johnson v. Tesco Stores Ltd (1976)***. In this case the application form stated that "a misstatement as to date of birth, previous employment details etc will render the application and any subsequent contract invalid." When a misstatement by the complainant as to his employment history was discovered, his job was terminated, despite having worked satisfactorily for 18 months. The tribunal held that the effect of the clause **could not** be to make a contract void from the outset when false statement was discovered. When the contract was terminated by the employer there was a dismissal, which could be regarded as fair or unfair applying the law relating to unfair dismissal.

It has also been deemed fair to dismiss an employee on the grounds of misconduct where they have used Internet facilities at work to access sexually explicit pictures and moving images: ***Parr v Derwentside District Council (1998)***. In this case Parr was dismissed on the grounds of gross misconduct when his employers discovered that he had used Internet facilities at work to access sexually explicit pictures and moving images. He admitted that this was true but claimed that he had accessed the website by mistake, 'got stuck' in it and had revisited it only because he was disturbed by the prospect that entry could be made easily by children. That explanation did not wash with his employers, who took the view that, being a local authority, they had a duty to provide a high standard of public service, which necessitated moral probity on the part of their employees. In dismissing Parr's claim for unfair dismissal the Employment Tribunal found that the employer had investigated events thoroughly, efficiently and objectively and had decided that Parr was guilty of violating established codes of conduct and of breaching trust and confidence.

It should be noted, that for a dismissal on the grounds of misconduct to be justified, it is not necessary to prove that the employee was indeed guilty of the offence. However, what must be established is that the employer honestly believed, on reasonable grounds, that the employee was guilty at the time when the employer took the decision to dismiss: ***BHS v. Burchell (1978)***. In determining whether dismissal on the grounds of misconduct is fair in the circumstances, the guidelines in the case of ***BHS v. Burchell (1978)*** provide valuable assistance, the test is threefold, namely that:

- The employer must have established a genuine belief that the employee has committed the act of misconduct
- The belief must be based on reasonable grounds and
- The employer must have carried out such investigation as was reasonable into all the circumstances of the case.

It should be noted, that in all cases the dismissal on the grounds of misconduct the dismissal of an employee **may** be rendered unfair if the employer has failed to follow the proper disciplinary and dismissal procedure when in dismissing the employee concerned. The procedures are contained in Schedule 2 of the Employment Act 2002.

(c) That the employee has retired: Section 98(2)(ba), ERA 1996.

(d) That the employee has been made redundant: Section 98(2)(c), ERA 1996

Broadly speaking, this is where the employer's need for employees to do certain work has ceased or diminished or is expected to do so in the future. However, if an employee accepts an offer of suitable alternative employment a redundancy situation will cease to exist: Section 141, ERA 1996.

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(e) That there is a statutory restriction on either the employer or the employee which prevents the employment from being continued: Section 98(2)(d), ERA 1996

If the principal reason for an employee being dismissed is that his work will involve contravention of *"a duty or restriction imposed by or under an enactment",* his dismissal can be regarded as prima facie fair: ***Appleyard v. FM Smith (Hull) Ltd (1972)***. In this case it was an essential requirement for mechanics that they should hold a valid driving licence so that they could test vehicles which they had repaired. When the claimant lost his licence, the company had given some thought to placing him elsewhere in the business, but this was not practicable in such a small firm, and his dismissal was held to be fair.

(f) Some other substantial reason, which could "justify the dismissal of an employee holding the position which the employee held": Section 98(1)(b), ERA 1996

In such cases the employer must be able to show that the reason is a fair one and that they have acted reasonably. A common SOSR is where a business reorganisation has taken place, which results in dismissals which do not meet the statutory definition of 'redundancy'. This is a long established SOSR for dismissal. If there are good business reasons for the change in terms and conditions, the employer will usually have no problem in establishing SOSR. However, the Employment Tribunal must also be satisfied that the dismissal has been carried out fairly and reasonably. This means that the employer must have followed fair procedure in attempting to introduce the change. This involves **consultation** about the change involved and an evaluation of any way in which objections raised by employees can be resolved.

Remedies Available to Applicant

There are five remedies are potentially available to the applicant:

(a) A declaration of rights that the worker is an employee and that they have the right to claim **unfair dismissal**.

(b) An order for **reinstatement**: Section 114, ERA 1996 whereby the employee returns to his old job with no financial loss (very rare to be awarded this remedy). If the employee requests it, reinstatement is the first remedy that the Employment Tribunal will consider. Only when this has been rejected as unsuitable does the tribunal then go on to consider re-engagement. Reinstatement is where the employer is ordered to treat the employee in all respects as if he had not been dismissed. This means that the employee is awarded all arrears of pay and all rights and privileges in relation to his contract are restored. Where reinstatement is not ordered, the tribunal then goes on to consider re-engagement.

(c) An order for **re-engagement**: Section 115, ERA 1996 whereby the employee is re-employed in a comparable job. Re-engagement is where the employee is re-employed in a job comparable to that from which he was dismissed, or other suitable employment. The terms of a re-engagement order must be, wherever possible, as favourable as an order for reinstatement **unless** the employee was partly to blame for his dismissal.

(d) A **compensation award**: Sections 117-124, ERA 1996: where the Employment Tribunal finds that an employee has been unfairly dismissed it will provide the alternative remedy of an award of compensation. At the moment the maximum amount of the compensatory award is £63, 300. Awards change at the beginning of February each year. Award figures are available from ACAS at www.acas.org.uk.

(e) Recommendations, for changes of policy: in relation to the disciplining of staff, for example.

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D. WRONGFUL DISMISSAL

The Main Circumstances under which a Wrongful Dismissal can Occur

- Where the employer terminates the employment without having any justification for failing to honour the employee's right to receive a minimum period of notice either under his employment contract or under Section 86(1) of the Employment Rights Act 1996 – link to the need to follow the modified procedure if dismissals on the grounds of gross misconduct (otherwise employee will get a damages award, subject to reduction on grounds of their contributory conduct). The statutory dismissal and disciplinary procedure contained in Schedule 2 of the Employment Act 2002 which by virtue of Section 34 of the 2002 Act has been incorporated into all contracts of employment.
- Where a fixed term contract is terminated by the employer before the date it was due to expire – link to the fact that damages may be awarded for the whole of the unexpired period of the contract.
- Where the employee is selected for redundancy in breach of a selection procedure which has been incorporated into his contract: ***Alexander v. Standard Telephones & Cables plc (1991)***.

Whether or not an employee's conduct may be classified as a breach of contract, which justifies their dismissal, is a question of fact and degree in each case (a dismissal will be wrongful where an employee has been dismissed in breach of their employment contract).

Examples of conduct by an employee, which could constitute gross misconduct and therefore **justify** summary dismissal include:

- The wilful refusal to obey a lawful and reasonable order: ***Pepper v. Webb [1969)***. In this case the plaintiff was a gardener with a history of complaints of insolence and inefficiency from time to time. The culminating incident was when the employer asked the plaintiff what arrangements he had made in relation to a greenhouse in his absence during the weekend. In response to which the plaintiff answered: "I couldn't care less about your bloody greenhouse or your sodding garden" and walked away. It was held that Mr Pepper had not been wrongfully dismissed. Under the circumstances his summary dismissal without notice was entirely justified. The action of the head gardener in wilfully disobeying a reasonable order was sufficient to amount to gross misconduct and provide grounds for summary dismissal, irrespective of the contract of employment providing for three months' notice.
- Misappropriating their employer's property: ***Sinclair v. Neighbour (1967)***. In this case money was illicitly borrowed from the employer's till. This was held to be a breach of duty sufficient to warrant summary dismissal irrespective of the fact that the employee fully intended to return the sum at a later date (i.e. he was merely borrowing it without permission).
- Fighting in the workplace: ***C.A. Parsons & Co Ltd v. McLoughlin (1978)***. In this case the summary dismissal by the employer of an employee for fighting was held to be justified irrespective of the fact that fighting was not included in the company's rules as gross misconduct. Kilner Brown J in the present case thought that

  'it ought not to be necessary for anybody, let alone a shop steward, to have in black in white in the form of a rule that a fight is something that is going to be regarded very gravely by management'.
- Passing on information to a former employee of the firm whom is now working for a competitor: ***Smith v. Du Pont (U.K) Ltd. (1976***. In this case Mrs Smith worked as a secretary and on two previous occasions had been warned about dealing with a former employee of the company who now worked for a rival concern. She was dismissed

when the company learned that she had given information of a contract – 'the name of the buyer at Sainsbury's' – to the former employee. The employment tribunal took the view that, although the information was of no great weight which would in fact damage the company, in view of the earlier warnings, Mrs Smith *'seemed to be setting up her own judgement against that of the company'*. In the circumstances, there was no obligation on the company to wait '*until she passed on information of significance'*. The dismissal was to be fair.

Who is Entitled to Claim Wrongful Dismissal?

Any employee who has **unjustifiably** been dismissed:

- In breach of his employment contract **and**
- Who has suffered loss as a result.

In wrongful dismissal cases, in direct contrast to unfair dismissal cases, the 'reasonableness' of the employer's decision to dismiss is not an issue.

Remedy Available to Successful Applicant

The main remedy available is the common law remedy of damages. Payments of damages in respect of wrongful dismissal are free of tax up to £30,000 i.e. any amount in excess of £30,000 is taxable.

Where are Wrongful Dismissal Cases Heard?

Employment Tribunals now have the power to hear certain categories of claims for breach of contracts of employment under the Employment Tribunals Extension of Jurisdiction (England & Wales) Order 1994.

This Order applies where the effective date of termination of the contract, or the last working day, was on or after 12 July 1994.

Subject to defined exceptions, the employee can bring before a Tribunal any monetary claim arising under the contract of employment, where the employee has brought a contract claim (but not otherwise) the employer can likewise counterclaim for any breach of contract by the employee. The exceptions to the Employment Tribunal's contract jurisdiction are set out in Article 5 of the 1994 Order and cover claims by either party which are for breach of terms relating to living accommodation, intellectual property, obligations pf confidence or covenants in restraint of trade.

The maximum payment, which an Employment Tribunal can award for contract claims, or for a number of claims relating to the same contract, is £25,000. Note, however, that there appears to be no jurisdictional bar on the Tribunal hearing claims relating to a sum in excess of £25,000.

Claims of up to £50,000 may be brought in the County Court and those for over £50,000 must normally be brought in the High Court. A High Court wrongful dismissal claim would normally be brought in the Queen's Bench Division.

The time limit for bringing a claim for wrongful dismissal in the High Court or County Court is the same as the limitation period for all simple contract claims, namely 6 years from the date of the breach of contract.

However, the Tribunal has the power to extend the time limits for employees and employers seeking to bring contract claims. The would-be claimant must satisfy the Tribunal that it was not reasonably practicable to bring the claim within the prescribed period. If so satisfied, the Tribunal may extend time for such further period, as it considers reasonable. This language closely mirrors that applicable to extensions of time for unfair dismissal claims and the same approach is likely to be applied.

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E. WRITTEN STATEMENT OF REASONS FOR DISMISSAL

Under the **Employment Rights Act 1996** an employee is entitled to be provided by his/her employer with a written statement giving particulars of the reasons for the employee's dismissal:

- If the employee is given by the employer notice of termination of his/her contract of employment
- If the employee's contract of employment is terminated by the employer without notice
- If the employee is employed under a contract for a fixed term and that term expires without being renewed under the same contract.

In the following cases, an employee is entitled to a written statement without having to request it and irrespective of whether she has been continuously employed for any period:

- If dismissal occurs at any time while she is pregnant
- After childbirth in circumstances in which her maternity leave period ends by reason of the dismissal.

In all other cases:

- An employee is entitled to a written statement only if he/she makes a request for one; and
- An employee is not entitled to a written statement unless on the effective day of termination he/she has been, or will have been, continuously employed for a period of not less than two years ending with that date.

A complaint may be presented to an employment tribunal by an employee on the ground that the employer unreasonably refused to provide a written statement when required to do so or the particulars of the reasons given are inadequate or untrue. The tribunal has power to make a declaration as to what the reasons were and to make an award of two weeks' pay to the claimant.

The object of this provision is to assist employees in any claim for unfair dismissal or redundancy pay which they may contemplate making. The statement is admissible in evidence in any proceedings.

F. REDUNDANCY

Firstly, do not confuse redundancy in this context with voluntary redundancy. Voluntary redundancy is where the employee agrees to be dismissed and therefore the rules relating to selection, consultation, etc. do not apply. It is not even necessary for the employer to prove that the job of the applicant for voluntary redundancy has gone.

What follows therefore only applies to **compulsory redundancy**.

Definition of Redundancy

Under the **Employment Rights Act 1996**, redundancy is deemed to arise where the employer dismisses an employee because:

- The employer has ceased or intends to cease to carry on the business for the purposes of which the employee was employed or
- The employer has ceased or intends to cease to carry on that business in the place where the employee was employed or

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- The needs of the business for employees to carry out work of a particular kind in the place where the employee was employed have ceased or diminished, or are expected to do so.

Thus, basically, redundancy occurs in two situations. First, where the employer ceases to exist, and secondly where the job ceases to exist. Two cases provide examples of these situations.

- In ***O'Brien v. Associated Fire Alarms (1968)***, O'Brien was employed at the Liverpool office of Associated Fire Alarms. This was the regional office for the north and west of England. Work of the type which he was doing diminished in the Liverpool area and Associated Fire Alarms required him to work in Barrow-in-Furness. O'Brien refused to do this because the distance to Barrow-in-Furness from his home was so great that he could not commute on a daily basis. It was **held** by the Court of Appeal that his dismissal was for reasons of redundancy.
- In ***Bromby and Hoare Ltd v. Evans (1972)***, Evans, a bricklayer, was dismissed when his employers decided that work previously done by employee bricklayers should henceforth be done by independent contractors. It was **held** that Evans had been made redundant because the business no longer needed to employ bricklayers. The work could be done more economically by self-employed independent contractors.

Entitlement to Redundancy Payment

A person dismissed for reason of redundancy, and who has at least two years' continuous service is entitled to claim a lump sum redundancy payment from the employer.

The amount of redundancy pay is based on:

- The claimant's age
- The number of years of continuous employment with the employer (up to a maximum of 20) and
- The claimant's weekly wage (up to a specified maximum).

Working backwards from the date of termination, the claimant is entitled to:

- 1½ weeks' pay for each year during the whole of which the employee was aged 41 or more
- 1 week's pay for each year during which the employee was aged 22 or more
- ½ week's pay for years when the employee was below 22, (as amended by the **Employment Equality (Age) Regulations 2006)**.

Rules for Redundancies

(a) Consultation

The **Trade Union and Labour Relations (Consolidation) Act 1992** (as amended by **The Collective Redundancies (Amendment) Regulations 2006**) places a duty on any employer who is contemplating redundancies among the workforce to consult at the earliest opportunity with any trade union which is recognised as representing the workers affected. New regulations implementing the European Court of Justice ruling in ***Commission v. United Kingdom (1995)*** extend the right to consultation to elected employee representatives when there is no recognised trade union in the workplace. Consultation must be "*meaningful consultation with a view to avoiding redundancies*".

If 20 or more employees are to be dismissed within a period of 90 days or less, then the employer must consult with the employee representatives at least 30 days before the proposed date of dismissal; for 100 or more employees, the period is 90 days.

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Failure to consult can lead a tribunal to make what is known as a "protective award" against the employer. This, in effect, requires the employer to pay compensation, in addition to redundancy money, to the employees affected.

Recent case law has clearly established that there is a need for an employer to consult individually with those likely to be selected for redundancy, in addition to any collective consultation with representatives.

(b) Selection criteria

If candidates for redundancy have to be selected from a larger number of employees, then the selection must be "fair"; otherwise, those selected may be able to claim unfair dismissal, the compensation for which is usually higher than the redundancy payment. In any proceedings, the tribunal will consider such factors as:

- The criteria used for selection
- The amount of individual consultation which took place
- The efforts made to find alternative employment within the company.

Unreasonable refusal to accept a suitable alternative job can disqualify a person from receiving redundancy pay.

G. EMPLOYMENT TRIBUNALS

Constitution of Employment Tribunals

The Secretary of State may by regulation make provision for the establishment of employment tribunals, and proceedings before such tribunals are, in general, heard by:

- The person who, in accordance with the appropriate regulation, is the Employment Judge and
- Two other members, or (with the parties' consent) one other member, selected as the other members (or other member) in accordance with relevant regulations.

Jurisdiction

Employment tribunals exercise the jurisdiction conferred on them by any Act. Complaints and claims under the **Employment Rights Act 1996** constitute a major part of the work of the tribunals.

Employment tribunals have an additional jurisdiction under the **Industrial Tribunals Act 1996** to consider:

- A claim for damages for breach of contract of employment or other contract connected with employment
- A claim for a sum due under such contract and
- A claim for the recovery of a sum in pursuance of any enactment relating to the terms or performance of such a contract

if the claim is such that a court in England and Wales or Scotland would under the law for the time being in force have jurisdiction to hear and determine an action in respect of the claim.

This additional jurisdiction does not, however, apply to a claim for damages, or for a sum due, in respect of personal injuries.

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Procedures before Employment Tribunals

A person may appear before an employment tribunal in person or be represented by:

- Counsel or a solicitor
- A representative of a trade union or an employers' association or
- Any other person whom he/she desires to appoint to represent him/her.

Where in any proceedings contractual matters are considered, the tribunal has power to order the respondent to the proceedings to pay any amount which it finds due.

A Minister of the Crown may on grounds of national security direct an employment tribunal to sit in private when hearing or determining any proceedings specified in the direction. Other provisions enable the tribunal itself to decide to sit in private.

Any sum payable in pursuance of a decision of an employment tribunal in England and Wales which has been registered in accordance with employment tribunal procedure regulations is, if a county court so orders, recoverable by execution issued from the county court or otherwise as if it were payable under an order of that court.

Conciliation

Where an application has been presented to an employment tribunal, and a copy has been sent to a conciliation officer of the Advisory, Conciliation and Arbitration Service (ACAS), it is the duty of the conciliation officer:

- If requested to do so by the person by whom and the person against whom the proceedings are brought or
- If, in the absence of any such request, the conciliation officer considers that he/she could act with a reasonable prospect of success,

to endeavour to promote a settlement of the proceedings without their being determined by an employment tribunal.

The Employment Appeal Tribunal

The Employment Appeal Tribunal (EAT) consists of:

- Such number of judges as may be nominated from time to time from the judges of the High Court and the Court of Appeal
- At least one judge of the Court of Session nominated from time to time by the Lord President of the Court of Session and
- Such number of other members as may be appointed from time to time by Her Majesty on the joint recommendation of the Lord Chancellor and the Secretary of State.

The EAT has a central office in London but may sit at any time and in any place in Great Britain.

Jurisdiction of the EAT

An appeal lies to the EAT on any question of law arising from any decision of, or arising in any proceedings before, an employment tribunal under or by virtue of:

- The **Equal Pay Act 1970**, the **Sex Discrimination Act 1975**, or the **Race Relations Act 1976**.
- The **Trade Union and Labour Relations (Consolidation) Act 1992**, the **Disability Discrimination Act 1995**, or the **Employment Rights Act 1996**.

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Procedure before the EAT

A person may appear before the EAT in person or be represented by:

- Counsel or a solicitor
- A representative of a trade union or an employers' association or
- Any other person whom he/she desires to represent him/her.

The EAT has in relation to the attendance and examination of witnesses, the production and inspection of documents and all other matters incidental to its jurisdiction, the same powers, rights, privileges and authority as the High Court (in England and Wales) and the Court of Session (in Scotland).

For the purpose of disposing of an appeal, the EAT may:

- Exercise any of the powers of the body or officer from whom the appeal was brought; or
- Remit the case to that body or officer.

Enforcement of Decisions

Any sum payable in England and Wales in pursuance of an award of the EAT is, if a county court so orders, recoverable by execution issued from the county court or otherwise as if it were payable under an order of that court.

Appeals from the EAT

An appeal on any question of law lies from any decision or order of the EAT to the relevant appeal court, with the leave of the EAT or of the relevant appeal court. The "relevant appeal court" means:

- In the case of proceedings in England and Wales, the Court of Appeal
- In the case of proceedings in Scotland, the Court of Session.

H. RACE RELATIONS ACT 1976

Employment Provisions of the Act

The **Race Relations Act 1976** tackles problems of racial discrimination at work in much the same ways as the **Sex Discrimination Acts** deal with problems of sexual discrimination at work.

Direct Discrimination

Case illustrations of conduct which would amount to direct discrimination include:

- Failing to consider an applicant for a job on the grounds that they are black: ***Race Relations Board v. Mecca (1976***
- Offering white employees' more favourable career prospects than a black employee: ***Commissioners of Inland Revenue & Another v. Morgan (2002)***
- Offering a job to a white girl with worse qualifications than a black girl simply because she is white and English: ***Owen & Briggs v. James (1982)***

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(a) Definition and interpretation

Section 1 (1) of the **Race Relations Act 1976** defines direct discrimination in the following way:

> *"A person discriminates against another in any circumstances relevant for the provisions of this Act if:*
>
> *(a) on racial grounds he treats that other (person) less favourably than he treats or would treat other persons; or*
>
> *(b) he applies to that other (person) a requirement or condition which he applies or would apply equally to persons not of the same racial group as that other (person) but -*
>
> *(i) which is such that the proportion of persons of the same racial group as that other (person) who can comply with it is considerably smaller than the proportion of persons not of that racial group who can comply with it; and*
>
> *(ii) which he cannot show to be justifiable irrespective of the colour, race, nationality or ethnic or national origins of the person to whom it applies; and*
>
> *(iii) which is to the detriment of that other (person) because he cannot comply with it."*

Note th following points within the above definition.

- A "person" can be an individual or a group of people, such as a business corporation.
- "Racial grounds" includes reference to colour, race, ethnic or national origins and nationality (Section 3(1)). It should be noted that in racial discrimination cases the grounds for the discrimination are racial, the race of the person discriminated against is irrelevant as under Section 1(1)(a) a worker can claim direct discrimination if he/she is less favourably treated on "racial grounds". This point is well illustrated by the case of Showboat Entertainment Centre v Owens (1984). In this case a white man employed as the manager of an amusement arcade was dismissed for refusing to obey an instruction not to admit young blacks to the arcade. This was held to constitute direct discrimination on 'racial grounds' contrary to the Race Relations Act 1976. He had been treated less favourably (by being dismissed) on racial grounds it did not matter that his own race was not the reason.
- "Racial group" refers to "a group of persons defined by any reference to colour, race, nationality, or ethnic or national origins", or to any racial group into which a person falls. In Northern Joint Police Board v. Power (1997) it was held that discrimination against an English person or a Scottish person based on national origins amounts to discrimination on "racial grounds" within the meaning of the Race Relations Act 1976.
- Section 78 provides that "nationality" includes "citizenship".
- Section 1(2) specifically refers to segregating a person from others on racial grounds as treating him less favourably than those others are treated. Hence, separate but equal treatment is classed as unlawful discrimination.
- "Race" and "colour" are not problematic terms and "nationality" and "national origin" give rise to few problems but the tribunals and courts have had problems with the concept of "ethnic origin". Basically it is a cultural distinction for a group sufficiently culturally distinct and recognisable as such. Thus while it may cover

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certain religions but not others, it also has been extended to culturally distinct groups which are not religious groups, such as Romany gypsies.

(Note that under the **Fair Employment Act 1980** in Northern Ireland, it is unlawful to discriminate on the grounds of religious or political affiliations.)

(b) Discrimination against nationals

It is a common misconception that the **Race Relations Act 1976** as amended by the **Race Discrimination Directive 2000/43/EC** applies only to non-white people and to those of a different religion from the Christian denominations commonly found in the UK. This is not so.

Discrimination against nationals of the EU is also unlawful under Article 48 of the Treaty of Rome and by virtue of Section 2(1) of the **European Communities Act 1972**.

The Treaty of Rome guarantees:

(i) Freedom of movement for workers within the EU

(ii) The abolition of any discrimination based on nationality between workers of member states as regards employment, remuneration and other conditions of work and employment

(iii) The right of subjects to accept offers of employment

(iv) The right of subjects to move freely within the boundaries of the member states for the purpose of (iii) above

(v) The right of subjects to remain within the boundaries of member states for the purposes of employment.

In ***Van Duyn v. The Home Office (1974)***, it was established that Article 48 had a direct, legal effect on member states, and that it conferred on individuals legal rights which were so strong as to leave no discriminatory powers to the national courts.

If a French or a German person wishes to enforce a right under Article 48, say, to work in the UK, or an English person wishes to enforce a right to work in Germany, their claims would have to be made through a court of law, or through the European Court of Justice: ***Amies v. Inner London Education Authority (1977)***, not via an Employment Tribunal.

As always, there are a number of exceptions to the above rules as far as **citizens** are concerned:

- The provisions of Article 48 **do not apply** to employment in the **public** sector
- Measures taken by national states in the EU on grounds of **public policy** or **public security** are also excluded from the provisions of Article 48.

Indirect Discrimination

In indirect race discrimination cases, Employment Tribunals must consider, not merely whether as a matter of theoretical exercise, a woman can comply with a particular **'provision, criterion or practice'**, which has been imposed but whether as a matter of reality and practice, it is possible for the applicant to do so.

In order to claim indirect race discrimination an applicant needs to establish **all** of the following:

- That a 'provision, criterion or practice' was applied e.g. that they must work on Sunday or on the Sabbath.

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- That the policy affects more members of one racial group than another. This means that the applicant has to look at the breakdown of the people from their racial group who are disadvantaged by the particular provision criteria or practice and that they have to show that this is to the detriment of a considerably larger proportion of people within their racial group than other racial groups e.g. non-Christians and people who are not Jewish. A Tribunal may look at statistical evidence drawn from the workforce as a whole or alternatively may decide to consider only the statistics drawn from the applicant's workplace. A Tribunal can decide to take into account their own knowledge and experience when considering whether a larger proportion of people from one racial group are disadvantaged. To this end, Employment Tribunals vary in their approach to this issue so applicants should be prepared with statistics if possible.
- That they have suffered a 'detriment' as a result of the provision, criterion or practice e.g. they haven't been able to take accept a job at a DIY store because they will be required to work every Sunday.

Once you have established all of the above, it is for the employer to show that it is genuinely necessary for the job to be done at a particular time, to meet a legitimate business need. If they can show that the 'provision, criterion or practice' used is justifiable then the applicant's claim is unlikely to succeed. It should be noted, that there is a time limit of 3 months within which an applicant's complaint must be received by the Employment Tribunal.

(a) Interpretation

Section 1(1)(b) of the **Race Relations Act 1976** covers indirect discrimination.

Here it is unlawful to apply any criterion to a person (say an applicant for a job) which, while on the face of it is neutral, has the effect of excluding a significant proportion of one racial group rather than another. Thus, for example, a language skill requirement (say, to be able to speak Urdu) may well exclude significantly more of one racial group than another. This has an indirectly discriminatory effect.

The critical difference between **direct discrimination** and **indirect discrimination** is that:

- In the case of direct discrimination it is unlawful regardless of motive or intent
- In the case of indirect discrimination it is only unlawful if the use of the criterion cannot be justified as a requirement of the job.

Thus in the above example the potential employer would have to show that there was a genuine need for the post-holder to speak Urdu as an essential part of that job: ***Jones v. Gwynedd County Council (1980)***.

The practical interpretation of Section 1(1) and Section 1(1)(b)(i) has given rise to immense difficulties. The main problems centre on the need for proportional comparisons between racial groups.

In ***Panesar v. Nestlé Co. Ltd (1980)***, an orthodox Sikh who wore a beard, as was required by his religion, sought a job in a chocolate factory. He was refused because the prospective employer applied a strict rule of no beards or excessively long hair, on grounds of hygiene.

The employers (Nestlé Co. Ltd) brought scientific evidence to support this claim that beards and long hair were unhygienic in the context of the food industry. The Sikh's complaint of **indirect discrimination** was **not** upheld.

In ***Bains v. Avon County Council (1978)***, a 45-year old Indian complained of both direct and indirect racial discrimination in respect of his unsuccessful application for the post of lecturer at a college. His qualifications were suitable, but he was not shortlisted. The college applied an upper age limit of 35 years. It was claimed that the

proportion of immigrants who could comply with this limit was smaller than native-born lecturers.

The appeal failed because:

- No evidence was submitted to show that persons on the short-list were less qualified than the Indian applicant
- The number of immigrants who could **not** comply was not considerably higher than the number of English-born persons.

(b) Discrimination by victimisation

Section 2(1) states that:

> *"A person discriminates against another person ('the person victimised') in any circumstances relevant for the purposes of any provision of this Act if he treats the person victimised **less favourably** than in those circumstances he treats or would treat other persons, and does so by reason that the person victimised has:*
>
> *(a) **brought proceedings** against the discriminator or any other person under this Act; or*
>
> *(b) **given evidence or information** in connection with proceedings brought by any person against the discriminator or any other person under this Act."*

Victimisation may amount to any behaviour to the detriment of the employee or applicant which is as a result of a complaint made by them either internally within the organisation, or to a tribunal, or giving evidence on someone else's behalf at such proceedings.

(c) Discriminatory practices

Under Section 28(1) of the **Race Relations Act**, it is unlawful for an employer or anyone else to carry out and maintain "discriminatory practices" against persons on grounds of race, nationality or ethnic origin. The working of the Act is such that it is almost impossible to suggest general guidelines or to say what might constitute such a practice.

"Discriminatory practice" here means the application of a requirement or condition which results in an act of discrimination, or which could be likely to result in such an act of discrimination, if the persons to whom it is applied include persons of any particular racial group.

A person acts in contravention of this section if:

- He/she applies a discriminatory practice
- He/she operates practices or other arrangements which, in any circumstances, would call for the application by him/her of a discriminatory practice.

In general, there are many analogies to similar provisions in the **Sex Discrimination Act 1975**, which we will be looking at shortly. To do something in the context of employment (in its broadest term) which treats any member of an ethnic minority less favourably, solely by virtue of race, colour or ethnic origin, than other employees, is unlawful.

Genuine Occupational Qualifications

The **1976 Act** allows for certain exceptions within the Act. These apply to specific types of jobs and where the potential employer claims that the job is covered by such an occupational qualification, then the Act will not apply. It is for the employer to prove that the exception applies to that job.

Basically the exceptions cover such issues as:

- The job requires the provision of personal services promoting the welfare of a particular racial group which can best be carried out by a person of that particular racial group
- The requirements of authenticity in a dramatic or artistic work
- The work involves the provision of food or drink to the public in a particular setting for which a person of a particular racial group is necessary to maintain the ambience and authenticity e.g. Chinese and Indian restaurants.

General Exceptions

Here we are concerned with those exceptions which apply to government departments and agencies.

(a) Government departments and agencies

Generally, the provisions of the **Race Relations Act 1976** bind the Crown, i.e. they are enforceable in the armed services, local government and areas under the direct control of the government. However, Sections 41 and 42 provide a number of exemptions from many of the Act's provisions.

Thus, an act of racial discrimination is **not unlawful** if it is done:

- To comply with a Parliamentary enactment
- By Order in Council
- To comply with an order of a ministry or any condition imposed by a Minister of the Crown
- To safeguard national security.

(b) Crown employment exemptions

In general, the terms of the **1976 Act** apply to servants of the Crown and to the armed services, but **Section 75(5)** states that:

> *"... nothing in the Act shall invalidate any regulation made by a Minister restricting employment in the service of the Crown or any rule made by a public body restricting employment, i.e. discriminating against or for persons of a particular nationality, birth, descent or residence, nor by virtue of Sections 4 and 29 of the Act is it lawful for a Minister of the Crown or public body to advertise for a person of a particular nationality, etc. to fulfil a vacancy."*

(c) Exemptions in education and training

Training bodies and employers are excluded from the Act if they have or run training facilities especially for specific racial groups to fit them for work usually not done by members of the group or whose members form a very small percentage of those engaged in that form of work. An example would be a special training course in computer applications or programming set up for West Indians in Toxteth or Handsworth. In fact, these provisions of Sections 37 and 38 are **examples of positive discrimination** allowed under the **Race Relations Act**.

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I. SEX DISCRIMINATION ACTS 1975 AND 1986

Employment Provisions of the Sex Discrimination Act 1975

The **1975 Act** has a broad concept of "employment". It covers employment under a contract of service (or apprenticeship) as well as employment under a contract personally to carry out any work or labour. Thus, the Act prohibits discrimination by the employer, not only against employees, but also against independent contractors engaged personally to carry out specific work.

Section 6 of the Act makes it unlawful for a person to discriminate on grounds of sex in relation to **employment at any establishment in the UK**. (Remember that the Act is equally applicable to men, and also covers discrimination against a person on the grounds of his/her marital status.) An "establishment" refers to any place of work and, since the passing of the **Sex Discrimination Act 1986**, includes private households, undertakings of five employees or less, small undertakings and business partnerships.

However, discrimination is allowed, in favour of the employment of a man or woman in cases where sex is a **genuine occupational qualification**.

Genuine Occupational Qualifications

Similarly to the Race Relations Act, the employer must prove the existence of these exceptions. In relation to sex discrimination they are:

- Authenticity and physiological requirements
- Decency and privacy requirements
- Live-in accommodation is provided where it would be impracticable to provide separate accommodation for both sexes
- The nature of the establishment provides for one sex in a caring capacity
- Personal services are involved in the job that can be best provided by a person of a particular sex, e.g. lady's maid
- The custom of another nation in which the work will be substantially performed e.g. Iran
- It is one of two jobs to be held by a married couple.

The Act makes it unlawful to discriminate on grounds of sex, gender or marital status against applicants for jobs in relation to the conduct of interviews, job advertisements, job descriptions, job application forms or any other arrangements made to select a suitable employee for a particular job. At all stages in applying for and obtaining employment, the woman is on an equal footing with a man in her ability to obtain the job.

It also covers any arrangements made by employers for the purpose of obtaining a vacancy if they discriminate against a woman, even though the particular arrangements were not made exclusively for that purpose.

The employer may not discriminate against a woman already employed regarding access to opportunities for promotion, transfer, or training, or any other benefits, facilities or services, nor by refusing or deliberately omitting to give her access to them, or by dismissing her or subjecting her to any other detriment i.e. disciplinary action.

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Direct and Indirect Discrimination

(a) Direct discrimination

Direct discrimination: Section 1(1)(a) of the **Sex Discrimination Act 1975**) is defined as existing where the employer, on grounds of a woman's sex, treats her less favourably than a man. If there is some good, rational reason for "less favourable treatment" and the less favourable treatment is not on account of sex, discrimination is not established.

The legislation is intended to discourage the attitude that, en masse, women are incapable of doing certain things, and to encourage employers to look on women as individuals. The traditional assumptions such as, "*the husband must always be the bread-winner*" or "*no woman can lift heavy objects*", are discriminating, if acted upon automatically and persistently.

The belief on the part of the employer that refusing to employ women in certain jobs is for the woman's own good is itself discriminatory. On the other hand, discrimination at work to take into account genuine differences between men and women is not necessarily discriminatory under the terms of the **Sex Discrimination Act 1975**.

Examples of conduct by an employer, which would constitute direct discrimination on the grounds of sex include:

- Refusal to employ a woman as a cave guide because "it is a man's job": Batisha v. Say (1977)
- Refusal to interview a woman candidate for a post requiring heavy lifting on the grounds that the employer required somebody with physical strength, and, that the work was unsuitable for a "young lady": Cockcroft v. Restus Ltd. (1989)
- Refusal of offer an applicant the job of trainee manager based on an assumption that as a woman, she was more likely than a man to have her career disrupted by family responsibilities: Brice v J Sainsbury Plc (1985).

(b) Indirect discrimination

In indirect sex discrimination cases, as with indirect race discrimination cases, Employment Tribunals must consider, not merely whether as a matter of theoretical exercise, a woman can comply with a particular **'provision, criterion or practice'**, which has been imposed but whether as a matter of reality and practice, it is possible for her to do so. This was the reasoning of the employment appeal tribunal in ***Price v. Civil Service Commission (1977)*** where the employer's advertised for the post of executive officers, a requirement being that the candidates had to be over the age of 17.5 years, but under the age of 28 years.

In order claim indirect sex discrimination the applicant needs to establish <u>all</u> of the following:

- **That a 'provision, criterion or practice' was applied**, for example: that the applicant must work full-time, or that they must work rotating shifts/work as and when required by their employer.
- **That the policy would affect more women than men**. This means that the applicant has to look at the gender breakdown of the people who are disadvantaged by the particular provision criteria or practice and that that they have to show that this is to the detriment of a considerably larger proportion of women than men. A Tribunal may look at statistical evidence drawn from the workforce as a whole or alternatively may decide to consider only the statistics drawn from your workplace. A Tribunal can decide to take into account their own knowledge and experience when considering whether a larger proportion of

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women than men are disadvantaged, e.g. some Tribunals are prepared to accept that raising young children places a greater burden upon women than it does on men and therefore, that more women than men are likely to be disadvantaged by the practice of full-time working. Tribunals vary in their approach to this issue so you should be prepared with statistics if possible.

- **That they have suffered a 'detriment'** as a result of the provision, criterion or practice e.g they have had to leave their job as a consequence of their employer insisting on full time working: ***Lowe v Peter Bainbridge Optometrist (1999)***. In this case Ms Lowe was a qualified dispensing optician who worked full time before taking maternity leave. She told her employer that she would like to return on a part time basis and discussed with her employer the possibility of job sharing with another member of staff. The employer said it would consider this and did speak to the other potential job sharer who allegedly raised some concerns about the arrangements. The employer told Ms Lowe that the job share arrangement would not be pursued any further and she would have to return to work full time. The employer had not met with Ms Lowe and the potential job sharer together, nor had it considered the options for divisions of Ms Lowe's duties or explored possibilities involving staff from other branches being involved in the job share. Ms Lowe did not return to work and claimed indirect sex discrimination. The Employment Tribunal **upheld** her claim and said that to justify a requirement to work full time the employer had to show that the job was inherently unsuitable for job sharing or that the efficiency of the employer's service would be significantly impaired by a job sharing arrangement. In this case, the employer had failed to do so, not least because it had not done anything to bring Ms Lowe and the potential job sharer together or really considered the option of staff from other branches being involved in the job share or even of offering Ms Lowe different work.

Once the applicant has established all of the above, it is for the employer to show that it is genuinely necessary for the job to be done say on a full-time basis, during specific hours or to a specific shift pattern, in order to meet a legitimate business need. If they can show that the 'provision, criterion or practice' used is justifiable then the applicant's claim is unlikely to succeed. It should be noted, that there is a time limit of 3 months within which the applicant's complaint must be received by the employment tribunal.

Indirect discrimination is dealt with in **Section 1(1)(b)** of the Act and applies where an employer imposes a condition on a woman which is also applied to a man, but:

(a) The condition is such that the proportion of women who can comply with it is **considerably smaller** than the proportion of men who can comply with it and

(b) It cannot be shown to be **justifiable**, irrespective of the sex of the person to whom it is applied and

(c) It is to the woman's detriment because she cannot comply with it.

What happens in practice is that the woman claimant must be able to prove (a) and (c). If she is successful, then the employer must prove justification under (b).

"*Can comply with*" has been construed by the courts as meaning "*can comply with in practice*". Thus, it is not enough for an employer to argue that it is technically feasible for a woman to comply if large numbers of women **cannot**, in fact, comply.

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Examples of indirect discrimination cases in the case of sex discrimination include the following.

- ***R. v. Secretary of State for Employment Ex Parte Equal Opportunities Commission (1994)***

  Prior to this case employees who worked for less than 16 but more than eight hours per week could only obtain protection against unfair dismissal and redundancy after they had been employed for five years (as opposed to two years for those with 16 hours per week or more). Those working less than eight hours never gained any employment protection. It was claimed that as about 90% of part-time workers working less than 16 hours per week were women, then this was indirect discrimination on the grounds of their sex.

  The House of Lords gave a declaration that it was unlawful indirect discrimination to maintain two separate qualifying criteria for different groups for the rights to statutory employment rights.

- ***Tickle v. Governors of Riverside C of E School and Surrey County Council (1995)***

  Here part-time teachers who were replaced by full-time teachers claimed that this was indirect discrimination. Part-time teachers were significantly more likely to be women than men. The effect was, therefore, indirect discrimination. The employers tried to justify the policy but the Tribunal could not be satisfied that the replacement by a full-timer was in any way necessary or advantageous to the employer.

- ***Connolly v. Strathclyde Regional Council (1994)***

  Here refusal to short-list a candidate for a promotion was queried. One of the criteria for selection was experience, and it was conceded that this criterion alone might be indirectly discriminatory. However, as it was only one of a number of criteria it could not, therefore, amount to a requirement or a condition of the job. The EAT followed ***Perera v. Civil Service Commission (1983)*** stating that there had to be a condition or requirement that barred the applicant from complying at all.

In the case of sex discrimination it is important to note that the European Union has passed a Directive on Equal Treatment of men and women at work. This Directive is just as enforceable in the UK as the 1975 Act. However, the Directive goes further than the 1975 Act and it is on the basis of the Directive that claims have been made that discrimination law should be extended to cover issues of sexual preferences and transexuality.

The European Court of Justice has ruled that a transexual is covered by the law of discrimination, and in a case relating to gays and lesbians: ***Grant v. South West Trains Ltd (1997)***) the court has also ruled that sexual preferences are included.

Sex Discrimination Act 1986

This Act extended the provisions of the **Sex Discrimination Act 1975** to private households, small undertakings and partnerships, as we have said. It also brought within the scope of the 1975 Act any provision made by an employer in relation to retirement, dismissal, demotion, promotion, transfer and training. The Act prohibits company policies which set different compulsory retirement ages for men and women in comparable positions.

The Act amended the unfair dismissal of the **Employment Protection (Consolidation) Act 1978** to ensure that men and women in the same position have the right to complain to an employment tribunal of unfair dismissal up to the same age.

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You should note, however, that it is possible for an employer to have a variety of retiring ages for different jobs provided there is no direct or indirect discrimination based on gender. In ***Bullock v. Alice Ottley School (1993)*** Mrs Bullock was a part-time pantry assistant at the school. She was dismissed at the age of 60 when she reached the school's retirement age, although male staff (gardeners) were allowed to retire at 65. The EAT accepted the employer's argument that the different retirement ages could be justified – gardeners and maintenance men required special skill and there were difficulties in recruiting them, which explained and justified their later retiring age.

Enforcement of the Law in both Sex and Race Discrimination

(a) Taking action

In the first instance, cases of illegal **sex discrimination** are brought before an Employment Tribunal. An appeal on a point of law then goes to the EAT, then to the Court of Appeal and from there to the House of Lords, who may refer it to the European Court of Justice in Luxembourg. Action may also be taken by the Equality and Human Rights Commission (see below).

In the case of illegal **race discrimination** the cases are brought before an Employment Tribunal. An appeal on a point of law then goes to the **EAT**, then to the Court of Appeal and from there to the House of Lords. Race discrimination is not covered by European Union law and therefore cannot go to the European Court of Justice in Luxembourg. Action may also be taken by the Equality and Human Rights Commission.

In the field of employment, a claim under either Act must be made **within three months** from the date of the act complained of.

(b) Employment tribunal remedies

If the Employment Tribunal finds for the claimant i.e. the employee bringing the action or making the claim, it will usually make three orders:

- A declaration that the employee's rights have been infringed
- An order for compensation
- A recommendation that the employer should take action within a given period to remove the discrimination.

If the employer fails to comply, the case will go back to the Tribunal which will increase the compensation to the employee. Since 1995 there has been no limit on the compensation payable in cases of sex or race discrimination.

Equality and Human Rights Commission

The Commission was formed in October 2007 when the Equal Opportunities Commission, Commission for Racial Equality and the Disability Rights Commission merged into a single organisation. It will issue a notice requiring termination of an act of discrimination. The employer has six weeks in which to appeal. If the appeal is dismissed, the court will then issue an injunction on behalf of the Commission.

The Commission also assist applicants with tribunal cases where the case justifies its intervention.

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J. DISABILITY DISCRIMINATION ACT 1995

Scope of the Act

It is not intended here to give a detailed coverage of the Act but simply to outline the structure and main duties that it contains.

The Act came into effect in December 1996 and its scope depends very much upon regulations, guidance notes and codes of practice issued through the Disability Rights Commission (now part of the Equality and Human Rights Commission). There is little case law in this area yet.

Meaning of Disability

> *"Physical or mental impairment which has a substantial and long-term adverse effect on a person's ability to carry out normal day-to-day activities."*

Schedule 1 clarifies the definition:

- **Impairment:** physical and mental impairment includes sensory impairment and covers mental illness only if it is "*clinically well recognised as a mental illness"*. This means that it must be accepted by a reasonably substantial body of practitioners that such a condition exists (Gulf War Syndrome?). Does this mean that tribunals will have to consider conflicting medical opinions on the existence of a condition?

  Regulations exclude such anti-social disorders as kleptomania, addictions, pyromania and paedophilia and other personality disorders not caused by psychotic conditions.

  Severe disfigurement is specifically included in the impairment and is to be treated as having a substantial adverse effect.

- **Long term** usually shall mean 12 months or likely to last at least 12 months. Recurring conditions such as multiple sclerosis and epilepsy are treated as having an adverse effect if they are likely to recur, even though they do not affect the day-to-day activities on a permanent basis.

- **Day-to-day activities** include: mobility, manual dexterity, physical co-ordination, ability to lift and carry or otherwise move everyday objects, speech, hearing, or eyesight, memory or ability to learn or understand.

- **Substantial adverse effect** is intended to include anything which is not minor, but the Act is silent on this point and the situation will be covered in guidance notes.

Progressive conditions are also dealt with in the Act and those registered as disabled under the **Disabled Persons (Employment) Act 1944** are deemed to be disabled by virtue of the new Act.

The Framework

The framework of the areas covered is similar to the **Sex Discrimination and Race Relations Acts**: employment, terms and conditions, etc. and also non-employment issues such as the provision of services.

Discrimination applies to refusal of employment to job applicants

- In the arrangements made for determining the offer of employment
- The terms of the offer
- Or a refusal of an offer of employment.

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It also applies in respect of discrimination against current employees,

- In the terms of employment
- The opportunities for promotion, transfer, training etc.
- Or by dismissing or subjecting them to any other detriment.

Provisions also exist in relation to the advertising of jobs and the Act also makes provision for the employer to be vicariously liable for the actions of the employee as in the **Sex Discrimination Act 1975** and **Race Relations Act 1976**.

The Act covers all disabled workers – this includes part-time workers, contract workers, self-employed staff and specialists.

Small businesses of less than 20 employees are exempt from the employment aspects of the Act.

The Act covers disabled consumers as well as employees, so it affects the providers of goods and services. They must not discriminate against or refuse to serve or provide inferior service for disabled people. The Act goes on to state that further regulations concerning premises, transport and procedures to be made accessible will be phased in over the next nine years.

Definition of Discrimination

Basically the definition of discrimination is the same as for the **Sex Discrimination Act 1975** and the **Race Relations Act 1976** but in this case even direct discrimination may be justified.

Under Section 5(1) a person discriminates against a disabled person if:

> *"a) For a reason which relates to the disabled person's disability, he treats him less favourably than he treats or would treat others to whom the reason does not or would not apply; and*
>
> *b) He cannot show that the treatment in question is justified."*

Thus discrimination is direct in this case and the applicant has to show that the decision was not necessarily *"on the grounds"* of the disability but *"related to"* it. Thus refusal to employ a wheelchair bound applicant in a job on a second floor where there is no lift is discrimination related to the disability.

There is provision for victimisation actions but there is no provision for indirect discrimination actions.

Under the original proposals and the Bill, a number of situations were set out whereby an employer could avoid the need to employ disabled persons. Quite clearly these gave rise to significant problems of interpretation and so the Act contains only one provision in relation to an employer avoiding liability. This is **justification**.

The Act does not provide much guidance on what will be "justified" but the Code of Practice does. The Act says that the reason must be both "*material to the circumstances of the particular case and substantial*". The burden of proof is on the employer.

Requirement to Make Reasonable Adjustments

A further requirement of the Act is that an employer may be required to make reasonable adjustments, either to the physical environment of the workplace, or to working practices, to accommodate a disabled person. Failure to do so will be taken into account in considering whether or not the employer has discriminated and whether or not the employer may rely upon the justification defence. It seems there is likely to be a mechanism for some form of cost benefit analysis on the adjustments and that no employer will be expected to make

unreasonable adjustments. The duty to make adjustments is not a general duty. It only arises when the employer has a disabled applicant for a job and cannot justify not employing them. Thus the duty to make adjustments occurs on a case by case basis and adjustments may be different depending upon each applicant.

For example, a wheelchair bound applicant applies for a job which is based on the third floor of an office block which does not have a lift. The employer must consider the following points:

- Can a lift be installed and how much would it cost?
- Can the job be relocated (the whole section) to the ground floor?
- Is it possible for this disabled applicant to work on the ground floor while the rest of his/her work colleagues remain on the third floor?

For each of these questions the employer must look at whether or not they could be reasonably expected to go to the expense of making the adjustments. In other words, are the adjustments reasonable? If the employer is a small employer, then (a) will be unreasonable, but a larger organisation with greater resources and a greater chance of having more than one disabled applicant may need to seriously consider it. Alternative (b) is probably impracticable and (c) may also be, given the nature of the work. Thus you can see how difficult it will be to generalise on what are "*reasonable adjustments*".

The Act uses examples to illustrate that its requirements go beyond removing physical limitations on disabled workers; they involve helping disabled people by reallocating certain duties, altering work hours, allowing time for treatment and rehabilitation. In terms of recruitment, promotion, etc., test procedures must be adjusted to avoid discrimination.

The sanctions that may be used when organisations do not comply with the requirements of the Act include complaints being made to employment tribunals and the involvement of ACAS. The causes of disabled people facing discrimination will also be taken up by trade unions.

K. HEALTH AND SAFETY AT WORK ACT 1974

Terms of Reference

(Words in quotation marks are taken from the Act and guidance issued by the Health and Safety Commission.)

The terms of reference of the Act were as follows:

> *"Secure health, safety, and welfare of persons at work".*

Thus the Act:

- Brought health and safety under the same legislation for the first time
- Covers all people at work except privately employed domestic workers, so it covers all employers, self-employed and employees
- Covers employees who were previously unprotected by law – about five million in the medical, transport and education industries.

The health and safety of the general public, in relation to work activities, was also covered for the first time:

> *"Protect persons other than persons at work against risks to health and safety arising out of, or in connection with, activities of persons at work."*

The Act is an "enabling" Act, consolidating all previous health and safety law. A Health and Safety Commission was set up with the prime function of reviewing, updating and improving such law by means of Regulations and Approved Codes of Practice (ACOPS).

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So, for example, the Control of Substances Hazardous to Health (COSHH) Regulations apply to the storage and utilisation of *"highly inflammable or otherwise dangerous substances and generally prevent the unlawful acquisition, possession, and use of such substances"*. Control is required even if such substances are not being used in connection with work, and also applies to "*emissions into the atmosphere of noxious or offensive substances*". This includes

- Control of all "airborne emissions"
- Control of emissions which, although not injurious to health and safety, cause environmental pollution or nuisance.

Basic Duties of People at Work

(a) Employers

Employers have an overall duty at work to improve the health, safety and welfare of employees. More specific duties include:

- Maintenance of "safe systems of work, plant, premises and working environment"
- Safety systems for "utilisation, handling, storage and transport of articles and substances"
- Provision of "information, training, supervision and instruction", ensuring health and safety
- Written statement of policy and administration of implementation of policy regarding health and safety to be communicated to employees
- To comply with rulings from the Secretary of State concerning the election of safety representatives to consult over health and safety matters and to consult with such representatives. To appoint a safety committee on request of such representatives and to enable review by such a committee of health and safety measures taken by the employer
- Not to expose the public to health and safety hazards and to adopt the best means to prevent harmful emissions
- To make available to the public, information about activities potentially harmful to health and safety.

(b) Self-employed people

These persons have a duty not to expose themselves or the public to health and safety hazards.

(c) Manufacturers, suppliers, importers

Duties are in relation to "*articles*" and "*substances*" to be used at work.

- Ensure that "design and construction" of "articles" do not risk the health and safety of users
- Test and examine for such risks
- Make utilisation and safety information available to users
- Research into minimisation of such risks to users
- "Erection" and "installation" of "articles" to be safe to users.

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(d) Employees

Employees have a duty to:

- Take care of their own health and safety, and that of others if their actions are likely to affect them
- To "co-operate" with an employer concerning their duties
- Not to "interfere" or impede health and safety provisions introduced by statute or by an employer.

The above is a summary of the responsibilities of employers and employees, forming the basis of the legal provisions in the health and safety area. The expectation was that such provisions would alleviate problems associated with the diversity and detail of legal requirements in the past.

Other Provisions

(a) Codes of Practice

The **1974 Act** allows for **Codes of Practice** to support the regulations made under the Act. Basically, regulations are law, whereas Codes of Practice offer guidance on how the law is to be obeyed. In the case of **Approved Codes of Practice**, these, like the Highway Code, can be used in a court of law to show that the defendant has **not** obeyed a specific regulation. The onus is then on the defendant to show that he/she met the requirement in as good a way as that contained in the Approved Code. Most regulations now have attached Approved Codes of Practice and Guidance Notes, which, as their title suggests, offer guidance only.

(b) Improvement and Prohibition Notices

In addition to prosecuting in the courts for contraventions of the Act and associated regulations, Health and Safety Executive Inspectors, empowered under the Act, can issue Improvement and Prohibition Notices to prevent what they consider dangerous practices.

- **Improvement Notices** give the employer a specific time in which the suggestions for improvement must be carried out
- **Prohibition Notices** prevent the work from continuing and are issued where the inspector feels there is risk of **imminent danger**.

Employers can appeal against notices to a tribunal but, in the case of Prohibition Notices, the work must stop until the tribunal has reached a decision.

The use of notices greatly increases the power of inspectors to prevent accidents occurring, rather than waiting for an accident to occur before taking an employer to court.

(c) Safety committees and representatives

The above is a very much shortened view of a complex set of regulations made before and after the **1974 Act**, but which now fit under its general framework of duties that apply to all workplaces. The **Safety Representatives and Safety Committee Regulations 1977**, for example, allow trade union-appointed safety representatives legal rights. The Regulations, and supporting Code of Practice, set out the functions of such safety representatives. Apart from representing employees in consultations with the employer, their functions are to:

- Examine potential hazards, dangerous occurrences, and causes of accidents at the workplace

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- Investigate complaints by any employee relating to the employee's health, safety or welfare
- Make representations to the employer arising out of the above. (The Code recommends that these be made in writing where possible.)
- Make representation to the employer on general matters
- Carry out inspections (normally every three months, and after giving the employer reasonable notice in writing)
- Represent employees in consultations with Health and Safety Inspectors, or inspectors of any other enforcing authority
- Receive information from inspectors
- Attend meetings of safety committees in their capacity as safety representatives.

So that they can fulfil their duties, the employer shall allow safety representatives sufficient paid time off to perform these functions or to undergo reasonable training.

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Study Unit 15

Principles of Consumer Credit

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A. HIRE PURCHASE

Round about the turn of the century, a demand arose for the purchase of mainly consumer durables on credit. To get around the provisions of legislation which controlled money-lending, the practice of "hire purchase" came into being. Under this type of arrangement, goods are leased to the debtor for a fixed period, with an option to purchase at the end of the period. During the leasing period, the purchaser pays the capital cost of the goods plus interest. At the end, he/she has an option to purchase them outright for nominal consideration.

The purchaser is not obliged to exercise this option, and is free to return the goods at the end of the leasing period. For obvious reasons, the option is invariably exercised. But until it is so exercised, the debtor has no title to the goods: they are purely on lease to him, and he cannot lawfully dispose of them. For this reason, a hire purchase agreement is not a "bill of sale", so it does not have to be registered under the **Bills of Sale Acts 1878** and **1882**.

The system, like that of money-lending generally, was open to abuse, so Parliament stepped in to control the matter with the **Hire Purchase Acts 1938**, **1954** and **1964**. These were consolidated and re-enacted by the **Hire Purchase Act 1965**, which was finally repealed on 19 May 1985. Such agreements are now covered by the **Consumer Credit Act 1974**.

B. CONSUMER CREDIT ACT 1974 (AS AMENDED BY THE CONSUMER CREDIT ACT 2006)

This Act is an extremely comprehensive and far-reaching statute which aims to control **all** forms of credit afforded to "consumers", under whatever guise it may appear. It applies to any transaction which involves the granting of credit of not more than £25,000 to an individual, including a partnership of up to three partners. Sums in excess of this, or any sums of credit to corporate bodies e.g. companies, are not caught by the provisions of the Act.

Terminology

The **Consumer Credit Act** introduces a number of concepts which were quite new at the time of its passage in 1974; Section 189(i) contains no less than 117 definitions. The terminology used is not necessarily the ordinary everyday meaning of the relevant word. The most important definitions and concepts are:

(a) Debtor

The debtor is the person who receives credit, n effect, the customer. The debtor can be an individual, a partnership, or a club or other unincorporated association, but not a company. It is important to remember that a "consumer" transaction is not necessarily one which is of a private nature unconnected with business. The distinction is between whether the recipient of credit, the debtor, is or is not incorporated.

(b) Creditor

This is the person or organisation supplying the credit. The creditor can be an individual, a company or any other organisation. It is frequently a finance company, a bank or a shop.

(c) Supplier

This is the person who, or organisation which, supplies goods or services which are the subject matter of the credit.

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For example, if a washing machine is acquired on hire purchase, the shop supplying it is the "supplier" and the HP company is the "creditor". If a bank grants an overdraft, it is both the "supplier" of a service, i.e. money and the creditor.

(d) Owner and Hirer (or Debtor)

These definitions apply only to leasing or hiring agreements. The words have the obvious meaning. The "hirer" must be an individual, like a debtor. However, you should note carefully that there is an unfortunate conflict of definitions in respect of hire purchase transactions. In the Consumer Credit Act 1974 (the Act), a person acquiring goods on hire purchase is **not** referred to as "the hirer" – he/she is the "debtor" – whereas the actual goods which are the subject of a hire purchase transaction are referred to in the Act as being "hired". This must be distinguished from the Hire Purchase Act 1965, which did call the person acquiring goods on HP the "hirer". It would be helpful if the two Acts were consistent!

(e) Credit

Credit is defined in Section 9(1) as a "*cash loan or other financial accommodation*". The concept is fundamental to the Act but it is not as simple as the definition would imply. The essential thing is that payment for goods or services must be deferred. Whether payment is subsequently made in one lump sum or by instalments does not matter; it is still credit if, by agreement, repayment of the cash sum advanced or provided is deferred.

However, if the actual payment for goods or services provided, as opposed to cash supplied so that goods or services may be acquired, is deferred, that is not credit within the terms of the Act. For example, if a shop permits payment by monthly account, it is not providing "credit", nor is British Telecom when it submits its account quarterly. Not even in a house building contract, where payment is due at stated stages of construction, is credit being given. On the other hand, an overdraft facility granted by the bank; a credit card transaction; a loan to buy a car, or a hire purchase or similar agreement all entail the granting of credit.

You should not carry the analysis too far, and it is not strictly true but, as a rule of thumb, we may say that if cash or the facility to use cash, for a purchase of goods or services is given or granted, then credit is being supplied. If, on the other hand, payment for goods or services already supplied is deferred, then credit is not being granted, under the terms of the Act.

Various types of credit are defined:

- **Running-account Credit**

  This is where the agreement calls for the provision of credit (usually up to a set limit, but not necessarily) as and when the debtor requires it. A bank overdraft facility is a typical example, or the provision of a credit card (e.g. Mastercard which sets a fixed limit, and is a "running account" credit). Note that American Express, which is unlimited in amount, is a charge card.

- **Fixed Sum Credit**

  This occurs, as the words **imply**, where the credit given is a stated amount and is not a running account. A hire purchase transaction or a loan from a finance company, money lender or pawnbroker are all examples.

- **Restricted or Unrestricted Use Credits**

  These definitions are obvious.

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(f) Agreements

Lastly, there are various **types of agreement** for the provision of credit which need definition.

- **Debtor–Creditor–Supplier Agreement**

  This is the typical hire purchase agreement, where there are three parties involved: the customer who acquires the goods, the shop which supplies them, and the finance company which provides the credit.

  It also applies to credit card transactions.

  Where there are only two parties involved, it is simply a Debtor–Creditor agreement, e.g. a bank loan.

- **Credit-token Agreement**

  These cover all forms of agreement involving the provision and use of credit cards, vouchers, coupons, trading stamps, and similar items. By far the commonest are the ordinary credit cards such as Mastercard, Barclaycard/Visa etc. The term also includes credit cards issued by shops for use only in that shop, bank cards, and similar cards.

- **Consumer Hire Agreement**

  The Act defines this as an agreement made by a person with an individual ("the hirer") for the bailment of goods to the hirer, being an agreement which:

  (i) Is not a hire purchase agreement

  (ii) Is capable of subsisting for more than three months

  (iii) Does not require the hirer to make payments exceeding £25,000.

  Credit is thus supplied by virtue of the hire charges. It covers normal domestic rental agreements e.g. for a TV and business rentals or leases of equipment e.g. photocopiers, to individual traders or partnerships.

- **Exempt Agreements**

  These are agreements exempted from the provisions of the Act by statutory instrument, under authority given by Section 16. At present these comprise the following:

  (i) Credit agreements connected with land

  (ii) Agreements where the debtor is required to make only a small number of repayments

  (iii) Agreements where the level of credit charges payable by the debtor is less than a certain level (less than the higher of 13% or 1% above the highest of the clearing bank base rates)

  (iv) Agreements connected with foreign trade.

- **Regulated Agreements**

  These are consumer credit or consumer hire agreements which are not exempt.

- **Small Agreements**

  These are regulated agreements for credit not exceeding £50. Certain provisions of the Act do not apply to small agreements.

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Licensing

(a) Regulations

Anyone who carries on a consumer credit or consumer hire business is required, under Section 21 of the Act, to be licensed to do so by the Director-General of Fair Trading. Any business which provides credit under **regulated** consumer credit agreements, or which bails goods under **regulated** consumer hire agreements, is required to have a licence. A licence is not, however, required if the business:

- Provides credit or hire only in excess of £25,000
- Provides it only to companies.

(b) Requirements

The requirements for the granting of licences are contained in Part III of the Act. Briefly, a licensee must be, in the opinion of the Director-General, a fit and proper person. If so, the Director-General is bound to grant a licence, but is empowered to look at all the evidence and circumstances, including hearsay, in coming to a decision.

The matters which the Director-General is specifically required to consider are:

- Convictions for fraud or dishonesty
- Any contraventions of the **Consumer Credit Act**
- Instances of racial or sexual discrimination. In ***Quinn v. Williams Furniture Ltd (1981)*** the defendants contravened the **Sex Discrimination Act**, and it was **held** that this fact entitled the Director-General to refuse a licence.
- Any improper business practices.

(c) Categories

A standard licence specifies the name of the person to whom it is granted, the name of the business to which it relates, and the activities which are permitted. There are six categories:

- Category A – consumer credit business
- Category B – consumer hire business
- Category C – credit brokerage
- Category D – debt adjusting and debt counselling
- Category E – debt collecting
- Category F – operating a credit reference agency.

We have already mentioned the first two, but certain other activities connected with credit, other than providing it, are caught by the Act. A licence is required by anyone undertaking the business of **credit brokerage**, which is arranging for credit to be supplied to an individual under a regulated agreement. Such people as "finance or mortgage brokers" and insurance brokers fall into this category.

A licence is also required for the business of **debt adjusting and debt counselling**.

The first of these encompasses the business of negotiating on behalf of an individual with his/her creditors for debts to be paid off over a period, reduced, or otherwise adjusted. The second is the business of giving advice in connection with the debts of an individual.

Debt collecting is the business of collecting debts from individuals on behalf of, or as agent for, the creditor, and for this a licence is required.

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Operating a **credit reference agency** entails the provision of references to creditors, or potential creditors, as to the creditworthiness of individuals. This includes not only such well known names as Dun and Bradstreet, but also trade associations and similar associations who provide credit references on individuals for their members.

(d) Group licences

A group licence is similar, but it applies to all those persons within a group which is specified in the licence, not merely to a single named trader or business. This is plainly appropriate to organisations whose members all carry on similar activities which are subject to the licensing requirements of the Act. A group licence is not intended to be granted to organisations with a number of branches, such as banks or chain stores.

A group licence has been granted, for example, to:

- Solicitors holding a practising certificate
- Chartered and certified accountants
- Liquidators and trustees in bankruptcy
- Certain charities
- Citizens Advice Bureaux.

(e) Proceedings

If the Director-General intends either not to grant a licence, or not to the full extent requested by the applicant, he is required to notify the applicant of this, giving his reasons. The applicant then has 21 days in which to make written representations to the Director-General or to request an oral hearing.

After considering the representations, written or oral, the Director-General may grant the licence in whole or in part, or refuse it. If it is refused or only partially granted, he must state his reasons in writing. In this event, if the applicant is aggrieved by the decision, he has a right of appeal to the Secretary of State and thereafter, on a point of law only, to the High Court.

(f) Renewals

A licence, whether standard or group, lasts for ten years; thereafter, it is renewable for a further period of ten years, and so on. If the Director-General is minded to refuse a renewal, the same procedure as for refusal of the original applies.

However, throughout its period of validity, a licence can be prematurely terminated or suspended by the Director-General. Either of these penalties may be incurred if the licensee or her employees or agents engage in improper practices in the conduct of their business. Termination is just what the term implies, i.e. revocation of the licence. Suspension can be either for a fixed period or indefinitely. In the latter event, the Director-General can at any time bring the period of suspension to an end, or alternatively the licensee can apply for the suspension to be lifted.

The procedure for revocation or suspension is again similar. The Director-General must give notice to the licensee. Then the licensee is entitled to make written or oral representations, followed if necessary by an appeal, as in the case of failure to grant a licence. The termination or suspension takes effect only after the licensee has exhausted the appeal procedure, if she does so.

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Unlicensed Trading

If a person carries out any business which is required by the Act to be licensed, without having the relevant licence, he/she commits a criminal offence. Any agreements entered into, while unlicensed, are normally thereby rendered unenforceable. Section 40(1) of the Act provides that:

> *"a regulated agreement other than a non-commercial agreement, if made when the creditor or owner was unlicensed, is enforceable against the debtor or hirer only where the Director General has made an order under this section which applies to this agreement".*

In other words, it can be enforced only if the unlicensed trader applies for a validating order, and receives it. So, if an unlicensed trader commences an action against a debtor without having obtained a validating order, then the action will be misconceived, he/she will have no cause of action, and the court will refuse to hear the dispute. Such proceedings cannot afterwards be revived if the trader subsequently gets a validating order: ***Eshelby v. Federated European Bank Ltd (1932)***.

Seeking Business

Part IV of the **Consumer Credit Act** controls the seeking of business by persons carrying on consumer credit or hire business, in respect of advertising, canvassing and providing quotations.

(a) Canvassing

Canvassing for debtor–creditor-supplier agreements and for consumer hire agreements is permitted only if specifically authorised in the trader's licence: Section 23(2).

Canvassing for debtor–creditor agreements is effectively forbidden, as it is for most other ancillary credit business such as credit brokerage, debt adjusting or counselling. Contravention is a criminal offence. The only form of canvassing that is readily permitted is for debt collecting or credit reference business.

For a canvassing offence to be committed:

- The canvasser must visit an individual and make oral representations (telephone calls or mail shots are excluded)
- The visit must be for the specific purpose of soliciting business
- Soliciting of business must actually occur
- The visit must not be in response to a prior request from the prospective client (in the case of debtor–creditor agreements, a request in writing and signed by the prospective client).

To constitute an offence, an unauthorised visit has to be to an individual's house. Visits to business or trade premises for the purpose of canvassing are therefore permitted.

(b) Circulars to minors

The **Betting and Loans (Infants) Act 1892** prohibited the sending of circulars to minors. Section 50 of the Act replaces these provisions. It is an offence to send documents in the prohibited categories to minors. Such documents are those which invite a minor to take up credit facilities, to hire goods or to seek information or advice as to obtaining credit or hire. However, for an offence to be committed, the sending of documents must be with intent to secure financial gain, and the sender must be aware or have reasonable cause to suspect that the recipient was a minor.

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(c) Unsolicited credit tokens

Section 51 prohibits the giving of unsolicited credit tokens. You will remember that a credit token is normally what is commonly called a "credit card", whether it is issued by one of the well known credit card companies or by a shop or other organisation in respect only of its own goods, or a bank card or cheque card.

It is an offence to issue a credit token unless it has been requested in writing by the recipient. The reason for the ban on unsolicited credit tokens is to control financial irresponsibility.

(d) Advertising

Advertising for consumer credit or hire business is controlled by Sections 43 to 47 of the Act. Firstly, the advertiser must be engaged in consumer credit or consumer hire business, or in a business in the course of which credit or hire is provided; secondly, he/she must provide certain ancillary credit business, such as credit brokerage. Other forms of ancillary credit business are not caught by the advertising provisions of the Act.

An advertisement must indicate that the advertiser is willing to provide credit or to hire goods. That "indication" must be positive and explicit: ***Jenkins v. Lombard North Central plc (1984)***.

Advertisements making it clear that credit is offered only in excess of £25,000, or that the debtor will not have to provide security, other than on land, are not covered.

Advertisements covered by the Act must:

- Comply with Advertisement Regulations made by virtue of Section 44
- Offer to supply goods or services on credit, in which case they must be offered for sale etc. at the price named in the advertisement
- Not be false or misleading.

An offence is committed if these requirements are breached.

(The actual requirements of the Advertising Regulations are lengthy and complex, and are outside the scope of this course.)

(e) Quotations

If individuals make requests for information in appropriate circumstances, the Act imposes a duty on relevant businesses to supply a written quotation. The businesses affected are those engaged in consumer credit, consumer hire, the lending of money to individuals on the security of land, and credit brokers.

A written quotation must be given by such organisations if the prospective customer asks for written information about a specific transaction of a relevant type, and such request is addressed to the prospective creditor, credit broker or owner, or is made at those organisations' premises (or by telephone in respect of a specific advertisement).

The quotation supplied is required to contain all relevant information concerning the credit offered, and especially it must state the **Annual Percentage Rate** (APR) for the credit. Other information includes:

- The extent to which credit charges may vary
- Whether security is required
- Details of the cash price
- Any deposit or advance payment

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- The total sum payable
- Repayment details.

Quotations for hire agreements are required to be similar.

Antecedent Negotiations

Section 56(1) of the Act defines "*antecedent negotiations*" as any negotiations with the debtor or hirer conducted by the creditor or owner in relation to any regulated agreement, or conducted by a credit broker in relation to goods sold, or proposed to be sold, by the credit broker to the creditor before becoming the subject of a debtor–creditor-supplier agreement, or conducted by the supplier in relation to a transaction financed or proposed to be financed by a debtor–creditor-supplier agreement.

In other words, anybody, other than the debtor, who is a party to or directly has a business interest in a consumer credit agreement and who negotiates with the debtor prior to entering into a consumer credit agreement and with the intention that the debtor shall enter into such agreement, is carrying out antecedent negotiations.

Antecedent negotiations commence when the negotiator and the debtor (or hirer) first enter into communication with each other, including by advertisement.

Once antecedent negotiations have started, or been shown to exist, the negotiator is deemed to be the agent of the creditor, even if, in fact, he/she is not so. As a result, the creditor becomes liable for any misrepresentations, or any contractual undertakings made by the negotiator. This liability of the creditor cannot be excluded.

C. THE CONSUMER CREDIT AGREEMENT

Regulations for Documents

Section 60(1) of the Act provides that the Secretary of State shall make regulations as to the form and content of documents embodying regulated agreements. This is to ensure that the debtor or hirer is aware of his rights and the remedies available to him, before he enters into the agreement. The agreement must contain the following information for the debtor or hirer:

> *"(a) The rights and duties conferred or imposed on him by the agreement*
>
> *(b) The amount and rate of the total charge for credit (in the case of a consumer credit agreement)*
>
> *(c) The protection and remedies available to him under the Act*
>
> *(d) Any other matters which, in the opinion of the Secretary of State, it is desirable for him to know about in connection with the agreement."*

The regulations which expand on the statutory requirements listed in Section 60(1) provide that the following minimum information must be given to the debtor or hirer:

(a) Any initial payment required

(b) The goods to be supplied and their cash price

(c) In the case of a fixed sum credit agreement, the amount of credit

(d) In the case of a running-account credit, the credit limit (if this can vary, a statement as to how it can vary must also be given)

(e) A statement of the total charge for credit

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(f) A statement of the total sum payable under the agreement, together with repayment details e.g. how much per month

(g) A statement of the Annual Percentage Rate (APR) for credit

(h) Details of any security provided by the debtor

(i) Any charges payable on default by the debtor.

To expand on these requirements where they are not obvious:

- The initial payment is variously described as a deposit or a down payment. In hire purchase agreements especially, it is invariable that a percentage of the cash price of the goods has to be paid at the outset. This is typically between 20% and 33 $\frac{1}{3}$ %.
- The debtor has to be given all three constituent elements of the price to be paid – the cash price of the goods, the total amount of credit, and the total payable.
- The total charge for credit is most important – the reason being that the amount of the interest or other charges payable is excluded for the purposes of ascertaining whether the transaction is a regulated agreement. You will remember that the limit for a credit agreement to come under the terms of the Act is £25,000. For example, if the cash price of goods is £23,000 and the charge for credit is £3,000, the total repayable is £26,000. However, this would still be a regulated consumer credit agreement, as you must exclude the cost of the credit. It is thus below the limit, notwithstanding that the total amount payable by the debtor is more than £25,000.
- The APR is required so that the debtor can equate the total charge for credit, which will often be the aggregate of several years, to an annual rate. APR is not always an easy calculation to make, so the creditor does not commit an offence if he/she states the APR within 1% of the actual rate.

Requirements for Completion

Section 61 of the Act provides that a regulated agreement is not properly executed unless the document embodying the agreement is signed by the debtor or hirer and also by, or on behalf of, the creditor or, if relevant, the owner. Furthermore, it must contain all the terms of the agreement, other than implied terms, and all the details and information prescribed in the regulations. All such terms and details must be readily legible.

Sections 62 and 63 provide for copies of the agreement to be supplied or sent to the debtor or hirer. The rules vary depending on the place of signature and the manner in which the agreement is to be executed. In all these cases the same applies for debtors or hirers. For simplicity, therefore, we refer to the debtor only.

(a) If the **unexecuted** agreement is presented personally to the debtor for her signature, and at the time when she signs it the creditor has already signed, then a copy of the agreement must there and then be given to the debtor. You will appreciate that in such an event the agreement becomes valid and binding when the debtor signs. In this event no further copies of the agreement need to be given to the debtor.

(b) If the **unexecuted** agreement, already signed by the creditor, is sent to the debtor for signature, a further copy must be enclosed at the same time. The debtor then signs one (thus making the agreement executed) and returns one copy to the creditor.

(c) If the **unexecuted** agreement which has **not** been signed by the creditor is presented personally to the debtor, for her signature, a further copy must be left with her. Then, a copy of the executed agreement i.e. after signature by the creditor, must be given or sent to the debtor within **seven** days.

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(d) If the **unexecuted** agreement is sent to the debtor before signature by the creditor, likewise a further copy must be enclosed at the same time. A copy of the signed agreement must then be sent to her within **seven** days of its having been signed by the creditor.

In all cases, except where (a) applies, if the agreement is a cancellable one (see below), the copy of the executed agreement must be sent by post and not delivered to the debtor personally.

If the requirements of the Act are not complied with, the agreement can be enforced only by order of the court.

D. WITHDRAWAL AND CANCELLATION

Withdrawal

At common law, as you will remember, either party can always withdraw from an offer at any time before it has been accepted. A consumer credit agreement is no different, but frequently a prospective debtor who changes his mind will have no idea as to whom he should notify of this, or indeed that he has a right to do so. So Section 57 of the Act extends the common law in respect of prospective regulated agreements or any linked agreements by providing:

(a) That any notice given by either party to the other, whether written or oral, however expressed, that indicates an intention to withdraw, operates as a withdrawal. This ensures that the creditor (usually) cannot evade the Act by insisting on any special form of notice.

(b) That each of the following people is deemed to be the agent of the creditor or owner for the purpose of receiving a notice of withdrawal:

- A credit broker or supplier who is the negotiator in any antecedent negotiations
- Any person who in the course of a business acts on behalf of the debtor in any negotiations for the agreement.

You will remember from the previous study units on agency that notice given to an agent serves as notice to the principal. Hence the debtor can validly give notice of withdrawal to any person with whom he/she negotiated or consulted with regard to the proposed agreement.

Cancellation

Following a similar provision in the **Hire Purchase Act 1965**, the **Consumer Credit Act 1974** allows for a "cooling off" period in certain regulated agreements. The object is to allow people who may have been pressurised by a doorstep salesman into signing a relevant agreement, time to think again and cancel the agreement.

Section 67 of the Act provides that a regulated agreement may be cancelled by the debtor if any of the antecedent negotiations included false oral representations made in the presence of the debtor by any person acting as, or on behalf of, the negotiator.

In ***Moorgate Property Services Ltd v. Kabir (1995)***, a credit agreement was signed on the borrower's premises without the lending company giving the borrower notice of his right to cancel the agreement. The issue was whether oral representations had been made to the borrower for the purpose of Section 67, **Consumer Credit Act 1974**.

HELD: Such representations had been made for the purpose of the Act.

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The principal exception is that this provision does not apply if the debtor signs the agreement actually at the business premises of the creditor or owner, or any party to a linked transaction, or the negotiator in any antecedent negotiations. (A linked transaction might be, for example, for insurance or maintenance of the article covered by the agreement.)

So in effect the agreement can be cancelled only if the antecedent negotiations were carried out away from the business premises of the creditor or his/her agents. Usually, of course, such objectionable negotiations would take place at the house of the prospective debtor.

Section 64 provides that in the case of all cancellable agreements, notice must be given to the debtor of the right to cancel the agreement, and how and when this right is exercisable. That is:

- The information notice must be included in every copy of the agreement given to the debtor under Sections 62 and 63.
- If no copy is required to be given (either because the unexecuted agreement has been given to the debtor for his/her signature or because it was sent to him/her for signature) then the information notice must be sent by post to the debtor within seven days following the making of the agreement.

The cooling off period is prescribed by Section 68 as being the period in which notice of cancellation may be given by the debtor. The period commences with the time of signature of the agreement, and ends at the end of the fifth day following the day on which the debtor receives the second copy of the agreement or, if no copy is required, then after he/she receives the information notice by post.

If therefore the debtor signs the agreement on Day One, and he receives either the second copy or the information notice on Day Five, then he has until midnight on Day Ten in which to serve notice of cancellation on the creditor, supplier or agent of either.

The effect of notice of cancellation is to cancel not only the agreement but also any linked transaction e.g. for insurance or maintenance of the article covered by the agreement. The creditor is then required to refund any deposit or other moneys paid under the agreement. By the same token, obviously the debtor must return the article if he/she has possession of it: Section 72. The debtor is not under any duty to deliver goods in respect of a cancelled agreement to the creditor or supplier at any place other than his/her own premises. First, the creditor or supplier must request their return in writing; then collect them from the debtor's premises.

If goods were given in part-exchange for goods supplied under a cancelled agreement, S.73 provides for what must be done. The person who agreed to take goods in part-exchange for others is deemed by the section to be the negotiator. He/she is then bound to return the part-exchanged goods to the debtor in substantially the same condition as they were delivered. If they are not so re-delivered within a period of ten days from the date of cancellation, the negotiator is bound to pay a sum equal to the part-exchange allowance. This takes care of the situation where the negotiator has either resold the part-exchanged goods, or otherwise rendered them unfit to be returned in substantially the same condition. But the negotiator does still have a lien on part-exchanged goods for the amount of any sums due from the debtor e.g. the deposit.

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E. RIGHTS DURING THE CURRENCY OF THE AGREEMENT

We have now dealt with matters that arise up to the time when a regulated consumer credit agreement validly comes into force. The Act also controls the execution of the agreement to ensure that suppliers of credit do not abuse their position.

Variation of the Agreement

As with any contract, the parties are free to vary or to rescind a regulated consumer credit agreement by agreement between them. The parties are quite free to rescind the original agreement and substitute for it a new agreement, provided that the new agreement complies in all respects with the provisions of the Act, as if it were a totally fresh contract. Likewise, the parties can vary the agreement by mutual consent. Whether an agreement is rescinded and a new one substituted, or the original merely varied, depends on the intention of the parties. It is perhaps a fine distinction but in view of the provisions of Section 82 (see below) it is likely that a variation will not be construed as a rescission and substitution unless that is plainly the intention of the parties.

But if **under a power contained in the agreement itself** the creditor or owner varies the agreement, Section 82 regulates the matter. Firstly, no such variation can take effect until notice of it has been given to the debtor or hirer in the prescribed manner. The procedure is contained in the **Consumer Credit (Notice of Variation of Agreements) Regulations 1977**, and the principal provision is that a notice giving details of the variation must be served on the debtor (or hirer) at least seven clear days before the variation takes effect. There are two main exceptions to this:

- Under Regulation 3, banks and credit card companies who charge interest on a daily basis and who have a provision in the agreement to vary the rate of interest, do not need to give individual notice of change. Instead, they may publish the change in three daily national newspapers.
- Under Regulation 4, owners of goods under regulated hire agreements who wish to account for any changes in VAT are permitted to serve a notice on hirers having immediate effect. This applies only if the increase or decrease in charges reflects no more than the change in VAT.

Secondly, Subsection (2) of Section 82 provides that where a "*modifying agreement*" supplements or varies an existing agreement, it has the effect of revoking the earlier agreement, and substituting a new agreement reproducing the combined effect of the two agreements. Thus obligations of either party outstanding in respect of the earlier agreement are treated as outstanding in respect of the modified agreement. The form of the modified agreement must comply with all the requirements we have already discussed as applying to a new regulated agreement; that is, pre-contract disclosure, signatures, copies, cancellation rights, etc.

Appropriation of Payments

If a debtor or a hirer has two or more regulated agreements with the same creditor or owner, and he/she makes a payment which is not sufficient to discharge the amount due under **all** the agreements, then Section 81 provides as follows:

(a) He/she is entitled to appropriate the payment he/she has made to satisfy wholly or partially the sums due on any of the agreements

(b) If he/she does not make any appropriation, then the creditor or hirer must apply the sum paid to each of the agreements in proportion to the sums owing on each of them.

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For example, say a debtor has two agreements with a creditor, Agreement A with £100 outstanding and Agreement B with £200 outstanding. Without any appropriation, he makes a payment to the creditor of £60. The creditor must apportion this as to £20 to Agreement A and £40 to Agreement B.

However, this provision applies only if the agreements in question are:

- Hire purchase or conditional sale
- Consumer hire or agreements in relation to which any security has been provided.

Early Settlement

Early settlement of a consumer credit or hire agreement may arise for two reasons. First, the agreement may provide that in the event of a breach of contract by the debtor, the full amount outstanding becomes immediately payable. Second, if the debtor wishes to pay off the outstanding amount before the contract has run its full course, he/she may do so.

Prior to the **Consumer Credit Act**, there was no statutory control, and only limited common law control over the creditor's actions. If the debtor was in breach of contract, the only restriction on the creditor's right to demand full payment, including interest over the whole period, was if it was deemed to be a penalty, rather than liquidated damages. Excessive amounts contracted to be paid in the event of termination by breach have always been void as penalties: ***Bridge v. Campbell Discount (1962)***. However, in ***Anglo-Auto Finance Ltd v. James (1963)*** it was **held** that an accelerated payment resulting from a breach by the debtor was void as a penalty, unless some discount was given to reflect the fact that the creditor was receiving earlier payment than was otherwise contractually due. In the event that the debtor desired to pay off earlier than necessary, he normally had to pay the full amount outstanding, without any allowance for the fact that the interest charge should thereby be reduced.

The **Consumer Credit Act** caters for these two injustices. Section 94 gives a debtor under a regulated agreement a right to pay off the outstanding amount at any time during the currency of the agreement, by notice to the creditor. Section 95 authorises regulations to be made to provide for a rebate to be given if the indebtedness is discharged early for any reason. The **Rebate on Early Settlement Regulations** duly provide for such rebate, regardless of the reason for the early settlement.

Default by the Debtor

The Act controls the remedies a creditor or owner may exercise in the event of default by the debtor, that is, the breach by him/her of a regulated agreement. Of course, in the great majority of cases, in practice the default will consist of failure to pay, but the procedures to be outlined apply to any breach of contract by the debtor.

Before the creditor can take any action to:

- Terminate the agreement
- Demand earlier payment of any sum
- Recover possession of goods or land
- Treat any right conferred on the debtor (or hirer) by the agreement as terminated, restricted or deferred or
- Enforce any security

under Section 87 he/she must first serve on the debtor a "default notice: ***Woodchester Lease Management Services Ltd v. Swain & Co (1999)***".

The contents of the statutory default notice are laid down in Section 88. The notice must state:

(a) The nature of the alleged breach

(b) If the breach can be remedied, what action is required by the debtor, and the date by which that action must be taken

(c) If the breach cannot be remedied, the sum required as compensation, and the date by which it must be paid (the dates to be given must not be less than seven days after service of the notice)

(d) Information as to the consequences if the debtor fails to comply with the notice.

So, before any action can be taken in respect of a breach of contract, the debtor must have received specific notice of the breach and a warning of the consequences. What happens if he/she fails to heed the notice depends on the terms of the contract, but is further controlled in respect of certain types of agreement and remedy, as we shall see.

Recovery of Goods

In the case of regulated hire purchase or conditional sale agreements, where the debtor has already paid one-third or more of the total price and remains in possession of the goods, the creditor can retake those goods only by obtaining a court order: Section 90.

The creditor or owner is allowed to enter any premises for the purposes of re-taking possession of goods under such a regulated agreement only if he/she has a court order: Section 91.

Any entry on to premises in contravention of this is actionable as a breach of statutory duty.

Security

A debtor may be required to provide security as a condition of entering into a regulated agreement. Such security is defined as any "*mortgage, charge, pledge, bond, debenture, indemnity, guarantee, note or other right provided by the debtor or hirer or at his request*".

Any security given must by virtue of Section 105 be made in the prescribed form, and contain all relevant information and particulars. What the Act sets out to do is to ensure that any surety – that is, a person giving the security – is aware of what is involved, and is protected in a similar manner as is the debtor. So, all documents must contain all the terms of the security, and the surety must receive copies of all such.

If there is any breach of the regulations, Section 106 makes any security given ineffective.

Extortionate Credit Bargains

Sections 137 to 140 of the Act give certain protection to debtors against extortionate credit bargains. The court has power to re-open any credit agreement if the bargain is extortionate, in order to do justice between the parties. This power is not confined to regulated consumer credit agreements, but extends to all agreements between a debtor and a creditor where credit of any amount is given.

By virtue of Section 138, a credit bargain is extortionate if it requires the debtor, or any relative of his/hers, to make payments (either unconditionally, or in the event of any contingency) which are grossly exorbitant or if the bargain otherwise contravenes ordinary principles of fair dealing (see ***Barcabe v. Edwards (1983)*** – APR of 319%).

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The factors which the court is required to take into consideration in determining whether the agreement is extortionate are the following:

- Interest rates prevailing at the time the agreement was made
- Age, experience, business capacity and state of health of the debtor
- The degree to which at the time of making the agreement, the debtor was under financial pressure, and the nature of the pressure
- The degree of risk accepted by the creditor, having regard to the value of any security
- The relationship between creditor and debtor
- Any other relevant circumstances.

The provisions extend also to any linked transactions.

In the event that the court does find a bargain to be extortionate it is empowered to re-open the transaction and make any order it sees fit to alleviate the situation.

F. OBLIGATIONS OF THE CREDITOR IN RELATION TO THE QUALITY (ETC.) OF THE GOODS

We have dealt with the making of an agreement, the agreement itself, and rights and obligations flowing from the agreement. Now we must turn to the goods themselves, and the rights of the debtor against various parties in the event of the goods being defective or not in accordance with the contract.

Defective Goods

The **Supply of Goods (Implied Terms) Act 1973** implied into all hire purchase agreements the terms as to merchantability and fitness for purpose (now "*satisfactory quality*" under the **Sale and Supply of Goods Act 1994**), and correspondence with description and sample, that are contained in the **Sale of Goods Act 1979**. The **Unfair Contract Terms Act 1977** ensures that these implied conditions or warranties, and those as to title, cannot be excluded or restricted by any contract term.

So in other words, in relation to goods covered by the **Consumer Credit Act**, if title passes at the time of the agreement, the provisions of the **Sale of Goods Act** apply and cannot be restricted. If title does not pass until some future time in a hire purchase agreement, then the same provisions apply from the time when the hirer takes possession. Of course if the agreement is a pure leasing one, where title at no time is intended to pass to the hirer, then the question of terms implied by the **Sale of Goods Act** cannot apply. However the **Supply of Goods and Services Act 1982** serves to imply similar provisions into all contracts for the hire of goods.

Rights of Action by the Debtor – Section 75

These rights against a supplier are of value only if the supplier is solvent and in existence at the time when any claim is made against him/her. The Act endeavours to provide for this by means of Section 75, but, as we shall see, only in some situations. Section 75(1) states:

> *"If the debtor under a debtor–creditor–supplier agreement falling within Section 12(b) or (c) has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor."*

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The object, therefore, is to give an aggrieved debtor the option of pursuing a claim in respect of any misrepresentation, faulty goods, or other breach of contract against either the supplier or the creditor or both. Obviously this is potentially a very valuable right if the supplier is insolvent or has "disappeared".

However, the trouble is that the section applies only to transactions falling within Sections 12(b) or (c). The commonest forms such transactions take are connected lending agreements where the article or service is provided by the supplier and is financed by a loan from the creditor to the debtor – or, where the article or service is paid for by means of a credit card e.g. Mastercard, Barclaycard, etc. These two subsections do not apply to hire purchase, conditional sale or credit sale agreements. These transactions are debtor–creditor–supplier agreements falling within Section 12(a) (which specifically does not apply).

As will be plain, Section 75 places a very heavy burden on the creditor, usually a finance company. It has no direct knowledge of the negotiations, nor probably any expertise in the particular goods or services in question. Nevertheless it is made responsible (with the supplier) for defects etc. If, therefore, a finance company wishes to take part in this type of business, it behoves it to be very careful in checking the suppliers it uses. As a result, many of them find it preferable to make a straight loan to the debtor without specifying, or being involved with, any particular supplier. Section 75 will not then apply.

Subsection (2) provides that the creditor shall be indemnified by the supplier for loss suffered by the creditor in satisfying his/her liability under the previous sub-section. This indemnity is, for obvious reasons, of limited value. It is also probably otiose in that he/she would have this right of indemnity anyway by virtue of the **Civil Liability (Contribution) Act 1978**.

Section 75(3) further restricts the ambit of the section by excluding from it:

- Non-commercial agreements
- Agreements for a single item with a cash price of less than £100 or more than £30,000.

The lower limit is so that credit card companies especially are absolved from liability in respect of complaints from customers over relatively trivial transactions. The upper limit, apart from the fact that it would normally not be a regulated agreement anyway, is so high that it would probably have involved the debtor in getting independent advice.

Relationship between Sections 75 and 56

As we have seen earlier in this study unit, Section 56 ensures that any person who conducts antecedent negotiations with a debtor is automatically deemed to be the agent of the creditor, as well as acting in his/her actual capacity. Hence it creates a potential liability on the creditor in respect of any representations made before or at the time of the agreement. Furthermore, Section 56 applies to any regulated agreement. There is, therefore, an overlap between the two sections:

- In respect of antecedent negotiations, the creditor will be liable for the acts of his/her deemed agent, always under Section 56 and also under Section 75 if the agreement is one to which that section applies.
- In respect of the goods themselves, as opposed to representations about them, the creditor will be liable only if the transaction is one to which Section 75 applies.

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Study Unit 16

Consumer Protection

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A. INTRODUCTION

We have outlined the protection given to consumers by the **Consumer Credit Act 1974** (as amended by the 2006 Act) that is, protection in respect of certain transactions involving credit in all its various forms. However, in addition, for many years Parliament has appreciated that the common law does not provide an adequate remedy for consumers in their dealings with traders and manufacturers.

Consumers, in practice, are represented by the ordinary shopper, who has neither the knowledge nor the means of ascertaining whether goods that are offered for sale are in reality what they are claimed to be, or whether he/she is the victim of unfair practices agreed between traders, or whether the goods are in fact reasonably safe to use.

As a result, a number of Acts have been passed to regulate these matters. In general, they impose criminal liability on traders or others who infringe them, rather than providing an aggrieved consumer with a civil remedy. As a generalisation, the common law provides the remedy, whereas the consumer protection legislation deters traders and others from attempting malpractices in the first place.

B. TRADE DESCRIPTIONS ACT 1968

In the light of questions in past examination papers, it is very important that you concentrate carefully on the **Trade Descriptions Act 1968**. Make sure that you learn carefully the actual provisions of the Act, as there have been questions on its language and content. Learn also the application of the provisions in the decided cases.

The descriptions under which goods are sold, or which are applied to them for the purposes of sale, are of course covered to an extent by the **Sale of Goods Act 1979**, with which we have already dealt. But this Act and the common law associated with it, provide only a civil remedy. The **Merchandise Marks Acts 1887 – 1953** strengthened the common law mainly in respect of the tort of "passing off" as it applies to goods. We shall be examining this tort in the context of trade marks and trade names in a later study unit, but for present purposes it can briefly be described as the representation of goods etc. as those of another person. These Acts gave both a criminal and a civil remedy. They were superseded by the **Trade Descriptions Act 1968**.

The **1968 Act** is the principal statute, and it provides comprehensive consumer protection over the whole range of goods sold in the course of a trade.

Section 1

Section 1 makes it an offence to apply, in the course of a trade or business, any false trade description to goods, or to supply, or offer for sale, goods to which a false trade description is applied.

(a) "... to apply ... or to supply, or offer for sale"

You will see from those phrases that the Act does not limit liability only to, for example, the seller of goods. The producer and wholesaler of goods can also be liable for a false trade description. Liability is strict, without proof and fault being necessary, unless an adequate disclaimer of liability has been given.

In ***Tarlton Engineering Co. Ltd v. Nattrass (1973)*** a dealer sold a car with a false odometer reading. He did not know it was false nor did he vouch for it. It was **held** that he had, nevertheless, applied a false description to the car.

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(b) "in the course of a trade or business"

Since ***Roberts v. Leonard (1995)***, this is deemed to include the professions as well (in this case, a vets' practice). In ***Southwark London Borough Council v. Charlesworth (1983)*** a shoe repairer sold electric fires which came from his own home, the sale taking place in his shop. However, this was a sale in the course of business, despite its not being a sale of the kind of thing which the shoe repairer normally dealt in.

Consider the following scenario:

Ms T Conalot, a private motorist, sells her car to a motor dealer, and falsely declares that the mileage reading is genuine. The motor dealer sells the car to another private motorist, Mr Vic Timm. Who would be liable for an offence under Section 1?

Only the motor dealer offered for sale **in the course of a trade or business** goods to which a false trade description had been applied, so only he is liable under Section 1. However, Ms Conalot would be liable under Section 23 of the Act, which provides that where someone commits an offence under the Act due to the act or default of some other person, that other person is guilty of the offence.

The case of ***Olgeirsson v. Kitching (1985)***, where the facts were very similar to those in the scenario, established that the "*some other person*" referred to in Section 23 does not have to be acting in the course of trade or business.

Section 2

Section 2 of the Act defines a trade description. In short, it is an indication, direct or indirect, which relates to the quantity, size, method, place or date of manufacture, composition, fitness for purpose, strength, performance, behaviour, accuracy or past history of goods.

In ***British Gas Corporation v. Lubback (1973)*** a brochure advertising cookers stated with respect to one of them, "*ignition is by hand-held battery torch supplied with the cooker*". The cooker was supplied without the torch, which was no longer suitable for use following conversion to North Sea gas. This was an offence under Section 1 of the Act as the statement constituted a (false) trade description – it related to the composition of the goods.

On the other hand the words "*extra value*" applied by Cadbury's to a product were **held** in ***Cadbury Ltd v. Halliday (1975)*** not to be a trade description. The court found that the term did not relate to any of the matters listed in Section 2.

A mileage figure on an MOT certificate is not a trade description: ***Corfield v. Sevenways Garage Ltd (1984)***. Although a statement about mileage would fall under Section 2, as we have already seen in ***Olgeirsson v. Kitching***, an MOT certificate is not a **trade** description.

An example of an indirect indication under Section 2 is ***Queensway v. Burke (1985)***. Photographs of assembled furniture which could be bought only in kit form constituted a false trade description.

You should also note the following:

(a) Place of Origin

If goods look as if they were manufactured somewhere other than they were i.e. if their presentation does not indicate their true origin, but suggests a different one, they must be marked with, or accompanied by, a clear statement as to their place of origin, under the **Trade Descriptions (Place of Production) (Marking) Order 1988**.

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(b) Bogus Price Reductions

Bogus price reductions constitute an offence under Section 11 of the Act, as do false indications that the price at which goods are being offered is less than the recommended retail price or than the price at which the same goods were previously being offered by the same supplier. This prevents the well-known trick of "sales", whereby immediately before the sale the prices of goods were increased then at the sale the goods were displayed at the old price with a large notice saying "10% reduction".

(c) Disclaimers

Only if a disclaimer is as prominent and precise as the description which it seeks to qualify will qualification of the description be effective: ***Norman v. Bennett (1974)***. This case involved a very small notice disclaiming responsibility for odometer readings on cars offered for sale. If a notice is used to say that mileage recordings may not be accurate on cars sold, the notice must be "*bold, precise and compelling*": ***Zawadski v. Sleigh (1975)***.

(d) Advertisements

Where a trade description occurs in an advertisement, there is a presumption that it refers to all goods of the class described, whether those goods are in existence or not at the time when the advertising is done.

Section 3

Section 3 of the Act defines "false" as false "*to a material degree*". In other words, a description is false if it is untrue or misleading, and whether given orally or in writing, or in any other way.

(a) Falseness

Three cases from 1981 illustrate the element of "falseness" in false trade descriptions.

- In ***London Borough of Southwark v. Elderson Industries Ltd (1981)*** the term "cold cast bronze" was applied to statuettes which were in fact made of fibreglass and oversprayed. This is a clear example of a deliberately misleading description.
- The situation is somewhat less clear in the case of ***Ealing London Borough Council v. Warren (1981)***, where the falsity had to be determined by reference to intention. Jewellery items were variously marked "9ct", "18ct" and "PLAT". Taken together, at any rate, these descriptions could be regarded as implying that the jewellery was 9 carat gold, 18 carat gold or platinum, and since it was not, these were false trade descriptions.
- A third case of 1981 shows that a dealer's estimate as to the goods can be taken as a false description if the effect is to mislead the customer: ***Holloway v. Cross (1981)***. A car dealer bought a car with a recorded mileage of 716 miles. The true mileage was 70,000 miles. He told a customer that in his opinion the true mileage was about 45,000 miles, and he wrote this estimate on the invoice. It was **held** that the estimate given was a trade description, and the discrepancy between the estimated and the actual mileage made it false to a material degree.

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(b) Examples of individual words

Many individual descriptive words have been examined, and the following have been held to be false trade descriptions:

- "*Beautiful*" – applied to a car which looked good but was in fact unroadworthy: ***Robertson v. Dicicco (1972)***
- *"Immaculate condition"*, applied to a car which was not mechanically sound: ***Kensington and Chelsea Royal London Borough Council v. Riley (1972)***
- "*Waterproof* ", applied to a watch that was not waterproof: ***Sherratt v. Geralds (1970)***.

It is possible for a description to be regularly used in a trade, and to have achieved a significance which prevents it from constituting a false trade description within the Act. This applied to the description "*rolled gold"*, which was used by Woolworths and was **held** to be incapable of being false or misleading because it was applied by trade custom and applied also only to very cheap items. Since they were so cheap, people could not have thought them to be other than they actually were: ***Kingston-upon-Thames Royal London Borough Council v. Woolworth (F W) & Co. (1968)***.

Section 14

Section 14 of the **Trade Descriptions Act** makes it an offence in the course of trade or business:

- To make a statement which the person making it knows to be false or
- Recklessly to make a statement, which is false.

A statement made regardless of whether it is true or false shall be deemed to be made recklessly, whether or not the person making it had reasons for believing that it might be false.

This section of the Act applies to the provision of services and accommodation. Examples of offences under this section include:

- A false oral statement that a bungalow was covered by the National Housebuilders Registration Council guarantee: ***Breed v. Cluett (1970)***
- The description of accommodation as air-conditioned when it was not: ***Wings v. Ellis (1984)***.

(a) Recklessness

Dishonest intent is not required for recklessness: ***M F I Warehouses v. Nattrass (1973)***. In this case the appellants had not appreciated that their advertisement appeared to offer an item for purchase under special conditions separately from the main item they were advertising. When the purchaser ordered the item separately, they did not apply the special conditions of free carriage. Their appeal against conviction under Section 14 was dismissed.

Sunair Holidays Ltd v. Dodd (1970) is an earlier case concerning "recklessness" under Section 14 of the Act. Travel agents described all the twin-bedded rooms of a hotel as including a terrace. This was a true statement when it was made, but by the time Mr and Mrs Dodd arrived at the hotel, the twin-bedded rooms did not have terraces. Sunair Holidays successfully appealed against their conviction because the court **held** that the statement was accurate at the time it was made, and that later events could not affect the question of recklessness at the time of making the statement.

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(b) Future services

Section14 does not apply to promises of future services.

Failure to fulfil a promise to complete a building by a particular date was not an offence under Section14: ***Beckett v. Cohen (1973)***. Nor was failure to honour a ticket because airline seats had been overbooked: ***British Airways v. Taylor (1976)***.

Note also that an untrue statement that a hotel **already** has certain facilities is a false statement: ***R v. Clarksons Holidays (1972)***.

Defences (Section 24)

Liability for breach of Section 1 is strict, whereas the offence under Section 14 is committed only if the trader knows the statement to be false or makes it recklessly. However, Section 24 provides a general defence to all offences. The section provides that it shall be a defence for the supplier to prove:

- That the offence was committed due to a mistake or to his reliance on information supplied or due to the act or default of another person, an accident or some other cause beyond his control and
- That he took all reasonable precautions and exercised "*all due diligence to avoid the commission of such an offence by himself or any person under his control*".

You should note that "*Good intentions and mistakes do not by themselves constitute a defence*" – per Lord Templeman in ***Wings v. Ellis (1984)***. Thus, the defendant must prove that he comes within the scope of one of the matters mentioned **and** that he took all reasonable precautions to avoid committing the offence himself.

An interesting application of the section occurred in the case of ***Tesco Supermarkets v. Nattrass (1972)***, where a store had sold washing powder at a price different from that advertised. The court **held** that Tesco as a company was not guilty because it had to rely on the individual store manager to ensure compliance with the Act; managers had full discretion in matters of pricing. (This case should be regarded as exceptional. It arose only because Tesco is a sufficiently large company to allow individual managers considerable discretion.)

Two defences connected with Section 24 deserve special mention:

(a) Suppliers' defence (Section 24(3))

This provides that it shall be a defence for the supplier to prove that he/she did not know and could not reasonably have ascertained that the goods supplied did not conform to the description. Thus, for example, it might be considered to be unreasonable to expect a dealer to check a car's history back through all its owners.

(b) By-pass provision (Section 23)

Although not strictly a defence it does link very closely to Section 24(1), which we looked at a little earlier. You will recall the section states that where the offence was committed due to the act or default of some other person, then that person can be charged with an offence, whether or not proceedings are taken against the supplier. It has already been seen that if A commits an offence but the real culprit is B, B may be prosecuted for the offence committed by A even if A is not prosecuted. However, if no offence is committed by A, B cannot be prosecuted.

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C. FAIR TRADING ACT 1973

The legislation previously mentioned in this study unit primarily creates criminal liability for contravening the standards laid down. The **Fair Trading Act 1973**, on the other hand, is of an administrative nature; it set up a statutory body, the Office of Fair Trading (OFT), to monitor the behaviour and practices of traders and manufacturers.

The **Enterprise Act 2002** abolished the post of Director-General of Fair Trading, and set the OFT up a corporate authority consisting of a chairperson, and a minimum of four other members.

The Act sets out the OFT's general functions:

- Obtaining and reviewing material relating to its functions in relation to competition and consumer matters
- Promoting the benefits of competition to consumers
- Acting in a consultative role to Ministers or public bodies
- Promoting good consumer practice.

The Act provides a procedure whereby certain designated consumer bodies can make complaints to the OFT of practices which are deemed to be capable of causing significant harm to the interests of consumers. The Act further enables the OFT to institute Enforcement Orders against businesses in breach via the courts.

The OFT is also responsible for licensing consumer credit and hire businesses, and is also under a statutory duty to encourage trade associations to prepare and distribute to members Codes of Practice promoting consumers' interests.

Food Labelling

An EC Council Directive of 1979 was implemented in the **Food Labelling Regulations 1984**. There must be a name for the food – one required by law, or customary or sufficiently specific to indicate the true nature of the food. There must be a list of ingredients, a note of any special storage conditions and an indication of minimum durability.

Note that there are controls on labelling of:

- Medicinal products
- Animal feedstuffs.

Weights and measures are, of course, also very tightly regulated, imposing, for example, tight restrictions on the "averaging" of stated weights.

You will see that the fair trading legislation goes considerably further than the **Sale of Goods Act**. Like the **Unfair Contract Terms Act 1977**, it introduces an idea of fairness or reasonableness. The **Sale of Goods Act** provides civil remedies and the **Trade Descriptions Act** introduces penalties. The **Fair Trading Act** provides a public "watchdog"; it brought regulation in consumer matters as there had already been in restrictive trade practices for some years.

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D. CONSUMER SAFETY

General Position in Civil Law and Criminal Law

(a) Civil law

The principal civil law remedies, in the event that a purchaser suffers injury as a result of a defective or unsafe product, will be outlined later. Such remedies can arise in contract, i.e. because the supplier has been in breach of a term, express or implied, of the contract of sale; **or** they can arise in tort, as a result of a breach of a duty of care owed by the manufacturer and/or the supplier.

However, there is an additional civil law remedy where consumer safety is in question. Numerous statutes are aimed at preventing unsafe trade practices, e.g. the **Agriculture Act 1970** imposes a warranty of fitness for their purposes on the sale of fertilisers and feeding stuffs.

If the statute merely imposes a criminal penalty then that is the only sanction and an injured purchaser has no right of action **under the Act** (although he/she may have in contract or in tort). If, however, the statute confers a right of action, as does the **Agriculture Act**, then an aggrieved purchaser can bring an action for **breach of statutory duty**. This is a civil law tort, and gives rise to a remedy in damages.

(b) Criminal law

Perhaps the most effective controls on manufacturers and others in the field of consumer safety are contained in statutes imposing criminal liability. These involve a penalty of a fine or sometimes imprisonment, in the event of contravention. Some such statutes apply only to specific goods. For instance, the **Road Traffic Act 1972** makes it an offence to sell a motor vehicle in an unroadworthy condition. Others apply generally, such as the **Consumer Safety Act 1978**.

Consumer Protection Acts 1961 and 1971

In the field of consumer safety, the **Consumer Protection Act 1961** empowered the Secretary of State to make regulations in respect of the construction, design, composition, finish etc. of a wide range of classes of goods. The regulations are designed to prevent, or reduce, the risk of death or personal injury to persons using those goods. The Act made it an offence to sell, or to have in a person's possession for the purpose of sale, any goods which contravene the regulations. As well as providing a criminal penalty, the Act also created civil liability for breach of the obligations imposed by the regulations. The 1961 Act was amended by the **Consumer Protection Act 1971**.

However, these Acts were found to be inadequate for their purpose. A number of transactions which could potentially cause a risk to safety were outside the ambit of the Acts, e.g. promotional gifts, trading stamp transactions, and contracts for "work and materials". The result was the **Consumer Safety Act 1978**, which replaced the 1961 and 1971 Acts.

Consumer Safety Act 1978

The **Consumer Safety Act 1978** gives the Secretary of State much wider powers to make regulations "*for the purpose of securing that goods are safe or that appropriate information is provided and inappropriate information is not provided in respect of goods*": Section 1(1). These include the power to prohibit the sale of dangerous products and to ensure that goods satisfy specified standards and are tested or inspected in a specified manner. Regulations made under the Act thus endeavour to ensure not only that goods are properly manufactured, tested and inspected to avoid or minimise the risk of danger to health and

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safety, but also that appropriate information about the goods and how to use or handle them, is given to purchasers. Equally, irrelevant or misleading information must not be given.

To back up the Regulations, the Secretary of State is empowered to issue Prohibition Notices, forbidding either a particular person, or persons in general, from supplying specific goods which have been designated as unsafe. Notices may also be given requiring people to publish warnings in a specified way about potentially hazardous goods which they supply.

The recipient of a Prohibition Notice is entitled to make written representations within 28 days, on receipt of which the Secretary of State is required to appoint a person to consider them. No Notice can be enforced until the report of that person has been considered. Likewise, in the case of Notices to persons generally, the Notice must first be published to allow representations to be made.

The **Consumer Safety Act** provides for criminal sanctions for infringement, and also permits civil action in respect of obligations imposed by the Act.

Consumer Protection Act 1987

(a) Provisions of the Act

The **Consumer Protection Act 1987** makes it an offence to sell goods that fall below the general safety requirement, that is that the goods are reasonably safe bearing in mind the manner in which and the purposes for which they are sold.

However, concerning the issue of product safety, its importance is that **it allows anyone**, whether the direct purchaser or not, **who has suffered damage** (death, injury or damage to personal property) **as a result of a defective product to sue the producer, or importer direct**. It establishes strict liability.

The victim is not required to prove negligence. He/she does naturally have to show causal connection, i.e. that the damage happened as a **result** of the defect.

Under either the **1987 Act** or the **Consumer Safety Act 1978** regulations have been made regarding:

- Aerosols
- Dangerous substances
- Electrical appliances
- Heating appliances
- Articles in contact with food
- Oil heaters
- Children's furniture and
- Toys, among many others.

In any case, with regard to food, there are also the **Food Act 1984** and the **Food and Environment Protection Act 1985**. In these days of concern over "green" issues, there will be calls for even further control. It is already an offence under these Acts to sell food which is not of the nature, substance or quality demanded by the buyer. There are statutory controls over the sale of poisons, dangerous and toxic substances, explosives, petroleum products and medicinal products.

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(b) Defences under the Consumer Protection Act

Although the claimant does not have to prove negligence against the supplier there are, nonetheless, some defences against liability available to the supplier. The one to which you should give most attention is the defence of "**development risks"**, or "**state of the art**", as it is sometimes called.

- ***Development risks***

  The producer will not be liable if "*the state of scientific and technical knowledge at the time when he put the product into circulation was not such as to enable the existence of the defect to be discovered*": ***Abouzaid v. Mothercare (UK) (2000)***.

- ***Other defences***

  The producer will not be liable if:

  (i) He/she did not put the product into circulation

  (ii) It is probable that the defect which caused the damage did not exist when the product was put into circulation

  (iii) The product was not manufactured for sale

  (iv) The defect is due to compliance with mandatory regulations

  (v) In the case of the manufacturer of a **component**, the defect is due to the design of the **product**.

- ***Reduced liability***

  The producer's liability may be reduced or disallowed when, having regard to all the circumstances, the damage is caused both by a defect and by the fault of the injured person or anyone for whom the injured person is responsible.

(c) Prices under the Consumer Protection Act

Under Section 20(1) it is an offence to give an indication which is misleading as to the price at which any goods, services, accommodation or facilities are available. Section 22(1) extends this very clearly to "*any services or facilities whatever*".

"Misleading" includes:

- That the price is less than it actually is
- That it does not depend on certain facts when it in fact does
- That there is in fact an additional charge for something which appears to be covered by the basic price
- That there is suggested a future rise in prices which is not in fact going to happen
- A comparison with something which is then inaccurately described.

A Code of Practice under this part of the Act (Section 25) is intended to give practical guidance with regard to Section 20 requirements, and to promote desirable practices.

General Product Safety Regulations 1994

Implementing the European Union Directive on product safety, these Regulations have widened the scope of the general safety requirement of the **Consumer Protection Act 1987**. The main points of the Regulations can be summarised as follows:

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(a) Producers

Producers are required to place on the market for consumers' use only products which are safe. The term "*producers*" includes manufacturers, importers, own branders (e.g. ASDA Baked Beans), wholesalers and "*other professionals in the supply chain in so far as their activities may affect the safety properties of a product*". This last category may cover designers, carriers, packers and warehouse staff.

(b) Distributors

Distributors are required to ensure that they do not supply products which they know, or should have presumed, do not comply with the general safety requirement. "*Distributor*" is defined as "*any professional in the supply chain whose activity does not affect the safety properties of a product*". The scope of this definition is not clear, but businesses which simply pass products on to consumers and take no part in product safety control are governed by the Regulations.

(c) General safety requirement

The general safety requirement is now to be assessed in relation to the **risk that a product presents to the health and safety of persons**.

Several factors are taken into account in the level of risk:

- The product's characteristics
- Its effect on other products
- Its labelling and instructions for use
- The category of consumers at risk when the product is used.

(d) Products

The term "*product"* is given a wider definition. Specifically, a product need not be sold, or supplied in exchange for another product, and may be **new**, **used**, or **reconditioned**. Excluded are second-hand products which are antiques, and products supplied for repair or reconditioning before use when it is made clear that such products are supplied solely on that basis.

(e) Monitoring of safety

As regards monitoring the safety of products, the Regulations impose additional duties on producers and distributors. These entail the setting up of post-marketing surveillance departments and programmes for obtaining and disseminating information to consumers during the period of the product's use.

E. THE ROLE OF LOCAL GOVERNMENT

Enforcement of Consumer Protection Legislation

Responsibility for the enforcement of consumer protection legislation mainly rests with local authorities. As a general rule, consumer protection functions are performed by the principal Councils in England and Wales, the London Boroughs and Scottish Regional or Islands' Councils and the Area Trading Standards Offices of the Department of Economic Development in Northern Ireland. The former Weights and Measures Departments are now generally called Trading Standards Departments or Consumer Protection Departments and these Departments are responsible for the enforcement of most of the legislation, particularly the **Weights and Measures Act 1985**, the **Trade Descriptions Act 1968**, the criminal aspects of the **Consumer Protection Act 1987** and the **Consumer Credit Act 1974**.

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Much of the time of these Departments is devoted to supervisory activities such as statutory weighing and verification of weights and measuring apparatus, e.g. testing and stamping of petrol measuring instruments relating to retail sales or the submission of food items for public health analysis. Most Trading Standards Departments also have comprehensive programmes to advise businesses on how to comply with consumer protection legislation, as well as enforcing the law against those in business who blatantly contravene it.

It can be said that the UK is outstanding amongst the EU member states in delegating the enforcement of basic trading standards legislation to local authorities. The advantage of this is greater local accountability and sensitivity to the needs of a particular area than could be achieved through enforcement of nationwide legislation through divisional departments of central government. A disadvantage is the tendency toward uneven levels of enforcement of, and differing interpretations of, the legislation in different local authority jurisdictions. To combat this tendency, the Association of County Councils and the Association of Metropolitan Authorities agreed in 1976 to form a new co-ordinating body called the Local Authorities Co-ordinating Body on Trading Standards (LACOTS).

The principal functions of LACOTS are:

- To co-ordinate operational practice of local authorities at the technical level and ensure uniform enforcement of legislation, including in particular legislation issued by the EU
- To provide co-ordinated machinery for Trading Standards Departments in the UK to liaise with central government and with industry on relevant technical issues and
- To advise local authorities on interpretation and enforcement of specific legislation.

Consumer Advice Centres

The functions of local authorities referred to above relate to the **enforcement** of consumer protection law. In addition, the **Local Government Act 1972** and the **Local Government (Scotland) Act 1973** enable local authorities to provide **advisory services** for the general public. Some 120 Consumer Advice Centres and 300 local price survey schemes existed in 1976, financed mainly by central government grants. These Centres sought to assist consumers to secure satisfaction from complaints against retailers and other suppliers of faulty goods or services. The price survey schemes supplied pre-shopping advice primarily on the premise of price comparisons. The Centres also supplied leaflets on matters affecting consumers generally.

A change of policy occurred after the 1979 change of government. Shortly after taking office, the Minister of State for Consumer Affairs announced that cash grants from central government for Consumer Advice Centres and price survey schemes were to terminate as from April 1980, thereby saving £3.5 million annually. Citizens' Advice Bureaux were to be the preferred vehicle for this type of service to the general public and financial support to them was doubled. Such Consumer Advice Centres as now exist are financed out of local authority revenue.

Trading Standards Departments also routinely engage Consumer Advisers who are not qualified trading standards officers but hold the Institute of Trading Standards' Diploma in Consumer Affairs (DCA) and specialise in advisory rather than enforcement work.

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F. MANUFACTURERS AND PRODUCT LIABILITY UNDER THE LAW OF TORT

Despite changes in statute law, it is still necessary to consider these matters under the law of tort. If a person suffers injury, whether personal or economic, due to a defect in any article she buys, she will normally have a right of action for breach of contract against the supplier. If the defect is not in fact the fault of the supplier, he in turn has a right against **his** supplier, and so on, back to the manufacturer.

Two snags can arise. First, the manufacturer, or some intermediate party, may have inserted in the contract a valid disclaimer of liability. Second, the chain may in practice have broken because one party has ceased to exist, or is unable to settle any liability because of liquidation, bankruptcy or death.

So a claim in contract cannot always be relied upon to remedy a complaint. Furthermore, the person who is injured by the defective product may not have been the person who bought it. On account of the doctrine of privity of contract, that person has no claim in contract against the seller. This is where the law of tort comes in.

Principles of the Tort of Negligence

A tort is a civil wrong not arising out of a contract. Now a person who is injured or has suffered economic damage as a result of defective goods has suffered a civil wrong, a tort. Usually in such cases this will be as a result of "negligence" by someone or other.

Negligence can be defined as:

> *"a breach of a duty of care owed by the defendant to the complainant which has caused damage to the complainant which was reasonably foreseeable and was not too remote".*

All ingredients of the definition are necessary to found liability, but the only one we need to examine in this context is the question of a duty of care. If a person applies his/her mind to the matter before doing any act, he/she owes a duty of care to anyone who, it is reasonably foreseeable, is likely to suffer damage as a result of that act.

The question was examined by the House of Lords in the famous case of ***Donoghue v. Stevenson (1932)***. The modern law of negligence as it applies to manufacturers is largely based on this case.

What happened was that a person bought a bottle of ginger beer in a case for her friend. In those days, ginger beer was sold in opaque bottles. The friend opened the bottle and drank most of the contents. Only afterwards did she discover, in the residue, the decomposing remains of a snail. Not surprisingly, she became ill. The problem was that the claimant did not have a contract with the café proprietor, so no action for breach of contract was possible. The only redress was an action for the tort of negligence. The House of Lords **held** that as the ginger beer was sold in an opaque bottle, so that no intermediate examination was possible, the manufacturer owed a duty of care to any person who suffered injury as a result of drinking the contents.

Liability under the tort of negligence

Liability occurs where the plaintiff can prove that:

- The defendant owes him a duty of care: ***Nettleship v Weston (1971)***
- The defendant has breached his duty of care: ***Nettleship v Weston (1971)***
- There is a causal link between the defendant's breach of duty and the plaintiff's damage: ***Nettleship v Weston (1971)***

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- The damage he sustained is **not too remote** a consequence of the defendant's negligence i.e. the type of harm suffered by the plaintiff was reasonably foreseeable: ***Nettleship v Weston (1971)***.

In ***Nettleship v Weston (1971)*** the defendant, a learner driver, went out for her first lesson, supervised by a friend, the plaintiff. The defendant crashed the car into a lamp post and the plaintiff was injured. The plaintiff's claim for damages was upheld by the Court of Appeal, subject to a deduction for contributory negligence. Even learner drivers, said the Court, are to be judged against the standard of the reasonably competent driver. The fact that a particular driver is inexperienced and incompetent does not excuse his falling short of this standard. The decision may seem harsh but it can be justified both philosophically and practically. Philosophically, although it may be unfair to penalise a driver who was doing her best, it would be even more unfair if an injured victim were made to go without compensation because the driver who caused his injuries was incompetent. The practical justification was offered quite openly by Lord Denning MR: the injured person can recover damages from an insurer, only if the driver is liable in law. So the judges must see that she is liable unless she can prove care and skill of a high standard.

In this branch of the law, he went on, we are moving away from the concept "No liability without fault" to another, "On whom should the risk fall?" Morally the learner driver is not at fault but legally she is liable because she is insured and the risk should therefore fall on her.

When does the defendant owe a duty of care?

In the intervening years, the principle in ***Donoghue v. Stevenson*** has been widely extended by the courts. The point that a manufacturer's liability for negligence is independent of contract and is owed to the ultimate consumer, was endorsed in ***Lee Cooper Ltd v. C H Jeakins & Son Ltd (1967)***. Furthermore, a claimant who does have a contract with a manufacturer or supplier of faulty products has the option of suing for breach of contract or for negligence. This was brought out in ***Batty v. Metropolitan Property Realisations Ltd (1978)***.

That the possibility of intermediate examination of the goods is no longer a bar to effective action was established in ***Clay v. A J Crump & Sons Ltd (1964)***. An architect and a demolition contractor left a wall standing in a dangerous condition on a building site which was being cleared. Later, the managing director of the building contractors, who were to develop the site, inspected the wall, but failed to discover its dangerous condition. In due course the wall collapsed. It was **held** that although the building contractors were jointly liable, the architect and the demolition contractors were not relieved of their liability by reason of the examination by the builders.

Hence, a manufacturer now owes a duty of care to all consumers of his products. If it is reasonably foreseeable that injury or damage is likely to be occasioned by his carelessness, he will be liable for any lack of reasonable care. This liability was extended to users of the products, rather than merely consumers, by ***Grant v. Australian Knitting Mills Ltd (1936)***, where the claimant got dermatitis through wearing a garment which had not been properly washed during manufacture.

The ***Donoghue v. Stevenson*** principle applies not only to manufacturers and manufactured goods, but also to the following:

- Containers and labelling of containers and goods: ***Kirbach v. Hollands (1937)***
- Hire purchase transactions: ***Andrews v. Hopkinson (1957)***
- Probably, free samples supplied by a manufacturer: ***Hawkins v. Coulsdon and Purley UDC (1954)***
- Erectors and assemblers of articles or structures: ***Dutton v. Bognor Regis UDC (1972***); also, in ***Brown v. Cotterill (1934)***, a monumental mason was liable when a

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gravestone he had erected toppled over; and in ***Malfroot v. Noxal Ltd (1935)*** an assembler who negligently fitted a side car to a motor cycle was held liable when it came off.

- Distributors: in ***Watson v. Buckley Osborne, Garret & Co. Ltd (1940)*** distributors of a hair dye advertised it as safe, without having made any tests. They were liable when a customer's hair was damaged.

When will the defendant be in breach of his duty of care?

It is for the plaintiff to show that the defendant has acted in breach of his duty of care. Defendants will be in breach of duty if they have not acted reasonably or if they have failed to act when they had a duty to do so. The standard of care varies in each situation but as a general rule, the standard of care is that of a reasonable person who uses ordinary care and skill. Whether or not a breach of duty has occurred is a question of fact.

Factors which the court will take into account in deciding whether there has been a breach of duty include:

- ***The degree of risk involved***

  In deciding what precautions to take, the hypothetical "reasonable person" (whether engaged in a skilled activity or not) will take various factors into account. These may include the degree of risk, the seriousness of the consequences if an accident does happen and the cost and practicality of guarding against the risk in question:

  In ***Latimer v. AEC (1953)*** a factory floor was flooded in a thunderstorm. The defendants had sufficient sawdust to cover 90% of the floor. The plaintiff slipped on the part, which was still slippery and his ankle was badly injured. It was argued that the defendants should have closed the factory. The plaintiff was unsuccessful. The House of Lords **held** that the defendants had done all that a reasonable person would do in the circumstances; they could not have eliminated the risk completely without closing the factory. The defendants had not failed to exercise reasonable care and so were not liable for the subsequent accident.

- ***Seriousness of harm if the risk materialises – the vulnerable claimant***

  While no account is generally taken of the peculiarities of the defendant, apart from his or her age, the peculiarities of the claimant are commonly relevant. If the claimant is known to be particularly vulnerable for any reason, this is a relevant factor in determining the appropriate level of care:

  In ***Paris v Stepney Borough Council (1951)*** the plaintiff, was a garage mechanic, who had lost the sight of one eye during the war. In order to loosen a stiff bolt he struck it with a hammer; a piece of metal flew off and (because he was not wearing goggles) struck him in his good eye, causing him to become totally blind. The probability of such an event was very small but its consequences were very serious and the House of Lords held that his employers, knowing of his disability, should have taken extra care to provide goggles for him. The more serious the possible damage, said Lord Morton, the greater the precautions that should be taken.

- ***Experts are expected to demonstrate the same high standard of care as other experts in the same field***

  The classic statement of the test of negligence in a situation which involves the use of a special skill or competence is the direction to the jury of McNair J in ***Bolam v. Friern Hospital Management Committee (1957)*** where it was stated that: "The test is the standard of the ordinary skilled man exercising and professing to have that special skill. *A man need not possess the highest expert skill at the risk of being found negligent…it is sufficient if he exercises the ordinary skill of an ordinary competent man exercising that particular art."*

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Establishing a causal link: the 'but for' test

Having proved that the defendant owed him a duty of care and was in breach of that duty, the claimant must finally prove that the defendant's breach of duty caused him some loss or damage. I.e. there must be a causal link between the defendant's breach of duty and the plaintiff's damage. No link = no liability for negligence. The claimant must show it is more likely than not that had the defendant not been negligent his injury or damage would not have occurred. If the injury would (probably) have happened anyway, or if it was (probably) caused by something other than the defendant's negligence, the claim will inevitably fail. Causation in fact is often established by applying the 'but for' test. If harm caused to the claimant would not have occurred 'but for' the defendant's negligence then that negligence is the **cause** of the harm it is not necessarily the 'cause' because there may well be other events which are causally relevant i.e. if the loss would have occurred in any event, the defendant's conduct is not the cause:

In ***McWilliams v. Sir William Arrol & Co Ltd (1962)*** the plaintiff, a steel erector, fell 70 feet to his death at work. The defendant had failed to provide a safety harness for their employees.

Whilst the defendants were held to be in breach of their statutory duty to ensure the plaintiff's safety, they were able to supply evidence to show that even if they had provided a safety harness, the plaintiff would not have worn it. In relation to liability for the plaintiff's death the court held that the firm's negligence and breach of statutory duty were not the cause of his death.

The plaintiff can only claim for damage, which is not too remote

The law also requires that the kind of damage actually caused by the defendant to the plaintiff be reasonably foreseeable; this is not hard to justify because even the most reasonable person cannot be expected to guard against a risk that cannot be foreseen. Where damage of a particular kind could not reasonably have been foreseen, it is sometimes said to have been "too remote". Damage is only recoverable if it is not too remote i.e. a defendant is only liable for damage that a reasonable person should have foreseen:

In ***"The Wagon Mound" (No. 1) (1961)*** a vessel took on bunker oil in Sydney Harbour. Owing to the negligence of the crew, a quantity spilled in the water. The wind carried the resulting oil slick across a creek to a ship repair yard opposite. A welder happened to be working there on a ship under repair and a spark from the welding operation fell on to some cotton waste floating on the water below. A serious fire resulted. It was held (by the Privy Council) that it was not reasonably foreseeable that a spark could ignite heavy fuel oil floating on the water. Hence, although the ship owners were liable for the foreseeable damage caused by oil fouling slipways, etc., they were not liable for the damage caused by fire.

However, it is the kind of damage that must be foreseeable and not its exact nature or extent. If some damage was a foreseeable result of the defendant's negligence, he is liable for all damage of that kind even if it was more serious than anyone could have foreseen:

In order for his claim to be successful the plaintiff must prove that on the 'balance of probabilities' that it is the defendant whom is 'liable' for his injuries.

Careless Statements Causing Damage

It is not only manufactured articles negligently made, or work negligently performed, which can found liability in tort. A person who makes a negligent statement can also cause damage to a consumer or, for that matter, any other person. Liability for careless statements where a duty of care is owed was established in ***Hedley Byrne & Co. Ltd v. Heller & Partners Ltd (1964)***. In that case, an advertising agency sought a credit reference for a

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new client from its bank. The agency's bank wrote to the client's bank, who replied with a favourable reference. However, it did add a rider to the effect that the reference was given "*without liability*". On the strength of this reference, the agency extended credit. Shortly afterwards, the client company went into liquidation. The House of Lords **held** that the client's bank owed a duty of care to anyone who it was reasonably foreseeable would act on the strength of the reference. However, the bank was saved from liability by reason of its disclaimer of liability.

The following rule was laid down by the House of Lords:

(a) A duty of care will be owed where a special relationship exists

(b) The special relationship will arise where:

- A person possessing special skill offers advice to another
- That other person relies on the advice and
- It is reasonable for that advice to be relied on (i.e. the advisor must know, or ought to have known, that the advice would be relied on).

In ***Esso Petroleum Co. Ltd v. Mardon (1975)*** it was stated that a duty could arise where the advice was given outside the ordinary course of the advisor's business, provided that it was given in a "*business context*". It appears to be an accepted principle that there will be no liability for advice given on purely social occasions, but many social occasions can take on a business character, e.g. the round of golf with a major client, the business lunch, etc.

Limits

In general, for a person to be liable for the tort of negligence he/she must have been careless i.e. he/she must have been at fault. There are exceptions to this, and where liability is imposed without fault, it is called "**strict liability**". You need not concern yourself with this aspect of the law of tort but very briefly it arises in two ways:

(a) At common law

Under what is called the rule in ***Rylands v. Fletcher***, a person who brings on to his/her land something which is dangerous, and is not naturally there, is strictly liable if that thing escapes and causes damage. The classic example which occurred in ***Rylands v. Fletcher (1868)*** was water escaping from an artificial reservoir. The principle has been extended to, e.g. fire, electricity, gas and explosives.

(b) By statute

Certain statutes impose strict liability: for example, under the **Health and Safety at Work Act 1974**, a manufacturer is strictly liable for damage caused by moving machinery which is not properly guarded. People who operate nuclear plants and assemblies are strictly liable for the escape of radioactive material.

However, apart from strict liability, the law of tort imposes limits on the extent of liability for negligence. In the first place, the damage caused by a negligent act must be of a type which was reasonably foreseeable as highlighted above. Furthermore it should be noted that, the standard of care that the law requires a manufacturer to exercise is not absolute. He/she is required to exercise only that care that a reasonably competent and proficient person carrying out the relevant work would exercise. The highest possible standard is not required.

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Study Unit 17

Negotiable Instruments 1: Bills of Exchange

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A. INTRODUCTION

In the last two study units of the course we will be considering the law relating to negotiable instruments, with particular reference to bills of exchange and cheques. The term "negotiable instrument" encompasses a wide variety of documents, e.g. bank notes, promissory notes, dividend warrants and exchequer bills. We will not consider these separately, because much of the law relating to bills of exchange applies equally to such instruments. Before we look closely at the law, you should note that any document is capable of being called a "negotiable instrument" as long as the following conditions are met:

- The holder of the instrument may sue in his/her own name
- Title to the instrument must pass on delivery, or on delivery and endorsement
- A "holder in due course" takes the instrument free from the defects in title of his/her predecessors.

Negotiable instruments are an essential part of a business-orientated society because of the ease with which they can be transferred from one person to another. We are all familiar with at least one type of negotiable instrument – the cheque – and we will be looking at the specific requirements of the **Cheques Act 1957** later on. However, first we must look at bills of exchange and the **Bills of Exchange Act 1882**. All references apply to this Bill.

B. CHARACTERISTICS OF A BILL OF EXCHANGE

As we have already seen, the law ascribes certain privileges to the holder of any negotiable instrument and because of this it is important to be able to establish whether or not the document concerned in a dispute is a negotiable instrument. We have seen that a bill of exchange is recognised as a negotiable instrument so all that we require, therefore, is a strict definition of what constitutes a bill of exchange.

Definition

Section 3 of the 1882 Act defines a bill of exchange as:

> *"An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer."*

The following example of a bill of exchange will be useful to you.

£77.50 London, 30 April 2008

Sixty days after date, pay to the order of Tom Jones the sum of seventy seven pounds and fifty pence for value received.

J Brown

To: W. Watts
10 Bunhill Road
London EC1

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Note the various parties:

- J Brown is the **drawer** of the bill
- W Watts is the **drawee** of the bill, and he has also become the **acceptor** by writing his name across it
- Tom Jones is the **payee** of the bill.

Important Terms

- The order to pay must be **unconditional**. For example, if the drawer stipulates "provided the balance in my account amounts to £100", this is not a bill of exchange since there is a condition imposed. If the bill orders payment to be made out of a particular fund, this is invalid as it is conditional on the fund being adequate to meet the bill, but if the drawee says "pay the bill and debit" a particular fund, this is in order since the acceptor can allow an overdraft.
- The instrument must be in the form of an **order**. To say "I shall be pleased if you will pay ..." is not an order but a mere request, but the expression "please pay ..." is a polite order.
- The instrument must be **in writing**. This includes print and typewriting, and also writing done with a pencil, though the latter is clearly undesirable, as it is open to fraudulent alteration.
- The instrument must be **signed** by the drawer, i.e. the person who makes out the bill of exchange. However, a person's "signature" can be put to a bill by his/her agent.
- The instrument must be an order **to pay**. If the instrument orders any act to be done in addition to the payment of money, it is not a bill of exchange.
- It must be to pay **a sum certain in money**. An order to pay "all moneys due" is not a bill of exchange but if the bill is drawn for a certain amount "plus interest" this will be a valid bill. If the rate of interest is not otherwise stated, it will be taken as 5%.
- Payments may be expressed to be made **on demand**. This means that the bill must be met when the holder presents it for payment, whenever that might be: "on sight" or "on presentation" are comparable expressions in this context. Note that, where no time for payment is expressed in the bill, it will be treated as **payable on demand**.
- Instead of being payable on demand, it may be payable **at a fixed or determinable future time**, e.g. "three months after date" i.e. after the date of the bill, or "thirty days after sight" i.e. after it is presented to the drawee for acceptance, the drawee being the person to whom it is addressed or "drawn". This maturity date of the bill may be fixed by reference to the occurrence of some event and this will be valid, provided the event is something that is **bound** to happen, e.g. "three months after I die"; if the event is not certain to happen e.g. "three months after I marry" the bill will be invalid, and the occurrence of the event will not make it valid.
- Payment may be expressed to be made **to bearer**, which means that the acceptor must pay the sum stated to whoever is the holder of the bill when it is duly presented for payment, i.e. the bill specifies no particular payee.
- It may be payable **to, or to the order of, a named payee**, in which case the drawer will have named the payee in the bill; but she can pass on the bill to someone else if she endorses it to this effect.

Note the following points concerning **payees**:

(i) A bill not payable to "bearer" must indicate the payee with **reasonable certainty** or it will be inoperative.

(ii) Where the payee is a fictitious or non-existent person, the bill may be treated as **payable to bearer**; this point will be considered further in a later study unit.

(iii) A bill may be drawn payable to two or more payees **jointly**, or it may be drawn payable to one of two (or several) payees **in the alternative**.

(iv) A bill drawn in favour of the **drawer him-/herself** will be a valid bill, e.g. making a cheque out to "Cash" or "Self". A bill drawn payable to the drawee will also be in order, e.g. when making payment to a creditor by credit transfer, you can give your bank a cheque for the amount instead of handing over cash.

(v) A bill may be drawn payable to the holder for the time being of a **particular office**.

(vi) A bill drawn for "Cash", usually a cheque, will generally be treated as **payable to bearer**. Strictly speaking, it is not a valid bill at all, and the acceptor may require the endorsement in blank of the holder.

The following points about **drawees** should also be noted:

(i) Where the drawer is a fictitious person, or a holder not having the capacity to contract, the holder may treat it there and then as **dishonoured**: Section 41. Section 5 provides that, where the drawee is a fictitious person or a person not having the capacity to contract, the holder may treat the instrument, at his/her option, either as a **bill of exchange** or as a **promissory note**.

(ii) Where the drawer and drawee are the same person, again the bill may be treated as either a **bill of exchange** or a promissory note.

(iii) Where the drawee is not indicated with reasonable certainty, but someone "accepts" it, the instrument may be treated as a promissory note: ***Mason v. Lack (1929)***.

(iv) A bill may be addressed to two or more drawees jointly, but an order to **alternative drawees** will not constitute a valid bill and will be of no effect.

C. ACCEPTANCE

Definition and Use

The term "acceptance" used in relation to bills of exchange has a special meaning. In common parlance, a person to whom something is given takes or accepts that thing, but you should be careful to avoid this use of the word when talking about bills of exchange.

Acceptance of a bill of exchange is the signification by the drawee that he accepts **the order of the drawer to pay over the sum stated to the payee**. As we have already mentioned, a bill of exchange is used by a debtor to settle his account with a creditor but it being an **order** to someone else to pay the sum stated, as opposed to a **promise** by the drawer to pay, the creditor is not normally going to take the bill of exchange in settlement unless the drawee acknowledges that he will meet the bill and,in addition, is a person of substance; until he does make such acknowledgement, the drawee is under no liability on the bill.

In practice, the bill is normally handed to the payee to present it to the drawee for acceptance. If the drawee agrees to pay the bill, he will sign his name across it, and by that act he accepts the liability to meet the bill when it is duly presented for payment.

You may, at this stage, ask why a third party should undertake to pay a bill of exchange drawn by a debtor to settle an account with a creditor. The answer is simply that the person drawing the bill will have an arrangement with the drawee to reimburse the cost of any bills met.

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This, of course, leads one to the question, why go through this procedure of drawing a bill of exchange instead of the creditor just waiting for the debtor to pay? The answer to this is that, by using a bill of exchange, the supplier can send the debtor goods on credit even if she is not sure of the latter's credit status, because before she releases the goods she receives this document, accepted by a person on whose credit she knows she can rely. Nowadays, bills of exchange are most commonly used in international trade and are drawn on bankers. You will appreciate how useful an arrangement is that allows goods to be sold on credit to someone the seller has never heard of, and against whom she would have great difficulty in bringing an action for recovery of the debt.

There are also other advantages in that there is a market for the "discounting" of bills, so that the creditor can receive immediate cash (for a charge, by way of interest), but this need not concern you here.

Technicalities of Acceptance

(a) Presentment for acceptance

Although a bill must be presented for acceptance and accepted by the drawee, to render the latter liable on the bill, it is not in fact **necessary**, as a general rule, for the holder of a bill to present it for acceptance. He/she can hold on to it, unaccepted, until maturity, or negotiate it to a third party, although a bill that has not been accepted will in practice be much harder to pass on for value.

The only occasions when the Act actually stipulates that the bill **must** be presented for acceptance are:

(i) Where the bill is payable a certain period "after sight". In this case, the bill must be presented for acceptance in order to **fix the maturity date**

(ii) Where the bill **expressly stipulates** that it shall be presented for acceptance

(iii) Where the bill is drawn payable **elsewhere than at the residence** or place or business of the drawee: Section 39.

In the case of (i), Section 40 of the Act qualifies the above, in that the holder of a bill payable "after sight" need not present it for acceptance if he/she is able to negotiate it to a third party within a reasonable time of its coming into his/her hands. But if he/she fails either to present the bill for acceptance or to negotiate it within a reasonable time, then the drawer and all endorsers prior to the holder will be discharged from liability

(b) Requirements of valid presentment

The Act lays down the following requirements for a valid presentment for acceptance:

- The presentment must be made **by or on behalf of the holder to the drawee** or some person authorised to accept or refuse acceptance on his/her behalf
- Presentment must be at **reasonable hour**, on a business day, and before the bill is overdue
- Where the bill is addressed to two or more drawees, who are not partners, presentment must be made to **them all**, unless one has authority to accept for all, in which case presentment may be made to him/her alone
- Where the drawee is dead, presentment may be made to his/her **personal representative**
- Where the drawee is bankrupt, presentment may be made to **him/her or to his/her trustee**

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- Where authorised by agreement or usage, a presentment through the **post office** is sufficient.

(c) Requirements of valid acceptance

For an acceptance to be valid, it must:

- Be written on the bill and be signed by the drawee: the mere signature of the drawee without further words is sufficient
- Not express that the drawee will perform his/her promise by any other means than the payment of money: Section 17.

Acceptance is incomplete and revocable and does not bind the acceptor until the bill has been delivered – that is to say, handed back to the person presenting it, with the signature of acceptance on it.

In ***Baxendale v. Bennett (1878)*** the defendant received from H a draft in blank as to the drawer's name, written in H's handwriting. The defendant wrote his name across the draft as acceptor and sent it to H who, finding he did not need it, returned it to the defendant. The defendant placed it in an unlocked drawer in his chamber in the Temple, from which it was taken. When it came into the hands of the claimant, a bona fide holder for value, the document had been completed by the insertion of the name of W Cartwright as the drawer. No such person as Cartwright was known to the defendant, and the name was inserted without his knowledge or consent.

HELD: The defendant was not liable on the document, as, although he had accepted it, he had not delivered it.

Dishonour by Non-acceptance

If the drawee is not prepared to meet the bill, he will return it to the holder with a note to this effect, and the bill is then said to be **dishonoured by non-acceptance**. The holder then knows that the debtor has given him a valueless scrap of paper, and will commence proceedings against him (the debtor, the drawer of the bill, not the drawee) to recover his **debt**. Technically, such action is not an action on the debt but an action on the bill, for in drawing the bill the drawer "*engages that on due presentment it will be accepted and paid according to its tenor and that if it is dishonoured he will compensate the holder*": Section 55(1)). However, this need not worry you for the moment. The position of the holder of a dishonoured bill is dealt with in the following study unit.

In certain circumstances, the bill can be treated as dishonoured by non-acceptance without ever having been presented for acceptance; these circumstances are where:

- The drawee is dead or bankrupt
- The drawee is a fictitious person
- The drawee is a person not having the capacity to contract
- After the exercise of reasonable diligence, such presentment cannot be effected
- Although the presentment has been irregular, acceptance has been refused on some other ground.

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Qualified Acceptance

It may be that the drawee is prepared to accept the bill but only subject to some modification. Any acceptance that varies the effect of a bill as originally drawn is termed a qualified acceptance. A qualified acceptance may be any of the following:

(a) Partial

An acceptance to pay only part of a bill, e.g. a bill drawn for the amount of £5,000 may be accepted for £4,000 only.

(b) Local

An acceptance to pay the bill only at a certain place; the acceptor stipulates that he/she will pay the bill at this place only and nowhere else.

(c) Conditional

An acceptance to pay the bill only on fulfilment of a certain condition e.g. an acceptance to pay the bill on delivery of the bills of lading.

(d) Qualified as to time

An acceptance say to pay a bill drawn payable after one month, only after six months.

(e) Acceptance by some only of several drawees

This is self-explanatory. Note, however, that a bill may be drawn on joint drawees and, if both accept, payment may be demanded of either of them.

An acceptance will be construed as general unless clearly qualified, the acceptance being construed most strongly against the acceptor: ***Smith v. Vertue (1860)***.

If the holder of the bill takes such a qualified acceptance, this has the effect in most cases of discharging from liability all prior parties to the bill except in so far as any prior party consents to the holder taking such qualified acceptance. Such consent will be implied if the holder gives notice of the qualified acceptance and the prior party does not object. In the case of a partial acceptance, prior parties are discharged only if the holder fails to give notice that he/she has taken the qualified acceptance. They have no right to object thereto.

On the other hand, the holder of a bill who is offered only a qualified acceptance is entitled to reject it and to treat the bill as dishonoured by non-acceptance.

Acceptance for Honour

Where a bill is dishonoured by non-acceptance, the holder of the bill may allow any other person to accept it in place of the drawer. The acceptance for honour must:

- Be written on the bill and indicate that it is an acceptance for honour **and**
- Be signed by the acceptor for honour.

The effect is that the acceptor for honour becomes liable to pay the bill.

D. TRANSFER OF BILLS OF EXCHANGE

Manner of Transfer

One of the features of bills of exchange is that where A gives B a bill accepted by X in settlement of her debt, this same instrument may be passed on by B to C in settlement of a debt between them – both B and C relying on the credit of X.

A number of formalities are laid down for the legal assignment of rights under a contract (one type of "chose in action", but not a negotiable instrument). For example, written notice of the

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transfer must be given to the debtor, and even for equitable assignment, notice has to be given to him/her. In the case of bills of exchange and other negotiable instruments, no such formalities are necessary and the debtor need not even be informed. The transfer of a negotiable instrument is termed "negotiation", and Section 31 of the Act provides as follows.

- A bill is negotiated when it is transferred from one person to another in such a manner as to make the **transferee the holder of the bill**
- A bill payable to bearer is negotiated **by delivery**
- A bill payable to order is negotiated by the **endorsement of the holder completed by delivery**.

Transfer of the instrument in this way is enough to vest the property represented thereby in the transferee, and no further formality is required.

Note that where an order bill is transferred without the endorsement of the transferor, the transferee is entitled to call for the missing endorsement to complete his/her title. Until this is done he/she holds the bill subject to any defence that could be raised against the transferor, and the endorsement will not cure any defect in the transferor's title of which the transferee had notice before the endorsement was obtained: ***Whistler v. Forster (1863)***.

The following points should be noted on the question of endorsement:

(a) The endorsement must be written **on the bill itself** (usually on the back) and be signed by the endorser: Section 32. It usually consists of the words "Please Pay ..." (then the name of the endorsee) followed by the signature of the endorser. The simple signature of the endorser on the bill, without additional words, is sufficient and is called an endorsement "in blank".

(b) An endorsement should **always correspond with the drawing**. In ***Slingsby v. District Bank Ltd (1922)*** it was **held** that a bill payable to "AB per X" must be endorsed "AB per X" and not "X". (Where the endorsee's name is incorrectly spelled, the **incorrect** spelling should be endorsed.)

(c) An endorsement **cannot purport to split the bill**. If the endorser directs that only part of the bill is to be payable to the endorsee, or that the bills to be paid to two or more endorsees severally, the endorsement is inoperative

(d) Where the bill is payable to two or more payees or endorsees, not being partners, **all must join** in the endorsement.

(e) No endorsee is specified in an **endorsement in blank**, and a bill so endorsed becomes payable to bearer: Section 34(1).

(f) A "special" endorsement **specifies the person** to whom or to whose order, the bill is to be payable: Section 34(2).

Note that a bill drawn payable to order can be changed into a bearer bill by the holder endorsing "in blank". A bill drawn payable to bearer cannot be specially endorsed – but a bill bearing an endorsement "in blank" can be converted back to an order bill by the holder adding the name of a particular person to the last (blank) endorsement.

(g) A "restrictive" endorsement is one which **prohibits further negotiation** of the bill. If a holder endorses a bill "pay AB only", this operates to destroy the negotiability of the bill so that no person taking the bill thereafter can be a "holder in due course". Indeed it appears that such endorsement operates to prohibit further **transfer** of the bill, so that no person taking a bill so endorsed will obtain a title to it even if the transferor's title was perfectly in order.

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Transferee's Title: "Holder in Due Course"

The position of the transferee of a bill of exchange depends to a large extent on whether or not he/she is a "holder in due course". We shall first examine the statutory definition of a holder in due course, and then see in what ways this position is peculiar.

(a) Definition of "holder in due course"

Section 29 of the Act states:

> *"A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, namely:*
>
> *(i) That he became the holder of it before it was overdue and without notice that it had been previously dishonoured, if such was the fact.*
>
> *(ii) That he took the bill in good faith and for value and that at the time the bill was negotiated to him, he had no notice of any defect in the title of the person who negotiated it."*

***You need to learn this definition**.*

Let us now examine the definition in detail:

- **Holder**: the Act defines a holder as "the payee or endorsee of a bill who is in possession of it, or the bearer thereof".
- **Complete** bill: a person who takes an inchoate bill before it is completed cannot be a holder in due course.
- **Regular** bill: a bill must meet the requirements of the statutory definition, and all endorsements must be there.

  In ***Arab Bank v. Ross (1952)*** a bill of exchange had been drawn in favour of "F & F N Co". This bill was then endorsed by one of the partners of "F & F N".

  HELD: The endorsement was irregular, therefore the transferee (the holder of the bill) could not be a holder in due course, i.e. the bill was not complete and regular on the face of it. The transferee could, however, be a holder for the value.
- **Before it is overdue**: a person taking a bill of exchange after maturity cannot be a holder in due course.
- **In good faith and without notice ... of dishonour ... or defects of title**. If there was any suspicion when the holder took the bill, he/she will not be a holder in due course unless he/she took reasonable steps to allay these suspicions. On the other hand, in ***Raphael v. Bank of England (1855)***, the holder was **held** to be a holder in due course, although actual notice had been received of a defect in the transferor's title, since at the time of taking the instrument the holder had forgotten the notice and took the instrument in good faith.
- **For value**: to be a holder in due course, the holder must have given consideration for the bill. Two points should be noted here:

  (i) As with the general law of contract, the consideration given must be of some "positive" value but need not be of equivalent value. The Courts will, however, take into account inadequacy of consideration in deciding whether or not the holder took "in good faith".

  (ii) Contrary to the general law of contract, past consideration will be acceptable to constitute a holder as a holder in due course. The Act provides that: "*Valuable consideration for a bill may be constituted either by*

any consideration sufficient to support a simple contract or by an antecedent debt or liability": Section 27(1).

Further points to note in relation to a holder in due course are:

- Subsequent to a **forged endorsement** being put to a bill, no one taking the bill thereafter can be a holder in due course
- If a **restrictive endorsement** is put to a bill, no one taking the bill subsequent thereto can be a holder in due course
- **The original payee** of a bill cannot be a holder in due course as the bill has not been negotiated to him/her: see statutory definition, ***R E Jones Ltd v. Waring & Gillow Ltd (1926)***.

(b) Rights of a holder in due course

A holder in due course enjoys the following rights:

- She holds the bill free of prior defects
- She can pass on this perfect title to a subsequent transferee
- She can sue on the bill in her own name.

We shall now consider each of these points in detail.

(i) Right to hold free of prior defect

As we saw when we were dealing with the sale of goods, the general rule of English law is expressed in the maxim *nemo dat quod non habet* (no one may give that which he does not possess). This means that when a person transfers property to another person, the transferee cannot obtain any better title to that property than the transferor possessed. The same rule applies to choses in action, since they are a form of property. However, bills of exchange (and in fact, all negotiable instruments) constitute **an exception** to this rule, provided the circumstances of the transfer are such that the transferee qualifies as a holder in due course, in which case he/she holds the bills free from prior defects of title affecting the transferor. Note, however, that where an endorsement has been forged, no one taking the bill subsequently can be a holder in due course, so a perfect title cannot be passed on.

(ii) Right to pass on this perfect title

Once a bill of exchange has come into the hands of a holder in due course, not only does that person hold the bill free of prior defects of title (free of "equities") but any such defects of title are in effect "wiped off" the instrument. Any subsequent transferee will also hold the bill free of equities, even if she herself did not give value or receive notice of the defects of title when taking the bill.

(iii) Right to sue in her own name

In the event of a bill of exchange being dishonoured, the holder of the bill will seek redress. In taking action on the bill, the holder is entitled to sue on the bill in her own name. She has an absolute right of action, without reference to prior parties.

In the case of other choices in action, the position varies somewhat according to whether or not the right assigned is a legal or equitable right and whether transferred by legal or equitable assignment but in some cases the holder is required to join the assignor to the action.

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Holder other than Holder in Due Course

The holder of a bill of exchange who does not come within the statutory definition of a holder in due course holds the bill subject to prior equities and his/her title may be upset if the title of a prior holder was defective. He/she does have remedies against intervening parties, but the general rule of "*nemo dat quod non habet*" applies.

However, the foregoing must be qualified in that where the bill has been endorsed by a holder in due course after the defect of title arose, any person holding the bill thereafter will not be affected by the defect and will enjoy a perfect title to the bill.

E. METHODS OF DISCHARGE

A bill will be discharged as follows:

(a) By **payment in due course**

To be "in due course", payment must be:

- To the holder
- Bona fide, and without notice of any defect in the title of the holder
- On or after maturity.

(b) By the **acceptor becoming the holder** thereof, provided he/she does so after maturity and in his/her own right.

(c) By **waiver by the holder of his/her rights against the acceptor**, provided such waiver is absolute and unconditional, made on or after maturity and made in writing or else accompanied by delivery of the bill to the acceptor. Note that no consideration is required for such waiver.

(d) By **cancellation of the bill by the holder**, such cancellation being intentional and apparent on the face of the bill.

F. LIABILITY OF PARTIES ON THE BILL

Statutory Responsibilities

Every person who has put his/her name to a bill of exchange, whether as drawer, acceptor or endorser, is a "party" to the bill, and as such will be liable on the bill in the event of its being dishonoured. **The Bills of Exchange Act** provides:

> *"The acceptor of a bill, by accepting it, engages that he will pay it according to the tenor of his acceptance": Section 54(1).*
>
> *"The drawer of a bill, by drawing it, engages that on due presentation it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder, or any endorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken": Section 55(1)(a).*
>
> *"The endorser of a bill, by endorsing it, engages that on due presentation it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder, or a subsequent endorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken": Section 55(2)(a).*

It will thus be seen that any person who puts his/her signature to a bill of exchange will be liable to compensate the holder of the bill in whose hands the bill is dishonoured, or any subsequent party who may be compelled to pay it.

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Conversely, the holder of the bill can, in the event of its being dishonoured, claim on the bill against any prior party, who in turn can sue any other prior party.

The holder can elect whether he will sue the immediate prior endorser or any other previous party. If he fails to secure redress from the party he first elects to sue, he can sue any other party liable. In practice, since the party sued can himself claim against any prior party, the various sections will be joined into one. Ultimately, of course, the acceptor will be liable, but if he has disappeared or cannot meet his liability, then the drawer will have to bear the loss, and if he cannot be found or cannot meet the bill, then the earliest endorser able to meet it will have to do so, and will be unable to obtain redress for himself.

In relation to the liability of parties and this "course of action", the following points should be noted.

Order of Endorsements

Endorsements will be deemed to have been made in the order in which they appear on the bill, unless the contrary is proved. Note, however, the case of ***Macdonald v. Whitfield***, in which three directors of a company endorsed a note together by way of surety for the company's debt. It was **held** that the three were liable equally to the holder and that the first of the three directors to sign the note was under no liability to the others.

Capacity

The Act provides that "*capacity to incur liability as a party to a bill is co-extensive with capacity to contract*": Section 22.

A corporation cannot render itself liable on a bill if to do so would be "*ultra vires*" (outside the powers of the particular corporation). As regards infants, it was **held** in ***Re Soltykoff (1891)*** that an infant is not liable on a bill either as acceptor, endorser or drawer, even though he has given it for the price of necessaries supplied. He may, however, be liable on the original contract.

The Act specifically provides that the intrusion onto a bill of a person not having the capacity to incur personal liability does not alter the rights of the holder against other parties to the bill.

Signature by Agent

Where an agent signs the bill clearly on behalf of another person, and is acting within the scope of his authority, then the agent will incur no personal liability and the principal will be liable. However, if the agent does not clearly show that she is signing on behalf of a principal, even if she adds to her signature words that describe her as a type of agent, she will be personally liable. Distinguish "for and on behalf of J Jones, B Smith" and "B Smith, Secretary".

Where a bill of exchange is signed by an agent on behalf of her principal, the person taking the bill is "on enquiry" to satisfy himself that the agent is acting within the scope of her authority, and if she is in fact acting without authority, the principal will incur no liability, even against a person who would otherwise be a holder in due course.

Signature by Firm

The Act provides that:

(a) "*Where a person signs a bill in a trade or assumed name, he is liable thereon as if he signed it in his own name*." John Smith may carry on his business under the name of "The Corner Shop" and he may sign all his bills in this fashion but nevertheless, he is personally liable on them.

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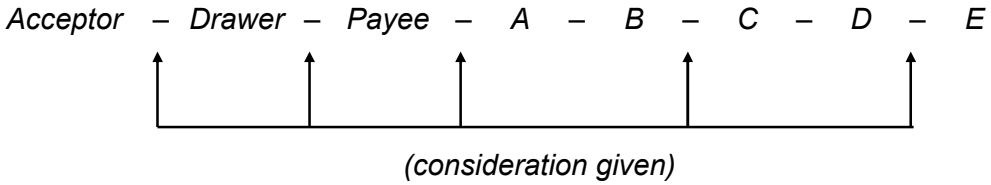
(b) The signature of the name of a firm by the person so signing is equivalent to the signature of the names of **all persons liable as partners of that firm**. In the case of a trading firm each person has *prima facie* authority to endorse or accept bills of exchange on the firm's behalf. If the bill gets into the hands of a holder in due course, the presumption of authority becomes absolute and the firm will be bound, whether the endorsement or acceptance was given for partnership purposes or not. In the case of a non-trading firm, however, the ordinary rules of agency apply and the firm will not be bound unless the partner was authorised to sign.

Consideration

It is not necessary that the holder of a dishonoured bill seeking to obtain redress from a prior party would have given consideration. However, consideration must have passed for the bill at some stage between the party to be sued passing on the bill and the holder receiving it. Thus, if the holder did not himself give consideration, he cannot sue the person from whom he received the bill but if the latter gave consideration for the bill, the holder can sue any prior party. Conversely, a prior holder of the bill who negotiated it to another person without consideration cannot be sued by that person but if the bill has been negotiated further and any of these subsequent transferees gave value, then that person and any subsequent holder can sue, even against the party who negotiated the bill, without receiving consideration.

Example



- E can sue any prior party
- D cannot sue C – but she can sue B and any prior party (including A, in which case we would have the situation of a person who did not give consideration suing a person who did not receive consideration!)
- C can sue any prior party
- B cannot sue A, but can sue the payee, drawer or acceptor.

So, bills of exchange provide an exception to the general rule that "consideration must move from the promisee". Two other features of consideration, already discussed, may conveniently be noted here:

(a) An **antecedent debt or liability** will constitute valid consideration. This is an exception to the general rule that "past consideration is no consideration"

(b) The law does not take account of the **adequacy** of the consideration given. This conforms with the general law of contract.

Section 27 of the Act effectively defines the term "*holder for value*" as follows:

> *"Where value has at any time been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time."*
>
> *"Where the holder of a bill has a lien on it, arising either from contract or by implication of law, he is deemed to be a holder for value to the extent of the sum for which he has a lien."*

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The first part of this definition has been explained. An example will make the second part clear. If a bank has bills of £500 pledged to it as security against an overdraft of £300, then the bank is a holder for value to the extent of £300 ("*to the extent of the sum for which [it] has a lien*").

Note also that, when a banker discounts a bill, he becomes a holder for value of that bill. On the other hand, when a customer lodges bills for collection with his banker, the latter is not a holder for value but merely an agent charged with the duty of collecting the bills, and may exercise his right of lien.

Accommodation Bills

An accommodation bill is drawn, accepted and put into circulation without any consideration passing.

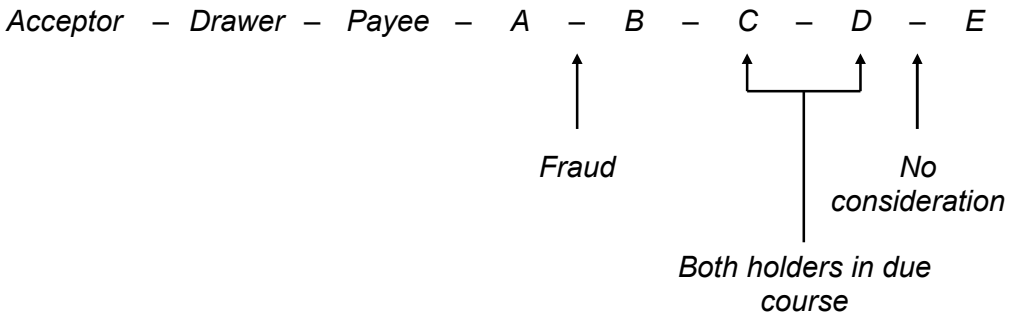
An accommodation party to a bill is a person who has signed a bill as drawer, acceptor or endorser, without receiving value therefore and for the purpose of lending his/her name to some person.

An accommodation party is liable on the bill to a holder for value; it is immaterial whether, when such holder took the bill, he/she knew such party to be an accommodation party or not.

Defects of Title

As we have already seen, a holder in due course takes the bill free of prior equities and can pass on a perfect title to a subsequent transferee, so that any person claiming through a holder in due course is unaffected by defects of title attaching to the bill prior to the holder in due course taking it. Thus, if a person obtains a bill by fraud, so that her title to the bill is defective, in the event of her presenting the bill for payment and being refused, she cannot sue any prior party on the bill but if she endorses the bill to a person who qualifies as a holder in due course, then that person and subsequent holder can sue all prior parties, regardless of the defect of title.

Example



- E cannot sue D but can sue all prior parties, including A (from whom the bill was obtained by fraud), even though he is not himself a holder in due course.
- C can sue all prior parties.
- B cannot sue anyone, because of the fraud.
- If E sues A and prior parties are insolvent, A can sue B on the tort of conversion or deceit (as the case may be) but cannot sue C or any subsequent party, because C is a holder in due course.
- If E presents the bill for acceptance and the acceptor pays in due course, everyone is happy except A but A still has the right of action in tort against B.

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- If the current holder of the bill is not a holder in due course and the bill has not passed through the hands of a holder in due course, the position will be somewhat different. E, on being refused payment by the acceptor, will not be able to sue any prior parties on the bill since he will have no title to the bill and will have to surrender it to A. However, he will be able to sue B, C or D for "breach of warranty of title", provided he gave consideration for the bill and had no notice of the defect of title. If B is insolvent and C has to pay, C will have to bear the loss as he cannot sue in conversion because he had no better title to the bill than later parties.
- A, on recovering the bill, will either renegotiate it or hold it until maturity and then present it for payment. If, in the latter case, the bill is dishonoured, he will be able to sue any prior parties on the bill, or (if they are all insolvent) he will be able to sue any subsequent holder for conversion, with any person so sued having an action back down the line to B for breach of warranty of title.

This may sound very complicated but try to follow it with the following three major points in mind:

(a) There can be three types of action involved:
- **Down** the line "on the bill"
- **Down** the line for breach of warranty of title
- **Up** the line in the tort of conversion.

(b) No action will be against a holder in due course, or any party claiming through such a person, since he/she has a **good title** to the bill.

(c) The final result should normally be that the loss falls on the person **responsible for the fraud**, or the first person taking after him/her who can meet the liability, but the intervention of a holder in due course can upset this.

G. RELEASE FROM LIABILITY

As we have said, any person who has put his/her name to a bill, in whatever capacity, will be liable to any subsequent holder in whose hands it is dishonoured or who has had to meet the bill. However, in certain circumstances a person who has put his/her name to a bill may be released from liability.

Cancellation of Endorsement

Where the holder of a bill intentionally cancels the endorsement of any prior party, provided such cancellation is apparent on the face of a bill, that party and all intervening parties will be absolutely discharged from liability. It is not necessary that consideration should be given for such cancellation for it to be effective: Section 63(2).

Failure to Present Bill for Acceptance or Payment

Where the holder of a bill payable after sight fails either to present it for acceptance or to negotiate it within a reasonable time, the drawer and any prior endorsers are discharged from liability: Section 40.

Where the holder of a bill fails to present it for payment on the date it falls due, the drawer and any prior endorsers are discharged from liability: Section 45.

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Holder Taking Qualified Acceptance

Where the holder of a bill takes a qualified acceptance, any prior party who does not assent thereto (or in the case of a partial acceptance, any prior party to whom notice is not given) is discharged from liability on the bill: Section 44.

Failure to Give Notice of Dishonour

Where a bill is dishonoured, either by non-acceptance or non-payment, any person (other than the acceptor) to whom notice is not given will be discharged from liability. An exception is that, in the case of dishonour by non-acceptance, the rights of a subsequent holder in due course (and any person claiming through him/her) will not be affected: Section 48.

Renunciation of Rights by Holder

The holder of the bill may, absolutely and in writing, renounce his/her rights against any party to the bill. Such renunciation will be effective but the party in question will remain liable on the bill to any subsequent holder in due course without notice of the renunciation: Section 62.

Negotiation Back

If a bill is negotiated back to the drawer or a prior endorser, all intermediate parties are discharged from liability vis-à-vis that holder. This is a very limited "release" and the reason for the provision is simply that otherwise there would be circuity of action: Section 37.

*Endorsement "*Sans Recours*"*

This is not strictly a case of release from liability, in that a person so endorsing the bill never incurs liability on it. The addition of the words "*sans recours*" to an endorsement has the effect that no action of the bill can be taken against that party. Obviously, a holder will find it much harder to persuade someone to take the bill from her if she insists on so exempting herself from liability.

Alteration of Bill

Where a bill or acceptance is materially altered without the assent of all parties liable on the bill, the bill is discharged except as against

- The party who has him-/herself made, authorised, or assented to the alteration and
- Subsequent endorsers.

The alteration must be intentional and not accidental.

H. LIABILITY "OUTSIDE" THE BILL

Any person through whose hands a bill of exchange passes, but who does not put his name to it, cannot be made liable on the bill. However, he may incur liability other than on the bill by way of breach of warranty of title. Thus, the transferee of a bearer bill who passes it on without endorsement cannot be liable on the bill as he is not a party thereto but in passing on the bill, he is deemed to have warranted to the transferee that he has a good title to the bill. If, therefore, the title to the bill was defective and the transferee has to reimburse a subsequent holder, he will in turn be able to sue the transferor on this breach of warranty.

However, it should be noted that liability in this case is limited to the immediate transferee, who must have given consideration for the bill.

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I. FORGERIES

Effect of Forged Signature

Where an endorsement on a bill of exchange has been forged, no person taking the bill thereafter can acquire a good title to it. Thus there can be no holder in due course after a forged endorsement and the bill cannot be discharged: Section 24.

The person holding the bill, including the acceptor if he/she has "met" the bill, must surrender it to the person whose endorsement was forged. The only redress of the holder is to sue for breach of warranty of title but there must be consideration between the parties to support such action and the line ends with the forgery, so that the person who took the bill immediately after the forgery will be left with no redress, except against the person responsible for the forgery, if he/she can be found.

In ***Kreditbank Cassel v. Schenkers Ltd (1927)*** Schenkers had a business which he carried on in London, having also a branch in Manchester. Schenkers left a manager, X, in charge of the Manchester branch. X without authority drew a number of bills of exchange on Schenker's behalf, signing them "X, Manchester manager". As the bills had been dishonoured, Kreditbank, a holder in due course, attempted to sue Schenkers as drawer.

HELD: As X drew the bills without authority, they amounted to forgeries; therefore, Schenkers was not liable to Kreditbank for the dishonour.

The person whose signature was forged, on recovering the bill, can present it for payment, and if the acceptor defaults she can sue prior parties on the bill. She has a further remedy in that in the event of none of the prior parties to the bill being able to pay, she can sue any person who took the bill subsequent to the forgery in the tort of conversion.

Example

Acceptor – Drawer – Payee – A – B – C – D – E

X steals the bill and forges B's endorsement to pass the bill to C

- B can reclaim the bill from E and present it for acceptance.
- If the acceptor pays, E will sue D, who will sue C – in each case, for breach of warranty of title, and in each case subject to there being consideration between the parties. C will sue X, if he can be found.
- If the acceptor fails to pay, B can sue A or the payee or drawer of the bill. If A has to pay, she can recover from the payee or drawer. Meanwhile, E having had to give up the bill, action will lie back along the line for breach of warranty of title.

Although in general the forgery of the signature of a party to a bill will thus invalidate the bill for subsequent holders, we may note here that the forgery of the drawer's signature as drawer (unlike a signature as payee by way of endorsement, if the bill is payable to drawer's order) has no effect on the bill.

Where a person signs his/her own name as agent of the payee, but without his/her authority and with intention to defraud, this will constitute a forgery of the payee's signature.

Note also that it is not possible to ratify a forged signature, though an unauthorised signature not amounting to a forgery may be ratified.

In ***Brooke v. Hook (1871)*** A forged H's signature to a promissory note for £20. Before the note matured, the holder discovered that H's signature was a forgery and threatened to prosecute A. To prevent a prosecution, H gave the holder a memorandum to the effect that he held himself responsible for the note for £20 bearing his signature. It was **held** that the ratification was invalid and that H was not liable on the note.

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Fictitious Payee or Endorsee

An interesting point arises where a bill may be drawn payable to or endorsed in favour of a fictitious or non-existent person. On the face of it, the attachment to the bill of the "signature" of this "person" would constitute a forgery and no party taking the bill thereafter would acquire a title to the bill. In fact, the Act provides that in such a case the bill may be treated as payable to bearer, and, since in this case no endorsement is required, the "forged endorsement" is superfluous and ineffective, and will be disregarded.

Where the drawer of a bill is induced by fraud to sign it but the person named therein as the payee is non-existent in that the drawer knows no one of that name, then the bill will be treated as a bearer bill: ***Clutton v. Attenborough (1897)***. But where the payee named in the bill is someone known to the drawer, though the bill is fraudulently prepared, this is not a case of fictitious payee, and the forgery of such payee's signature will be operative as a forgery.

In ***Vinden and Rogers v. Hughes (1905)*** cheques were drawn by a fraudulent clerk payable to actual customers for sums, which were not in fact owing. As the principal who signed the cheques actually intended that the named payees should have the money, those payees were **held** not to come within the definition of "fictitious or non-existing persons".

If the drawer's signature is forged in order to obtain the acceptance of the drawee and the payee's signature is then forged, this will again come under the heading of fictitious payee on the grounds that the "drawer" never intended the payee to receive payment. In ***Vagliano Brothers v. The Bank of England (1891)*** the Vagliano Brothers were in the habit of dealing with two clients whom we will call "A" and "X and Co." A dishonest clerk in the employ of Vagliano Brothers forged the signature of A and brought to his employers, for signature as acceptors, bills purporting to be drawn by A payable to the order of X and Co. The clerk obtained the acceptance of Vagliano Brothers and then forged the endorsement of X and Co. The bills were subsequently presented by the clerk to the Bank of England for payment and as the acceptances were genuine, the bills were paid by the Bank. The first point considered by the Court was that the endorsement of the payee was forged and upon this ground the Bank of England would not have been able to charge Vagliano Brothers with the amount of the bills. However, the defence was raised that as it had never really been intended that the payee, X and Co., should obtain the money and their name had been inserted by way of pretence only, it was a fictitious payee, the bills consequently being payable to the bearer. On this ground the Bank of England was successful in its claim and was permitted to charge the bills to the account of the claimants, Messrs.Vagliano Brothers.

J. DISHONOUR OF A BILL

A bill may be dishonoured either by non-acceptance or by non-payment.

We have already examined the question of acceptance and have seen that if the holder of a bill presents it to the drawee for acceptance and is refused, then he/she may treat the bill there and then as dishonoured. In the previous study unit we noted the requirements for valid presentment, the requirements for valid acceptance and the circumstances where presentment may be dispensed with.

Even if the drawee does accept the bill and undertakes to pay it when it falls due, he/she may in fact fail to meet it when presented for payment. Here, too, the bill is dishonoured.

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Requirements for Valid Presentment

- The presentment must be made by the **holder** or by some person authorised to receive payment on his behalf.
- Presentment must be at a **reasonable hour**, on a business day, and before the bill is overdue.
- Presentment must be made to the person designated by the bill as **payer**, or to some person authorised to pay or refuse payment on his behalf.
- Presentment must be made at the **place specified**, if any; otherwise at the address of the acceptor, if shown; otherwise at his business address, if known; and, if not, at his residence, if known. If none of the aforementioned addresses is known, the presentment can be made to the acceptor wherever he can be found, or at his last known place of business or residence.
- Where the bill is drawn on, or accepted by, two or more persons who are not partners, and no place of payment is specified, presentment must be made **to them all**.
- Where the acceptor is dead, and no place of payment is specified, presentment should be made to the acceptor's **personal representative**.
- Where authorised by agreement or usage, a presentment through the **post office** is sufficient.

Excuses for Non-presentment for Payment

In certain circumstances, the bill can be treated as dishonoured by non-payment:

- Where, after the exercise of reasonable diligence, **presentment cannot be effected**
- Where the drawee is a **fictitious person**
- As regards a **drawer**, where the drawee or acceptor is not bound as between him-/herself and the drawer to accept or pay the bill and the drawer has no reason to believe that the bill would be paid if presented
- As regards an **endorser**, where the bill was accepted or made for the accommodation of that party, and he/she has no reason to expect that the bill would be paid if presented.

Notice of Dishonour

On a bill being dishonoured, either by non-acceptance or by non-payment, the holder must at once give notice of the dishonour to all prior parties if he/she is to have any rights against them.

The following points should be noted regarding the notice to be given:

- Notice may be given either by the **holder or by any endorser** who, at the time of giving such notice, was him-/herself liable on the bill.
- The notice may be given **verbally or in writing**. The return of a dishonoured bill to the drawer or an endorser is itself a sufficient notice of dishonour, but normally the holder should state how the bill has been dishonoured and for what reason.
- The notice must be given within a **reasonable time** of the bill being dishonoured. Normally, notice must be actually communicated or posted on the day that the bill is dishonoured or the day after, but failure to meet this time may be excused if caused by circumstances beyond the holder's control: ***The Elmville (1904)***.

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In ***Eaglehill Ltd v. J Needham Builders (1972)*** a notice of dishonour posted prior to actual dishonour, which arrived after such time and was false in its information, that a bill **had been dishonoured** at the time of posting, was transformed in the Court of Appeal into a valid notice as its message was a true statement of the facts upon arrival. The notice is taken to speak from when it is opened in the ordinary course of business, or would be opened if the ordinary course of business was followed.

- Where a notice of dishonour is **duly addressed and posted**, it will be effective even if never delivered to the addressee.
- If the **holder gives notice** to any party, that party will be liable to anyone else between himself and the holder if the latter elects to sue the more immediate party. If the holder gives notice to party D but does not give notice to party C (who became a party to the bill before D), then D should himself give notice to C as soon as he is himself given notice, if he is to be able to sue C in his turn; in such event, the notice given by D to C will enable the holder to sue C direct.

Where Notice Is Unnecessary

Notice of dishonour may be dispensed with in certain circumstances, as follows:

(a) As regards any party, where:
- After the exercise of reasonable diligence, **notice cannot be given** or does not reach the party
- Notice is **waived** by the party.

(b) As regards any endorser; where:
- The drawee is a fictitious person, or a person not having the capacity to contract, and the endorser was aware of this fact at the time he/she endorsed the bill
- The endorser is the person **to whom the bill was presented for payment**
- The bill was accepted or drawn from the **accommodation** of the endorser.

(c) As regards the drawer, where:
- The drawer and the drawee are the **same person**
- The drawee is a **fictitious person**, or a person not having the capacity to contract
- The drawee is the person **to whom the bill is presented for payment**
- The drawee or acceptor is, as between him-/herself and the drawer, **under no obligation** to accept or pay for the bill
- The drawer has **countermanded payment**.

K. CONSEQUENCES OF DISHONOUR

Noting and Protesting

"Noting" and "protesting" of a bill occur in the event of a bill of exchange being dishonoured.

Noting the bill is the making of a minute by a Notary Public who has to present the bill either at the acceptor's office, if it is made payable there, or if made payable at a bank, to that bank and obtains the answer given for non-payment of the bill. Then she affixes to the bill a slip of paper which has briefly typed (or written) on it the fact that she presented this bill to "..." and that it was dishonoured by non-payment with answer (specified). She then appends her signature and affixes a stamp, this being the stamp required on a notarial document.

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Protest is more formal than noting; in fact, it is a more elaborate execution of noting procedure. A protest must contain the following:

- An **exact copy** of the bill
- A **statement of the parties** for whom and against whom the bill is protested
- The **date and place** of the protest
- A statement that **acceptance of payment was demanded** by the notary, the terms, if any, of the answer, or a statement that no answer was given or that the drawee or acceptor could not be found
- A **reservation of rights** against parties liable
- The **subscription and seal** of the notary.

It is not normally necessary to have an inland bill noted or protested on dishonour. However, when a foreign bill is dishonoured it must at once be noted and protested, to preserve recourse against the drawer and endorsers (this brings the English legal position into line with numerous foreign systems which make protesting essential). The bill must be noted on the actual day of dishonour, but the protest may be completed subsequently. If a foreign bill is noted and protested on dishonour, the drawer and prior endorsers are discharged from liability on the bill.

In every case, of course, notice of the dishonour must be given to all prior parties.

Where a dishonoured bill is required to be noted and the services of a notary cannot be obtained at the place where the bill is dishonoured, Section 94 of the 1882 Act provides that "*any householder or substantial resident of the place may, in the presence of two witnesses, give a certificate, signed by them, attesting the dishonour of the bill, and the certificate shall in all respects operate as if it were a formal protest of the bill*". This is known as a "householder's protest", and a form of certificate to be given is provided in Schedule 1 to the Act.

Referee in Case of Need

The drawer of a bill and any endorser may put on the bill the name of a person to whom the holder of the bill may resort in the event of the bill's being dishonoured.

The holder has the option whether or not he/she will obtain payment from the referee in case of need, but if he/she does so the bill must be noted before action is taken.

When the drawer of a bill refuses to accept a bill of exchange, some other person may step in and offer to accept the bill in his/her place for the honour of the drawer or an endorser.

This can be done only if the following conditions are satisfied:

- The **holder agrees** to such acceptance
- The bill is not **overdue**
- The person accepting "for honour" is **not already a party** to the bill
- The bill is first **noted and protested**.

The acceptance must show clearly that it is an acceptance for honour and should indicate the person for whose honour it is accepted. If no person is named, it is presumed to be for the drawer's honour.

The acceptor for honour agrees that she will, on due presentment, pay the bill according to the tenor of her acceptance if it is not paid by the drawee, provided that it has been duly presented for payment, and protested for non-payment and that she receives notice of these

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facts. She is liable to the holder of the bill and to all parties to the bill subsequent to the party for whose honour she has accepted.

If an acceptor for honour pays, her rights are as those of a payer for honour (see below).

When a bill is dishonoured by non-payment, any person may intervene and pay it *supra* protest for the honour of any party liable thereon. Before such payment is made, the bill must be noted and protested and the protest must be attended by a declaration on the part of the person making payment that he is paying the bill for honour and for whose honour he is paying.

Where the bill is paid for honour in this way, all parties subsequent to the party for whose honour the bill is paid are discharged but the person making payment for honour is subrogated to the holder i.e. stands in his place, with the same rights and duties, as regards the party for whose honour he has paid and all prior parties liable to that party.

Measure of Damages

In the event of a bill being dishonoured, the holders and in turn, every other party to the bill who is compelled to pay it, may recover from any preceding party liable:

- The **amount** of the bill
- **Interest** by way of damages, such interest to be calculated from the date of presentment for payment if the bill is payable on demand, and from the date of maturity of the bill in any other case
- The **expenses of noting** (and if necessary) protesting the bill.

L. INCOMPLETE BILLS AND ALTERATIONS

Incomplete (Inchoate) Bills

It is possible for a bill to be drawn incomplete, leaving the holder to fill in the amount payable.

So long as he/she does so within the terms agreed, there is no problem, but the holder may fraudulently complete the bill by inserting an excessive amount. In such a case, the holder will not be able to enforce the bill in any amount against anyone who became a party to it prior to its completion, except that if the bill is negotiated to a holder in due course after completion he/she can enforce the bill **in the full amount shown** against any prior party: Section 20.

A blank, stamped piece of paper may be signed and given to someone for it to be completed as a bill. So long as the intention is there, the holder can fill in all the particulars of the complete bill and the position is as described above.

Where a bill expressed to be payable a fixed period after date is issued undated, or where the acceptance of a bill payable a fixed period after sight is undated, the bill is similarly incomplete. However, the bill is not invalid and the holder has authority to insert the true date of issue or acceptance him/herself.

Where the sum payable is expressed both in words and in figures and there is a discrepancy between the two, the sum denoted by the **words** is the amount payable.

An incomplete bill may be transferred from one person to another, but no person taking the bill in this form can be a holder in due course. A bill that has not yet been accepted, however, is not an incomplete bill within this context.

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Altered Bills

When a bill is materially altered, all prior parties are at once discharged from any liability whatsoever on the bill (even the original amount) unless they assent to the alteration. However, exception is made where the alteration is not apparent on the face of it and the bill is in the hands of a holder in due course, who may enforce it against those persons who became parties to the bill before the alteration, **according to the original tenor of the bill**: Section 64.

An example of this would be where a bill is altered in a non-apparent manner from £50 to £500 and then comes into the hands of a holder in due course; the latter would be able to enforce payment of the original amount of £50.

Persons who become parties to the bill after the alteration will be liable for the full amount of the bill.

The Act lists the following alterations as material: alteration of the date, the sum payable, the time of payment, the place of payment; and, where a bill has been accepted generally, the addition of a place of payment without the acceptor's assent.

Note the following cases.

- ***Koch v. Dicks (1933)***: The defendant accepted seven bills of exchange purported to be drawn in London and which, when handed to the drawers, were complete inland bills. The payee endorsed the bills to the claimant, who converted them into foreign bills by altering the place where they were drawn from "London" to "Deisslingen". The alteration was made without the defendant's knowledge or consent. It was **held** that the defendant was not liable on the bills as the alteration was material and the bills were void under Section 64 of the Act.
- ***Gerrard v. Lewis (1883)***: This case concerns a signed acceptance with the amount not filled in the body of the bill, but with the following figures in the margin: £14. 0s. 6d. The bill was handed to the drawer in that state. The drawer, having filled up the bill for £164. 0s. 6d. fraudulently altered the figures in the margin to that sum. The bill was endorsed over to the claimant. It was **held** that the defendant was liable **for the larger amount** as the marginal figures were not a material part of the bill and as the person entrusted with such acceptance in blank had authority to fill in the bill as he pleased, within the limits of the stamp. This was, therefore, an instance of **fraudulent completion**.
- ***Hong Kong and Shanghai Banking Corporation v. Lo See Shi (1928)***: It was **held** that where the erasure of the number of a bank note is due to accidental mutilation there is no material alteration sufficient to void the bill.

Lost Bills

The Act states:

> *"Where a bill has been lost before it is overdue, the person who was the holder of it may apply to the drawer to give him another bill of the same tenor, giving security to the drawer, if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again.*
>
> *If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so": Section 69.*

As it is possible that the lost bill may get into the hands of some person who takes it innocently, it is possible under certain circumstances for the drawer to be called upon to pay both the original and the duplicate instrument. He should, therefore, satisfy himself before

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he issues a duplicate that the original is in fact lost or destroyed and, in addition, ensure that adequate security is granted to him against the eventuality.

Overdue Bills

We have already discussed overdue bills, but it may be convenient to summarise the position here.

- A bill **must be presented for payment** before it is overdue, or the drawer and all prior endorsers will be discharged from liability. The acceptor, however, remains liable, as too does any person who puts his/her name to the bill after the date of maturity.
- No person taking a bill **after its date of maturity** can be a holder in due course, and any such person will take the bill subject to any defects of title affecting the bill at its maturity. However, if there is a holder in due course who puts his/her name to the bill before maturity, all defects of title that arose prior to his entry on the bill remain inoperative.

A bill is overdue:

- In the case of a bill payable "on demand", when it has been in circulation for **more than a reasonable length of time**. What is a reasonable time is a question of fact to be determined in each case.
- In the case of a bill payable on a fixed or determinable future date, *prima facie* **on that date**. Prior to the coming into force of the **Banking and Financial Dealings Act 1972**, three "days of grace" used to be added to the due date. However, this Act, which redefined the days of Bank Holidays, stated that all bills due for payment on a Bank Holiday shall be deemed to be complied with if paid on the following day, provided that it is not a Saturday, Sunday, or a Bank Holiday. This had the effect of abolishing days of grace.

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Study Unit 18

Negotiable Instruments 2: Cheques

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A. INTRODUCTION

In this study unit we will be considering the law relating to cheques. Remember that a cheque is merely one form of negotiable instrument. It is being considered separately because there are special rules relating to banks and their customers. There are also slight differences which we must note between a cheque and a bill of exchange.

B. THE NATURE OF A CHEQUE

General Comparison with Bills of Exchange

The statutory law relating to cheques is mainly contained in the **Bills of Exchange Act 1882** and the **Cheques Act 1957**.

Section 73, **Bills of Exchange Act 1882**, defines a cheque as:

> *"A bill of exchange drawn on a banker, payable on demand."*

Note the two special requirements for a cheque:

- It must be drawn on a banker
- It must be payable on demand.

Although cheques are a special type of bill of exchange, and the Bills of Exchange Act applies to cheques, there are a number of important points of difference:

(a) Because of the contractual relationship between banker and customer, there are a number of **special obligations** on these parties

(b) The **rules relating to acceptance do not apply to cheques**; the banker on whom the cheque is drawn never "accepts" it, so that the drawer is the party primarily liable on the instrument

(c) There are special provisions for the **crossing** of cheques which do not apply to ordinary bills of exchange

(d) Special statutory protection is given to bankers in relation to **forged endorsements**.

In practice, cheques are rarely used in the way of bills of exchange as negotiable instruments. The vast majority of cheques are presented for payment by the person to whom they are initially given and negotiation of a cheque is comparatively rare. In effect, cheques are generally used merely as a directive by the drawer to his/her bank to transfer money from an account to the account of the payee.

It may be convenient here to indicate diagrammatically the normal course of a cheque.

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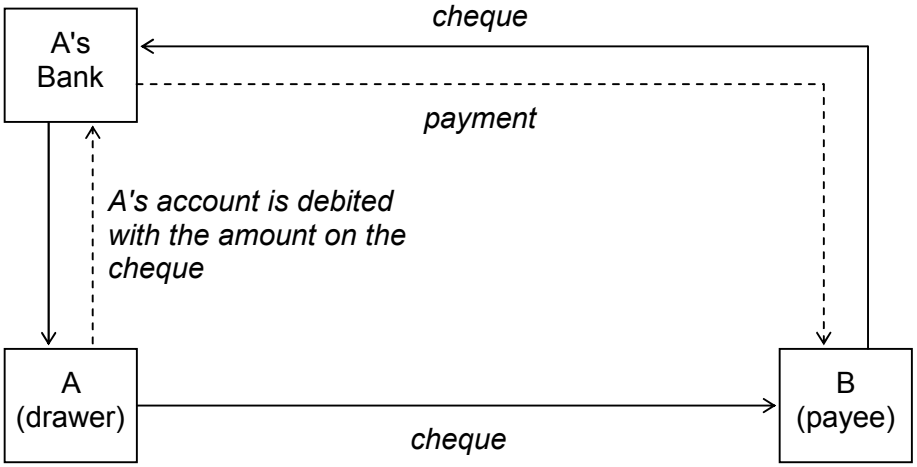
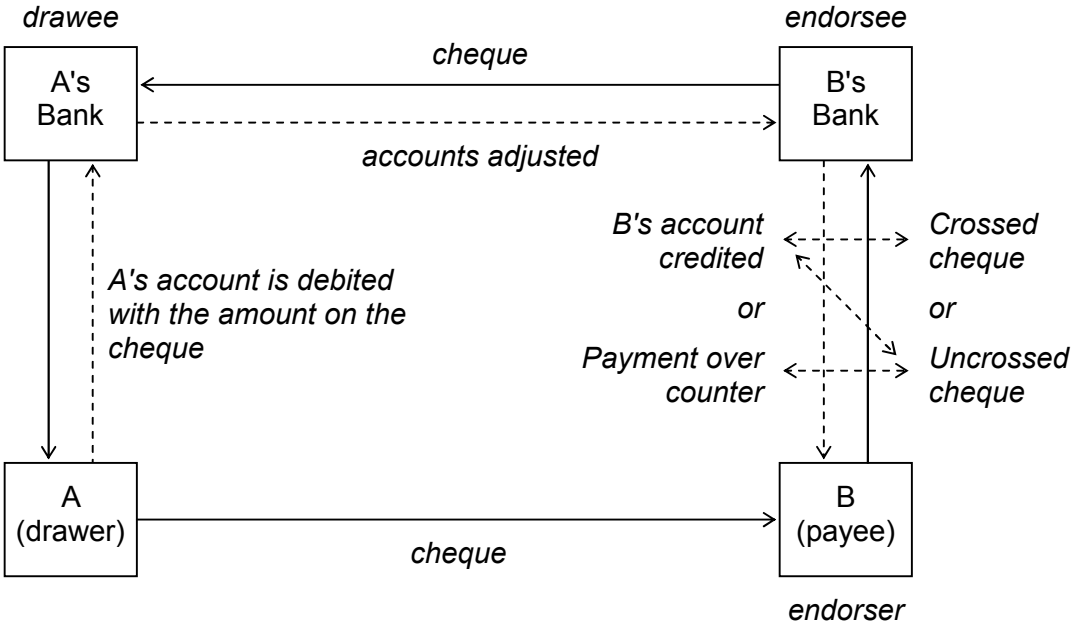
Figure 18.1



If A draws a cheque in favour of B, B may either take it to A's bank and obtain payment (Figure 18.1), or he can pay it into his own bank who will, on his behalf, collect payment from A's bank (Figure 18.2). A's bank (the paying bank) will debit A's account as they meet the cheque and B's bank (the collecting bank) will credit B's account with the money collected.

Figure 18.2



Cheques and Receipts

In addition to the principal points of difference between cheques and bills of exchange referred to above (and to be considered in detail later), there are a number of other special features of cheques that may be noted here.

Prior to 1957, it was common practice for the payee of a cheque to endorse it on the back as he paid it into his bank for collection and a cheque so endorsed was sufficient evidence of receipt of payment for the drawer of the cheque (to whom, of course, the paying bank would return the discharged cheque in due course).

This practice was generally found rather tedious and the **Cheques Act 1957** contained various provisions to make it unnecessary, of which Section 3 provides that "*an unendorsed cheque which appears to have been paid by the banker on whom it is drawn is evidence of the receipt by the payee of the sum named in the cheque*". Thus, a paid cheque, whether or not endorsed by the payee (but not if endorsed in favour of some other person) will nowadays normally be adequate evidence of receipt of payment by the payee (for auditors, etc.) and the payer is unlikely to ask for any other receipt. However, if he/she does do so the payee is bound to provide it.

In this connection it may be noted that some cheques are found with a form of receipt attached, and require as a condition that the receipt must be duly completed before the cheque can be paid. Since such an instrument does not constitute "an unconditional order in writing", it is not strictly a cheque, and falls outside the **Bills of Exchange Act**; therefore bankers usually require an indemnity from customers using such instruments, in order to safeguard themselves.

Post-dated Cheques

The **Bills of Exchange Act 1882** allows bills to be dated as at a date subsequent to that on which they are actually drawn. In the case of cheques such a practice should strictly invalidate the instruments as they cannot be said really to be payable on demand but in fact such cheques are held to be valid as payable on demand as from the date entered.

Overdue Cheques

A bill payable on demand must be presented for payment within a reasonable time of the bill's date and if this is not done the drawer and prior endorsers are discharged from liability. In the case of cheques, however, the drawer cannot escape liability in this way (though any endorser will), and will remain liable on the cheque for the normal limitation period of six years. In practice, a cheque presented more than six months after date will be returned as "stale" but the holder can obtain a fresh cheque from the drawer.

However, where the cheque has been held for more than a reasonable time and the drawer suffers actual loss through this delay, then the drawer will be discharged to the extent of such loss. This might arise where, after the cheque has been held for more than a reasonable time, the drawer's bank goes into liquidation and is only paying £0.25 in the £. Since the holder of the cheque is responsible for the drawer having the excess funds represented by the unpresented cheque in the bank at this time, he/she will be able to claim from the drawer only one-quarter of the value of the cheque and must him/herself prove in the liquidation (i.e. seek funds owed as a proven creditor) for the balance.

C. BANKER/CUSTOMER RELATIONSHIP

The relationship between banker and customer is a contractual one whereby the customer deposits money with the bank on the understanding that the bank will meet cheques drawn by the customer on the account up to the amount of the balance standing therein or of any agreed overdraft.

Bank's Duties

The duties of the banker under this contract are two-sided: to honour cheques duly drawn up to the amount available, and not to pay without proper authority.

In ***Schioler v. Westminster Bank Ltd. (1970)*** it was also said that a bank owes a duty to credit a customer's account with dividends received on the customer's behalf and it owes a duty to take care in doing so.

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The limitations on this duty are illustrated by ***United Overseas Bank v. Jiwani (1977)*** where the defendant had been informed by his bank that his balance amounted to 31,000 dollars when in fact it was 25,000 dollars. The defendant then ordered the bank (he claimed in good faith), to make a payment of 30,000 dollars to a third party, being the purchase price of a hotel sold by the third party. On being asked by the bank for repayment, the defendant claimed that he was protected by an estoppel arising from the bank's representation. The court refused this argument, pointing to the fact that there must be a reliance on the representation **and** a change in position such as to make it inequitable to order repayment. Satisfied that the defendant would have purchased the hotel in any event, borrowing a part of the purchase price if necessary, the court concluded that there was in this case no such change in position.

If the bank fails to meet a cheque that is duly drawn where there are funds available to meet it, it will be liable for damages to the drawer. Where the drawer is a trader, damages will be awarded without proof of actual loss, but in other cases loss must be established.

On the other hand, the bank will be liable if it pays a cheque on which the drawer's signature is forged, or if it pays a cheque not properly drawn e.g. if a company's cheques require the signature of two directors and only one signature is present.

The bank will also be liable if it meets a cheque after the customer has countermanded payment. Note that where the countermand is received by telephone or telegram (so that the bank cannot verify the authority) the bank should return the cheque to the payee marked "payment countermanded by telephone – present again" and then obtain written confirmation from the customer. Such action will not amount to refusal to meet the cheque which would render the bank liable if the countermand was unauthorised. The bank's authority to meet cheques will also be terminated in the following circumstances:

- Notice of the customer's death or insanity
- Notice of an act of bankruptcy by the customer or the making of a receiving order against the customer
- Receipt of a garnishee order (an order awarded to a judgment creditor which "freezes" the balance then standing in the customer's account).

The effect of computers upon this relationship between banker and customer is illustrated by the case of ***Momm v. Barclays Bank International (1976)*** in which it was decided that a bank transfer is effected when the bank accepts the instructions of a customer to credit another customer and the bank computer processes for doing so are set in motion. The fact that the entry can be later reversed has no bearing on the transaction.

Two companies banked at the same branch and transactions were computerised. Final balances on customers' accounts were not known until the date after, and transactions were reversed if a customer's indebtedness was unacceptable. One of the companies instructed the bank to transfer £120,000 on 25 June to the second company and on 26 June the computer process was set in motion. On the afternoon of 26 June, the company making the payment announced it was going into liquidation; on the following day its account was in debit and the bank reversed the entries. The company which should have received payment claimed the money from the bank. It was **held** that, as the bank could not accept countermanding instructions from the paying-in company once the computer process had been set in motion, the transfer was then completed. It was not essential that notice to the payee should be given.

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Customer's Duties

The customer owes the bank a duty of care in the way a cheque is drawn. Where the amount of a cheque is altered and the cheque is met by the bank, the position will be as follows:

(a) If the alteration was **apparent**, the bank must bear the loss.

(b) If the alteration was **not apparent** but was not facilitated by negligence on the part of the customer in drawing the cheque, then the customer will be chargeable with the original amount but the bank must bear the excess.

So far, the position is comparable to the general rule of bills of exchange, however:

(c) If the alteration was not apparent and was made possible through the **careless way in which the customer drew the cheque**, then the loss will fall on the customer.

In ***London Joint Stock Bank v. Macmillan & Arthur (1918)***, a bearer cheque was drawn for £2 in figures, but with sufficient space for this to be changed to £120 without the alteration being apparent, and without the amount being written in words at all, so that a fraudulent clerk was able to write in "*one hundred and twenty pounds*". It was **held** that the customer had to accept the full charge of £120 when the cheque was met.

The case of ***Slingsby v. District Bank (1931)*** may also be noted in this context. The drawer left a gap between the inserted name of the payee and the printed words "*or order*", into which gap one Cumberbitch inserted the words "*per Cumberbitch and Potts*". He then endorsed the cheque and obtained payment. It was **held** that this did not constitute negligence on the part of the drawer so that the bank had to bear the loss.

Acting in excess of authority created by the relationship can give rise to criminal liability, as in the case of ***R v. Charles (1976)***. C had authority to overdraw his account up to £100 and he also had a cheque card which contained an undertaking by the bank that any cheque not exceeding £30 would be honoured subject to the usual conditions. In the course of one evening at a gambling club, C drew 25 cheques for a total of £750. He was convicted under the **Theft Act 1968** of dishonestly obtaining a pecuniary advantage for himself by deception. In the course of judgment, it was said that, where the holder of a cheque card presents the card together with a cheque made out in accordance with the conditions of the card, it is open to the court to infer that a representation has been made by the drawer that he has the authority as between himself and the bank to use the card in order to oblige the bank to honour the cheque. If that representation is false and the payee has been induced to accept the cheque by reason of that false representation, the drawer has thereby obtained a pecuniary advantage by deception.

Greenwood v. Martins Bank Ltd (1933) illustrates how the bank will be protected in the event of the customer's negligence. Greenwood's wife had been drawing money from his account by forging his signature on his cheques. In order to protect his wife, he did not inform the bank. The wife later committed suicide and he then decided to sue the bank for the return of the money.

HELD: The husband was under a duty to disclose what had happened, and as he had failed to do so his conduct precluded him from alleging the forgery.

An important case showing the limit of the customer's duty to his bank was decided by the Privy Council in ***Tai Hing Cotton Mill v. Ling Chong Hing Bank (1985)***, where the bank had over a period of time paid out on cheques that had been forged by an employee of the appellant company. The total involved was in excess of $5 million and the fraud had continued for some considerable time.

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The bank argued that the appellant customer company had been negligent because they had received bank statements over the period which showed that the bank had been paying out on the forged cheques. The customer should have noticed the errors and informed the bank. Since it had not done so it was negligent and, the bank argued, that it should bear the loss.

The Privy Council **held** that the customer did not owe a duty to inform the bank of errors on bank statements unless it was expressly agreed. If the customer actually knew about the forgeries then he had to tell the bank but he was not under any duty to take steps to find out about the forgery by, for example, checking the accuracy of his bank statements. Therefore, the bank was held liable to bear the loss. The case shows how the law, when it comes to cases between banks and their customers, tends to side with the customer, presumably on the basis that the bank is more able to bear the loss.

In the absence of express contractual terms, there has been a general unwillingness on the part of the courts to further extend the duties of customers to their banks in the way in which customers operate their accounts: ***Patel v. Standard Chartered Bank (2001)***.

D. CROSSING A CHEQUE

Purpose of Crossings

The **Bills of Exchange Act 1882** makes provision for the "crossing" of cheques and this provision does not apply to any other type of bill of exchange.

The effect of a crossing is that the cheque may be met only by payment to a banker and cannot be cashed over the counter of the paying bank. The object of this is that it is thus possible for the drawer of the cheque to trace it after it has been paid through a bank account, to a known holder. Also, it gives more time to countermand payment.

The crossing does not initially affect the negotiability of the cheque, nor does it mean that the cheque must be endorsed.

General and Special Crossings

There are two types of crossing – "special" and "general".

- **Special crossing**

  In a special crossing, the name of a particular bank is written between the lines of the crossing, e.g. Barclays; a cheque bearing a special crossing must be met only by payment to that particular bank, i.e. Barclays.

- **General crossing**

  A general crossing is made by drawing across the face of the cheque two parallel lines with or without the words "and company", or any abbreviation thereof, e.g. "& Co.". The original intention was that the payee could insert the name of his/her bank, making it a special crossing, but the bank usually does this by stamping its name on the crossing.

The crossing must appear on the face of the cheque and it is desirable that it should be across the middle of the document.

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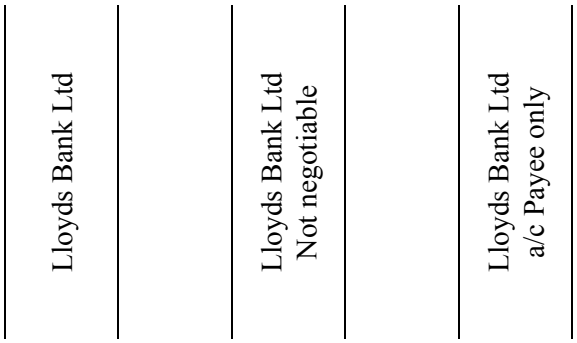
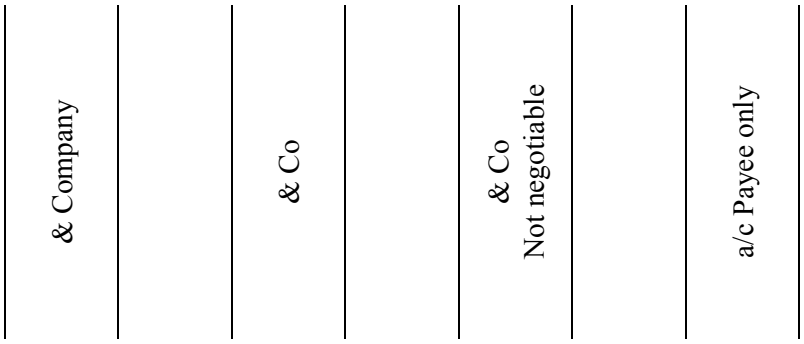
Examples of special crossings are:



And here are some examples of general crossings:



"Not Negotiable"

Section 81 of the **Bills of Exchange Act** also provides for the addition of the words "*Not negotiable*" to the crossing. The effect of these words is to take away the attributes of negotiability from the instrument, though not the right of transfer, so that no person taking a cheque bearing such a crossing can obtain a better title than that of the transferor.

Let us consider a cheque which has been crossed "not negotiable" and which has been stolen. Obviously, the thief's title to the cheque is a bad one and henceforth all successive holders of that cheque, no matter how innocently they may have acted or how great has been their good faith, have defective titles to the cheque. If the drawer has succeeded in stopping the cheque, the holder with defective titles acquired through the thief cannot compel the drawer to remove his/her stop. Moreover, the holder with a defective title who succeeds in cashing such a cheque (paid in through his account) is liable to refund the proceeds to the true owner. This liability extends for the statutory period of six years.

"A/c Payee Only"

The **Cheques Act 1992** (which became law on 16 June 1992) amended the law on cheques crossed with an "account payee" crossing by adding a new Section 81A to the Bills of Exchange Act 1882 which stipulates that:

- Where a cheque is crossed and bears across its face the words "account payee" or "a/c payee", either with or without the word "only", the cheque shall not be transferable, but shall only be valid as between the parties thereto.
- A banker is not to be treated for the purposes of Section 80 above as being negligent by reason only of his/her failure to concern him-/herself with any purported endorsement of a cheque which under Subsection (1) or otherwise is not transferable.

Thus, account payee cheques are now non-transferable and it seems clear that a bank collecting such a cheque for a person other than the payee will lose its statutory defence

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(see below) contained in the Bills of Exchange Act 1882 and the Cheques Act 1957. This is in keeping with the purpose of the 1992 Act which is to diminish the possibility of fraud by making appropriately crossed cheques impossible to transfer.

Drawer and Banker

The authority to cross cheques is set out in Section 77, **Bills of Exchange Act 1882**, as follows:

> *(1) "A cheque may be crossed generally or specially by the drawer.*
>
> *(2) Where a cheque is uncrossed, a holder may cross it generally or specially.*
>
> *(3) Where a cheque is crossed generally, the holder may cross it specially.*
>
> *(4) Where a cheque is crossed generally or specially, the holder may add the words 'not negotiable'*
>
> *(5) Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker for collection.*
>
> *(6) Where an uncrossed cheque, or a cheque crossed generally is sent to a banker for collection, he may cross it specially to himself."*

Once a cheque has been crossed, the crossing can be "opened" only on the authority of the drawer.

Following the introduction of the Cheques Act 1992, the major clearing banks changed the standard format of their cheque books so that they are now pre-printed with the "Account Payee" crossing and, in some cases, the word "only" on the payee line replacing the words "or order".

Let us now consider the position of the paying bank in relation to crossed cheques. Quite simply, it is bound to pay in accordance with the crossing, and Section 79, **Bills of Exchange Act 1882** provides that a banker who pays a crossed cheque otherwise than in accordance with the crossing will be liable to the true owner of the cheque for any loss the latter may incur by reason of the banker's default.

Where, however, a crossing has been obliterated or altered without this being apparent, a banker who pays in good faith and without negligence within the apparent terms of the cheque will not incur any liability under Section 79.

E. SPECIAL PROTECTION OF PAYING BANKER

The **Bills of Exchange Act 1882** and the **Cheques Act 1957** between them provide special protection for bankers paying and collecting cheques.

If the paying bank meets a cheque without discharging it, so that the true owner is able to claim the cheque and demand payment him/herself, the bank will be liable to the customer in conversion in respect of the first payment and will have to bear the loss.

A relevant case is that of ***National Westminster Bank v. Barclays Bank International Ltd. and Another (1974)***. During a burglary, a cheque was stolen from the cheque book of X, a customer of the National Westminster Bank. Subsequently, he learned that his account had been debited with a cheque for £8,000, which had been collected by Barclays Bank and credited to the second defendant, one of their customers. The claimants admitted that the cheque had been forged and that they were not entitled to debit it to X's account.

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They brought an action to recover the £8,000 from the defendants as money paid under a mistake of fact. It was contended by the second defendant that the claimants were prevented from recovering the £8,000 since their action in honouring the cheque amounted to a representation that it was genuine. This plea was rejected. It was **held** that, merely by honouring a forged cheque without negligence, the claimants had not impliedly represented to the payee that the signature was genuine so as to prevent recovery from him.

Bank as Customer's Agent

Protection is, however, afforded under Section 1, **Cheques Act 1957**. In order to discharge a bill, payment must be made to "*the holder*" defined as "*the payee or endorsee of a cheque who is in possession of it, or the bearer thereof*". Where a cheque is paid in by a customer to his/her bank for collection, this will not normally constitute a "negotiation" of the cheque, for the banker does not purport to be a holder but acts as agent for the customer.

Bank as Holder

In some circumstances, however, the collecting bank does not act as a mere agent, but as a holder in its own right, namely in the following cases:

- The cheque is paid in to reduce the customer's overdraft
- The bank credits the customer's account before the cheque is cleared, and there is an express or implied agreement between the parties that the customer can draw against such cheques before they are cleared.

In such cases, if the cheque is payable to the customer and he/she is not required to endorse it before it is paid in, payment by the drawee bank to the collecting bank will not discharge the cheque because the latter will not come within the definition of a holder. Of course, where the collecting bank is merely acting as an agent, the endorsement of the holder of the instrument is not required for payment by the drawee to discharge it, but, since the paying bank cannot know of the circumstances in which the cheque is paid in by the customer, it was the practice prior to the **Cheques Act 1957** to refuse to meet any cheque not endorsed by the payee.

Endorsement when Paying In

The practice of endorsement was extremely inconvenient, and both the business and banking communities pressed for measures to render it unnecessary. As a result, Section 1, **Cheques Act 1957** was enacted, providing that

> *"Where a banker in good faith and in the ordinary course of business pays a cheque drawn on him which is not endorsed or is irregularly endorsed, he does not, in doing so, incur any liability by reason only of the absence of, or irregularity in, endorsement, and he is deemed to have paid it in due course."*

Notwithstanding their objection to the endorsement of cheques as a general practice, however, the committee of London Clearing Banks subsequently announced that, as a matter of practice, banks would still require the endorsement of cheques in the following cases:

(a) If the payee (or endorsee) presents it to the bank on which it is drawn for payment over the counter, his/her endorsement will be required

(b) If the cheque is paid in for the credit of an account other than that of the payee or last endorsee, the endorsement of the payee or last endorsee will be required. (Under the wide drafting of the section, intermediate endorsement also could be missing and the protection would still apply.)

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But where the payee pays in the cheque for the credit of his/her own account, his/her endorsement will not be required; equally, in case (b) above, the endorsement of the person to whose account the cheque is to be credited will not be required.

The effect of this announcement is that, if a bank pays a cheque in the stipulated circumstances without requiring the endorsement specified, the cheque would not be paid "in the ordinary course of business" and the protection would not apply.

In ***Lumsden and Co. v. London Trustee Savings Bank (1971)*** damages for conversion were reduced by apportionment under the **Law Reform (Contributory Negligence) Act 1945**. A clerk employed by the claimants opened an account at the defendants' bank in the fictitious name of John Arthur George Brown, the defendants failing fully to carry out their own procedure for checking on new customers. The clerk then converted cheques properly drawn on the claimants' business to the name of J A G Brown, paid them into his account, and eventually absconded with the proceeds. When sued in conversion the bank pleaded the statutory defence of Section 4(1), **Cheques Act 1957** and in the alternative contributory negligence.

HELD: Section 4 did not apply owing to the bank's negligence in opening the account but the defence of contributory negligence did. The claimants were negligent in signing cheques with a gap before the word "Brown" and in not ensuring the words "and Co." were added, thus allowing the clerk to add the fictitious name. Judgment was given for the claimants, amounting to 90% of their claim.

Forged Endorsements

Even where payment is made to the holder, the cheque will not generally be discharged if it bears a forged endorsement. However, Section 60, **Bills of Exchange Act 1882**, affords special protection to bankers in its provision that, if an order cheque with a forged endorsement is paid by a banker in good faith and in the ordinary course of business, the cheque will be deemed to have been discharged, notwithstanding the forgery.

In ***Goldman v. Cox (1924)*** Goldman drew a number of cheques in favour of X. In the meantime, Goldman's clerk obtained the cheques, forged X's endorsement and negotiated the cheques to Cox. Cox took them in good faith and for value, and he received payment from the bank for the cheques.

HELD: Although the bank was protected under Section 60, as Cox had received money under a forged endorsement he was liable to Goldman as the true owner. Goldman could therefore recover the money.

Note that the protection of this section applies only to cheques **drawn to order**.

Further protection is afforded by Section 80, Bills of Exchange Act 1882, which covers the event of a cheque bearing a forged endorsement, or the situation where a thief, having stolen an order cheque, opens a bank account in the name of the payee and obtains payment by this device instead of forging the payee's signature (the cheque is not discharged by payment, since it is not in fact made to the payee). Note, however, the following points:

- Section 80 applies only to crossed cheques and only if the terms of the crossing are complied with
- To obtain the protection of Section 80, the banker must act "without negligence" and not just "in the ordinary course of business".

Section 80 expressly extends its protection to the drawer, provided the cheque has actually passed through the payee's hands, and the true owner of the cheque cannot claim payment on the drawer's account. Under Section 60, the cheque is actually discharged, so the drawer is thus cleared from liability.

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F. SPECIAL PROTECTION OF COLLECTING BANKER

If the customer presenting the cheque has not title thereto, the collecting banker would normally be liable to the drawer for conversion if the latter suffered loss.

However, Section 4, **Cheques Act 1957** (which repeals and replaces Section 82, **Bills of Exchange Act**) provides that the bank collecting a cheque for a person who has no title thereto (including the holder of a cheque that bears a forged endorsement) will not itself incur any liability for this action. The limits of Section 4 should be noted:

(a) The bank must act **without negligence**. As usual, this must be determined by reference to **general practice** but it would probably be deemed negligent if different endorsements appeared in the same handwriting (indicating forgery) or if, without adequate enquiry, it collected a cheque payable to a customer's employer for the account of the customer, even if it carried an endorsement purporting to be that of the employer.

(b) The bank must be **acting for a customer**. The person for whom the cheque is collected must have an account with the bank, though it would probably be sufficient if the account were opened only with the disputed cheque.

(c) The following **guidelines** have been laid down by the Courts in order to determine whether the bank has been negligent and thereby loses the protection of Section 4, **Cheques Act 1957** or Section 80, **Bills of Exchange Act 1882**. The rules were decided upon in the case of ***Marfani v. Midland Bank (1968)***.

- The standard of care required of banks is that of the ordinary careful banker.
- However, the duty does not extend to the thorough examination of accounts.
- If negligence is alleged in relation to a bank receiving a cheque and collecting money for it, the court must look carefully at the circumstances in which the bank accepts customers and opens new accounts.
- The burden of proving that he/she acted without negligence is on the defendant.

  It has been held that the bank is negligent in the following circumstances.

  (i) If the bank opens an account without enquiring as to the identity of the customer: ***Lumsden & Co. v. London Trustee Savings Bank (1971)***.

  (ii) If it fails to scrutinise the customer's accounts occasionally to see if they are proper and correct: ***Lloyds Bank v. Chartered Bank of India (1919)***.

  (iii) If it receives payment for a customer when the cheque is drawn either in favour of the customer's employer: ***Underwood v. Martins Bank (1924)***, or when the cheque is drawn in favour of a third party and the bank fails to enquire into the customer's title to the cheque: ***Lloyds Bank v. Savory (1933)***.

Collecting Bank as Holder in Due Course

As we have already noted, the banker normally acts as an agent of the customer, but in certain circumstances, he will be regarded as a holder in his own right. In these cases, provided he satisfies the conditions of a holder in due course he will be able to avoid any liability in conversion on this ground.

In this connection, it should be noted that, just as Section 1, **Cheques Act 1957** provided statutory protection for the paying bank even if the cheque was not endorsed by the customer to the collecting bank, Section 2 preserves the rights of the collecting bank as a holder in due course.

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Without the endorsement of the customer paying in the cheque (being an order cheque) for collection, the banker will not be a holder within the definition of the **Bills of Exchange Act** (since he/she is not the payee or endorsee), but by Section 2, **Cheques Act 1957**, the cheque will be deemed to have been endorsed in blank so that the collecting bank meets the definition as a bearer.

Section 4 gives much wider protection, and a banker cannot claim as holder in due course if there is a forged endorsement on the cheque. On the other hand, in the appropriate circumstances, the banker may be able to claim as a holder in due course even if he/she has been negligent (which negligence would lose him/her the protection of Section 4).

G. PROMISSORY NOTES

Definition

Section 83, Bills of Exchange Act 1882 states:

> *"(1) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of, a specified person or to bearer.*
>
> *(2) An instrument in the form of a note payable to maker's order is not a note within the meaning of this section unless and until it is endorsed by the maker.*
>
> *(3) A note is not invalid by reason only that it contains also a pledge of collateral security with authority to sell or dispose thereof.*
>
> *(4) A note which is, or on the face of it purports to be, both made and payable within the British Isles is an inland note. Any other note is a foreign note."*

Where a promissory note specifies payment at a particular place, presentment at that place is necessary to render the maker liable.

In ***Re British Trade Corporation Ltd (1932)*** it was **held** that the document, though in the form of a bill of exchange, had the same drawer and drawee. If treated as a promissory note, it would require to be presented for payment if it was "*in the way of it made payable at a particular place*". In this case, the place for payment was not inserted in the body of the note. Consequently, time began to run under the Statute of Limitations from the date of the note.

The following is a specimen of a promissory note payable on demand.

London, 30 April 2008

£75.20

On demand I promise to pay at the English Bank Limited, Chelmsford, to A Smith or order, the sum of Seventy Five Pounds and Twenty Pence only for value received.

J Brown

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An IOU, as generally understood, is not a promissory note, since it does not strictly contain any promise to pay, and in this form it does not constitute a negotiable instrument.

Necessity of Delivery

> *"A promissory note is inchoate and incomplete until delivery thereof to the payee or bearer":* Section 84.

No precise form is necessary for a promissory note, but the essential feature is that there must be an unconditional promise in writing to pay a certain sum in money. In a similar manner to a bill of exchange, the note must not be made payable on a contingency, although a note may contain a pledge of collateral security with authority to sell or dispose thereof.

Liability of Maker

Section 88 specifies that:

> *"The maker of a promissory note, by making it:*
>
> *(1) Engages that he will pay it according to its tenor.*
>
> *(2) Is precluded from denying to a holder in due course the existence of the payee and his then capacity to endorse."*

Joint Notes

> *"A promissory note may be made by two or more makers, and they may be liable thereon jointly, or jointly and severally, according to its tenor": Section 85(1).*

Joint liability is not the individual liability of each of the makers but the collective liability of them all together. Thus a joint note is good against the makers jointly. Should one of the makers of a joint note die or become bankrupt, his/her estate is freed from all liability, and the liability falls entirely on the remaining maker or makers. Again, all the parties of a joint note must be sued together. If any party is not included in the action he/she will be released from liability. Should judgment be obtained against one or some of the parties, whether that judgment is satisfied or not, then the other or others will be released.

Joint and Several Notes

Section 85(2) defines a joint and several note:

> *"Where a note runs 'I promise to pay' and is signed by two or more persons it is deemed to be their joint and several note."*

Joint and several liability is the liability of all the makers together collectively and of each of them separately. In other words, where a note is a joint and several one, made by two or more makers, the note is good against all the makers jointly or against each one of them separately, for the full amount of the note. If one of the makers to a joint and several note dies or becomes bankrupt his/her estate is not freed from liability. Again, it is not necessary for the holder of a joint and several note to sue all the parties together; the holder can sue the parties singly or in any way he/she pleases and the remedy against them is not satisfied until "twenty shillings in the pound" (i.e. the full amount) has been recovered.

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Application of Bills of Exchange Act 1882

Section 89 provides as follows:

> *"(1) Subject to the provisions in this part and, except as by this section provided, the provisions of this Act relating to bills of exchange apply, with the necessary modifications, to promissory notes.*
>
> *(2) In applying those provisions the maker of a note shall be deemed to correspond with the acceptor of a bill, and the first endorser of a note shall be deemed to correspond with the drawer of an accepted bill payable to drawer's order.*
>
> *(3) The following provisions as to bills do not apply to notes; namely, provisions relating to:*
>
> *(a) presentment for acceptance;*
>
> *(b) acceptance;*
>
> *(c) acceptance supra protest;*
>
> *(d) bills in a set.*
>
> *(4) Where a foreign note is dishonoured, protest thereof is unnecessary".*

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