NATIONAL OPEN UNIVERSITY OF NGERIA

SCHOOL OF LAW

COURSE CODE:LAW 100

COURSE TITLE:INTRODUCTION TO LAW

ANSWER TO SELF ASSESSMENT EXERCISE

1. Point-Form Approach

The following approach is appropriate to a problem in this area.

Point-Form Approach to Intention

Step 1 is the agreement social or commercial

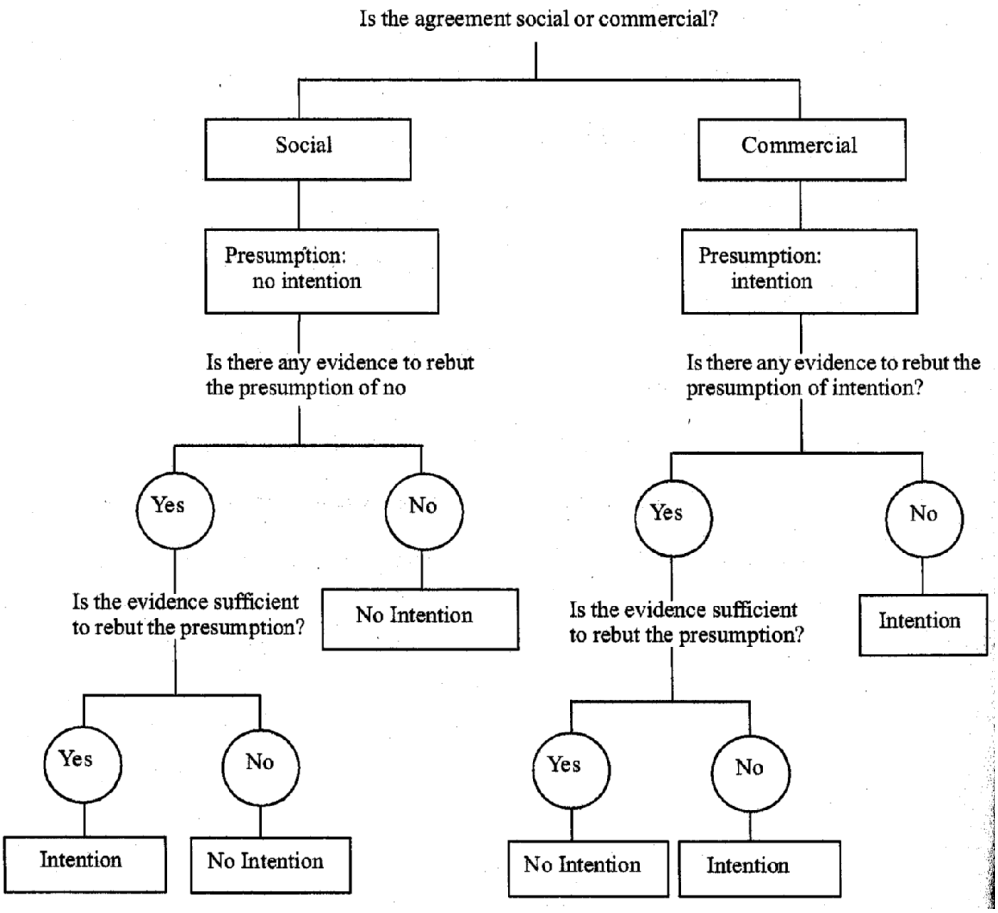
Step 2 (a) If it is **social,** the law presumes **that there is no intention to create legal relations.**

(b) If it is **commercial,** the law presumes **that there is intention to create legal relations.**

Step 3 Is there any evidence to **rebut the relevant presumption?**
Step 4 Is this evidence sufficient to **rebut the presumption?**

Step 5 Therefore the parties did/did not intend to create legal relations.

2. Algorithmic Approach



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UNIT 3 CONSTRUCTION OF TERMS OF A CONTRACT

CONTENTS

1.0 INTRODUCTION

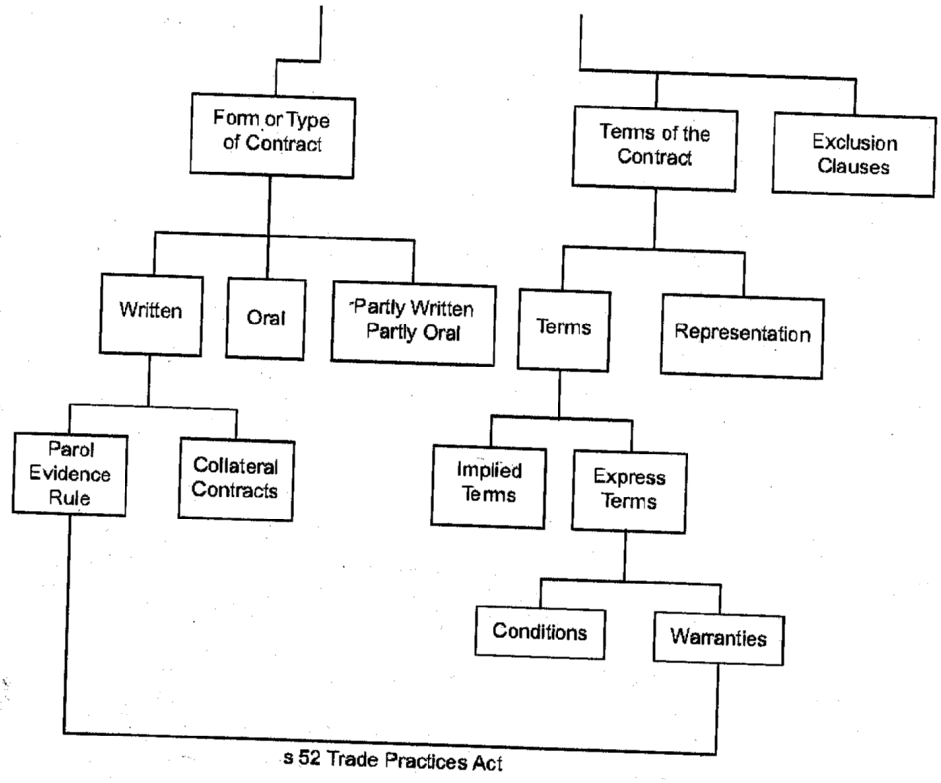
Up to this point, we have been concerned with an inquiry into whether a simple contract has the basic elements which must be present for it to be formed. These basic elements are offer and acceptance, intended to create legal relations and consideration.

It may come as a surprise to you that very little of the court's time is taken up with this enquiry. In the vast majority of cases there is no contest between the parties that an agreement of some sort is in existence, that there is consideration and that there was present, an attention that the contract be legally enforceable.

In most contract disputes which are fought out in the courts, probably none of the matters referred to above will be in issue. What is more likely to happen is that the parties disagree not about the existence of the contract but about its **terms.** The real issue between the parties is what is the correct interpretation to be placed on the agreement. In fact about

forty per cent of the contract cases decided by Courts involved at least one dispute over the meaning of a term.
In this module we look at the steps a court will take in analyzing the circumstances surrounding a contract in order to reach a conclusion about its ambit and the legal effect of terms.

Contract: Construction of the Terms of a Contract



2.0 OBJECTIVES

On successful completion of this module, you should be able to:

- evaluate which terms (express or implied) fall within the scope of a contract
- assess the legal significance of statements made outside the scope of a main contract
- determine the meaning and effect of terms of a contract, in particular of exclusion clauses.

General Rules of Interpretation

In the discussion that follows reference will be made to an number of specific rules and factors that bear upon the interpretation of a contract. There are however a number of general considerations or approaches that courts adopt when dealing with this area. These are:

a. As a matter of policy the courts' approach to determining whether a contract exists or not is that agreements should be preserved rather than struck down. Courts will prefer a construction that will render a contract effective rather than one which will cause it to fail for uncertainty. This is the justification then for courts implying terms into contract, which is dealt with below.

b. As with statutory interpretation, the contract is interpreted as a whole. Words must be read in the light of the clause as a whole which must also be looked at in the context of the contract as a whole.

c. When a meaning must be attributed to a particular word, the courts look first to the interpretation clause (which is often included in important commercial transactions), and if this does not clarify the matter, they will give the word its ordinary meaning ie that by which it is generally understood. This is subject to the words being used in a technical sense. If they are legal words, they will be interpreted according to the established legal meaning unless a contrary intention clearly appears from the context. Where the words are non legal technical words, the courts will follow the technical meaning which is usually established by oral evidence from experts and reference to trade or technical publications.

d. Where it appears that the parties have only agreed and have not provided a satisfactory mechanism to resolve outstanding issues, the courts will treat the 'contract' as void for uncertainty.

   This does not apply if a commercial transaction is merely ambiguous. As long as a meaning can be attributed, the courts treat an ambiguity as merely a problem of construction and decide upon the most appropriate meaning. Ambiguous terms will be interpreted in accordance with normal rules of interpretation. One rule which can be vital as to the outcome of the case is the *contra proferentum* rule. The effect of this rule is that any ambiguity in a written document will be resolved against the person who drew up or proposed the document and now seeks to rely on it.

e. A term to which no meaning can be attributed is treated as void for uncertainty. It the contract can stand on its own without the clause, the courts will sever the offending clause. Where it involves an essential matter, the 'contract' cannot be found to be complete.

'When I use a word', Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean, neither more nor less".

'The question is', said Alice, 'whether you can make words mean so many different things.'

'The question is,' said Humpty Dumpty, 'Which is to be master – that's all.

Approach to be adopted in this Module

When we are faced with the task of interpreting or construing a contract it can be difficult to develop a clear approach because there are a number of overlapping rules and considerations. To assist here four broad headings are adopted which translate into eight steps, which should be used to answer questions in this area. The eight steps are set out at pages 8.10 and 8.11. The headings are:

1. What is the form or type of contract?
2. What are the terms of the contract?
3. What weight should be given to the terms?
4. The impact of Restrictive Trade Practices Act or other Statute.

3.0 MAIN CONTENT

3.1 The Form or Type of Contract

In this context contracts can be divided into three types:

- Oral
- Written; and
- Partly oral and partly written.

As you should be aware by now, few contracts have to be in writing. The vast majority can be, and are, either in an oral form or partly oral and partly in writing. Frequently there is a verbal agreement plus some evidence of the contract in a written form. A simple purchase of goods will usually involve the production of a receipt, which may contain some terms of the contract such as the price, description of the goods etc.

3.1.1 Findings of Fact

At this early stage of its investigation, the court is primarily concerned with discovering what the facts are. There may be no dispute that, the contract is wholly oral but there could be a real dispute about who said

what and whether one party made a promise to the other. The task of the judge is to establish what the scope of the contract is, which is obviously much easier when the contract is in writing. In reaching any findings of fact, the judge will draw upon rules of evidence, reliability of witnesses, corroboration and so on. Some of these issues we touched on earlier. In this course we are not concerned so much about this process of fact finding (it is study on its own) and in any event in any problem or exam question you will be given the facts so this first phase is completed for you.

If a contract is oral or partly written and partly oral, then apart from the process of the court defining the scope of the contract, there are no specific rules that we need to be aware of at this stage.

More importantly from our point of view is the need to realize that there is an important consequence if the contract in question is in writing as district from the contact which is oral or partly written and partly oral. If a contract is wholly in writing then the parol evidence rule comes into play.

3.1.2 Parol Evidence Rule (PER)

The general patrol evidence rule is that extrinsic evidence is unadmissible to add to, vary, or contradict a written document where a judgment, contract, disposition of property or other transaction is wholly written then no oral evidence will be admitted to vary or expand the terms of the written document. So it is not permissible to call witnesses to give evidence of an oral promise. An example of the PER would be if a person (the vendor) agreed to sell their business to another (the buyer) and at the end of the negotiations they signed a contract completely covering the agreement. Suppose in the course of the discussions the vendor gave certain verbal assurances to the buyer about the turnover of the business then unless those assurances were placed in the written contract, no evidence could be called by the buyer about them/ accordingly, the buyer would be limited to whatever the written agreement contained.

Quite frequently to make certain the general rule applies, the person drawing up the contract (who is usually the vendor in the example given above) will include a clause stating ‘that the parties agree that the whole of the contract is contained within the written terms and cannot be varied by oral agreement or representations’ or words to that effect. You should be aware that it is not necessary to have such a clause for the rule to apply, - its just that it makes its application quite clear.

3.1.3 Exceptions to the Rule

There are cases in which extrinsic evidence may be admissible. So whether a contract is wholly in writing or only partly is a crucial matter for the courts to decide number of exceptions the general. These exceptions have been developed by the courts to overcome some of the hardship that can be cause by a strict application of the rule. Extrinsic evidence is admissible in the following cases even through the transaction is embodied in a written instrument.

1. To show that there is no valid transactions e.g. want of consideration
2. To prove a condition precedent to any obligation under a contract or disposition of property
3. To add supplemental or collateral terms contained in a separate oral agreement
4. To incorporate local or trade customs
5. To show a subsequent oral agreement varying or rescinding the written instrument. These are examples only.

You will notice repeated problems in this area the fact that the contract is partly written, partly oral and whether there is a collateral contract are important issues.

3.1.4 Collateral Contracts

The third exception to the general rule arises from the notion of collateral contracts.

A statement may fall outside the main contract under consideration, for example because of the rule, however the courts may still consider that it should have legal effect as a collateral contract.

A collateral contract must have evidence same as the same three basic elements, as in any other contract and consideration in this context, is the making of the main contract. In addition, the statement in question must be a promise.

For example if one party is hesitating about signing the main contract and in order to ‘clinch the deal’, the other may promise that a particular act will be done. In such a situation if the promisor reneges on his/her promise the plaintiff can argue that the promise, should be enforced as, in exchange, he or she entered into the main contract. A good example of a collateral contract is *de Lassalle v Guildford* [1910] 2KB 215.

The consideration for the collateral contract is entry into the main contract. Without that reliance, entry into the main contract would not be good consideration for the collateral contract.

The question that arises is what happens where there is inconsistency between the main contract and the collateral contract, the main contract will prevail over any such collateral promise. However in an appropriate case it appears promissory estoppel may apply.

3.1.5 Other Issues

Two final points are relevant to this phase in the interpretation of a contract:

- Since much depends on what is inside and what is outside the contract, the courts pay particular attention to the exact point at which the contract arises. This is the case whether the contract is oral, partly oral, partly written or even wholly in writing. The obvious point is that once the contract has been formed there is closure on additional terms and promises that might be incorporated within it.
- Many of the problems or issues that arise under the rule, collateral contracts and generally defining the scope of the contract, are swept away by the operation Restrictive *Trade Practices Act* or other statute.

SELF ASSESSMENT EXERCISE 1

1. Distinguish between the following:

(a) a term
(b) a representation
(c) puffery
(d) a Condition
(e) a warranty and
(f) a Collateral Contract

2. What is the effect of a breach of?

(a) a Condition and
(b) a Warranty.

3.2 What are Terms of the Contract?

3.2.1 Terms or Representations

Once a court has decided as matter of evidence, what statements (oral or in writing) were made by the parties, the next step is to decide what is the legal effect of each statement. In deciding this question the courts ask whether the statement is part of the contract (and therefore binding) or are they outside the contract. To be contractually binding they need to be **promissory** in nature in which case they are called **terms** of the contract. Otherwise the statement while designed to induce or encourage the other party to enter the contract, does not form part of the contract and are not legally binding. These statements are called **representations** or 'mere' representations.

Say for example, A sells his business to B. The price, what stock, is included in the price, when B is to take over the business are all terms of the contract. Suppose though that in the course of the negotiations A said to B 'I've been in this business for 10 years' then it is highly likely that such a statement will only be regarded as a representation, if it was relevant at all. The difference between a term and a representation is reasonably clear in this case but frequently the business line is quite blurred. What if, in the example above A said to B that the turnover of the business next year 'will be X', assuming that X is higher then the current figure. Would that be a term of the contract? For a case example of the difference between a term and a mere representation see ***Oscar Chess Ltd v Williams.***

3.2.2 Test and Indicative Factors

To decide between a term and a representation, the courts apply an **objective test** of the intention of the parties. The **test** is whether a reasonable person in the position of the parties would have understood that the statement in question would be enforceable. The test is similar to that encountered in the area of intention to create legal relations. As mentioned above, the dividing line between the term and the mere representation is often quite unclear. To assist here there are a number of **indicative factors** developed by the courts which are useful, however it goes without saying that these factors are not elements. They are:

1. How closer in time to the formation of the contract was the statement made? The closer in time the more likely that the statement was a term.

2. If the statement was oral was it then included in the subsequent written contract if there was one? A failure to do so will be taken