# CERTIFIED INVESTMENT AND FINANCIAL ANALYSTS

## PART TWO

## SECTION

## STUDYNOTES

# REGULATION OF FINANCIAL MARKETS

# CONTENT

# CHAPTER ONE

# APPLICATION OF THE LAW OF CONTRACT IN FINANCIAL MARKETS

A contract may be defined as a legally binding agreement made by 2 or more parties. It has also been defined as a promise or set of promises a breach of which the law provides a remedy and the performance of which the law recognizes as an obligation.
The most important characteristic of a contract is that it is enforceable. The genesis of a contract is an agreement between the parties hence a contract is an enforceable agreement. However, whereas all contracts are agreements, all agreements are not contracts.
Types of contracts

**Contracts may be classified as:**

1. Written / specialty contracts
2. Contracts requiring written evidence
3. Simple contracts
4. Contracts under seal

## 1. Written contracts

These are contracts which under the law must be written, that is embodied in a formal document e.g. hire purchase agreement, contract of marine insurance, contract of sale of land.
Contracts under seal: this is a contract drawn by one party, sealed and sent to the party/parties for signature. Such a contract requires no consideration e.g. a lease agreement, mortgage, and charge.

## 2. Contracts requiring written evidence

These are contracts which must be evidenced by some notes or memorandum.
Contents of the note / memorandum:

1) A description of the parties sufficient to identify them.
2) A description of the subject matter of the contract
3) The consideration (value)
4) Signature of the parties

Examples include; contracts of insurance other than marine, contract of guarantee.

## 3. Simple contracts

These are contracts whose formation is not subject to any legal formalities. The contract may be:

- Oral
- Written
- Partly oral and written
- Implied form conduct of the parties

Examples include; contract of sale of goods, partnership agreement, and construction contracts.

## Elements of a contract

These are the constituents or ingredients of a contract. They make an agreement legally enforceable. These elements are:

a. Offer
b. Acceptance
c. Capacity
d. Intention
e. Consideration
f. Legality
g. Formalities, if any

## Sources of law contract

Under section 2 (1) of the Law of Contract Act, Cap 22, the sources of law of contract are:

1. **Precedents**- These are cases made laws that are derived from various court decisions
2. **Doctrines of equity**-it deals with issues of fairness and justice. It's used to mitigate the harsh effects of common law
3. **Certain Statutes of General Application**-these are statutes that came into force in England in 1990.
4. Other Acts of the Kenyan Parliament-e.g. the sale of goods act, age of majority act, higher purchase act, insurance act, bill of exchange act etc.

### Creation/formation of contract

A contract comes into existence when an **offer** by one party is unequivocally **accepted** by another and both parties have the requisite **capacity**. Some **consideration** must pass and the parties must have **intended** their dealings to give rise to a **legally binding agreement**. The purpose of the agreement must be **legal** and any necessary **formalities** must have been complied with.

## The offer

An offer has been defined as: an unequivocal manifestation by one party of its intention to contract with another. The party manifesting the intention is the **offeror** and the party to whom it is manifested is the **offeree**

**Rules/characteristics of an offer**

1. An offer may be oral, written or implied from the conduct of the offeror.
2. An offer must be communicated to the intended offeree or offerees. An offer remains ineffective until it is received by the offeree.
3. An offer must be clear and definite i.e. it must be certain and free from vagueness and ambiguity. In *Sands v. Mutual Benefits* as well as in *Scammell and Nephew Ltd v. Ouston***,** it was held that words used were too vague and uncertain to amount to an offer.
4. An offer may be conditional or absolute. The offeror may prescribe conditions to be fulfilled by the offerer for an agreement to arise between them.
5. The offeror may prescribe the duration the offer is to remain open for acceptance. However, the offeror is free to revoke or withdraw his offer at any time before such duration lapses e.g. in *Dickinson v. Dodds*, the defendant offered to sell a house to the plaintiff on Wednesday 10/06/1874 and the offer was to remain open up to Friday 12th at 9.00 am. However on the 11th of June, the defendant sold the house to a 3rd party. The plaintiff purported to accept the offer of Friday morning before 9.00 am. It was held that there was no agreement between the parties as the defendant had revoked his offer by selling the house to a 3rd party on June 11th. A similar holding was made in *Ruoutledge v. Grant*, where the defendant's offer was to remain open for 6 weeks but he revoked or withdrew it after 4 weeks. It was held that there was no agreement between the parties.
6. The offeror may prescribe the method of communication of acceptance by the offeree. If he insists on a particular method, it becomes a condition.
7. An offer may be general or specific i.e. it may be directed to a particular person, a class of persons or the public at large. In *Carlill v. Carbolic Smoke Ball Co*, the defendant company manufactured and owned a drug name the "Carbolic Smoke Ball" which the company thought was the best cure for influenza, cold and other diseases associated with taking cold water. The company put an advertisement in a newspaper to the effect that a £100 reward would be given to any person who contracted influenza or related diseases after taking the smoke ball as prescribed i.e. 2 tablets, 3 times a day for 2 weeks. The advertisement further stated that the company had deposited £1000 with the Alliance Bank on Reagent Street as a sign of their sincerity in the matter. Mrs. Carlill who had read the advertisement bought and took the Smoke balls as prescribed but contracted influenza. The company rejected her claim and she sued. The company argued that the advertisement;

a. Was nothing but mere sales talk
b. Was not an offer to the whole world
c. Was not intended to create legal relations

The Court of Appeal held that though the wording of the advertisement was unclear, it amounted to an offer to the whole world and the person who fulfilled its conditions, contracted with the company hence Mrs. Carlill was entitled to the £100 reward.
Examples of offers

1. Public transport: as was the case in *Wilkie v. London Passenger Transport Board.*
2. Bidding at an auction as was the case in *Harris v. Nickerson.*
3. Submission of a tender
4. Application for employment

**An offer must be distinguished from an Invitation to treat.**

**Invitation to treat**

This is a mere invitation by a party to another or others to make offer or bargain. The invitee becomes the offeror and the invitor becomes the offeree. A positive response to an invitation to treat is an offer.

**Examples of invitation to treat**

**1. Advertisement of sale by auction:**
At common law, an advertisement to sell goods or other property by public auction is an invitation to treat. The prospective buyer makes the offer by bidding at the auction and the auctioneer may accept or reject the offer.
It was so held in *Harris v. Nickerson* where a commission agent had sued as auctioneer for failure to display furniture he had advertised for sale by auction. It was held that there was no contractual relationship between the parties as the advertisement was merely an invitation to treat and as such, the auctioneer was not liable.

**2. Sale by display:**
At common law, the display of goods with cash price tags is an invitation to treat. The prospective buyer makes the offer to buy the items at the stated or other price which the shop owner may accept or reject. In *Fisher-v-Bell*, the defendant was sued for 'offering for sale' a flick knife contrary to the provision of the Offensive Weapons
Act. The defendant had displayed the knife in a shop with a cash price tag. Question was whether he had offered the knife for sale. It was held that he had not violated the
Act as the display of the knife was an invitation to prospective buyers to make offers.

**3. Sale by self-service:**

At common law, a sale by self-service is an invitation to treat.

Prospective buyers make offers by conduct by picking the goods from the shelves and the offer may be accepted or rejected at the cashier's desk. The offeror is free to revoke his offer to buy the goods at any time before reaching the cashiers desk.

In *Pharmaceutical Society of Great Britain v. Boots Cash Chemists (Southern) Ltd (1952)***.** The defendant owned and operated a self-service store which stocked among other things, drugs which under the provisions of the Pharmacy and Poisons Act (1933) could only be sold with the supervision of the registered pharmacist. The defendant's pharmacist was stationed next to the cashier's desk. The plaintiff society argued that the defendant had violated the Act as the pharmacist was not stationed next to the shelves where the drugs were displayed. Question was at what point a sale took place. It was held that the defendant had not violated the provisions of the Act as its pharmacist was stationed next to the cashier's desk where the actual sale took place.

This case is authority for the proposition that in a sale by self-service, a sale takes place at the cashier's desk. A similar holding was made in *Lasky v. Economy Grocers Ltd.*

## Types of offers

**1. Cross offer**

This is a situation where a party dispatches an offer to another who has sent a similar offer and the two offers cross in the course of communication. No agreement arises from cross offers for lack of consensus between the parties. The parties are not at *ad idem.*

**2. Counter offer**

This is a change, variation or modification of the terms of the offer by the offeree. It is a conditional acceptance. A counter offer is an offer in its own right and if accepted an agreement arises between the parties.

Its legal effect is to terminate the original offer as in *Hyde v. Wrench (1840),* the defendant made an offer on June 6th to sell a farm to the plaintiff for £1,000. On 8th June, the plaintiff wrote to the defendant accepting to pay £950 for the farm. On 27th June, the defendant wrote rejecting the £950. On 29th June the plaintiff wrote to the defendant accepting to pay £1,000 for the farm. The defendant declined and the plaintiff sued for specific performance of the contract. It was held that the defendant was not liable as the plaintiff's counter offer of £950 terminated the original offer which was therefore not available for acceptance by the plaintiff on 29th June as the defendant had not revived it.

A counter offer must however be distinguished from a request for information or inquiry.

**Request for information:**
An inquiry which does not change terms of the offer. The offeree may accept the offer before or after inquiry is responded to as was the case in *Stevenson-v-Mc Lean*, where the defendant had offered to sell 3,800 tonnes of iron to the plaintiff at £ 40 per tonne and the offer was to remain open from Saturday to Monday. On Monday morning, the plaintiff telegraphed the defendant inquiring on the duration of delivery. The defendant treated the inquiry as a counter offer and sold the iron to a third party. The plaintiff subsequently accepted the offer but thereafter received the defendant's notice of the sale to the 3rd party. The plaintiff sued in damages fro breach of contract. It was held that the defendant was liable.

### 3. Standing offer

A standing offer arises when a person's tender to supply goods and service to another is accepted. Such acceptance is not an acceptance in the legal sense. It merely converts the tender to a standing offer for the duration specified if any. The offer is promising to supply the goods or services on request and is bound to do so where a requisition is made.

Any requisition of goods or services by the offeree amounts to acceptance and failure to supply by the offerer amounts to a breach of contract. As was the case in *Great Northern Railway Co Ltd v. Witham*. The plaintiff company invited tenders for the supply of stores for 12 months and Witham's tender was accepted. The company made a requisition but Witham did not supply the goods and was sued. It was held that he was liable in damages for breach of contract.
In standing offer, the offeror is free to revoke the offer at any time before any requisition is made, unless the offeror has provided some consideration for the offeror to keep the standing offer open.

This consideration is referred to as '**an option'**. This is an agreement between an offeror and the offeree by which an offeree agrees to keep his offer open for a specified duration. In this case, the offeror cannot revoke the offer.

In a standing offer, if no order to requisition is made by the offeree within a reasonable time, the standing offer lapses.

## Termination of an offer

A contractual offer may come to an end or terminated in any of the following ways

### 1. Revocation

This is the withdrawal of the offer by the offeror. At common law, an offer is revocable at any time before acceptance

**Rules of revocation of offers**

1. An offer is revocable at any time before it becomes effectively accepted. It was so held in *Paybe v. Cave.* In *Dickinson v. Dodds*, the sale of the house by the defendant to a 3rd party revoked his offer to the plaintiff.
2. Notice of revocation must be communicated to the offeree. However, such communications need not to be effected by the offeror. It suffices, if communicated by a 3rd party as was the case in *Dickinson v. Dodds.*
3. An offer is revocable even in circumstances in which the offeror has promised to keep it open to a specified duration, unless an option exists, as was the case in *Dickinson v. Dodds.*
4. Revocation becomes legally effective when notice is received by the offeree.
5. An offer is irrevocable after acceptance. It was so held in *Byrne v. Van Tienhoven.*
6. In unilateral contracts, an offer is irrevocable if the offeree has commenced and continues to perform the act which constitutes acceptance.
7. A bid at an auction is revocable until the hammer falls.

### 2. Rejection

An offer terminates if the offeree refuses to accept the same, the refusal may be express or implied from the conduct of the offeree e.g. silence by the offeree amounts to a rejection as was the case in *Felthouse v Bindley*.

### 3. Counter offer

This is a change or variation of the terms of the offer by the offeree. It is a form of rejection. The legal effect of a counter offer is to terminate the original offer as was the case in *Hyde v. Wrench.*

**4. Lapse of time**

If an offer is not accepted within the stipulated time and not revoked earlier, it lapses on expiration of such duration. Where no duration is specified, the offer lapses on expiration of reasonable time. What is reasonable time is a question of fact and varies from case to case. In *Ramagate Victoria Hotel Ltd v. Montefiore* in early 6/1864, the defendant made an offer to purchase 40 shares of the plaintiff company, the offer was not accepted until November by which time the defendant had given up. The company sued for the value of the shares, the defendant pleaded that the offer had not been accepted within a reasonable time. It was held that the defendant was not liable as the offer had lapsed for non-acceptance within a reasonable time. A similar holding was made in *Virji Khimji v Chatterbuck* The defendant ordered timber from the plaintiff and indicated that it be supplied as soon as possible. The plaintiff did not respond but delivered the timber. 4 ½ months later, the defendant refused to take delivery and was sued. It was held that he was not bound to take delivery as his offer had lapsed for non- acceptance within a reasonable time.

**5. Death**

The death of the offeror or offeree before acceptance terminates an offer. However, the offer only lapses when notice of death of the one is communicated to the other.

**6. Insanity**

The unsoundness of mind of either party terminates an offer. However, the offer only lapses when notice of the insanity of the one is communicated to the other.

**7. Failure of a condition subject to which the offer was made**

These are conditional offers. If a condition or state of affairs upon which an offer is made fails, the offer lapses. In *Financings Ltd v. Stimson*, the defendant opted to take up a vehicle on hire purchase terms. He completed the hire purchase application form and paid a deposit. This form constituted his offer. He took delivery of the vehicle but returned it to the showroom after 2 days for some minor rectification. The vehicle was stolen from the showroom and when recovered it was badly damaged by reason of an accident. The defendant refused to take delivery or pay installments and was sued. He pleaded the state of the vehicle. It was held that he was not liable as his offer had lapsed. This offer was conditional upon the motor vehicle remaining in substantially the same condition as it was before and since its condition had changed, his offer had lapsed.

## Acceptance

This is the external manifestation of assent by the offeree. It gives rise to an agreement between parties. In legal theory, an agreement comes into existence at the subjective moment when the minds of the parties meet. This moment is referred to as *Consensus ad idem* (meeting of minds). However, this subjectivity must be externally manifested by the offeree for the agreement to arise. Acceptance may be oral, written or implied from the conduct of the offeree.

### Rules of acceptance

**1. Acceptance may be oral, written or implied from the conduct of the offeree.**

In *Carlill v. Carbolic Smoke Ball Co*, acceptance by Mrs. Carlill took the form of her conduct by purchasing and consuming the smoke balls. In *Brogden v. Metropolitan Railway Co*, where it was held that the 1st load of coal supplied by Brogden constituted acceptance of the defendants offer to supply the coal and hence there was an agreement between the parties.

**2. The offeree must have been aware of and intended to accept the offer:**

A person cannot accept an offer whose existence he is unaware of. In *Crown-v-Clarke*, the Australian government offered £1,000 to any person who volunteered information leading to the arrest and conviction of the killers of 2 police officers. Any accomplice who gave information would be pardoned. Clarke, who was aware of the murder gave the information and the killers were arrested and convicted. However, he made it clear that he had given the information to clear his name. It was held that he was not entitled to the reward as he had given the information for a different purpose and therefore had not accepted the offer.

**3. Acceptance must be unconditional and unqualified:**

The offeree must accept the offer in its terms, any variation or modification of the offer amounts to a conditional acceptance which is not an acceptance as was the case in *Hyde v. Wrench* where the plaintiff modified the defendant's offer of £1,000 to £ 950.

**4. An offer must be accepted within the stipulated time if any or within a reasonable time failing which it lapses.**

As was the case in *Ramsgate Victoria Hotel v. Montefoire*, where the defendant's offer made in June was not accepted until November by which time had elapsed. A similar holding was made in *E.A Industries Ltd v. Powyslands.*

**5. Acceptance must be communicated to the offeror in the prescribed method if any or an equally expeditions method.**

Where no method of communication is prescribed, the method to apply depends on the type of offer and the circumstances in which the offer is made.

**6. As a general rule, silence by the offered does not amount to acceptance**,

It was so held in *Felthouse v. Bindley.* The plaintiff intended to buy a house owned by a nephew named John who had no objection. The plaintiff intended to buy it or £30 15p. He wrote to Jon stating 'if I hear no more about him, I consider the horse mine at that price.'

John did not respond but 6 weeks later he gave the horse to the defendant for sale but instructed him not to sell the particular horse. It was sold by mistake. The plaintiff sued the auctioneer in damages for conversion. Question was whether there was a contract of sale between the plaintiff and John. It was held that there was no contract as John had not communicated his acceptance of the offer.

**7. Where parties negotiate by word of mouth in each others presence, acceptance is deemed complete when the offeror hears the offeree's words of acceptance.**

It was so held in *Entores Ltd v. Miles Far East Corporation* , where Lord Denning observed that there was no contract between the parties until the offeror hears the words.

8. Where parties negotiate by **telephone,** acceptance is deemed complete when the offeror hears the offeree's words of acceptance. It was so held in *Entores Ltd v. Miles Far East Corporation.*

9. Where parties negotiate by **telex** acceptance is deemed complete when the offeree's words of acceptance are received by the offeror. It was so held in *Entores v. Miles Far East Corporation.*

10. In **unilateral offers**, commencement and continuation of performance constricts acceptance. During performance, the offeror cannot revoke the offer but to do so if performance is discontinued as was the case in *Errington v. Errington and Woods.*

A father bought a house where the son and daughter in-law lived by paying a deposit of £250 and raising the balance by a loan from a Building society. He promised to transfer the house to them if they paid all installments as and when they fall due. The £250 would be a gift to them. They commenced payment of the installments but stopped before the entire sum had been paid. The father was compelled to pay the remaining installments. He declined the transfer of the house to them. It was held that he was not bound to do so as they had discontinued payments' of the installments.

11. In **standing offers**, a specific order or requisition by the offeree constitutes acceptance and the offerer is bound as was the case in *Great Northern Railway Co. v. Witham.*

12. An offer to a **particular/specific person** can only be accepted by that person for an agreement to arise. It was so held in *Boulton v. James.*

13. An offer to a **class of persons** can only be accepted by a member of that class for an agreement to arise. It was so held in *Wood v. Lecktrick*.

14. An offer to the **general public** may be accepted by any person who fulfils its conditions. As was the case in *Carlill v. Carbolic Smoke Ball Co.*
15. The postal rule of acceptance:
Where the offeror expressly or impliedly authorizes the offeree to communicate acceptance by post, acceptance is deemed complete when the letter is posted whether it reaches its destination or not. It was so held in *Byrne v. Van Tienhoven and Co Ltd***.**

a) **Express authorization:**

These are circumstances in which the offeror expressly permits the offeree to communicate acceptance by post. As was the case in *Adams v. Lindsell***,** on **2/9/1817,** the defendant offered to sell to eth plaintiff a quantity of wood on certain terms and required a response 'in the course of post.' The plaintiff received the letter on **5/9/1817** and posted an acceptance. On **8/9/1817** the defendant posted a letter revoking the offer. The plaintiff's letter of acceptance was received on **9/9/1817**. It was held that there was a contract between the parties as the plaintiff had posted the letter of acceptance by the time the defendant purported to revoke the offer. Hence, the revocation was ineffective.

b) **Implied authorization:**

There are circumstances in which the offeror by implication authorized the offeree to communicate acceptance by post.
In *Household Fire Insurance Co.-v-Grant,* the defendant offered to buy 100 shares to the plaintiff company. The offer was communicated by post. The Company allotted the shares to him and the company secretary made out the letter of allotment which was posted but never reached the defendant who was subsequently sued for the amount due on the shares. He denied liability on the ground that the company had not communicated its acceptance. However, it was held that since the company had posted the letter of acceptance, there was a contract and the defendant was liable. In *Henthorn v. Fraser,* X made an offer to Y to take up a lease. On the following day between noon and1 pm, X posted a letter withdrawing the offer which was received by Y at 5pm. At 3.50pm on the same day, Y had posted a letter accepting the offer. The letter was read by X on the following day. It was held that there was a contract between parties which came into existence at 3.50pm when Y posted the letter of acceptance.

The purported revocation at 5pm had no effect. In *Byrne v. Van Tienhoven and Co Ltd* on 1/10 the defendant made an offer to sell to eth plaintiff 1000 boxes of tin plates but on 8/10 the defendant posted letter revoking the offer. The same was received on 15/10. On 11/10 the plaintiff telegraphed the defendant an acceptance which he confirmed by a letter posted on 15/10. It was held that there was a contract between the parties which come into existence on 15/10 when the letter of acceptance was posted.

**c) No authorozation:**

If the offeror does not expressly or implied authorizes the offeree to use the post but the offeror uses the post, acceptance is deemed complete when the letter of acceptance is received by the offeror.

16. If the offeror instructs his **messenger** to deliver to him the letter of acceptance in any from the offeree, acceptance is deemed complete when the letter is handed over to the messenger.

17. Acceptance need not be communicated to the offeror where such communication is expressly or impliedly **waived**. This was the case in *Carlill v. Carbolic Smoke Balls Co*, where Mrs. Carlill was not required to communicate the fact of purchase and consumption of the Smoke balls.

18. Acceptance need not be communicated to the offeror where it makes the form of conduct. This was the case in *Brogden v. Metropolitan Railway co Ltd***.**

Once an offer is accepted, an agreement arises between the parties as there is consensus between them. Offer and acceptance constitutes the foundation of a contractual relationship.
They do not constitute a contract as a contract must be characterized by other elements.

**Intention to create legal relation**

In addition to offer and acceptance, an agreement must be characterized by intention. The parties must have intended to create legal relations. Intention is one of the basic elements of a contract as common law. An agreement is unenforceable unless the parties thereto intended such a consequence.

**Ascertainment of intention:**

To determine whether parties intended to create legal relations, courts consider;

1) Nature or type of agreement i.e. whether commercial or business and domestic or social.
2) The circumstances in which the agreement was entered into. These two factors demonstrate whether the parties intended to contract.

### a. Business or commercial agreement

In considering such agreements, courts proceed from the presumption that the parties intended to create legal relations.

**1. Advertisements**

These are intended to promote sales of the advertiser. They have a commercial objective. In *Carlill v. Carbolic Smoke Ball Co. Ltd*, the company had manifested an intention to create legal; relations by stating that it had deposited £1,000 with Alliance Bank Regent Street. Hence Mrs Carlill was entitled to the £100 as she had contracted with the company.

**2. Employment agreement**

These are commercial agreements intended to impose legal obligations on the parties thereto.
In *Edwards v. Skyways Ltd,* the plaintiff was a former employee of the defendant company as a pilot and was declared redundant but promised on *ex-gratia* sum. He provided consideration for the promise.
By reason of many other redundancies, the company was unable to make good the promise to Edwards who sued. It was held that he was entitled to the sum as this was a business agreement intended to create legal relations.
The court was emphatic that this was not a domestic agreement.
However, the circumstances in which a commercial or business agreement is entered into may show that the parties did not intend to create legal relations and this would be the case where **honour clauses** or **honourable pledge clauses** are used.
This is a clause in agreement to the effect that the parties do not intend to create legal relations. It denies the agreement legal intention thereby converting it to a gentleman's agreement binding in honour only.
Such an agreement is unenforceable in law as was the case in *Rose & Frank v. Crompton Brothers* where the agreement between the two companies contained an honour clause, but one of them purported to enforce the agreement.
The court of Appeal held that it was unenforceable as the honour clause had denied it legal intention.
A similar holding was made in *Jones-v-Vernon Pools Ltd* where the agreement had an honour clause.
It was observed that whenever an agreement contained an honour clause, the plaintiff was obliged to trust the defendant as the agreement cannot be enforced by court of law.

### b. domestic or social agreement

Courts proceed on the presumption that the parties did not intend to create legal relations.

**1. Agreement between husband and wife**

Such agreements are generally not intended to impose upon the parties any rigid obligations.
In *Balfour v Balfour*, the defendant was a civil servant in Sri Lanka. At the time, he and his wife were in Britain on holiday.
His wife fell ill and it became clear that she was not in a position to accompany him back to Sri Lanka.
He promised to send her 30 pounds per month for the duration they would remain apart. He did not and the wife sued.
It was held that her action was not sustainable as the parties had not intended to create a legal relationship. A similar holding was made in *Gould v Gould.*

**2. Agreement between parent and child**

Such an agreement is ordinarily not intended to be a contract but a working relationship.
In *Jones v. Pandervatton*, the plaintiff persuaded her daughter to leave a well paying job to study Law in Britain, she was promised a maintenance allowance as she studied. She reluctantly agreed. In the meantime, the plaintiff bought a house where the defendant lived as part of the maintenance. Before the daughter completed her studies, the 2 quarreled and the mother sought to evict her from the house. She argued that there was a contract between them.
However it was held that the parties had not intended to create legal relations and the mother was entitled to evict her.
However the circumstances in which a domestic or social agreement is entered into may show that the parties intended to create legal relations.
Such intentions may be collected from the words used by the parties, their conduct and the circumstances of the agreement;

**1. Agreement between husband and wife**

Such an agreement may be forced if the parties have manifested an intention to contract. E.g. in *McGregor v McGregor,* a husband and wife sued each other for assault but later resolved to withdraw the cases but live apart. The husband promised to pay a weekly sum as maintenance while the wife promised to maintain the children.
The husband was in arrears for 6 weeks and the wife sued. It was held that her action was sustainable as the parties had manifested an intention to contract. A similar holding was made in *Merrit v Merrit.*

***2. Other social agreements***

Such agreements may be enforced if the parties if the parties have manifested an intention to contract. In *Simpkins v. Pays*, the defendant owned a house where she lived with a grand daughter; the plaintiff was a paying boarder (a lodger).
The three took part in a Sunday newspaper competition. All entries were made in the defendant's name. However, there were no rules on payment of postage.One week's entry won £750.
The plaintiff claimed 1/3 of the sum. The defendant argued that this was a pastime activity not intended to create legal relations.
However the court held that the plaintiff was entitled to 1/3 of the sum as the parties had manifested an intention to contract.
A similar holding was made in *Parker v. Clark.*
Case law demonstrates that an agreement is legally unenforceable unless the parties to it intend such a consequence.

## Capacity

In addition to consensus and intention, a contract must be characterized by capacity. This is the legal ability of a party to enter into a contractual relationship. For an agreement to be enforceable as a contract the parties must have had the requisite capacity.

As a general rule, every person has a capacity to enter into any contractual relationship. However, in practice, the law of contract restricts or limits the contractual capacity of certain classes of persons namely;

i. Infants or minors.
ii. Drunken persons.
iii. Persons of unsound mind.
iv. Corporations.
v. Undischarged bankrupts.

### i. Contractual capacity of infant and minors

Under Section 2 of the Age of Majority Act1, an infant or minor is any person who has not attained the age of 18.
Contracts entered into by an infant are binding, voidable or void depending on their nature and purpose.

**1. Binding contracts**

These are legally enforceable contracts; the infant can sue or be sued on them. Both parties are bound to honour their obligations.
These contracts fall into 4 categories

**a) Contract for supply of "necessaries"**

Under section 4 (2) of the Sale of Goods Act necessaries mean goods suitable to the condition in life of such an infant or minor and to his actual requirement at the time of sale and delivery.
In *Nash v. Inman,* the defendant was an infant college student. Before proceeding to college, his father bought him all the necessary clothing material.
However, while in college, he bought additional clothing material from the plaintiff but did not pay for them and was sued.
His father gave evidence that he had bought him all the necessary clothing material. It was held that he was not liable as the goods were not necessaries when supplied.

**b) Contract for supply of " Other necessaries"**

These are necessaries other than those covered by Section 4 (2) of the Sale of Goods Act. E.g. Legal services, transport to and from work, lodging facilities etc.
An infant is bound by any contract for the supply of such necessaries. Under the Sale of Goods Act, whenever an infant is supplied with necessaries, he is liable to pay not the agreed price but what the court considers as reasonable.

## 3. Educational Contracts

An infant is bound by a contract whose purpose is to promote his education or instruction.

**c) Contract for beneficial service**

These are beneficial contracts of service. Case law demonstrates that an infant can sue or be sued and is bound by contracts whose object is to benefit him as a person.
In *Doyle v. White City Stadium,* the plaintiff was a qualified infant boxer. He applied to join the British Boxing Board and was granted a license.
One of the rules of the body empowered it to withhold payment of any price money won if a boxer was disqualified in a competition.
The plaintiff was disqualified on one occasion and the Board withheld payment. The plaintiff sued. Question was whether the plaintiff was bound by the contract between him and the Board. It was held that he was as in substance it was intended to benefit him hence the money was irreco A similar holding was made in *Chaplin V. Leslie Fremin (Publishers) Ltd.* Where the plaintiff, an infant had engaged the defendant to write a book for him. He subsequently

discontinued the transaction. It was held that the contract was binding as it was intended to benefit him.
A similar holding was made in *Clements v. London and North Western Railway Co.*verable.

## 2. Voidable contracts

Certain contracts entered into by an infant are voidable i.e. the infant is entitled to repudiate the contract during infancy or within a reasonable time after attaining the age of majority.
By avoiding the contract, the infant escapes liability on it. The infant cannot be sued on the contract during infancy. These contracts confer upon the infant a long term benefit. Examples include: Partnership agreements, lease or tenancy agreement and contract for the purchase of shares.
Under Section 12 of the Partnership Act, an infant partner is not liable for debts and other liabilities of the partnership during infancy since the contract is voidable at his option.
However under Section 13 of the Act, if the infant does not avoid the contract during infancy, or within a reasonable time after attaining the age of majority, he is liable for debts and other obligations of the firm from the debt he became partner.
In *Davis v. Beynon-Harris* where an infant had taken up a lease but failed to repudiate the contract during infancy or within a reasonable time thereafter, it was held that he was liable under the contract.

## 3. Void contracts

Under the provisions of the Infants Relief Act (1874) which applies in Kenya as a statute of general application, certain contracts entered into by infants are void. These are contracts which the law treats as nonexistent. They confer no rights and impose no obligations on the parties.

These contracts are;

a. All accounts stated with infants: These are debts admitted by an infant. The infant cannot be sued on such admission.
b. Contracts for the supply of goods other than necessaries.
c. Money lending contracts: An infant is not bound to repay any monies borrowed from a 3rd party as the contract is void. However if the infant repays, the amount is irrecoverable.

In *Leslie Ltd. V. Sheil,* the defendant, an infant borrowed £400 from the plaintiff, a money lending firm in 2 lots of £200 each and was liable to pay £475 inclusive of the interest but failed to do so and was sued.
The plaintiff argued that it was entitled to damages for misrepresentation as the defendant had fraudulently misrepresented his age.
It further argued that the defendant had received the money on its behalf. It was held that the amount was irrecoverable as the contract was void by reason of the **Infants Relief Act 1874.**

Since a money lending contract was void, any security given by the infant is also void and therefore unenforceable by the lending party. It was so held in *Valentini v. Canali.*
If an infant uses monies borrowed under a void contract to purchase necessaries, the lending party is in Equity put into the shoes of the party supplying the necessaries and can sue the infant for the recovery of the amount borrowed as was used to purchase the necessaries.
This is the principle of **subrogation** as was explained in *In re: National Permanent Benefits Building Society Ltd.*
Question has arisen as to whether an infant can ratify contracts made during infancy after he has attained the age of majority. Any such purported ratification or adoption has no legal effect.

**2. Contractual capacity of drunken persons**

A contract entered by a drunken person is voidable at his option by establishing that:

i. He was too drunk to understand his acts.
ii. The other party was aware of his condition.

By avoiding the contract, the person escapes liability on it. In *Gore v. Gibson,* the defendant was sued on a bill of exchange he had signed and endorsed. He pleaded that when he did so he was too drunk to understand what he was doing and that the plaintiff was aware of his condition.
It was held that he was not liable as the contract was voidable at his option by reason of the drunkenness.
If a contract entered into by a person when drunk is ratified by him when sober it is no longer voidable as was the case in *Mathews v Baxter* where the defendant had contracted to sell a house to the plaintiff. When sued he pleaded drunkenness.
However it was held that he was liable as the plaintiff proved that he had subsequently ratified the transaction while sober.
Under Section 4 (2) of the Sale of Goods Act, if a drunken person is supplied with necessaries he is liable to pay a reasonable price.

**3. Contractual capacity of persons of unsound mind**

A contract entered into by a person of unsound mind is voidable at his option by establishing that:

i. He was too insane to understand his acts.
ii. The other party was aware of his mental condition.

By avoiding the contract the party escapes liability on it. In *Imperial Loan Co. Ltd v Stone,* the defendant was sued on a promissory note he had signed. He argued that at the time, he was insane and therefore incapable of comprehending the nature or effects of his acts and that he was not liable on the promissory note as the contract was voidable by reason of insanity.

In the words of Lopes L.J. "In order to avoid a fair contract on the ground of insanity, the mental capacity of the one contracting must be known to the other contracting party. The defendant must plead and prove not merely his insanity but the plaintiff's knowledge of that fact and unless he proves these 2 things he cannot succeed."
If a contract entered into by a person of unsound mind is ratified by him when he is of sound mind it ceases to be voidable.
Under Section 4 (2) of the Sale of Goods Act, if a person of unsound mind is supplied with necessaries, he is liable to pay a reasonable amount.

**4. Contractual capacity of undischarged bankrupts**

These are persons who have been declared bankrupt by a court of competent jurisdiction. There capacity to contract is restricted by the provisions of the Bankruptcy Act2.

**5. Contractual capacity of corporations**

These are artificial persons created by law, either by the process of registration or by statute. The capacity of the corporations to contract is defined by law e.g. a statutory corporation has capacity to enter in transactions set out in the statute as well as those reasonably incidental thereto.
Other transactions are **ultra vires** and therefore null and void. The contractual capacity of a registered company is defined by the object clause of the memorandum. At common law a registered company has capacity to enter into transactions set forth in the objects and those that are reasonably incidental to the attainment or pursuit of such objects.
It was so held in *Ashbury Railway Carriage and Iron Co. v. Riche* as well as in *Attorney General v. Great Eastern Railway Co*
Other transactions are *ultra vires* (beyond the powers of) the company and void. Transactions within the powers of a company are said to be *intra vires* a company.
An *ultra vires* transaction cannot be ratified and any purported ratification has no legal effect. It was so held in *Ashbury's Case*.

## Consideration

In addition to consensus, capacity and intention, an agreement must be characterized by consideration to be enforceable as a contract. At Common Law, a simple contract is unenforceable unless supported by some consideration. Consideration is the bargain element of a contract.
It is nothing but mutuality. It has been defined as "an act or promise offered by the one party and accepted by the other party as price for that others promise."

**Judicial Definitions**

In the words of Lush J. in *Currie v. Misa,* "a variable consideration may consist of some right, interest, profit or benefit accruing to the one party or some loss, forbearance, detriment or responsibility given, suffered or borne by the other."

In the words of Patterson J in *Thomas v. Thomas* "consideration means something which is of some value in the eye of the law moving from the plaintiff. It may be some benefit to the defendant or detriment to the plaintiff but at all events it must be moving from the plaintiff."

Consideration is whatever the promisee gives or provides to buy the promisors promises. By so doing the promisee becomes party to the contract. Consideration takes various forms. In *Carllil v. Carbolic Smoke Ball Co,* it took the form of detriment i.e. swallowing of the smoke balls by Mrs. Carllil. In *Patel v. Hasmani*, it took the form of forebearance to sue.

## Types of consideration

Consideration may be **executory** or **executed** but must not be **past.** However in certain circumstance past consideration may support a contractual claim.

### 1. Executory consideration

Consideration is executory where the parties exchange mutual promises. Neither of the parties has performed its part of the contract. The whole transaction is in future.

Executory consideration is good to support a contractual claim. E.g. purchase of goods on credit for future delivery.

### 2. Executed consideration

Consideration is executed where a party does an act to purchase the others promise. The act may be partial or total performance of the party's contractual obligation. It is good consideration to support a contractual claim.

### 3. Past consideration

Consideration is past where a promise is made after services have been rendered. There is no mutuality between the parties. Past consideration is generally not good to support a contractual claim.

In *Roscorla v. Thomas,* the plaintiff had just bought a horse from the defendant and as he was leading it away, the defendant assured him that it was a good horse free from any vice.

The statement turned out to be untrue and the plaintiff sued for damages. It was held that the defendants promise was unenforceable by the plaintiff as consideration was wholly past.

A similar holding was held in *In re McArdles Case* where Mrs. McArdles spent £488 improving and decorating the house they lived in at no ones request. The house belonged to Mrs. McArdles husband's father and was to be sold after her mother-in-law's death. The beneficiaries of the estate signed a document promising Mrs. McArdle £488 when the estate was distributed. However no payment was made and Mrs. McArdle sued. It was held that the promise was unenforceable as consideration was past.
In certain circumstances, past consideration is sufficient to support a contractual claim.
These are exceptions to the general rule:

**1. Acknowledgement of a statute barred debt**
Under the Limitation of Actions Act, Cap 32 Laws of Kenya, a debt becomes statute barred after 6 years. In such a case, the debtor is not bound to repay. However, a written acknowledgement of the debt by the debtor is enforceable by the creditor though consideration is past. It was so held in *Ball v. Hasketh* and *Heyling v. Hasting.*

**2. Negotiable Instruments**
One of the characteristics of negotiable instruments e.g. cheques, bills of exchange, promissory notes, share warrants e.t.c. is that past consideration is good to support any action on the instrument.
A holder of a negotiable instrument can sue on it even though he has not given consideration provided a previous holder gave some consideration.
This exception is contained in Sec 27(1) of the Bills of Exchange Act3, and was relied upon to enforce an action in *Lombard Banking Co. Ltd v. Gandhi and Patel***.**

**3. Rendering of Services on request**
Where services are rendered by a party, at the express or implied request of another in circumstances that give rise to an implied promise to pay, a subsequent promise to pay for the services is enforceable.
The law takes the view that the rendering of the services and the promise to pay are an integral part of the same transaction.
In *Lampleigh v. Brathwait* the defendant had killed a man named Patrick. He requested the plaintiff to secure pardon for him from the king. The plaintiff exerted himself and made a number of trips to see the king and ultimately secured the pardon. The defendant promised to pay him £100 for the trouble, a promise he did not honour and was sued.
He argued that the plaintiff had not provided consideration for his promise to pay. However it was held that the promise was enforceable as it was inseparable from the request for the services.
A similar holding was made in *Re Casey Patents Ltd.*

## Rules of consideration

### 1. Mutual love and affection is not sufficient consideration

It was so held in *Thomas v. Thomas.* Mr. Thomas had expressly stated that if he died before his wife, she was free to use his house as long as she remains unmarried. His brothers who later became executors of his estate knew of this wish.
After his death, Mrs. Thomas remained in his house and unmarried. After the death of one of the executors, the other sought to evict Mrs. Thomas from the house. She sued the late husband's estate. It was held that the husbands promise was enforceable as she had provided consideration by way of the £1 she paid for every year she lived in the house.
The love she had for the late husband was not sufficient consideration but the £1 she paid every year was.

### 2. Consideration must be real

The act or promise offered by the promise must be lawful as illegal consideration invalidates the contract.

### 3. Consideration must not be past

As a general rule, past consideration is not good to support a contractual claim as exemplified by the decisions in *Re McArdles case* and *Roscorla v. Thomas.*
However, in certain circumstances, past consideration is sufficient to support a contractual claim, as indicated above.

### 4. Consideration must be real

This rule means that consideration must be something of value in the eyes of the law. It means that consideration must be sufficient though it need not be adequate.
This rule means that as long as something valuable in law passes, the promise is enforceable. It means that the law does not concern itself with the economics of a transaction.
It means that the courts of law do not exist to correct bad bargains. In *Thomas v. Thomas*, the £1 Mrs. Thomas paid per year was sufficient consideration.
However if the consideration is too low in comparison and there is evidence of a mistake, misrepresentation, duress or undue influence, the courts may intervene.

### 5. Consideration must flow from plaintiff/promise

This rule means that the person to whom the promise is made provides consideration and by so doing there is a bargain between the parties or mutuality.
By providing consideration, the promise becomes party to the transaction. In *Thomas v. Thomas*,

Patterson J was emphatic that "consideration must at all times flow from the plaintiff."
The rule that consideration must flow from the plaintiff is referred to as The Doctrine of Privity of Contracts.

**The doctrine of privity of contracts**

This doctrine is to the effect that only a person who is party to a contract can sue or be sud on it. It means that only a person who has provided consideration to a promise can sue or be sued on it. It means that a stranger to consideration cannot sue or be sued even if the contract was intended to benefit him. It was so held in *Scruttons Ltd v. Midland Sillicones Ltd*. In *Price Easton*, X agreed to pay the plaintiff a sum of money if Y did some work for him. Y rendered the services to X but X did not honour the promise to pay.
The plaintiff sued to enforce the promise. It was held that the promise was unenforceable as the plaintiff was not a party to the transaction. He had provided no consideration.
A similar holding was made in *Dunlop v. Selfridge* as well as in *Tweddle v. Atkinson*.
However in certain circumstances, persons who are not party to a contract or who have not provided consideration may sue or be sued on it.

**These are exceptions to the Doctrine of Privity of Contracts**

**i) Agency**
In an agency relationship, the agent contracts on behalf of the principal. The principal is not directly involved in the transaction. However the principal may sue or be sued on a contract entered into by the agent. This exception is more apparent than real as in law the agent represents the principal.

**ii) Legal Assignment**
Under the provisions of the ITPA4 if a creditor assigns his debt to another person in a legal assignment the assignee becomes entitled to sue the debtor as if he were the original creditor.

**iii) Negotiable Instruments**
A holder of a negotiable instrument can sue on it in its own name not withstanding the absence of consideration provided a previous holder of the instrument gave some consideration.

**iv) Trust**
This is an equitable relationship whereby a party expressly impliedly or constructively holds property on behalf of another known as the beneficiary. In certain circumstances, the beneficiary can sue or be sued under a trust.

**v) Third Party Insurance**

Under the provisions of the Insurance (Motor Vehicles Third Party Risks) Act5, , victims of motor vehicle accidents are entitled to compensation by Insurance companies for injuries sustained from the use of motor vehicles on the road.

However the insurer is only liable if the motor vehicle was in the hands of the insured or some authorized driver. If the authorized driver pays the amount due to the victim for the injury, such amount is recoverable from the insurer but through the insured as was the case in *Kayanja v. New India Insurance Co. Ltd.*

**vi) Restrictive Covenants (Contracts running with land)**

In certain circumstances, certain rights and liabilities attached to land are enforceable by or against subsequent holders of the land. This is particularly the case in the law of leases.

## 6. Consideration must be something in excess of a public duty owed by the plaintiff

This rule means that performance by the plaintiff of a public duty owed by him is not sufficient consideration for a promise to pay.

In *Collins v. Godefroy,* the defendant was involved in a civil case and the plaintiff had given evidence in the matter but was reluctant to do so in future. The defendant promised him 6 pounds if he continued giving evidence which he did.

The defendant did not honour his promise and was sued. Question was whether the plaintiff had provided consideration for the defendants promise to pay.

It was held that the promise was unenforceable as the plaintiff had not provided consideration but had merely performed a public duty.

However anything in excess of a public duty amounts to consideration. In *Glassbrook Brothers v. Glamorgan County Council,* the defendant owned a mine and at the material time the workers were on strike. The defendant requested the plaintiff to provide a stationary guard to protect the mine and promised to pay for the services. The plaintiffs who are not bound to provide a stationary guard provided the service but were not paid.

In an action to enforce the promise, it was held that the plaintiffs were entitled to payment as they had done more than the duty required and had therefore provided consideration.

## 7. Consideration must be something in excess of an existing contractual obligation

This rule means that performance by the plaintiff of an existing contractual obligation is not sufficient consideration for a promise. In *Stilk v. Myrik,* the defendant who was a ship captain entered into a contract with his crew members to assist him on a journey from Britain to the Baltic Sea and back. In the course of the journey, 2 sailors deserted.

The captain promised to share their wages between the remaining crew members a promise he did not honour and was sued. It was held that the crew members were not entitled to the extra pay as they had not provided consideration.
They had merely performed an existing contractual obligation. However, doing something in excess of a contractual obligation constitutes consideration.
In *Hartley v. Ponsonby* where in the course of a journey, a substantial number of crew members deserted and a promise for extra pay was made, it was held that they were entitled to the pay as they had done more than a contractual obligation.
The willingness to expose themselves to danger for longer hours constituted consideration for the promise

**8. Payment of a lessor sum on the day in satisfaction of a larger sum is not sufficient consideration for the creditors promise to accept such sum in full settlement for the debt**

This is referred as the **"Rule in *Pinnels Case (1602)".*** Cole owed Pinnel 8 pounds payable on 11th November 1600. However on 1st October 1600, Pinnel requested Cole to pay 5 pounds which he agreed to accept in full settlement of the debt. Subsequently, Pinnel sued Cole for the balance. The case was decided on a technical point of pleading and Cole was held liable for the balance. This rule was applied in *Foakes v. Beer (1884).* However in certain circumstances, payment of a smaller sum extinguishes the entire debt.

**These are exceptions to the rule in Pinnel's Case:**

1. If the lesser sum is paid in advance and the creditor accepts the same in full settlement of the debt.
2. If the lesser sum is paid in the form of an object which the creditor accepts in settlement thereof. In **Pinnel's Case**, Brian C.J. observed, "but the gift of a horse, hawk or robe, is sufficient consideration.
3. If the lesser sum is paid in addition to an object which the creditor accepts.
4. If the lesser sum is at the creditor's request paid at a different place.
5. Where the lesser sum is paid in a different currency and the creditor accepts the same in full settlement thereof.
6. Where the lesser sum is paid by a third party. In *Welby v. Drake*, the defendant owed the plaintiff 18 pounds and was unable to pay. The defendant's father paid the plaintiff 9 pounds which he accepted in full settlement of the debt but subsequently sued for the balance. It was held that the promise was enforceable as it was made to a 3rd party.
7. If a debtor enters into an arrangement with his creditors to compound his debts, whereby he promises to pay part of the amount due to each of the creditors who in turn promise not to sue the debtor or insist on full payment, the lesser sum paid by the debtor extinguishes the entire debt.

The mutual promises by the parties constitute consideration.

## Doctrine of promissory or equitable estoppels

This doctrine was developed by equity to mitigate the harshness of the common law rule of consideration. It is an equitable intervention which modifies the rule of consideration.
The Doctrine was explained by Lord Denning in *Combe v. Combe*. It is to the effect that where parties have a legal relationship and one of them makes a new promise or representation intended to affect their legal relations and to be relied upon by the other, once the other has relied upon it and changed his legal position, the other party cannot be heard to say that their legal relationship was different. The party is estopped from denying its promise.

**For the doctrine of estoppel to apply the following conditions are necessary:**

i. A legal relationship between the parties.
ii. A new promise or representation in intended to be relied upon.
iii. Reliance upon the representation.
iv. Change in legal position as a result of the reliance.
v. It would be unfair not to estop the maker of the representation.

The Doctrine of Promissory Estoppel is often referred to as "The Rule in the High Trees Case."

In *Central London Property Trust v. High Trees House Ltd*, the plaintiff owned a block of flats which it leased to the defendant for 99 years at 2500 pounds per year. After the outbreak of the 2nd world war, it became clear that the defendant was not in a position to pay the agreed rent as most of the flats were unoccupied. The plaintiff promised to accept half of the rent as long as the war continued.
By the end of 1945, all the flats were occupied. The plaintiff sued for the defendant to be compelled to pay:

1. The full rent.
2. The arrears.

The defendant argued that it was inequitable (unfair) for the plaintiff to claim the arrears. It was held that whereas it was fair for the defendant to pay the full rent, it was unfair to claim the arrears as the plaintiff had made a promise which the defendant had reliede upon and changed its legal position.
The plaintiff was estopped from insisting on the arrears

**The doctrine of equitable estoppels in east Africa**

In *Century Automobile v. Hutchings Biemer Ltd,* the defendant took a lease of the plaintiff's premises which was terminable by a 3 month notice of either party. The defendant intended to make alterations to the building but feared doing so only for the lease to be terminated. The plaintiff promised not to terminate the lease in 4 years time.