Since the document must now contain all the terms agreed by the parties and be signed by both parties, solicitors and conveyancers are no longer at risk that pre-contract correspondence signed by only one party might amount to a contract itself as was a possibility before. The practice of heading correspondence 'subject to contract' can now be brought to an end but some lawyers may advise its retention in case a judicial interpretation reveals an unexpected trap in its omission. Also, there should not be a problem as to whether the parties to a sale or other disposition of land intended legal relations because there will be a formal contract.

Contracts which must be evidenced in writing

Here we are concerned with contracts of guarantee where the Statute of Frauds 1677 requires writing which, though not essential to the formation of the contract, is needed as evidence if a dispute about it comes before a court. The court will not enforce the guarantee in the absence of written evidence.

The provision in the Statute of Frauds applies to guarantees and not to indemnities. It is therefore necessary to distinguish between these two. In a contract of indemnity the person giving the indemnity makes himself primarily liable by using such words as 'I will see that you are paid'.

In a contract of guarantee the guarantor expects the person he has guaranteed to carry out his obligations and the substance of the wording would be: 'If he does not pay you, I will'. An indemnity does not require writing because it does not come within the Statute of Frauds: a guarantee requires a memorandum.

An additional distinction is that it is an essential feature of a guarantee that the person giving it is totally unconnected with the contract except by reason of his promise to pay the debt. Thus a *del credere* agent who, for an extra commission, promises to make good losses incurred by his principal in respect of the unpaid debts of third parties introduced by the agent, may use the guarantee form 'if they do not pay you I will' but no writing is required. Such a promise is enforceable even if made orally because even where a person does promise to be liable for the debt of another that promise is not within the Statute of Frauds where it is, as here, an incident of a wider transaction, i.e. agency.

Mountstephen v *Lakeman*, 1871 – Guarantee and indemnity distinguished (**108**)

The memorandum in writing to satisfy the court need not exist when the contract is made but must be in existence when an action, if any, is brought for breach of the guarantee. A guarantee cannot be proved orally – writing is required as evidence. The memorandum must identify the parties, normally by containing their names. The material terms must be included, e.g. that it is a guarantee of a bank overdraft facility limited to £50,000. The memorandum must also contain the signature of the party to be charged or his agent properly authorised to sign. However, the law is not strict on this point and initials or a printed signature will do (contrast the position under the Law of Property (Miscellaneous Provisions) Act 1989, above). The 'party to be charged' is the proposed defendant and there may be cases where one party has a sufficient memorandum to commence an action whereas the other may not since the memorandum does not contain the other party's signature. This could happen where the memorandum was in a letter written by Bloggs to Snooks. The letter would presumably be signed by Bloggs but not by Snooks. It would therefore be a good memorandum for an action by Snooks but not by Bloggs. Section 3 of the Mercantile Law Amendment Act 1856 dispenses with the need to set out the consideration in the memorandum but it must exist. It is normally the extension of credit by A to B in consideration of C's guarantee of B's liability if B fails to pay.

Signatures and electronic trading

A problem which has faced those wanting to engage in electronic commerce is the fact that the law did not recognise the validity of electronic signatures so that e.g. there was no way in which a deed could be made by electronic means. However, the Electronic Communications Act 2000 is now in force. Among the main provisions is one to introduce measures to promote the legal recognition of electronic signatures. In this connection the Law of Property (Miscellaneous Provisions) Act 1989 has abolished the previous rule that a deed must be written on paper, thus clearing the way for the making of deeds by electronic means. The Act provides that digital signatures be given legal force and will set up a voluntary licensing system for trusted third parties that offer signature and encryption services. Existing laws (as set out in this chapter) which require the use of paper will be swept away. Digital signatures are forgery-resistant computer codes which are used to prove someone's identity.

Delegated legislation will be required to make the Act of 2000 fully effective. There are so many instances, e.g. in the law of real property, where paper documents with signatures on them are required. Areas for change are being identified prior to legislation.

An electronic signature need not be in the form of a code. For example, an e-mail which is signed off 'yours faithfully, J. Bloggs' is a valid electronic signature. However, the High Court ruled in *J Pereira Fernandes SA* v *Mehta* [2006] 2 All ER 891 that a guarantee was unenforceable because the only thing approaching a signature in the e-mail which set out the guarantee was the automatic insertion of the sender's e-mail address after the e-mail had been transmitted by an internet service provider. An e-mail address, said the court, was not a signature but in the view of the court more like a phone or fax number.

Capacity to contract

Adult citizens have full capacity to enter into any kind of contract but certain groups of persons and corporations have certain disabilities in this connection. The most important groups for our purposes are dealt with below.

Minors

The Family Law Reform Act 1969, s 1, reduced the age of majority from 21 to 18 years. Contracts made by minors were governed by the common law (including parts of sale of goods legislation) as amended by the Infants Relief Act 1874 and the Betting and Loans (Infants) Act 1892. The Minors' Contracts Act 1987 repealed the relevant parts of the 1874 and 1892 Acts so that minors' contracts are now governed by the rules of common law (including the Sale of Goods Act 1979) as amended by the Minors' Contracts Act 1987.

Valid contracts

These are as follows:

(a) Executed contracts for necessaries. These are defined in s 3(3) of the Sale of Goods Act 1979 as 'Goods suitable to the condition in life of the minor and to his actual requirements at the time of sale and delivery'. If the goods are deemed necessaries, the minor may be

compelled to pay a reasonable price which will usually, but not necessarily, be the contract price. The Sale of Goods Act does not, of course, cover necessary *services* such as, for example, a series of treatments by an osteopath. However, the common law applies and follows the Sale of Goods Act by requiring the minor to pay a reasonable price. The minor is not liable if the goods, though necessaries, have not been delivered or the service has not yet been rendered, i.e. there is no claim for breach of contract. This, together with the fact that he is only required to pay a reasonable price, illustrates that a minor's liability for necessaries is only quasi-contractual.

If the goods (or services) have a utility value, such as clothing, and are not merely things of luxury, e.g. a diamond necklace, then they are basically in the category of necessaries. Whether the minor will have to pay a reasonable price for them depends upon:

(i) the minor's income which goes to his condition in life. If he is wealthy, as where he has a good income from a trust, then quite expensive goods and services may be necessaries for him, provided they are useful;
(ii) the supply of goods which the minor already has. If the minor is well supplied with the particular articles then they will not be necessaries, even though they are useful and are well within his income.

(b) Contracts for the minor's benefit. These include contracts of service, apprenticeship and education.

However, trading contracts of minors are not enforceable no matter how beneficial they may be to the minor's trade or business. The theory behind this rule is that when a minor is in trade his capital is at risk and he might lose it, whereas in a contract of service there is no likelihood of capital loss.

Nash v *Inman*, 1908 – What are necessaries? (**109**)
Roberts v *Gray*, 1913 – Contracts which are beneficial (**110**)
Mercantile Union Guarantee Corporation v *Ball*, 1937 – Trading contracts not 'beneficial' (**111**)

Contracts not binding unless ratified

These are as follows:

(a) Loans. These are not binding on the minor unless he ratifies the contract of loan after reaching 18 which he may now legally do. No fresh consideration is now required on ratification.

(b) Contracts for non-necessary goods. Again, these are not binding on the minor unless he ratifies the contract after reaching 18, as he may now legally do. Once again, no fresh consideration is required on ratification.

It should be noted that in spite of the fact that the contracts in (*a*) and (*b*) above are not enforceable against the minor, he gets a title to any property which passes to him under the arrangement and can give a good title to a third party as where, for example, he sells non-necessary goods on to someone else (who takes in good faith and for value). This was decided in *Stocks* v *Wilson* [1913] 2 KB 235. Furthermore, any money or property transferred by the minor under the contract can only be recovered by him if there has been a total failure of consideration (see below).

Contracts binding unless repudiated

These are usually contracts by which the minor acquires an interest of a permanent nature in the subject matter of the contract. Such contracts bind the minor unless he takes active steps to avoid them, either during his minority or within a reasonable time thereafter. Examples of voidable contracts are shares in companies, leases of property and partnerships.

Steinberg v *Scala (Leeds) Ltd*, 1923 – Minors: voidable contracts (**112**)

Consequences of the defective contracts of minors

We must now have a look at what happens where there has been some performance of a contract with a minor which is either not binding unless ratified or binding unless repudiated.

Recovery by minor of money paid

Where a minor has paid money under these defective contracts he cannot recover it unless total failure of consideration can be proved, i.e. that the minor has not received any benefit at all under the contract. The court is reluctant to say that no benefit has been received. This can be seen in the context of a contract not binding unless ratified in *Pearce* v *Brain* (see below) and in the context of a contract binding unless repudiated in *Steinberg* v *Scala* (see above).

Pearce v *Brain*, 1929 – Recovery of money paid or property transferred (**113**)

Effect of purchase by minor of non-necessary goods

As we have seen, the minor acquires a title to the goods and can give a good title to a third party who takes them *bona fide* and for value (*Stocks* v *Wilson* [1913] 2 KB 235). The tradesman who sold the goods to the minor cannot recover them from the third party.

However, as regards recovery from the minor, if he still has the property, s 3 of the Minors' Contracts Act 1987 provides that the court can order restitution, for example, of non-necessary goods to the tradesman, where the minor is refusing to pay for them. As we know, he cannot be sued for the price.

The question of recovery in any particular case is left to the court which must regard it as just and equitable to allow recovery, though a restitution order can be made whether the minor is fraudulent, as where he obtained the goods by overstating his age, *or not*. Fraud is no longer a requirement for restitution. Money will be virtually impossible to recover because it will normally be mixed with other funds and not identifiable. However, the minor could be made under s 3 to offer up any goods acquired in exchange for the non-necessary goods. The tradesman recovers the goods in the state he finds them and cannot ask for compensation from the minor if they are, for example, damaged.

Thus, if Ann, a minor, buys a gold necklace and does not pay for it, the seller can recover the necklace from Ann. If Ann exchanges the necklace for a gold bangle, the seller can recover the gold bangle from Ann. If Ann sells the necklace for £500, it is not clear whether the seller can get restitution of the money unless it has been kept separate from Ann's other

funds or can be identified in a fund containing other money of Ann's, for example, a bank account into which she has paid her salary. Section 3 says that the seller can recover the article passing under the contract 'or any property representing it'. It is at least arguable that Ann's general funds do not solely represent the necklace in the way that the bangle does. Judicial interpretation is required.

Guarantees

Section 2 of the Minors' Contracts Act 1987 provides that a guarantee by an adult of a minor's transaction shall be enforceable against the guarantor even though the main contractual obligation is not enforceable against the minor. Thus, if a bank makes a loan to a minor or allows a minor an overdraft and an adult gives a guarantee of that transaction, then although the loan or overdraft cannot be enforced against the minor, the adult guarantor can be required to pay.

Mental disorder and drunkenness

Where the property and affairs of a person who lacks capacity under the Mental Capacity Act 2005 are placed under the management of the Court of Protection by means of a court appointed person called a 'deputy' (formerly a 'receiver'), that person has no capacity to contract as regards that property but the deputy has. In other cases, s 1 of the 2005 Act states that a person must be assumed to have capacity unless it can be established, normally to the satisfaction of the court, that he or she lacks capacity, in which case there is no contract. The burden of proof falls on the person who says that capacity is lacking. Section 7 of the 2005 Act deals with necessary goods and services and provides that, if necessary goods or services are supplied to a person who lacks capacity to contract for the supply, he or she must pay a reasonable price for them. The section goes on to define 'necessaries' as goods or services suitable to a person's condition in life and to his or her actual requirements at the time of supply. The common law rule that a person who makes a contract while lacking capacity can ratify it at a later stage if he or she recovers sufficiently to understand the transaction would seem to survive and continue to apply.

As regards persons who make contracts while drunk, the common law applies and the position is as follows:

(a) A contract made by a person who by reason of drunkenness is incapable of understanding what he is doing is valid unless he or she can prove:

(i) that he or she did not understand the nature of the contract; and
(ii) that the other party knew this to be the case.

(b) A contract made by such a person is binding on him or her if he or she afterwards ratifies it at any time when the state of mind is such that the person can understand what he or she is doing.

(c) Where necessaries are sold and delivered to a person who by reason of drunkenness is incompetent to contract, he or she is bound to pay a reasonable price (Sale of Goods Act 1979, s 3(2)). This is also true of services, but by reason of the common law.

(d) Necessaries are 'goods suitable to the condition in life of such person and to his actual requirements at the time of the sale and delivery' (1979 Act, s 3(3)). The common law defines necessary services in the same way. Therefore the principle of 'necessaries' is applied to

persons who are drunk in the same way as it is to minors and s 7 of the Mental Capacity Act follows this.

Imperial Loan Co v *Stone*, 1892 – Contract and mental disorder (**114**)
Matthews v *Baxter*, 1873 – Contracts with drunkards (**115**)

Lasting powers of attorney

Professionals in practice, such as solicitors and accountants, may have clients who are of advancing years and whose sanity may come into doubt at a future time and where there is a desire to avoid the cost and delay of deputy proceedings through the court. In this connection the Mental Capacity Act 2005 makes it possible for the ageing person to enter into an agreement with, say, a younger member of the family (or the practitioner) being the agent. Such an agreement does not terminate on the client's loss of capacity as other forms of agency do. Thus an application for a deputy is avoided as are the uncertainties that may arise from not knowing precisely when or if the client/principal actually became mentally incapable. The instrument creating the power must be in the form prescribed by the 2005 Act. Lasting powers of attorney are wider in scope than the former enduring powers of attorney. The latter related mainly to financial affairs, whereas the lasting power extends also to things such as healthcare and general welfare of the person who gives the power.

Corporations

We have seen that regardless of the method by which it is formed, a company on incorporation becomes a *legal person*, acquires an identity quite separate and distinct from its members, and carries on its activities through agents (see Chapter 8). In carrying out those activities and making contracts companies and their agents are to some extent restrained by the *ultra vires* rule. *Ultra vires* acts are those which are *beyond the powers* of the company. Our main concern here is to look at that rule as it affects registered companies.

Ultra vires rule – statutory and registered companies

The powers of statutory corporations are contained in the statute setting them up and these powers are sometimes increased by subsequent statutes or by delegated legislation. Acts beyond these powers are *ultra vires* and *void*, i.e. of no effect.

Before proceeding to discuss the contractual capacity of the registered company after the intervention of the Companies Act 2006 and previous legislation, the reader should refer to the *Ashbury* case (see below) for a classic example of the *ultra vires* rule at common law as a way of appreciating the statutory changes.

Ashbury Railway Carriage & Iron Co v *Riche*, 1875 – The *ultra vires* rule before the intervention of Parliament (**116**)

By way of explanation of the decision in the *Ashbury* case, it should be said that the *ultra vires* rule was brought in by the courts in earlier times to protect shareholders. It was thought that if a shareholder X bought shares in a company which had as its main object publishing

and allied activities then X would not want the directors of that company to start up a different kind of business because he wanted his money in publishing.

In more recent times it has been noted that shareholders are not so fussy about the kind of business the directors take the company into so long as it makes money to pay dividends and raises the price of the company's shares on the stock market thus giving a capital gain. In these days of the conglomerates it is doubtful whether any investor invests in a company because of only one facet of its trading.

The legal position today

Section references are to the Companies Act 2006.

Section 39 – A company's capacity

This section provides that the acts of a company are not to be questioned on the ground of lack of capacity because of anything in the constitution of the company and so contracts beyond the company's powers (where the articles, and not as before the memorandum, contain restrictions on business) are valid and enforceable by the company and the other party. Post the coming into force of the Companies Act 2006, new companies requiring restrictions will put them in a clause in the articles of association and where an existing company has restrictions in the memorandum these will be deemed to be in the articles. The articles can be altered by a resolution of the members.

There is no power, as there was in previous law, giving members the right to restrain acts of the directors beyond the company's powers or their own because under the provisions of the Companies Act 2006, companies will normally have unrestricted objects so that such a power would be pointless. Where there are restrictions in the articles on the company's powers or on the directors' powers, there are provisions in the Companies Act 2006 for the company to have civil remedies against the directors, e.g. to recoup for the company any loss it has suffered from the directors involved.

Section 40 – Power of directors to bind the company

For those dealing with the company in good faith, the power of the directors to bind the company or authorise others (agents) to do so is deemed not to be constrained by the company's constitution. External parties need not enquire whether there are any limitations on the powers of the directors, nor are they affected by actual knowledge that the directors have no power. External parties must, however, be 'dealing with the company', which will normally require involvement with some commercial transaction such as the buying and selling of goods or the provision of services.

Section 41 – Constitutional limitations: directors and their associates

Company insiders such as directors and their associated persons, e.g. husband or wife, do not have the protection of s 40 so that the relevant transaction can be avoided by the company and not enforced against it.

Insiders and any authorising directors are liable to account to the company for any gain made by them and to indemnify the company for any loss or damage caused to it even though the contract was avoided by the company, e.g. legal costs not recoverable by the company in connection with the avoidance.

Insiders who are not directors may be able to avoid the abovementioned liability if they did not know when entering into the transaction with the company that the directors were acting beyond their powers and so an associated or connected person, such as a husband or a wife, may not always be liable.

Transactions will not be avoidable if restitution of the company's property is not possible, as where the company's money has been spent by a director on a cruise (and there is no restitution against the cruise company unless it was in some way involved in the director's breach of duty) or the company has been indemnified or the company through its members has affirmed (or approved) of the transaction.

Section 42 – Charities

This section provides that, for companies that are charities, the rules relating to the capacity of the company and the power of its directors to bind it shall not apply to an external party unless that party did not know that the company was a charity when the act was done or the charity receives full consideration in regard to the act done and the external party did not know that the act was beyond the powers of the company and therefore beyond the powers of its directors to bind it.

Charitable companies cannot affirm a transaction so as to make valid those acts infringing the above rules without the prior written consent of the Charity Commissioners.

The above rules would not apply so as to invalidate an illegal act as where the directors issue shares at a discount, i.e. a share with a nominal value of £1 for 80 pence, because this is forbidden by the Companies Act 2006.

12

REALITY OF CONSENT I

In this chapter we begin a study of the various factors which can affect an agreement once it has been formed. We begin by dealing with the law relating to mistake which affects the true consent of one or both parties so that one or both of them may be asked to be released from their contractual obligations.

Introduction

A contract which is regular in all respects may still fail because there is no real consent to it by one or both of the parties. There is no *consensus ad idem* or meeting of the minds. Consent may be rendered unreal by mistake, misrepresentation, duress and undue influence. There are also instances of inequality of bargaining power where it would be inequitable to enforce the resulting agreement.

It is particularly important to distinguish between mistake and misrepresentation because a contract affected by mistake is void, whereas a contract affected by misrepresentation is only voidable. As between the parties themselves, this makes little difference since in both cases goods sold and money paid can be recovered. However, the distinction can be vital so far as third parties are concerned. If A sells goods to B under circumstances of mistake and B resells them to C, then C gets no title and A can recover the goods from him or sue him for damages in conversion. If, on the other hand, the contract between A and B was voidable for misrepresentation, then if B sold the goods to C who took them bona fide and for value before A had rescinded his contract with B, then C would get a good title and A would have a remedy only against B.

Agreement mistake in general

Mistake, to be operative, must be of *fact* and not of *law*. Furthermore, the concept has a technical meaning and does not cover, for example, errors of judgment as to value. Thus, if A buys an article thinking it is worth £100 when in fact it is worth only £50, the contract is good and A must bear the loss if there has been no misrepresentation by the seller. This is what is meant by the maxim *caveat emptor* (let the buyer beware).

The various categories of mistake will now be considered, beginning with the rather special case where a document is signed by mistake.

Documents mistakenly signed

If a person signs a contract in the mistaken belief that he is signing a document of a different nature, there may be a mistake which avoids the contract. He may be able to plead *non est factum* ('it is not my deed'). This is a defence open to a person who has signed a document by mistake. Originally it was a special defence to protect those who could not read who had signed deeds which had been incorrectly read over to them. At one time the defence was available only where the mistake referred to the *kind* of document it was and not merely its contents. Now the defence is available to a person who has signed a document having made a *fundamental* mistake as to the kind of document it is or as to its contents. However, the defendant must prove that he made the mistake despite having taken all reasonable care. If he is negligent he will not usually be able to plead the defence.

Since the courts have taken the view that merely to sign a document without knowing its contents is in itself negligent, the plea will rarely be successful, though it may be where the document is commonly regarded as confidential, such as an alleged will where the signer believes he signs in the capacity of a witness but in fact appears to incur liability on the document which is not in fact a will as in *Lewis* v *Clay* (1898) 77 LT 653.

Saunders v *Anglia Building Society*, 1970 – Documents mistakenly signed: the legal effect (**117**)

Unilateral mistake

Unilateral mistake occurs when one of the parties, X, is mistaken as to some fundamental fact concerning the contract and the other party, Y, knows, or ought to know, this. This latter requirement is important because if Y does not know that X is mistaken the contract is good.

The cases are mainly concerned with mistake by one party as to the *identity* of the other party. Thus a contract may be void for mistake if X contracts with Y thinking that Y is another person, Z, and if Y knows that X is under that misapprehension. Proof of Y's knowledge is essential but since in most cases Y is a fraudulent person, the point does not present great difficulties.

Higgins (W) Ltd v *Northampton Corporation*, 1927 – Relevance of knowledge of the mistake (**118**)

Cundy v *Lindsay*, 1878 – Mistake as to identity (**119**)

There were difficulties where the parties contracted face to face because in such a case the suggestion could always be made that whatever the fraudulent party was saying about his identity, the mistaken party must be regarded as intending to contract with the person in front of him, whoever he was. Thus in this situation, the court might find on the facts of the case that the contract was voidable for fraud or sometimes void for mistake.

However, the position is now a little clearer as a result of the decision in *Lewis* v *Averay* (1971) (see below) where it was said that if the parties contracted face to face the contract will normally be voidable for fraud but rarely void for mistake. However, much depends upon the facts of the case and if the court is convinced on the evidence that identity was vital then

even a 'face to face' contract will be regarded as void for mistake, as *Ingram* v *Little* (1961) (see below) shows.

Lewis v *Averay*, 1971 – Mistake as to identity when the parties are face to face (120)
Ingram v *Little*, 1961 – Another approach (121)

Effect of unilateral mistake in equity

If the claimant is asking for an equitable remedy, such as rescission of the contract or specific performance of it, then equitable principles will apply. As far as unilateral mistake is concerned, equity follows the principles of the common law and regards a contract affected by unilateral mistake as void and will therefore rescind it or refuse specific performance of it. Rectification of the contract is also available.

Webster v *Cecil*, 1861 – Unilateral mistake: the equitable approach (122)

12

Bilateral identical (or common) mistake

This occurs where both parties are mistaken and each makes the same mistake. In other words it is a *shared mistake*. There is no general rule that common mistake affects a contract and in practice only common mistakes as to the existence of the subject matter of the contract or where the subject matter of the contract already belongs to the buyer will make the contract void at common law. The principles applied are considered below.

(a) Cases of *res extincta*. Here there is a common mistake as to the existence of the subject matter of the contract. Thus, if S agrees to sell his car to B and unknown to both the car had at the time of the sale been destroyed by fire, then the contract will be void because A has innocently undertaken an obligation which he cannot possibly fulfil. It should be noted that the goods may actually exist but the rule of *res extincta* applies if they are not in the condition envisaged by the contract.

(b) Cases of *res sua*. These occur where a person makes a contract about something which already belongs to him. Such a contract is void at common law.

Couturier v *Hastie*, 1856 – An example of *res extincta* (123)
Cochrane v *Willis*, 1865 – *Res sua* illustrated (124)

(c) Other cases – mistakes as to quality. These occur when the two parties have reached agreement but have made an identical mistake as to some fact concerning the quality of the subject matter of the contract. Suppose, for example, that X sells a particular drawing to Y for £5,000 and all the usual elements of agreement are present, including offer and acceptance and consideration, and the agreement concerns an identified article. Nevertheless, if both X and Y think that the drawing is by a well-known Victorian artist when it is in fact only a copy worth £25, then the agreement is made in circumstances of common mistake.