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SCOTTISH BUSINESS LAW

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Contract 4:

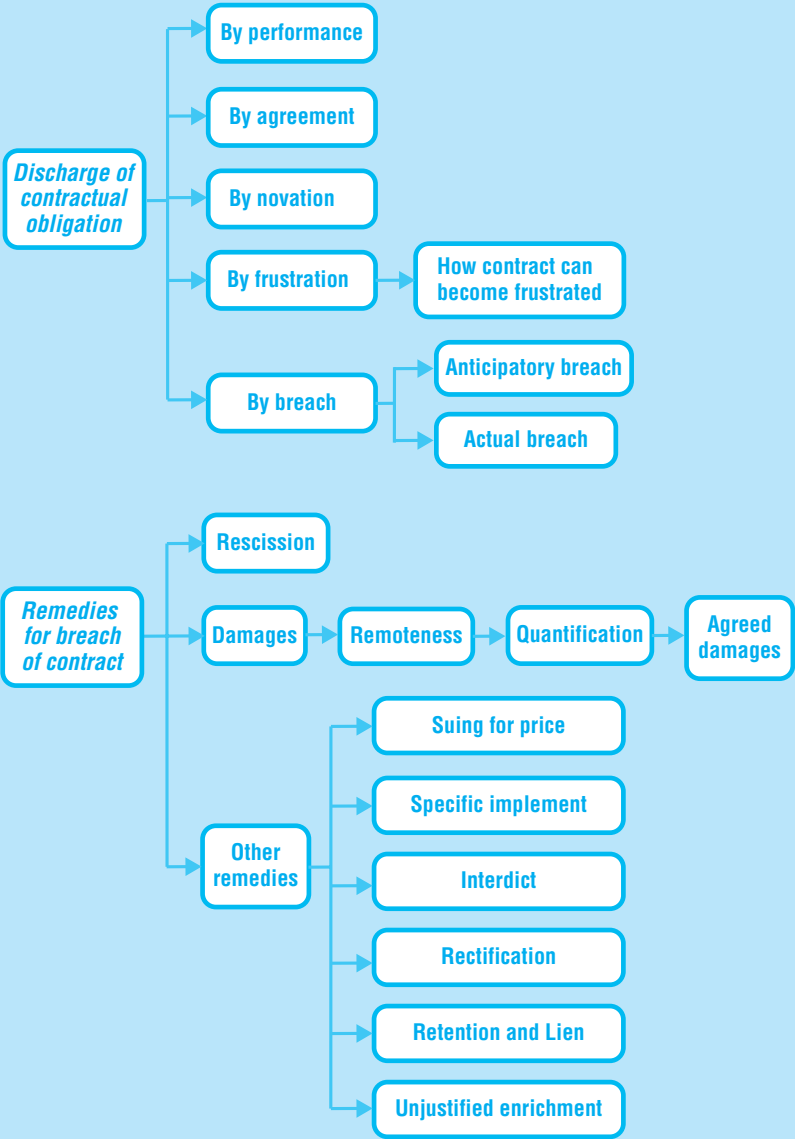
Discharge of contractual obligations and remedies

Revision checklist

Essential points you should know:

- ☐ The ways in which contractual obligations can be discharged
- ☐ The remedies available for breach of contract

■ Topic map



■ Introduction

This area of contract law is often overlooked but it features in many exam questions.

Discharge of contractual obligations deals with the ways in which contractual obligations cease to exist. A remedy for breach of contract will be available whenever a term of a contract is breached. However, if the breach causes no loss, only nominal damages will be awarded, in recognition of trouble and inconvenience to the pursuer.

ASSESSMENT ADVICE

Read the question. Is it about discharge, or remedies, or both? Is it about just one method by which a contract might be discharged, or several? Should more than one remedy be considered?

Don't forget that a question on a different topic, such as offer and acceptance or exclusion clauses, might also require you to deal with remedies. Whenever a contract is breached remedies should be considered unless the question indicates otherwise.

■ Sample question

Could you answer this question? Below is a typical problem question that could arise on this topic. Guidelines on answering the question are included at the end of this chapter, while a sample essay question and guidance on tackling it can be found on the companion website.

PROBLEM QUESTION

Box Ltd manufactures cardboard boxes. Sparks Ltd agreed to install electrical wiring in Box Ltd's new factory, so that machines and lights could be used. The contract stated that this work would be finished by 1 June. Sparks Ltd could not complete the work until 1 October because two of their key employees left their jobs. Consequently, Box Ltd were unable to run their new factory until 1 October. Box Ltd are now suing for breach of contract, claiming damages in respect of the following losses: lost profits of £40,000; damages of £17,000 which became payable to one of their customers when cardboard boxes which they had ordered were not delivered; and £32,000 which the general manager of Box Ltd spent on private healthcare. This healthcare expenditure was incurred on account of the stress caused by Sparks Ltd's breach of contract.



Advise Box Ltd of their legal position. How would your advice differ, if at all, if the contract between Box Ltd and Sparks Ltd had said that in the event of late completion by Sparks Ltd the damages payable would be £6,000 a week?

■ Discharge of contractual obligations

The terms of a contract impose obligations on the parties, as we saw in Chapter 3. When these obligations are discharged they cease to exist. This can happen in five ways:

- by performance;
- by agreement;
- by novation;
- by frustration; or
- by breach.

Discharge by performance of the contract

Almost all contracts cease to exist when the parties fully perform their contractual obligations. Difficulties arise when one party does not fully perform. If the other party's obligations are discharged, that party can withhold performance of those obligations without being in breach of contract.

EXAM TIP

Remember that discharge of contractual obligations is about whether or not a party still has to perform the contract. It is not about whether a claim for damages can be made. Any breach of contract allows the injured party to claim damages.

REVISION NOTE

The difference between unilateral and bilateral contracts was considered in Chapter 1.

In bilateral contracts the *general rule* is also that if one party fails to entirely perform the contract the other party need not perform at all. This is because of the mutuality principle, by which the obligations of the parties to a contract are generally regarded as reciprocal.

KEY CASE

Graham v United Turkey Red Co. Ltd 1922 SC 533

Concerning: the operation of the mutuality principle to bar a claim for payment

Facts

G had a contract of agency with U under which he was to sell goods for U. The contract contained a restrictive covenant that he was not allowed to sell the goods of other manufacturers. He breached this, and started to sell the goods of rivals. He terminated the contract and sued for commission for work done for U.

Legal principle

If a party to a contract ceases to perform the contract according to its terms, he is entitled to commission up to the point when the breach occurred, but, under the mutuality principle, not in respect of work done after the breach.

The general rule is subject to the following exceptions.

A *severable contract* consists of several independent obligations. A party who performs only some of these can claim in respect of the obligations performed, but will remain liable in damages for the obligations not performed. So the injured party's contractual obligations are not fully discharged by the other party's failure fully to perform. Whether or not a contract is severable depends upon the intentions of the parties.

A party who very nearly completes all of the contractual obligations is said to have made *substantial performance*. That party can insist that the other party performs the contract, but will remain liable in damages for failing to fully perform his own obligations.

Voluntary acceptance of partial performance may allow for a claim based on unjustified enrichment, a remedy explained later in this chapter.

Prevention of performance by one contracting party may allow the party who was prevented from performing to make a claim based on unjustified enrichment.

Discharge by novation

The parties assume obligations when they make the contract. They are free to make a second contract under which they agree to discharge each other from their obligations under the original contract. The new contract replaces the old one.

REVISION NOTE

A contract is discharged by novation only if a new contract is made. Discharge by novation is therefore about formation of contracts, a subject considered in Chapter 1.